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**FINANCIAL ACCOUNTABILITY AS A CONDITION
FOR EU MEMBERSHIP**

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ABSTRACT

The objective of this thesis is to provide advice on how to establish a reliable system of financial accountability in Serbia, as a condition for EU membership. The creation of a functional financial accountability system in Serbia is important not only for further Serbian development, but also to secure efficient and effective use of the EU/Member States monies, which are already being used in Serbia.

The *acquis communautaire* prescribe certain obligations for the aspiring Member States in the area of financial accountability. However, as these requirements represent just basic elements of a system of financial accountability, there is a need to analyse other EU Member States financial accountability frameworks in order to get inspiration and provide options for further development of financial accountability in Serbia.

In this light, this thesis analyses financial accountability systems of two EU Member States: UK and France and a supranational EU system, which are then compared with the Serbian system. The legal frameworks of these systems of financial accountability are analysed against their socio-historical backgrounds, focusing on the key challenges they face in both their strategic developments and everyday work.

The conclusion of this thesis is that Serbia has still not met the financial accountability conditions for EU membership outlined in the *acquis communautaire*. The comparative socio-legal analysis has demonstrated that the application of pure, more advanced Western European models of financial accountability would not be possible in the transitional Serbian environment. However, specific elements of these systems, exemplified in the emerging European system of financial accountability, could be well applied in the Serbian context. A creation of a sound financial accountability system in Serbia will take a significant amount of effort on the part of all financial accountability actors in Serbia whose roles need to be enhanced simultaneously so that the balance of the financial accountability system is achieved and maintained, both in the pre-accession phase and, hopefully, upon obtaining membership.

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Financial Accountability as a Condition for EU Membership

Introduction

Objective of the study

This thesis is a contribution to a debate as to how to establish an effective financial accountability system in Serbia, which would facilitate Serbian integration into the EU. The creation of a sound financial accountability system is one of the key elements for further progress in economic and social reform in Serbia. The establishment of an effective system of control and audit powers over spending of public money should prevent the misuse of public funds and combat the high incidence of corruption that plagued the Serbian public administration in the 1990s and provide better value for money of use of public funds. Sound financial accountability is also a precondition for setting up closer relations with the EU, as one of the main objectives of the Serbian Government. Therefore, reforming the financial accountability system will be a key part of the reform agenda in the years to come.

This study must be seen against the background and in the context of Serbian efforts to become a member of the EU. After the democratic changes in 2000, important steps have been taken in this regard. The Copenhagen Council in December 2002 and Thessaloniki European Council of June 2003 confirmed the European perspective of state union of Serbia and Montenegro and underlined the European Union's determination to support its efforts to move closer to the European Union.¹ In April 2005 the European Commission approved a Feasibility Report that assessed positively the readiness of Serbia and Montenegro to negotiate a Stabilisation and Association Agreement. The negotiations

¹The Thessaloniki European Council explicitly states that the Western Balkan countries are to become members of the EU "once they meet the established criteria". *Cf.* Presidency Conclusions of the Thessaloniki European Council, 19 and 20 June 2003.

process started in October 2005,² but was suspended in early May 2006 due inadequate cooperation with the International Criminal Tribunal for the former Yugoslavia (ICTY) in the Hague. Shortly after the suspension of the negotiations, the majority of the Montenegrin population voted for independence on the referendum of 21 May 2006, which resulted in the creation of two fully sovereign states of Serbia and Montenegro. Both countries have shortly gained recognition of the international community and will naturally continue European Union accession process as two fully independent states.

The accession of Serbia and other countries of the Western Balkans to the EU constitutes a particular challenge for the EU. The overall EU enlargement policy is put to the serious test of whether it is able to transform the region of states of weak governance and divided societies, with recent history of armed conflicts.³ A clear political perspective for EU accession is one of the key drivers for continuity of reforms in these countries. But it is also clear that Serbia and other Western Balkan countries can join only once they meet all EU membership criteria, including conditions regarding financial accountability.

The concept of financial accountability is the key concept of this thesis. Accountability is defined through operationalisation of 4 key questions: “of whom”, “for what” “to whom” and “how”. Financial accountability is primarily understood as the relationship between the citizens, as accountors, and the Government, as an accountee, where the citizens hold the Government to account for the stewardship of public money. The essence of financial accountability is an obligation of the Government to assure the citizens that money is spent in the best possible and effective way. The Government has to provide answers and justifications for its actions and to regularly inform the public on how it spends the public funds.⁴

² The commencement of negotiations for Stabilisation and Association Agreement in October 2005 has symbolically marked 5 years from democratic change in Serbia.

³ EU Commission, *Communication from the Commission: 2005 enlargement strategy paper*, Brussels, November 2005, COM(2005)561, www.europa.eu.int, p. 2.

⁴ Cf. S. Redlynch, “Holding to Account, The Review of Audit and Accountability for Central Government”, February 2001, www.hm-treasury.gov.uk.

The next level of analysis of financial accountability encompasses the complexity of government's institutions, rules and procedures, which provide an accountability framework at the central government level. Financial accountability is exercised typically between numerous actors within the government, and in particular between the executive and the parliament. Legally speaking, the financial accountability relationship is embedded in the parliament's authorisation of the public expenditure by legislation.⁵ Expenditure legislation provides a framework of law, which is the basis for calling the Government to account for its actions. Therefore, our analysis will focus on the financial accountability relationship established after the parliament's approval of the expenditure, i.e. parliament's entrustment of the public money to the government. We shall also, however, analyse the process of Parliamentary approval of the expenditure, as one of the key aspects of *ex-ante* financial accountability.⁶ We shall then examine the variety of accountability mechanisms to ensure that money is spent in accordance with parliamentary wishes.⁷ In this sense, the emphasis is placed on the legal/regulatory framework and accountability mechanisms inside the executive (internal accountability mechanisms) and external accountability devices (external accountability mechanisms), which are to support and secure the stewardship of public money.⁸

Furthermore, it is important to stress that financial accountability mechanisms are not isolated phenomena, but mutually interrelated elements, which are in the process of constant interaction, mutually supporting their structures and functions. For this reason, we introduce the concept of a financial accountability system,⁹ which consists of different mutually related elements/mechanisms of financial accountability. The effectiveness of financial accountability as a system depends mostly on the existence of a proper balance

⁵ Appropriation Act in UK and Budget Act in France and Serbia as well as permanent legislation authorising conditions and purposes of expenditure.

⁶ Cf. D. Coombes et al, *The Power of the Purse*, (London George Allen & Unwin Ltd), 1976.

⁷ Cf. F. White, K. Hollingsworth, *Audit, Accountability and Government*, (Clarendon Press, Oxford, 1999) p. 3.

⁸ The World Bank, *Federal Republic of Yugoslavia, Country Financial Accountability Assessment*, 2002.

⁹ Cf. L. Bertalanffy, *General Systems Theory*, (George Braziller Publishers), 1969.

between its different supporting mechanisms, so that weaknesses in one form of financial accountability can be compensated for by controls through other mechanisms.¹⁰

In this thesis financial accountability is analysed through two key levels – the national level and supra-national level of the EU. Whereas the financial accountability relationship established at the national level is rather straightforward, the financial accountability created at the supra national level of the EU is more complex and requires further theoretical discussion, as will be elaborated in Chapter IV. Special attention shall also be paid to the EU requirements for the acceding countries in the area of financial accountability, i.e., internal financial control, internal audit and external audit.

It is not in dispute that the EU has a keen interest in building and strengthening the financial accountability system in Serbia and other acceding countries, as potential future members of the enlarged European Union. The EU has already been investing significant funds to strengthen the Serbian Government institutional structure and revive its economy. Only the establishment of an effective financial accountability system would be able to guarantee that the provided money has been spent in accordance with its intended purpose and in the most efficient and effective way. An ineffective system of financial accountability may also be costly for the EU as it may generate additional burdens on the control institutions, such as the European Court of Justice and the European Court of Auditors. This is why it is of utmost importance to prepare Serbia and other potential candidate countries to manage EU funds – both during the pre-accession phase and upon achieving membership.

The issue of the candidate states' financial accountability has not been only the concern of the EU institutions, but also of the current Member States, especially those who significantly contribute to the EU's budget. Bearing in mind that about 80 % of the EU's budget is managed and implemented solely by the Member States, both the EU and the

¹⁰ Cf. T. Verheijen, M. Millar, "Reforming public policy processes and securing accountability: Ireland in a comparative perspective", *International Review of Administrative Sciences*, [1998], p. 98.

Member States are worried about the ability of aspiring Member States to protect the European Union's financial interests when managing EU funds.

Serbia has recognized the importance of establishing a sound financial accountability system and although many important reforms in this area have been started, results are still far from satisfactory. In the Serbian Government's view, the financial accountability framework should rest on the three key pillars: a strong Treasury, efficient internal controls and independent external audit, as a basis for the efficient democratic, Parliamentary control of the public finances. However, the attention of the Government given to these three elements has not been equal. Greater emphasis has been placed on the establishment of a functional Treasury system, expected to be a vital Government tool for managing resources, monitoring their use and supporting line managers in programme delivery.¹¹ Internal control and audit systems, on the other hand, have just started to be developed and will require a long time until their proper functioning can be expected. Lastly, and perhaps most importantly, mechanisms of external audit are still missing, six years after the democratic changes. For this reason, annual consolidated financial statements have not been audited and presented to the Parliament since 2002.¹² Therefore, there is currently no official record of Government expenditure for 2002, 2003, 2004 and 2005 and no external oversight of Government accounts. As a result, the Parliamentary, democratic scrutiny of the public money spending has been ineffective and disappointing. This all gives a rather bleak general picture of the current system of financial accountability in Serbia.

The key question which this thesis asks is how to build an efficient and effective financial accountability system in Serbia. The EU Treaty does not specify any predetermined model of financial accountability and control to be applied by the Member States. The European Commission could in no way impose a specific model of public expenditure

¹¹ Cf. The World Bank, *Republic of Serbia – Public Expenditure and Institutional Review*, Volume Two, February 2003., available at <http://www.worldbank.org.yu>

¹² Consolidated accounts for 2001 were audited by a private firm, in the absence of a supreme audit institution.

control on any Member/Candidate State.¹³ In fact, there are a number of different systems of financial accountability, varying from one Member State to another. All of them have their own specificities and are strongly embedded in their overall institutional context. Although the *acquis communautaire* prescribe certain obligations for the aspiring Member States in the area of internal control, these requirements represent just basic elements of a complex system. Therefore, although Serbia is urged to build an effective financial accountability system and has been given the suggestions in that respect, it is still left to find its own way towards this aim.

The objective of this thesis is to provide possible solutions for creating an efficient and effective system of financial accountability that would best serve the Serbian case. It is not in dispute that each country needs to find its own financial accountability system, best suited to the local institutional environment and culture. However, in order to achieve this aim, insights into financial accountability systems of other countries can be a powerful source of inspiration.

This thesis analyses financial accountability systems of two EU Member States: UK and France and a supranational EU system, which are then compared with the Serbian system. Notwithstanding the difficulties to assign various European countries models of financial accountability into separate categories, due to refined distinctions that characterise each of them, we have chosen the UK and French system of financial accountability as representatives of two models of financial accountability, which can broadly be defined as the Anglo-Saxon and the continental (Roman) system. The Anglo-Saxon model is characterised by an existence of an audit office without a judicial function, headed by a sole head, usually an Auditor General.¹⁴ Instruments of internal

¹³ R. Koning, "Public Internal Financial Control (PIFC) in the context of European Union enlargement", *Public Management Forum*, vol. V, No. 6, 1999, pp.4-5.

¹⁴ The model of an audit office headed by an Auditor General exists in the United Kingdom, Ireland and Denmark and in the USA. There are four main types of supreme audit institutions within the European Union, namely the 'court' with a judicial function; the 'collegiate' body without a judicial function; the independent audit office headed by an Auditor General; and the audit office headed by an Auditor General within the structure of the Government. (In addition Austrian Rechnungshof is a distinct model headed by a

financial control, on the other hand, are devolved from the Ministries of Finance to heads of line ministries or officials in the budget and finance departments of these public bodies, where the role of the Ministry of Finance is one of coordinator. The Roman model, in turn, is characterized by the existence of an external auditor with judicial functions¹⁵ and more centralized internal financial control exercised by the Ministry of Finance itself. It may be argued that the devolved Anglo-Saxon approach is more focused on ensuring that priorities and objectives of an agency are achieved, while the centralized continental approach emphasizes respect for legality and regularity of expenditure. However, in the last two decades, financial accountability systems of both groups of countries have experienced gradual harmonization, mainly towards greater devolution of internal control functions to agency's management and insistence on achieving value for money in the use of the public funds. The EU system of financial accountability represents a unique mixture of these two basic models of financial accountability, which faces additional challenges in the context of shared financial management between the EU institutions and the Member States.

The analysis of UK, French and EU system is taken as a source of information and knowledge which can be used for building the Serbian accountability system. Possibilities of incorporating strengths of particular systems into other systems of financial accountability are thus carefully considered and weighed and recommendations for further development of the Serbian financial accountability system are given.

President and auditing at central, regional and local level). Cf. UK National Audit Office, *State Audit in the European Union*, December 2005, available at http://www.nao.org.uk/publications/state_audit/state.htm

¹⁵ Supreme audit institutions in six EU countries (in France, Belgium, Portugal, Spain, Italy and Greece) can loosely be grouped together as 'courts', which exercise judicial functions. The similarities in structure and functions stem from the spread of French administrative practice across Europe after the French revolution and in the nineteenth century. In Greece and Portugal, for example, the SAI is the part of the judiciary and is constitutionally equal with other courts. The Netherlands, Germany and Luxembourg, in turn, have 'collegiate' structure, but no judicial functions, which brings them closer to the Anglo-Saxon system. It is interesting to note that Sweden and Finland's external audit institutions are part of the Government structure, and therefore represent a specific model of external audit. Cf. UK National Audit Office, *Ibid.*

Methodology

In our research, we have combined several methods: normative method, socio-legal method, comparative legal method and historical method.

Normative method is used to examine normative framework of financial accountability and its mechanisms in different countries and in the EU. Analysis of normative legal texts has provided us with a good basis for understanding of what are the standards that one financial accountability system aims to attain. However, as institutions and norms represent just a part of the broader social background, they cannot be analyzed isolated from their social context.¹⁶ Therefore, in order to provide a better understanding of the adopted financial accountability mechanisms, we have devoted considerable attention to analysis of respective social environments through the employment of socio-legal method.

The use of the socio-legal method has brought about a special dimension to our legal research, providing a greater understanding of researched phenomena through analysis of their empirical settings.¹⁷ The object of the socio-legal analysis is to provide knowledge about administrative bodies and processes: their structure and organization, how they work in practice, the effect on legal rules and doctrines on them, and the nature and effectiveness of methods of regulation, control and recourse.¹⁸ The sociological interpretation has also provided a ground for critical assessment of the adopted financial accountability mechanisms and has helped opening up debate for challenging the existing frameworks.

¹⁶ Cf. D. Kokkini-Iatridou "Some Methodological Aspects of Comparative Law", *Netherlands International Law Review*, 1986, pp. 166-167.

¹⁷ Cf. R. Cotterrell, "Why Must Legal Ideas Be Interpreted Sociologically?", *Journal of Law and Society*, Volume 25, Number 2, 1998, pp. 185-187.

¹⁸ D.J. Galligan (ed.), "Introduction: Socio-Legal Readings in Administrative Law", *A Reader on Administrative Law*, (Oxford University Press), 1996, pp. 1-8.

Although the use of socio-legal research is invaluable for understanding the legal phenomena and their critical analysis, it is doubtful whether it can provide solutions for the posed problems.¹⁹ This limitation of the sociological method, in our opinion, can be overcome by mutual application of comparative research methodology.

The comparative analysis of different systems of financial accountability provides information on variety of ways, institutions, mechanisms and processes that are used to support the establishment of a sound system of financial accountability in different social settings. The comparative method is thus of critical importance for our research, which aims at providing different options for development of the Serbian system.

Furthermore, the employment of comparative law methodology also plays an important role in the process of harmonization of Serbian law with the EU law. The application of the comparative law methodology should facilitate the process of alignment of Serbia's financial accountability mechanisms with the *acquis communautaire*. In that sense, the comparative law methodology also serves a function of *legal unification*.²⁰

The employment of normative, socio-legal and comparative method has been coupled with the use of historical method, which has helped us to understand the development of different financial accountability systems throughout time, and explain why they have evolved in different directions. In that sense, it is interesting to see and compare how the different cultural-political and legal-tradition backgrounds have influenced the establishment and changes in the financial accountability legal framework (the social-historical change in this case is taken as an independent variable and legal change as

¹⁹ Cf. D. Nelken, "Blinding Insights? The Limits of a Reflexive Sociology of Law", *Journal of Law and Society*, Volume 25, No. 3, 1998, pp. 422-423.

²⁰ For more about functions of comparative law methodology see: R. Dehousse, "Comparing National and EC Law: The Problem of the Level of Analysis", [1994] 42, *American Journal of Comparative Law*, pp. 762-764; J.H. Merryman, "Comparative Law and Scientific Explanation" in *Law in the USA in Social and Technological Revolution*, pp. 85-86; E. Orucu, *Comparative Law and Methodology*, University of Glasgow handout, 2000.

dependent variable).²¹ Thus, we have tried to explain why certain financial accountability mechanisms have been established in the UK and not in France and vice versa and which factors have influenced the development of the EU financial accountability system. This explanation coupled with an in depth analysis of the current social institutional context in Serbia provided us with a sound basis to predict²² which of the analysed financial accountability mechanisms may be most suitable for Serbia.

Finally, for the purposes of our research, we have conducted a number of interviews, primarily with the members of staff of the French *Cour des Comptes*, Serbian officials working on financial accountability issues and other practitioners in this field. The interviews with French colleagues served to elucidate important points about the operation of the French financial accountability system, while the interviews with Serbian officials have helped us to understand peculiarities of the Serbian transitional model and very much contributed to formulation of conclusions presented in the final chapter. The list of persons interviewed is attached in Annex 2.

Structure of the dissertation

In conducting our research on financial accountability, we have undertaken several distinctive steps.

Firstly, our focus is on conceptualization of the notion of financial accountability. This has provided us with a basis for carrying out a comparative research, as a comparative legal analysis cannot be undertaken unless we have a clear picture of what is going to be compared. In that sense, we have born in mind the important principle of comparative methodology – the principle of *functionality*, which assumes that only things which fulfil the same function in a society can be compared.²³ Therefore, the task of our preliminary comparative inventory is the identification of various mechanisms which have a role of

²¹ Cf. J.H. Merryman, op. cit., pp. 100-101.

²² Cf. D. Kokkini-Iatridou, op. cit., pp. 187-188.

²³ Cf. K. Zweigert, H. Kotz, *Introduction to Comparative Law*, (Clarendon Press, Oxford), 1987, p. 31.

securing financial accountability in different European states. In this way we have determined the *tertium comparationis*, as a precondition for any comparative research undertaking.²⁴ The identification of the object of our comparative research has led us to several financial control mechanisms, which are used to secure financial accountability in modern states. These are: the mechanisms of securing democratic accountability of use of public funds, discerned through budgetary control of Parliaments; the mechanisms of internal financial control within the administrative structures of the Government and the mechanisms of external financial control, provided by specialized independent audit institutions.

In order to provide Serbia with ideas on how to build a reliable system of financial accountability, the second chapter is devoted to an analysis of the UK system of financial accountability. Diverse mechanisms of financial accountability are analysed, with special emphasis on the internal Treasury mechanisms, the Public Accounts Committee and the National Audit Office in holding the executive to account for spending of public money.

The third chapter examines the financial accountability system of France, as the representative of a continental legal tradition. Special emphasis is laid on the specificities of internal financial control in France, the role of the *Cour des Comptes* and an emerging focus on Parliamentary accountability to secure effective spending of public funds.

The fourth part of our research is devoted to an analysis of the financial accountability system of the EU. We have first focused on the examination of an interplay of various EU financial accountability mechanisms and their overhaul over the last couple of years. This is followed by an analysis of the concept of financial accountability in the EU supranational context. After that, we have focused on the specific requirements for internal financial control, internal and external audit stipulated by the *acquis communautaire* and presented in negotiations Chapter 32 on financial control. We have tried to reveal the logic behind these requirements, provide their legal justification and explain their importance for the process of accession.

²⁴ Cf. D. Kokkini-Iatridou, *ibid*, pp. 158-161.

The fifth chapter shall focus on the current problems experienced by the Serbian Government in securing financial accountability. This chapter also analyses in more depth the historical development of financial accountability mechanisms in Serbia, in order to provide insights into traditional approaches to the financial accountability problems.

The final part of the dissertation focuses on identification of differences and similarities between the described financial accountability systems, conditioned by their different historical developments. We have pointed out what changes Serbia will need to make in its legal frameworks as well as within institutional structures, for adhering to the EU financial accountability standards. We have further explored the possibilities of adoption of some of the UK, France and EU's financial accountability mechanisms in the Serbian environment. Bearing in mind that legal rules, principles and institutions cannot simply be transplanted from one legal system to another,²⁵ the ways in which modern Western standards of financial accountability could be applied within the still fragile Serbian transitional context are carefully analysed.

Lastly, we would like to note that the enlargement is a costly and lengthy undertaking that requires sacrifices on both candidate countries and the EU.²⁶ Lots of investment that will only later be paid off is needed in order to secure peace and stability in Europe on a long-term basis. This dissertation is a small contribution aimed at achieving this goal.

²⁵ Cf. J. Bell, "Mechanisms for Cross-fertilisation of Administrative Law in Europe", in J. Beatson, T. Tridimas *New Directions in European Public Law*, (Hart Publishing, Oxford), 1998, p. 147; S. Cassese, "Toward a European Model of Public Administration", in D. Clark ed., *Comparative and Private International Law*, (Duncker & Humblot), Berlin, 1990, pp. 361-362.

²⁶ E. Brok, "The EU after Enlargement: Managing Coexistence of Newcomers and Veterans in a United Europe", *Public Management Forum*, Vol. VI, No 1, 2000.

Chapter I

Financial Accountability – Concept and Securing Mechanisms

Concept of Accountability

Accountability is one of the most often found terms in current administrative law and public policy theory and practice. It is therefore quite surprising to note that just a few decades ago this word was used in a very restrictive sense and still has, interestingly enough, no equivalent in any European language other than English.²⁷ The concept of accountability has gradually evolved and encompassed a number of different meanings, which often call for further clarification of its genuine sense.²⁸

Linguistic analysis of the words ‘accountability’, ‘accountable’, ‘account’ and ‘accounting’ demonstrates the common roots of all these terms. They go back through Old English and Old French to Latin – *computare*, which is also the root of the verb “to compute”.²⁹ *Computare* is the compound of *com*, which means together, and *putare*, which means to count, reckon, consider, as well as to settle (an account).³⁰ Therefore, the term accountability undoubtedly draws its origin from financial accounting, which is focused on checking the way the books are kept and how the money is spent. It is quite interesting that during the time the concept of accountability has been spread to other disciplines and gained a much broader meaning. In order to understand the full complexity of the contemporary meaning of the concept of accountability, we shall

²⁷ Cf. M. Dubnick, “Clarifying accountability: an ethical theory framework”, in C. Sampford and N. Preston (eds.) *Public Sector Ethics* (London, Routledge), 1998, pp. 68-81.

²⁸ Cf. R. Mulgan, “Accountability: an Ever-expanding Concept?”, *Public Administration*, No 3/2000, pp.555-573.

²⁹ Cf. R. Behn, *Rethinking Democratic Accountability*, Brooking Institution Press, 2001.

³⁰ Ibid., Oxford English Dictionary.

explore its usage through current academic literature. Only then will we be able to fully define the concept of financial accountability, which will provide a basis for our overall research.

The traditional dictionaries define the concept of accountability in different ways, mainly through a notion of the attribute “accountable”. Oxford dictionary defines “accountable” as one required or expected to *justify* actions or decisions; explicable or understandable. Other sources interpret “accountable” as subject to giving an account - “answerable” and capable of being accounted for - “explainable”.³¹

On the basis of the provided definitions and at the most general level of understanding, accountability could be defined as answerability or justification for one’s actions and behaviour. Therefore, accountability presupposes the existence of at least two key actors – an accountee, who is obliged to provide answers and/or justify his/her behaviour, and an accountor, who has the right to ask questions, require explanations, justifications etc. Although this seems to be a straightforward relationship, the question which naturally arises is why an accountee has to provide answers or justify his/her behaviour/actions to an accountor? What is the underlying logic behind this concept?

It may be argued that *delegation* of duties and responsibilities lies at the heart of any accountability relationship. An accountor delegates his/her authorities to an accountee, who is being entrusted with certain tasks and activities and is obliged to report back on his/her actions, so that his/her ultimate principals/accountors can be sure the job has been done in the way it was intended. Thus, for example, Romzek and Dubnick define accountability as “a relationship in which an individual or agency is held to answer for performance that involves some delegation of authority to act”.³² In a similar vein, Lord Sharman states that “Accountability is needed wherever there are hierarchical

³¹ Cf. J.M Shafritz, *The Dorsey Dictionary of American Government and Politics* (Dorsey Press, 1988).

³² Cf. B. Romzek, M. Dubnick, “Accountability” in J. M. Shafritz, *The International Encyclopedia of Public Policy and Administration*, (West-view Press, 1998), p. 6.

relationships, or where delegation of duties or responsibilities takes place.” The establishment of any accountability relationship hence presupposes a delegation of tasks and duties between an accountant and accountee or the existence of an already established hierarchical framework, which is also based on prior entrustment of certain tasks and authorities.

The content of the accountability relationship comprises two main mutually related elements – the obligation of an accountee to provide information about the discharge of his/her duties (that have been delegated by the accountant) and the right of an accountant to require such information. However, it should be noted that the first element entails not only the obligation of an accountee to provide information for carrying out certain conduct or duty to the accountant,³³ but also a duty to explain why tasks and responsibilities have been exercised in a certain way, to justify the way the things have been done so far as well as to reveal further plans and assure the accountant that activities are being performed in the way he/she wishes.³⁴ The content of the second element of the notion of accountability is the accountant’s right to request information and answers from an accountee. However, most authors agree that accountability cannot be solely identified with answerability.³⁵ Accountability seems to be a “stronger” concept, which encompasses not only the right to get answers, but also the possibility to sanction or reward taken actions or behaviour, depending on the performance.³⁶ If the accountant is happy with the accountee’s performance, he/she may want to reward the accountee. However, if this is not the case, the accountant has the right to criticize the accountee,

³³ Cf. F. White, K. Hollingsworth, *Audit, Accountability and Government*, (Clarendon Press, Oxford, 1999), p. 6.

³⁴ Cf. L. Normanton, “Public Accountability and Audit: A Reconnaissance”, in B.L.R. Smith and D.C. Hague (ed.), *The Dilemma of Accountability in Modern Government – Independence versus Control*, (Macmillan, 1971), p. 311.

³⁵ Cf. M. Geoffrey, *Constitutional Conventions. The Rules and Roles of Political Accountability*, 1986, (Oxford, Clarendon); R. Pyper, “The Parameters of Accountability”, in Robert Pyper (eds.), *Aspects of Accountability in the British System of Government*, 1996, (Tudor Business Publishing Ltd.).

³⁶ R. Behn, *Rethinking Democratic Accountability*, Brooking Institution Press, 2001.

direct the accountee's act in a particular way, require faults be remedied or/and impose sanctions. It should be noted that the meaning of "sanction" is taken here in its broadest sense, encompassing in some situations only the right to criticize, while in others it involves more severe measures, such as the right to dismiss the accountee, impose various fines and penalties.³⁷

The concept of accountability is mainly understood as an *ex-post* category, meaning that the relationship between accountant and accountee is established only after the performance by the accountee has taken place. This feature of accountability has provoked many critics, who argue that *ex-post* control alone is not sufficient to ensure the proper performance of delegated tasks. If the accountant has no means of influence over the accountee before and during the performance, it is likely that errors and omissions will eventually be made.³⁸ Thus, all the *ex-post* observations and criticisms will come too late, which makes the accountability relationship ineffective.

The main answer to these critics is that accountability, although almost always established *ex post*, has an immense *ex ante* impact. The awareness that the action will come under scrutiny may be a very strong deterrent of an accountee's *ex ante* action and therefore strongly prevent carelessness, negligence or any kind of abuse of power.³⁹

The question, however, remains whether expectance of scrutiny is enough to ensure the accountee's compliance especially when accountability is exercised in a highly complex environment, such as that of the contemporary state. It could be furthermore argued that strong emphasis on the *ex post* nature of accountability has quite a negative effect on the accountee's creativity and willingness to take any kind of risk.⁴⁰ A number of authors are

³⁷ Cf. F. White, K. Hollingsworth, *ibid.*

³⁸ Cf. E.L. Normanton, *The Accountability and Audit of Governments – A Comparative Study*, (Manchester University Press, 1964), p. 83.

³⁹ *Ibid.*

⁴⁰ A. Lovell, "Notions of Accountability and State Audit: A UK Perspective", *Financial Accountability & Management*, 12(4), 1996, pp. 267-268.

therefore of the opinion that accountability should not be comprehended only as *ex post*, but also as *ex ante* category, where accountability processes operate before or at least during the performance of an accountee.⁴¹ Besides its preventive function, accountability thus defined enables the performance of an accountee to be continuously scrutinized and, if necessary, his/her actions appropriately directed in a certain way. Another argument in favour of using broader understanding of accountability is that it is undoubtedly more suitable for comprehending the complexity of a contemporary state, which is based on numerous both *ex post* and *ex ante* accountabilities. Having all these arguments in mind, we shall base our research on the concept of accountability perceived in both the *ex ante* and *ex post* sense.

Every accountability relationship implies the existence of a certain social framework, as a basic setting for the defining the accountability relations. Accountability may be established between two or more individuals as well as different organizational structures of various degrees of complexity. In any case, it is essential that accountant and accountee, whether they are individuals or institutions, accept their obligations and duties/rights stemming from the accountability relationship, as well as share the expectations about the respective activity and the sense of justifiable reasons for the need for an explanation of conduct.⁴² If participants have different expectations and do not share the same reasoning in terms of justifications, it is difficult to talk about accountability, but rather of different kinds of relationships, based on unclearly defined settings.⁴³

⁴¹ Cf. F. White, K. Hollingsworth, op. cit. p. 6; M. Power, *The Audit Explosion*, (Demos, 1994); M. Harmon, *Responsibility as Paradox: A Critique of Rational Discourse on Government* (Sage Publications), 1995.

⁴² Cf. P. Day, R. Klein, *Accountabilities – Five Public Services*, (Tavistock Publications, London and New York), 1987, p. 5.

⁴³ Ibid.

The distinction between accountability and other similar concepts

The concept of accountability should be differentiated from other closely related concepts, such as responsibility and liability. Although these concepts are fairly similar, it is possible to delineate between them, by placing an emphasis on key features of these distinct notions. To be responsible is usually described as to have the authority to act, power to control, freedom to decide (so-called responsibility as “*capacity*”)⁴⁴, but foremost “to behave rationally and reliably and with consistency and trustworthiness in exercising internal judgment”.⁴⁵ Therefore the concept of responsibility (sometimes called moral, professional accountability)⁴⁶ refers primarily to the professional capacity and internal personal values of officials related to discharge of professional duties, in contrast to accountability whose focus is placed on external pressure to provide answers and justifications for one’s actions. It could further be argued that responsibility is an utterly personal concept, always related to an individual, while accountability is principally an institutional concept, which denotes relations between different institutions and between institutions and the general public and only to a lesser degree also a personal concept.

The concept of liability, on the other hand, assumes the duty of making good, but even more so “to restore, to compensate, to recompense for wrongdoing or poor judgment”. It generally implies the existence of a malpractice or misconduct, which needs to be remedied. Although the concept of accountability shares some of the features of liability, it does not presuppose the existence of the wrongdoing and compensation, but merely

⁴⁴ Cf. A. B. Cendon, “Accountability and Public Administration: Concepts, Dimensions, Developments”, in *Openness and Transparency in Governance: Challenges and Opportunities*, (NISPACEE and IEPA), 1999, pp. 24-25.

⁴⁵ Cf. O.P. Dwivedi, J.G. Jabbra, “Public Service Responsibility and Accountability” in O.P. Dwivedi, J.G. Jabbra (eds.) *Public Service Accountability - A Comparative Perspective*, (Kumarian Press, Inc., 1989), pp. 24-25.

⁴⁶ Cf. A. Sinclair (1995), “The Chameleon of Accountability: Forms and Discourses”, *Accounting, Organization and Society*, 20. 219-237; O.P. Dwivedi, J.G. Jabbra, op. cit., pp. 5-7.

points out the duty to provide answers, justifications and provide assurance of an appropriate running of the entrusted affairs.

The complexities of a precise definition of the concept of accountability is even more apparent in the comparative context, mainly due to an absence of a concept of accountability in other countries and, hence, the lack of adequate translation of the concept of accountability in other languages. For example, in French language, only one term “*responsabilite*” is used to denote the meaning of 3 different English concepts of accountability, responsibility and liability.⁴⁷ A similar situation can be found in the Serbian language, which also contains only one word “*odgovornost*” for all three mentioned terms. The meaning of “*responsabilite*” and “*odgovornost*” is narrower than one of accountability and is quite close to English term of “responsibility”, which, as we could see, is much more a personal, individual concept than institutional. “*Responsabilite*” and “*odgovornost*” definitely refer to one’s capacity to act and decide (above mentioned responsibility as ‘*capacity*’), but also include the notion of liability.⁴⁸ Therefore, these terms may also have a rather negative connotation, as they generally contain an inherent element of a wrongdoing and subsequent punishment.⁴⁹ As accountability concept does not exist, it is not represented in the academic writing and practice. Instead, researchers prefer to use similar, but well-established concepts, in particular the concept of “*control*”.

Attempts to differentiate the concept of accountability and control are again complicated by different meanings these concepts have in various national settings and languages. In the English language, the meaning of control tends to be rather broad, starting from influencing and guiding to restraining and inspecting.⁵⁰ In the French and Serbian languages, on the other hand, the meaning of control (*controle*) is much more restrictive

⁴⁷ Cf. P. Avril, “Responsabilite et accountability”, in O. Beaud, J.M. Blanquer (eds.), *La Responsabilite des Gouvernants*, (Descartes & Cie, SODEM), Paris, 1999.

⁴⁸ Ibid.

⁴⁹ Cf. A. B. Cendon, op. cit., pp. 24-25.

⁵⁰ Cf. D. Coombes et al, *The Power of the Purse*, (London George Allen & Unwin Ltd), 1976, pp. 16-17.

and precise than in English and refers to inspection, verification, examination, checking against fixed standards,⁵¹ which is close to the English meaning of accountability. At first sight, it may seem that control is a looser concept than accountability, since accountability refers only to one type/means of control where persons are actually called to account and have to provide answers for their actions and accept possible sanctions. However, the main distinction between the concepts of accountability and control is an existence of delegation of functions, as the key element of accountability. Whereas accountability assumes delegation of functions between an accountor and accountee, control does not imply any entrustment of tasks. Control is primarily a tool for ensuring that things are done in the way it was required and that expected standards have been met. Thus, control could be defined as a *process* “designed to provide reasonable assurance regarding the effectiveness and efficiency of operations, reliability of reporting and compliance with applicable laws and regulations.”⁵² Therefore, control may very well be used as a mechanism for ensuring accountability and a basis for calling someone to account, as will be explained in more detail later.

Dimensions of accountability

In order to comprehend the notion of accountability further, it will be useful to distinguish between its several dimensions. These are:

1. who is accountable;
2. to whom;
3. for what;

⁵¹ Cf. Cassell's French Dictionary, (MacMillan Publishing Company, 1981); Concise Oxford Hachette French Dictionary, (Oxford University Press), 1998. Z. Tomic, *Upravna kontrola uprave*, (Draganic) Belgrade, 1995. The word *controle*, is a compound of the words “contre” and “role”. “Role” is a official registry which contains certain important facts, while “controle” is another parallel registry which is being run for the purpose of checking the data of the first registry.

⁵² OECD Policy Brief, “Public Sector Modernising Accountability and Control”, (OECD Observer), 2005.

4. how it is secured and measured.⁵³

The who-dimension provides the answer to the question of who is/are the accountee/s of the accountability relationship. Is it an individual who is performing a task, or is it a group of people? Is it a sub-unit of an organization or the whole organization, from those with rather simple organizational structures to very complex ones, such as that of the state?

The to-whom-dimension refers to the accountant/s (principal/s) of accountability in the accountability relationship. The accountant is the locus of accountability who determines the mandates and the resources of the agent.

The simplest categorization of the to-whom dimension of accountability is one which distinguishes between the internal and external loci of accountability. Internal accountability is established between persons and/or units which operate within the same organization. External accountants/principals, on the other hand, are those outside of the agent organization, such as a customer or a group of customers, tax payers in general (as an electorate), one's political party, union, governmental auditors etc.⁵⁴ It should be noted that external and internal accountability are closely related, since organizations can fulfil their external accountability responsibilities only if they are performing efficiently and effectively their internal duties.⁵⁵

Similarly to this conception, public administration theory distinguishes between traditional "upward" - political or parliamentary accountability and the more recently developed image of "outward" or direct public accountability to clients and the public.⁵⁶

⁵³ Cf. T. Virtanen, *Financial Autonomy and Accountability of Public Managers*, European Group of Public Administration Leuven, Belgium, September 1997.

⁵⁴ Cf. D. Fuller, B. Roffey (1993), "Improving Public Sector Accountability and Strategic Decision-Making", *Australian Journal of Public Administration*, 52, 149-163.

⁵⁵ Ibid.

⁵⁶ Cf. A. Sinclair, op. cit., pp. 219-237.

In most cases, the accountant/principal in the accountability relationship has the ability to directly scrutinise the behaviour of the accountee. However, there are some instances in which the accountant/principal, for various reasons, cannot supervise the accountee, and therefore needs help of some third actor. In that sense, it is possible to imagine many various combinations, of which two shall be of our closer interest:

- 1) The structure where the accountant/principal cannot exercise direct power over the accountee and therefore delegates his/her authorities to the third actor, who will carry out the supervision on his/her behalf;
- 2) The structure where the accountant/principal exercises direct power over the accountee, but does not have enough knowledge to successfully scrutinize the accountee's work, and therefore hires a third person or a body, who/which helps him/her make the right assessment of the accountee's work.⁵⁷

The for-what-dimension has to do with the *object* of accountability: particular tasks or organizational action including both its aims and consequences. There have been quite a few classifications of accountability notions according to this dimension.

Smith (1971), thus, distinguishes between fiscal, programme and process accountability. While fiscal/regularity accountability is concerned whether the money has been spent as agreed, according to appropriate rules, programme/effectiveness accountability addresses the question whether the defined results have been achieved. Process/efficiency accountability, furthermore refers to employment of general processes and operations, so that value for money is achieved in the use of resources.⁵⁸

⁵⁷ Cf. F. White, K. Hollingsworth, op. cit. pp. 6-7.

⁵⁸ Cf. B. Smith "Accountability and Independence in the Contract State", in B. Smith and D.C. Hauge (eds.), *The Dilemma of Accountability in Modern Government*, (Macmillan, 1971), p. 29.

Day and Klein's (1987) framework for analysis of accountability rests on the distinction between political and managerial accountability. While political accountability is about those with delegated authority being answerable to the people, managerial accountability is mainly a neutral technical process aimed to make those with delegated authority answerable for carrying out agreed tasks according to politically agreed criteria of performance. On the basis of that definition, Day and Klein tried to build a hierarchical model of accountability, with political accountability, which sets the policy objectives and generates the criteria used in the technical process of managerial accountability, on the top of the accountability chain. However, the authors are aware of the number of arguable assumptions on which this model is built (for example, the model presupposes that there are effective institutional and organizational links between political and managerial systems of accountability, which may be indeed questionable in the conditions of the 21st century service delivery state; that political process does generate precise, clear-cut objectives etc.).⁵⁹ Day and Klein also distinguish a category of financial accountability, as a merely neutral, technical activity of keeping true and accurate accounts, which does not have any direct links with democratic government. Financial accountability, in their opinion, thus exists both in despotic and democratic regimes, with the distinction that in the despotic regime the principal of accountability is the ruler, while in democratic regime it is the citizen.⁶⁰

Dwivedi and Jabbra (1989) separate out the following accountability categories: administrative/organizational, legal, political, professional and moral accountability.⁶¹

⁵⁹ Cf. P. Day, R. Klein, op. cit., pp.6-7.

⁶⁰ Ibid.

⁶¹ Cf. O.P. Dwivedi, J.G. Jabbra, op. cit., pp. 5-7. While organizational accountability is linked to strict hierarchical relationships within the organization and relies on internal means of control, legal accountability "relates actions in the public domain to the established legislative and judicial process". The main task of political accountability, on the other hand, is to assure the legitimacy of a public programme. Professional accountability, furthermore, is about balancing the professional interests with the wider public interests, which, in their opinion, need to have precedence over the former. Lastly, the aim of moral

In similar vein, Sinclair (1995) distinguishes between five types of accountabilities—political, public, managerial/administrative, professional and personal.⁶² Similar classification of accountability could also be found with Cendon (1999), who differentiates political, administrative, professional and democratic accountability.⁶³

Behn (2001) provides a slightly different classification, which recognizes four accountability types: accountability for finances, for fairness, for the use (or abuse) of power and performance.⁶⁴ For Behn, the substance of financial accountability is rather straightforward and is provided in the answer to a question “whether the organization and its officials have been wise stewards of the resources with which they were entrusted”. Accountability for fairness, on the other hand, deals with the issue of respect of ethical standards. Accountability for the use (or abuse) of power encompasses the earlier defined accountabilities for finances and fairness, while the accountability for performance provides information on the effectiveness of Government’s programmes.⁶⁵

accountability is to combat political and bureaucratic corruption and bring about the highest standards of personal integrity, honesty and fairness within the state structure.

⁶² Cf. A. Sinclair (1995), op. cit. pp. 219-237. Sinclair defines political accountability as a direct line of accountability where a public servant is accountable for the exercise of its public authorities to the Permanent Head, who is in turn accountable to the minister, to the executive of cabinet, to Parliament and hence to the electors. Public accountability is more informal, but direct accountability of the state to the public, interested community groups and individuals, is expressed through the requirement that Government, through various channels (debates, hearings), gives responses to public concerns about administrative activity. The managerial model of accountability requires that those with delegated authority are answerable for producing outputs or the use of resources to achieve certain ends. Very similar to managerial accountability is administrative accountability, where the emphasis is not on monitoring outputs, but the processes by which inputs are transformed. Professional accountability, furthermore, invokes the sense of duty that one has as a member of a professional or expert group. Finally, personal accountability is seen as faithfulness to personal conscience in basic human and moral values.

⁶³ Cf. A. B. Cendon, op. cit., pp. 24-25.

⁶⁴ Cf. R. D. Behn, op. cit., pp. 6-10.

⁶⁵ Ibid.

These classifications of accountability are useful since they highlight various accountability relationships established within the democratic state. Day and Klein's framework of accountability seems to be particularly helpful, since it attempts to provide a coherent structural design of different accountability relationships within the state-society sphere. However, their model may be criticized for its problematic underlying assumptions as well its emphasis on strictly hierarchical relations between different dimensions of accountability. The other classifications, Dwivedi, Jabbra's and Sinclair's can be further criticized for their foundation on over-expanded concept of accountability, which is at times based exclusively on internal values (i.e. in the case of moral and personal accountability), instead of external scrutiny, mixing it with a concept of responsibility. However, in spite of inherent deficiencies of possible for-what classifications of accountability, their value should not be underestimated. Mapping of different public sphere accountability relationships can greatly enhance our understanding of the complexity of the contemporary state and provide a basis for building more specific concepts of accountability, such as that of financial accountability.

The final dimension of accountability refers to ways it can be assessed and ensured. It provides answers to the question of possible channels and securing mechanisms of accountability.⁶⁶

This dimension of accountability may be the most controversial, as it widens the concept of accountability and relates it to other concepts, such as rules, procedures, control, institutions etc. The basic assumption is that in order to hold someone to account for something, there is first a need to determine our expectations and values that we want individuals and organizations to uphold.⁶⁷ Furthermore, there is a need for specification of those expectations through rules, procedures and standards. Given the complexity of the modern state, it is necessary to create controlling and reporting mechanisms to demonstrate that determined rules, procedures and standards have been followed. Only

⁶⁶ Cf. R. Pyper, op. cit., pp. 7-8.

⁶⁷ Cf. R. D. Behn, op. cit., pp. 5-6.

creation of such a reliable structure of accountability mechanisms would enable an accounter to assess whether the entrusted tasks are being carried out in accordance with his/her wishes and would provide the basis for holding someone to account. In this sense, all the rules, regulations, institutions in support of specific accountability relationship are understood as accountability mechanisms/devices.

Some authors are of the opinion that an introduction of diverse accountability mechanisms as elements of accountability brings about over-extension of the accountability concept.⁶⁸ Namely, encompassment of all rules, institutions and methods of constraining public organizations other than through calling them to account significantly broadens the concept of accountability, bringing about more confusion in academic writing and practice than clarification.⁶⁹ In order to avoid this, accountability should be associated only with the process of being called to account to some authority for one's actions, as the original or core sense of "accountability" and not be related to other broader concepts of control and regulation in general.⁷⁰

Although we do understand the worries of the over-extension of the accountability concept, we are of the opinion that accountability could not be well understood and exercised without the existence of numerous accountability supporting structures, i.e. mechanisms and devices, which do not have to be accountability relationships themselves. There is certainly a possibility that all the rules aimed at constraining individual and organizational functioning would get an attribute of accountability device and this risk should undoubtedly be taken into account. Nevertheless, it should be stressed that (democratic) accountability, watched through the prism of the contemporary state, is a fairly complex concept, which assumes the existence of a number of different securing mechanisms, embodied in numerous rules, regulations, procedures. Only after a

⁶⁸ Cf. R. Mulgan, *op.cit.*, pp. 555-573.

⁶⁹ *Ibid.*

⁷⁰ *Ibid.*

careful identification and analysis of all these elements of accountability would we be able to understand the full meaning of this elusive notion.

In the context of the democratic state, two broad categories of accountability mechanisms can be discerned, based on different *to-whom* dimensions of accountability. The first category relates to *internal accountability mechanisms*, such as administrative/managerial accountability. Administrative/managerial accountability assumes numerous channels focused on the need to secure the accountability of officials to their administrative/managerial superiors. This primarily refers to rules of defining the goals of officials, budgeting resources, the qualitative and quantitative measurement of goal achievement, and formal and informal interaction between the superiors and officials in the process of assessment.⁷¹ The second category provides *external accountability mechanisms*, i.e. means of holding the Government to account to Parliament and other institutions outside of the administration, such as the Ombudsman and external audit. The main mechanisms of this category are scrutiny by legislative and investigatory committees, various public debates and, in the last resort, parliamentary elections.

The Concept of Financial Accountability

In the most simple terms, financial accountability is about responsible stewardship for the use of public money. Financial accountability is a means of ensuring that public money has been used in a responsible and productive way. It is about verification of legality and regularity of financial accounts, but also about making sure that value for money has been achieved in the use of resources.⁷²

These definitions of financial accountability provide the answer to one of the crucial dimensions of accountability – for what. They define the *object* of financial

⁷¹ Cf. T. Virtanen, op. cit. p. 7.

⁷² Cf. Lord Sharman of Redlynch, “Holding to Account, The Review of Audit and Accountability for Central Government”, February 2001, www.hm-treasury.gov.uk, pp. 9-25.

accountability: organizational actions undertaken with the aim of stewardship and productive use of public money.

The outlined definitions of financial accountability further trigger a number of questions. What is public money? What is stewardship of public money? What is meant by its proper and productive use?

Although the concept of public money seems to be clear, there are a number of ways of defining it, depending on the interest from which it is approached.⁷³ One of the possible definitions of public money is that it is all the money raised by the Government in the form of taxes, fees and charges, or under other Government statutory powers, or borrowed by the Government and used for the purposes of funding governmental activities. Once public money is allocated to be spent, it is possible to talk about another complex and mainly economic concept of “public expenditure”. Public expenditure could be defined as simply everything that is currently spent in the government’s name, as well as its future obligations and liabilities.⁷⁴

Things are, of course, not as simple as that. However, it is very difficult to provide an accurate and extensive definition of public money and public expenditure, especially since there is still no universally accepted definition of what is the scope of the public sector, especially in a comparative context. The definitions of public expenditure have been changing and developing over time⁷⁵ and are often found to be biased, to suit the objectives of the research being undertaken. Therefore, we shall not attempt to give a comprehensive definition of either the concept of public money or public expenditure,

⁷³ Ibid.

⁷⁴ Cf. S. Watson, “What should count as Public Expenditure”, in D. Corry (eds.), *Public Expenditure, Effective Management and Control*, 1997, (Harcourt Brace & Company Limited), 41-62.

⁷⁵ Ibid.; A. Likierman, *Public Expenditure*, 1988, (Penguin books); D. Heald, *Public Expenditure*, 1983, (Martin Robertson, Oxford); P. Else, “The Scope and Content of Government Expenditure”, in D. Coombes et al (eds.), op. cit. 22-35.

but will operate with them as defined earlier, restricting their scope to central Government level funding.

In a democratic state, the standards of public money stewardship are normally expected to be higher than in the private sector. The main reason for this lies in the fact that there is often an element of coercion involved in raising public money, which should oblige the Government to take a very good care on how to use it.⁷⁶ What is more, the fact that most public services are not subject to competition should bring even more pressure to bear on the Government to apply high standards of public money stewardship.⁷⁷

Although there is no generally accepted definition of stewardship of public money, it is possible to discern several elements of this concept, which are represented in most Western democracies.

The lowest common denominator of public money stewardship is the requirement that public money is spent in accordance with existing laws, regulations and principles. Depending on the country in question, we can talk about legality, regularity and propriety of expenditure. The requirements of legality and regularity generally mean that public money could only be used for the purposes intended by authorising legislation (including delegated legislation, i.e. secondary legislation) and other Parliamentary authority.⁷⁸ In some countries (e.g. UK) requirement of probity, on the other hand, refers to compliance

⁷⁶ Cf. L. Sharman of Redlynch, op. cit, p. 15.

⁷⁷ Ibid.

⁷⁸ Such as for example Appropriation Act in the UK and budget law in France (*loi de finances*) and Serbia. It should further be noted that parliamentary authorisation of expenditure provides a basis for two elements of control. The first is that expenditure must conform with the ambit of the relevant Parliamentary Vote for appropriations (Appropriation Act in UK, Budget Law in France and Serbia), which represents a qualitative allocation of money between Government's priorities. The second is that public money has to be spent in accordance with its, perhaps even more important, qualitative framework, provided in the permanent legislation. Permanent legislation lays down the purposes to which government can spend requested money and provides the basis for quantitative allocation of public money, provided in appropriations.

with other rules, procedures, principles and standards of behaviour, which are not governed by statutory authority, as will be explained in more detail in the chapter II.

A more advanced feature of the public money stewardship concept is achievement of “value for money” for the use of resources. Value for money could be defined in different ways, but generally denotes the obligation of public bodies to make the best use of the resources at their disposal and obtain three Es – economy, efficiency and effectiveness. In this sense, “economy” is concerned with minimising costs, “efficiency” with achieving the maximum output from a given input, while “effectiveness” is concerned with the extent to which policy objectives have been achieved.

On the basis of the outlined standards, we may conclude that the key objective of financial accountability is to attain stewardship of public money through securing the principles of legality, regularity, propriety and value for money for the use of public funds.

The next question to be raised is the definition of the first dimension of accountability-who is the accountee in the financial accountability relationship? Who is the one who undertakes the action and spends the public money? Who is the one to be held to account, to provide information, explanation and be the subject of possible sanction?

It may be argued that the state/Government as an entity is the accountee of financial accountability. At a lower level of generalization, it is the executive who is authorized to spend public money and which is, therefore, called to give an account of its actions. Lastly, financial accountability accountees are the officials who deal with public funds, and who, therefore, can individually be held accountable for dealing with public funds.

The question which naturally follows is what do we understand by the ‘state’/Government/executive? Not attempting to get into details of the theory of the

state, we shall just point out the key elements of these concepts, necessary for carrying out our comparative research.

In the continental law tradition the concept of the state is a key notion of legal and political theory. The state is perceived as an autonomous actor supreme to its citizens.⁷⁹ The state is thus defined as an “abstract identity bearing inherent responsibility for the performance of public functions”.⁸⁰

In contrast, in the Anglo-Saxon legal tradition the clear state conception is missing and reference is usually made to the term ‘Government’.⁸¹ The term state is generally used only at the level of international relations or in the terms of welfare state. This is explained by the lack of the ideological barrier between the state and its citizens, developed during centuries of authoritative rule on the continent.⁸² It should further be noted that the Government can have a narrow meaning in the sense of only elected politicians holding office, that is, ministers; or it can have a broad sense and include not only ministers but also the whole range of public organizations, such as departments, agencies, along with the civil servants and other officials.

For the purposes of our research, we shall use the Anglo-Saxon term Government in its broader sense (unless being more strictly specified), encompassing the variety of entities or units that in addition to fulfilling their political responsibilities and their role in economic and social regulation “deliver public services for individual or collective consumption and redistribute income and wealth.”⁸³ Furthermore, we shall at times

⁷⁹ Cf. B. Connaughton, “Teaching Ideas and Principle of Public Administration: Public Education in Europe”, paper presented at EPAN conference in Granada, 2002.

⁸⁰ Cf. C. Knill, *The Europeanisation of National Administrations*, (Cambridge University Press, 2001), p. 73.

⁸¹ Cf. R.J. Stillman, *Preface to Public Administration*, (New York: St. Marint’s), 1991.

⁸² Cf. C. Knill, *op.cit*, p. 73.

⁸³ Cf. R. Allen, D. Tommasi (eds.), *Managing Public Expenditure, A Reference Book for Transitional Countries*, SIGMA, OECD, 2001, p. 44.

interchangeably use the terms “state” and Government, as concepts with the same meaning of encompassing the variety of organisations of a country’s public sector. Nevertheless, we shall attempt to be consistent throughout our research and base it on the concept of the Government as explained above, in order to avoid possible confusion.

There exist several possible levels of Government operations: general, central, regional, local and supranational. ‘General Government’ is a term used to describe all government entities at whatever level, central, regional or local. ‘Central Government’ is used to denote entities responsible for those functions that affect the country as a whole: for example, national defense, conduct of relations with other countries and international organizations, establishment of legislative, executive and judicial functions that cover the entire country, and delivery of public services such as healthcare and education.⁸⁴ ‘Local Government’, in turn, is a collection of public bodies with authority over a subdivision of a significant area of country’s territory. ‘Regional Government’ has independent authority for certain functions in a significant area of country’s territory.⁸⁵ Supranational level of Government operates beyond all above mentioned national Government institutions and represents a particular international layer of administration, such as, for example, the European Union.

Due to the great complexity of the contemporary state and its possible operation at several different levels, we shall restrict our research to financial accountability arrangements established at the central Government level. This means that local and regional levels of governance shall be excluded from our area of interest, since they raise specific financial accountability issues and require separate treatment. Financial accountability established at the supranational level of Government will be a subject of our special interest and will be analysed in more depth in the chapter IV.

⁸⁴ Ibid.

⁸⁵ Ibid.

The following crucial dimension of accountability, which needs to be addressed is the one which defines the principal of the financial accountability relationship. In order to provide the answer to this question, it is necessary to draw a conditional distinction between two main types of political regimes – despotic and democratic. It may be argued that financial accountability relationships exist in both kinds of regimes. Officials in both despotic and democratic regimes are held accountable for dealing with public funds by their superiors.⁸⁶ However, while in despotic regimes the highest superior, and therefore the main principal of financial accountability is the ruler, in democratic regimes the ultimate principals/accountors of the financial accountability relationship are citizens.⁸⁷ As our financial accountability research is focused on the analysis of the democratic state, we may conclude that the ultimate accountor's power in the financial accountability relationship belongs to citizens.

It should be stressed that the financial accountability relationship established between the Government and the citizens is in many ways problematic. The main reason for this is the practical impossibility of close and detailed scrutiny of the Government's actions by the citizens. Such a situation has brought about a need for the introduction of the mentioned third actor/s in the accountability relationship – representative or professional body/ies, which would, on the citizens' behalf, provide "indirect" supervision of the executive.⁸⁸ Therefore, it is possible to talk about several 'levels' of financial accountability.

Financial accountability in its core sense is a "democratic" accountability, as a relationship established between the Government and its citizens, where citizens, through direct (elections) or more often indirect means and institutions (representative institutions and other bodies), are holding the Government to account for stewardship of public money. The core financial accountability relationship assumes that citizens need to be assured that possible public wrongdoing is minimized within government at all levels in

⁸⁶ Cf. P. Day, R. Klein, op. cit. pp. 8-9.

⁸⁷ Ibid.

⁸⁸ Cf. F. White, K. Hollingsworth, op. cit. pp. 7-8.

the chain of command. This implies the reassurance that sufficient internal and external checks exist so that reliable outside judgment can be made on Government operations.⁸⁹

It is obvious that the core financial accountability relationship relies on a number of more specific financial accountability relationships and controlling devices as its securing mechanisms. These supporting accountabilities/ accountability mechanisms are established between key state institutions and can be initially classified as external or internal to the executive. It may be argued that the main loci of financial accountability is external, since key accountability mechanisms are established outside the executive's structure (with parliament, external audit institution, judiciary etc.). However, since the executive can fulfil its external accountability responsibilities only if it is efficiently and effectively performing its internal duties, the financial accountability relationship is also established within its internal structure, between public officials dealing with public funds and their administrative/managerial superiors, through establishment of a number of controlling mechanisms. Therefore, we can see that financial accountability encompasses features of various previously mentioned types of accountabilities – external political and public accountability on the one hand and internal managerial/administrative on the other hand, which are all connected by one common denominator – the aim of securing and safeguarding of public money.

Before making the final specification of the concept of financial accountability and its securing mechanisms, we should further examine the historical origin and nature of the financial accountability relationship, which will help us draw the final conclusion on the concept of financial accountability in the remainder of this chapter.

Origins of financial accountability

Accountability for the use of public money has always been at the centre of attention of politicians, philosophers, lawyers, economists as well as ordinary people. In the old ages,

⁸⁹ Cf. O.P. Dwivedi, J.G. Jabbra, op. cit., pp. 5-7.

the Greek philosophers devoted considerable attention to handling of public money. Aristotle, thus, wrote:

*“Some officials handle large sums of public money; it is therefore necessary to have other officials to receive and examine the accounts. These inspectors must administer no funds themselves. Different cities call them examiners, auditors, scrutineers and public advocates”.*⁹⁰

During history, the notion of financial accountability was developing and gaining different meanings, depending on the nature of the Government itself.

During medieval history, the key pattern of accountability was expressed in accountability of a servant to a ruler.⁹¹ This pattern of accountability was complicated by the growth of the state, when the servant was no longer able to render account to the ruler, but had to deal with the royal auditors.⁹² The nature of financial accountability, however, was not changed in this way, as the ruler remained the main accountant. The same remained true under the absolute monarchies of the Renaissance and the Baroque Age.⁹³ The other main feature of such accountability was its secrecy of operation, far from the eyes of citizens. The ruler had to learn what his servants had been doing, so that he would be able to promote or punish them. Private persons, on the other hand, did not need to know about the functioning of administration and in most of such regimes were not allowed to do so.

The broadest trend of the state development from the seventeenth until the twentieth centuries was to break the hierarchy of the medieval history down and distribute power more widely. A very important part of this movement was to distinguish a law-making function from an executive or administrative function and to entrust them to different

⁹⁰ Cf. Aristotle, *The Politics and Constitution of Athens*, S. Everson (eds.), (Cambridge University Press, 1996).

⁹¹ Cf. E.L. Normanton, op. cit. p. 3.

⁹² Ibid, pp. 3-5.

⁹³ Ibid.

elements of the state. This was the idea of the separation of powers, expressed by Montesquieu.⁹⁴ In that sense, the legislative power was dissociated from the executive and judicial power. Legislative power rested with a democratically elected parliament, which obtained one of the most important functions – voting the money to the executive power.⁹⁵

The first elements of a democratic financial accountability were developed in medieval England, in a struggle between the Parliament and monarch over finances.⁹⁶ In fact, the English Parliament owed its origin and existence almost entirely to the English age-old determination not to be taxed without consent (see Annex 1).⁹⁷ Interestingly enough, it was through the achievement of this end that British representative institutions secured political freedoms for British citizens much earlier and much more effectively than the Parliaments which had originated through fight for political freedoms.⁹⁸

The earliest financial demand was for legislative control of taxation; the control of expenditure gradually followed, with the requirement of proper accounts.⁹⁹ These had to be public documents, so that the spirit of secrecy in financial administration had to be broken. The idea of finance as a private dynastic secret was incompatible with the constitutional state. Therefore, ideas of democratic financial accountability were spreading to most newly established constitutional states.

⁹⁴ Cf. Montesquieu, *The Spirit of Laws*, (University of California Press, London), 1977.

⁹⁵ Cf. D. Coombes (ed.), op. cit., pp. 13-21.

⁹⁶ S. Walkland, "Parliamentary control of public expenditure in Britain", in D. Coombes, *The Power of the Purse*, (London George Allen & Unwin Ltd.), p. 179-198.

⁹⁷ P. Einzig, *The Control of the Purse – Progress and Decline of Parliament's Financial Control*, (London, Secker & Warburg), 1959, p. 17.

⁹⁸ Ibid.

⁹⁹ E.L. Normarton, op. cit. p. 5.; J.E.D. Binney, *British Public Finance and Administration 1774-92*, (Oxford Clarendon Press), 1958, pp. 4-5.; I.E. O'Brien, *The Scottish Parliament in the 15th and 16th Centuries*, Ph.D. Thesis (Glasgow, 1980), 180.

Thus, the United States Constitution states that:

“No Money shall be drawn from the Treasury but in Consequence of Appropriations made by Law; and a regular Statement and Account of Receipts and Expenditures of all public Money shall be published from time to time.”¹⁰⁰

The French Revolution went much further and proclaimed a doctrine of popular sovereignty over finance:

“All citizens have the right to ascertain, either in person or through their representatives, the necessity for public taxation, to consent freely thereto, to observe its expenditure and to determine its apportionment, its assessment, its collection and its duration.”¹⁰¹

Establishment of the constitutional state has changed the pattern of accountability. Now accountability started being exercised between the executive and citizens, which, in practice, meant, to the parliament.¹⁰²

In order to be fully implemented in practice, financial accountability demanded the development of an appropriate securing mechanism, starting from the structure of financial planning, accounting and banking to the establishment of auditing institutions. In that respect, the introduction of financial law, by which the legislature reinforced its control over finance, was of immense importance. The role of the budget for accountability was that it provided quite precise standards by which annual accounts were judged. Accountability thus became a comparison of the accounts submitted at the end of the cycle with the authorization of expenditure laws made at the beginning.¹⁰³

¹⁰⁰ Article I, Section 9 of the USA Constitution.

¹⁰¹ Article 14, Declaration of the Rights of Man and Citizen, 1791.

¹⁰² Cf. E.L. Normarton, op. cit. pp. 7-8.

¹⁰³ Ibid, pp. 10-11.

Although the executives retained strong powers of leadership within most legislatures, by the end of the XIX century, the legislature had an absolutely prime interest in effective accountability.¹⁰⁴ This was not simply a matter of preventing financial scandals, but mainly the question of power itself. Firm restrictions on the executive to the financial limits set by law was the key element of legislative influence over policy, as well as over the cost of everyday administration.¹⁰⁵

Since the First World War, however, the state itself has tremendously changed. Public spending has vastly increased in most European countries, including those of Central and Eastern Europe.¹⁰⁶ The state has taken over a number of the activities reserved in the previous period only for the private sector. The number of state employees has continually grown from one year to another. The imposition of vast operations, which Government has taken over from the private sector, upon the relatively small and fragile state machinery has had two clear results. There has been a crisis of planning and a crisis of accountability.¹⁰⁷ This amounted to a crisis of the whole system of financial control, experienced in all advanced countries.¹⁰⁸

The subordination of administrative bodies to the traditional political powers became more and more difficult to achieve as the number of civil servants grew, together with the problems with which they had to handle in everyday life. The commonest reaction to “big government” has been merely to expand old public bodies. But the expansion has often

¹⁰⁴ P. Einzing, *The Control of the Purse*, (London, Secker & Warburg, 1959); B. Chubb, *The Control of the Public Expenditure*, (Oxford, Clarendon Press, 1952) pp. 42-71.

¹⁰⁵ Cf. E.L. Normarton, op. cit. p 8.

¹⁰⁶ P. Else, “The Scope and Content of Government Expenditure”, in D.Coombes, *The Power of the Purse*, (London George Allen & Unwin Ltd.), pp.22-45; P. Enzing, *The Control of the Purse*, (London, Secker & Warburg), pp. 223-232.

¹⁰⁷ E. L. Normarton, *ibid.*

¹⁰⁸ *Ibid.*

upset the arrangements for the democratic financial accountability, bringing about new challenges for keeping its proclaimed democratic nature.¹⁰⁹

Nature of the financial accountability relationship

The question which arises from the above discussion is whether the “democratic” notion of financial accountability as we described above, the accountability established between the state and the citizens, does accurately describe reality, or whether the elements of financial accountability relations in despotic states still remain visible in a modern state. Putting it the other way around, is spending of public money by the state still in many ways based on power and coercion, or does it represent a sole reflection of the unwritten social contract, where both parties have given their consent to enter the financial accountability relationship, maintained through regular elections?

This question leads us to another key issue which needs to be addressed when talking about financial accountability. It is the question of the nature of the basis of financial accountability.

Any serious search for providing the answer to this question necessarily leads to the writings of constitutional philosophers. Although the concept of financial accountability is rarely, if ever, mentioned in their writings, the nature of the financial accountability relationship cannot be comprehended without understanding broader concepts, primarily the concept of political and public accountability. As we could see, the concept of financial accountability has many common features with the notions of political and public accountability. This should not be surprising, bearing in mind that the development of a constitutional theory of political accountability went hand in hand with the development of the public financial accountability and substantial efforts of parliaments to overtake control of finance from the monarchs.¹¹⁰

¹⁰⁹ Ibid.

¹¹⁰ Cf. P. Day, R. Klein, op. cit., pp.12-13;

The key theorists providing the theoretical basis for the development of the public accountability concept are certainly Thomas Hobbes, John Locke and Jean-Jacques Rousseau. The main idea presented in writings of all the three philosophers is that of a social contract. Government is established by the “social contract” between those who exercise public power and those who are expected to obey public power. The former hold authority and exact obedience only in so far as they pursue the interests of the latter. Should officials substitute their own interests or misinterpret common interests, the public is no longer bound by the social contract and could withdraw its support and find other officials who would respect its wishes. In short, public officials are responsible and accountable to the people on whose behalf they exercise public power.¹¹¹

The theory of social contract can easily be applied to the financial accountability relationship. In this sense, it may be argued that a basis of financial accountability relationship is a *hypothetical* agreement concluded between the state and the citizens, where the citizens have entrusted their monies to the Government, which has in turn taken the responsibility of using the respective funds in the pursuit of the public good. Looking from the level of statal institutions, it may further be argued that the Parliament has entrusted the money to the Executive, and is holding it to account for its spending.

The basis of the financial accountability relationship can further be located in the theory of democracy, which plainly claims that: “power emanates from the people and is to be exercised in trust for the people”.¹¹² Putting this the other way around, we may well argue that money emanates from the people and therefore has to be exercised in trust for the

¹¹¹ Cf. J. Locke, *Second Treatise of Government*, (J.M. Dent & Sons Ltd, London, 1924); J.J. Rousseau, *The Social Contract*, (Penguin books, London), 1968; D. Gauthier “Hobbes’s Social Contract”, in C.W. Morris (ed.), *The Social Contract Theorists*, (Rowman & Littlefield Publishers, Inc), 1999.

¹¹² Cf. B.L.R. Smith “Accountability and Independence in the Contract State”, in B.L.R. Smith and D.C. Hague (ed.), *The Dilemma of Accountability in Modern Government – Independence versus Control*, (Macmillan, 1971), p. 26.

people. The state is responsible for the proper handling of public money and has to continually give an account of its actions to the public.

Turning to the question of the nature of the financial accountability relationship, we are of the opinion that the social contract theory is quite a valuable means in explaining the essence of the financial accountability relationship. Furthermore, the social contract theory definitely provides a good theoretical basis for understanding the nature of financial accountability. The problem which may, however, arise while relying on the social contract theory is its obvious falsity. The contract between the state and the citizens in general has never actually existed. Are we not then relying for our theoretical understanding on something for which we are sure has nothing to do with the reality?

The answer to this question is that social contract theory should not, at any point, be interpreted literally, but metaphorically.¹¹³ In that sense, it may be argued that the main idea of social contract theory is that societal institutions and arrangements are the creation of people and cannot be sustained without their support for a long period of time, even in the case of the most severe despotic regimes. Henceforth, we would argue that the basis of financial accountability needs primarily to be searched for in the willingness of people to transfer part of their private funds to the state, expecting the proper handling of those funds in return.

Quite a separate issue worth discussing is whether the concept of financial accountability as described and explained above accurately depicts the contemporary reality, reflected in often found feelings of the citizens that the state is taking more than it is actually giving? Furthermore, citizens may experience immense difficulties in trying to hold the Government to account for the spending of public money and there is almost no doubt that any individual effort in that respect will be in vain. Citizens may also feel that entering the financial accountability relationship with the state is the corollary of state coercion rather than their own will.

¹¹³ Cf. C.W. Morris (ed.), *The Social Contract Theorists*, (Rowman & Littlefield Publishers, Inc), 1999.

All these criticisms of the concept of financial accountability outlined above certainly have their relevance. However, they still cannot override the general framework of the financial accountability relationship, which is, in our opinion, primarily based on the special kind of contractual relationship existing between the citizens and the state.

Specification of the Concept of Financial Accountability and its Securing Mechanisms

After attempting to define the nature of financial accountability and trace its historical origins, it is necessary to define more precisely the scope of financial accountability concept that will be used in our research.

It could be argued that the financial accountability relationship, in its widest sense, encompasses two broad processes: 1) adequate taxation, i.e. raising and collection of money from citizens in an appropriate manner and 2) adequate allocation and use of these resources. Although there is undoubtedly an integral relationship between these processes,¹¹⁴ financial accountability in our understanding refers only to the second process, where the emphasis is placed on the responsible and productive *use* of public money, i.e. public expenditure. The process of taxation and collection of public money, i.e., taxes, charges etc. represents a special area of research, which requires particular and extensive attention and exceeds the limits of our research.

Furthermore, it is necessary to specify the concept of financial accountability in relation to the overall process of public expenditure management. In this sense, it is useful to distinguish between several key stages of public expenditure management:

- 1) Expenditure planning by the executive
- 2) Parliamentary debate and approval

¹¹⁴ R. Allen, D. Tommasi, op. cit., p. 19.

- 3) Spending of the money voted
- 4) Accounting for the money spent.¹¹⁵

The public expenditure management process could thus be depicted as follows. The Executive first plans the expenditure and then asks Parliament for authorisation of expenditure of public funds. The necessity of Parliament's authorization of expenditure (as well as taxation), called in British constitutional tradition as the "power of the purse", is a focal point of Parliament's authority to hold the Government to account. If the authorisation is denied, the Government of the day is forced to resign. If, on the other hand, the approval is granted, it means that the Parliament has entrusted public money to the Government, who is responsible for ensuring that arrangements are in place to safeguard these funds and is held accountable for how it has used the money.

The essence of the financial accountability relationship lies in the Parliament's authorisation of the public expenditure plans (as well as revenue) by legislation. Authorising expenditure legislation provides a framework of law, which is the basis for calling the Government to account for its actions. Statutory approval of expenditure thus provides a good foundation for exercising financial accountability, which in most basic form consists of a comparison of the submitted accounts to those initially approved.¹¹⁶

¹¹⁵ Cf. F. White, K. Hollingsworth, op. cit. p. 1. It should be noted that in the UK and many other countries, draft laws on public expenditure proposals and tax changes are presented to parliament separately. The spending side of the budget is provided in supply estimates, which subsequently lead to the Appropriation Act. The tax side of the budget eventually leads to the Finance Act. From 1993-1996, the British Government started to present to Parliament its expenditure decisions along its tax proposals in a 'unified Budget', but afterwards got back to the earlier practice of separate presentation of revenue and expenditure side. In contrast, in most continental law tradition countries (including France and Serbia), revenues and expenditures are always presented jointly in the budget law. Therefore, continental law public finance theory generally distinguishes between 4 key stages of budget management: planning of the budget, approval of the budget, execution of the budget and budget control. Cf. G. Paovic-Jeknic, *Kontrola budžeta – jugoslovensko i italijansko pravo*, Podgorica, 1999. B. Jelacic, *Nauka o financijama i finansijsko pravo*, (Narodne novine, Zagreb), 1990. D. Aleksic, *Finansije i finansijsko pravo*, (Informator, Zagreb), 1982.

¹¹⁶ Cf. L. Normanton, op. cit. pp. 6-7.

Henceforth, it may be concluded that only after the expenditure has been appropriately planned and authorized is the accountability relationship established between its numerous actors. Although it may be argued that the initial stage of expenditure planning subsumes some elements of ex-ante accountability, our financial accountability research will not encompass this preliminary phase. Instead, our analysis shall comprise the second phase of Parliamentary debate and approval of expenditure (as the key aspect of ex-ante financial accountability), but will primarily focus on the third and the fourth phase of public expenditure management, when the public money is being spent and after it is spent and is being accounted for (as ex-post financial accountability).

Variety of Financial Accountability mechanisms

The Government can be held accountable by the Parliament and, in the last resort, citizens, only if there are appropriate accountability mechanisms to ensure that money is spent in accordance with Parliamentary wishes.¹¹⁷ The Government thus has an obligation to the citizens for providing a credible legal/regulatory framework which will be able to support and secure the stewardship of public money.¹¹⁸ Furthermore, numerous accountability mechanisms must exist outside of the Government structure to enable citizens to hold the Government to account for the stewardship of their money.

The ultimate financial accountability mechanism is established directly between the Government and citizens. Taxpayers hold the state to account for management of monies which they have entrusted to it. The state has to give an account for its spending to citizens assuring the taxpayers that their money has been spent not only in a proper but also in a productive way. Otherwise, the legitimacy of the Government of the day will be put in question. If the citizens are not satisfied with the way their money has been handled the sanction they may impose is the change of Government at the next elections.

¹¹⁷ Cf. F. White, K. Hollingsworth, op. cit. p. 3.

¹¹⁸ The World Bank, *Federal Republic of Yugoslavia, Country Financial Accountability Assessment*, 2002.

Therefore, it may be argued that elections represent the ultimate and direct financial accountability securing mechanism within a system of representative democracy.

Transferred to the terrain of statal institutions, the basic framework for accountability has in most parliamentary democracies been provided by the concept of ministerial responsibility to Parliament. The minister is obliged to give account for the exercise of power within his/her department and provide explanations and justifications for the undertaken course of action.¹¹⁹ Although having undisputable constitutional value, ministerial responsibility to Parliament represents just one and perhaps not the most important mechanism for securing financial accountability of the Government. Financial accountability is primarily safeguarded by a number of different forms: Parliament's activity, work of parliamentary investigatory committees, internal controls and reporting mechanisms within departments and external audit.¹²⁰

It should further be noted that traditional emphasis placed on Parliament's key role in securing financial accountability (especially in the UK, but also on the continent) has for quite some time been questioned.¹²¹ The general opinion has been that parliamentary control over public expenditure is rapidly declining and that traditional concepts which place Parliament at the centre of the financial accountability mechanisms may bring more confusion than clarification.¹²² It has further been argued that many procedures established for the purposes of parliamentary control over public funds remain under heavy influence of the Government¹²³. Bearing in mind the importance of parliamentary

¹¹⁹ Cf. F. White, K. Hollingsworth, op. cit. p. 4; Z. Loncar, *Ministarska odgovornost* [Ministerial Responsibility], PhD Dissertation, Novi Sad, 1999.

¹²⁰ Cf. Lord Sharman of Redlynch, op. cit. pp. 9-25.

¹²¹ Cf. G. Reid, *The Politics of Financial Control*, (Hunchinson & C0), 1966, p.62; Heclo H., Wildavsky A., *The Private Government of Public Money* (2nd edn, Macmillan, 1981), I. Harden, "Money and the Constitution: Financial Control, reporting and audit", [1993], *Legal Studies*, 16.

¹²² Cf. D. Coombes et al., *The Power of the Purse*, (London George Allen & Unwin Ltd), 1976.

¹²³ Cf. J. McEldowney, "The Control of Public Expenditure" in J.Jowell, D.Oliver ed., *The Changing Constitution*, (Oxford University Press), 2000.

control over public expenditure, as a democratic means of holding the Government financially accountable to the public, many voices have been raised for the establishment of more effective procedures helping the Parliament to hold the Government to account for the use of public money.¹²⁴ Due to obvious crises in the current post-modern political systems, many authors are calling for the introduction of more effective extra-parliamentary pressures in both constitutional systems as a whole and area of public expenditure control.¹²⁵

In most parliamentary democracies, external audit provides a key mechanism which on behalf of the taxpayer scrutinizes how Government uses the money voted to it and holds Government to account. Throughout the world, national audit bodies have been established with the task of examining the regularity and efficiency of use of public funds and reporting their findings.¹²⁶ Although the organizational arrangements and practices widely differ from country to country, reflecting various administrative cultures and traditions, their work is based on the same general principles: organizational and financial independence of the audit office, ability to decide its own work programme as well as the right to freely report the findings of their work.¹²⁷

Although the external audit over public finances provides the substantive basis for effective financial control, its limitations as a sole instrument of financial control and accountability remain obvious. One of the main criticisms of audit processes is that they make public officials risk averse, constraining development of innovative ideas and new

¹²⁴ Ibid; J. Garrett, "Developing State Audit in Britain", *Public Administration* Vol. 64, 1986.

¹²⁵ Cf. P. Barberis, "The New Public Management and a New Accountability", *Public Administration* Vol. 76, 1998. 451- 469; Smith, "Post-modern Politics and the Case for Constitutional Renewal", *Political Quarterly* 65, 1994, pp. 128-37.

¹²⁶ In most Central and Eastern European countries, external audit institutions have been established after the fall of the Berlin Wall and are slowly building their capacities for auditing of public funds.

¹²⁷ Cf. Lima Declaration of Guidelines on Auditing Precepts, available on the INTOSAI web site, www.intosai.org.

approaches to service delivery.¹²⁸ Audit procedures have also been criticized for their opacity and lack of transparency.¹²⁹ However, the key complaint against audit is that its observations and remarks are too late, that the errors and waste of money has already occurred at the time the audit is taking place and that nothing has been done in order to prevent it. Although, it may be argued that audit has certainly a preventive function in a sense that plain knowledge that the accounts will come under scrutiny at some point of time will discourage negligent behaviour,¹³⁰ it is obvious that external control can not bring about great results if it is not underpinned by active, internal financial controls, exercised by the Government itself.

The widely held opinion is that sound financial accountability depends on a combination of both strong internal, managerial accountability and independent external audit.¹³¹ It is not disputed that internal, mostly preventive, control of public spending is a necessity of a modern, financially accountable state, as much as external, ex-post control by independent auditors. Responsibility for safeguarding of public funds rests undoubtedly with the management of the Government bodies receiving the money, who are responsible for establishing effective arrangements for control. Such arrangements include the measures taken to verify the legality and regularity of expenditure before it is made (ex ante accountability) and those which occur after the expenditure is made (ex post accountability).

Internal accountability systems in Europe vary from country to country, depending on different traditions and socio-legal backgrounds. Broadly speaking, two main approaches to internal financial accountability can be discerned. The first one can be found in countries of continental Europe (France, Portugal, Spain) where the controls are exercised by a third party organization, often an agency of a ministry of finance. A

¹²⁸ Cf. A. Lovell "Notions of Accountability and State Audit: A UK Perspective", *Financial Accountability & Management*, 12(4), November 1996.

¹²⁹ Cf. M. Power, *The Audit Explosion*, (Demos, 1994), pp. 48-49.

¹³⁰ Cf. E.L. Normanton, op. cit. p. 83.

¹³¹ Cf. Lord Sharman of Redlynch, op. cit. 9-25.

second approach, which can be found in the UK, Netherlands and the Scandinavian countries, is based on decentralization of financial control from the Ministries of finance to heads of line ministries or officials in the budget and finance departments of these public bodies, where the role of the Ministry of finance is one of the coordinator, who remains responsible for the overall effectiveness and consistency of the systems.¹³² It may be argued that the centralized continental approach emphasizes respect for legality and regularity of expenditure, while the devolved system is more focused on ensuring that priorities and objectives of an agency are achieved.¹³³

In the past two decades, internal control systems of both groups of countries have experienced gradual harmonization, mainly towards greater devolution of internal control functions to agency's management, which is taking overall responsibility for the management of funds, and abolition of controls exercised by a third party organisation. With increasing devolution of managerial discretion and financial responsibility, ministries, departments and agencies face increasing pressures to show that their managers have used their money and other resources in a way that accomplishes their functions efficiently. The question that remains, however, is which type of system of internal control would be most suitable for transitional countries, who are facing numerous challenges in building new systems of financial accountability.

There are number of types of internal control, whose aim is to improve performance and reinforce financial accountability in the public agencies and bodies. Those are: financial accounting and reporting, accounting controls, procurement controls, physical controls, performance measurement, internal audit.¹³⁴

¹³² Cf. R. Allen, D. Tommasi (eds.), *op. cit.* pp. 260-261.

¹³³ OECD Policy Brief, *Public Sector Modernisation: Modernising Accountability and Control*, (OECD Observer), 2005.

¹³⁴ *Ibid.*

Establishment of appropriate accounting systems has an increasingly important role in securing financial accountability. Once the authorized money has been spent, it has to be firstly accounted for and then audited subsequently. There are two key accounting techniques relevant for current public sector: cash and accrual accounting.¹³⁵ Under cash based accounting, transactions and events are recognized when cash is received or paid. Furthermore, there is no accounting for assets and liabilities. Accrual-based systems, in turn, recognize transactions or events at the time economic value is created, transformed, exchanged, transferred or extinguished and when all, not only cash flows, are recorded.¹³⁶ This means while the cash accounting measures only flow of cash resources, accrual accounting includes all the revenues and expenses (including depreciation)¹³⁷, assets (financial and physical, current and capital), liabilities and other economic flows.¹³⁸ It may therefore be argued that accruals accounting presents a truer picture of the financial costs of an organization. Furthermore, accrual accounting basis are believed to encourage good stewardship of public money.¹³⁹ However, cash accounting also has its advantages over accrual. It is simpler, cheaper (since it requires less work and expertise), less subjective and comparable to monetary data.¹⁴⁰ It should be noted that accounting bases in many countries are not based solely on cash or accrual accounting, but most of the time represent a mixture of the two systems, with different variants.

Internal audit is another valuable tool in securing financial accountability. Internal audit could be defined as “independent, objective assurance and consulting activity designed to

¹³⁵ Cf. F. White, K. Hollingsworth, op. cit. pp. 15-25.

¹³⁶ R. Allen, D. Tommasi, op. cit., p. 437.

¹³⁷ Depreciation techniques are those which spread the costs of assets over their lifetime. Expenses in accrual accounting, therefore, reflect the amount of goods and services consumed during the year, whether or not they are paid for in that period.

¹³⁸ R. Allen, D. Tommasi, op. cit, pp. 291-292.

¹³⁹ Cf. F. White, K. Hollingsworth, *ibid*.

¹⁴⁰ *Ibid*, R. Allen, D. Tommasi, *ibid*.

add value and improve an organization's operations.”¹⁴¹ Historically, internal auditing has solely focused on financial systems and financial controls within an organization. However, the role of internal audit has been changing and widening over time. Thus, in the past few decades, the internal audit function extended to examination of various kinds of risks to the organization and reviewing the adequacy of the underlying activities to manage those risks.¹⁴² Nevertheless, the role of the internal audit in financial matters has remained quite valuable and very important for building reliable new transitional systems of financial accountability.

Conclusion

The concept of financial accountability, as a relationship in which citizens hold the Government to account for the stewardship of public money is fairly complex and intricate. Establishing and securing an effective financial accountability relationship requires setting up of a network of internal and external financial accountability mechanisms, including adequate accounting, reporting and internal and external auditing.

However, it needs to be emphasized that financial accountability is not only about establishing and maintaining accounting and auditing systems and checking the legality of public expenditure. Financial accountability goes further, requiring the Government to manage finances prudently and regularly inform the public what has been achieved with the use of public funds.¹⁴³ Therefore, in procedures of both internal and external financial accountability, the emphasis is gradually shifting from the classical concern of regularity and propriety of public expenditure, to “value for money” investigations, which examine

¹⁴¹ The Institute of Internal auditors, *Internal Control Systems in Candidate Countries*, Volume 2, SIGMA, OECD, 2004.

¹⁴² Ibid; Cf. N. Hepworth, “Is the modern UK/US approach to internal audit appropriate in all circumstances and especially for countries with less developed systems and less well trained public officials”, unpublished manuscript, 2004.

¹⁴³ Cf. The World Bank, “Clean Government and Public Financial Accountability”, OED Working Paper Series, No.17, Summer 2000.

whether economy, efficiency and effectiveness in the use of resources has been attained. Growing attention has furthermore been paid to the establishment of systems of performance measurement¹⁴⁴ within Government departments, which should enable the Parliament and the public to assess how well public money is spent and what has been achieved with it. Finally, increasing attention has lately been paid to the regular reporting on the financial control findings to the public, which should attain greater transparency in the conduct of public finances and reinforce the level of trust between state and citizens when spending of public money is in question.

Finally, it should be stressed that financial accountability mechanisms cannot be analysed as isolated phenomena, but as mutually interrelated elements, which are in the process of constant interaction, mutually supporting their structures and functions. Therefore, we can easily talk about financial accountability in terms of a system,¹⁴⁵ which consists of different mutually related elements/mechanisms of financial accountability. It should be stressed that the effectiveness of financial accountability as a system depends mostly on the existence of a proper balance between its different supporting mechanisms, so that weaknesses in one form of financial accountability can be compensated for by controls through other mechanisms.¹⁴⁶

There are a number of different systems of financial accountability, varying from one country to another. As pointed out in the introduction, our research shall be based on the analyses and comparison between three different national systems of financial accountability: British, French and Serbian and one supranational system of the European Union, aiming at providing possible recommendations for improving the Serbian system in order to achieve standards necessary for the EU membership. The first national financial accountability system to be analysed in the next chapter is the UK system.

¹⁴⁴ Performance measurement can briefly be described as the use of measure and targets to assess objectively the performance of a body.

¹⁴⁵ Cf. L. Bertalanffy, *General Systems Theory*, (George Braziller Publishers), 1969.

¹⁴⁶ Cf. T. Verheijen, M. Millar, "Reforming public policy processes and securing accountability: Ireland in a comparative perspective", *International Review of Administrative Sciences*, 1998, p. 98.

Chapter II

Financial Accountability in the United Kingdom

As we saw in the first chapter, financial accountability is a relationship established between the citizens, as accountors, and the state, as accountee, where citizens hold the state to account for the stewardship of entrusted public money. This rather abstract definition involves three main aspects of the accountability notion – *who* is accountable, *to whom* and *for what*. Understanding financial accountability in the United Kingdom necessitates operationalisation of this definition and clarification of its elements in the British context. As the *to whom* dimension of financial accountability seems to be rather clear and, in our opinion, does not require further elaboration, we shall devote our closer attention mainly to two/three other categories of financial accountability. Firstly, we shall discuss the meaning of the accountee/agent of the financial accountability, i.e. the British central Government. Secondly, we shall analyse in more detail the *for what* dimension of financial accountability, aiming at the provision of a framework for the understanding of the concept of “stewardship” of public money in the British Government context. The focus of our inquiry, furthermore, will be placed on the fourth financial accountability dimension – mechanisms *through which* the accountability relationship operates. As the effectiveness of a financial accountability depends mostly on the existence of a proper balance between the different mechanisms, so that weaknesses in one form of accountability can be compensated for by controls through other mechanisms,¹⁴⁷ we shall identify the key financial accountability mechanisms in the UK focusing on their role in the overall British system of financial accountability.

¹⁴⁷ T. Verheijen, M. Millar, “Reforming public policy processes and securing accountability: Ireland in a comparative perspective”, *International Review of Administrative Sciences*, 1998, p. 98.

A Highly Complex Accountee – the British Central Government

The British Government¹⁴⁸ operates within a political system of constitutional monarchy, without a written Constitution. Ministers of the Crown govern in the name of the Monarch, who is both the Head of the State and head of the Government. Sovereignty, however, is vested in the UK Parliament. In constitutional terms, the Westminster Parliament consists of the directly elected House of Commons, the House of Lords (traditionally unelected) and the monarch.

It should be noted that in recent years, the British Constitutional arrangements have been subject to substantial changes aimed at making a clear separation between three powers: legislative, executive and judicial. These reforms, introduced by the Constitutional Reform Act 2005, involve the modification of the office of Lord Chancellor,¹⁴⁹ detaching the UK highest court from the Upper House of Parliament and the creation of a UK Supreme Court¹⁵⁰ and an independent Judicial Appointments Commission,¹⁵¹ to allow greater level of independence of the judiciary from the executive. Such an ambitious reform agenda has prompted intense academic and professional discussion¹⁵² and its outcomes are yet to be seen in the years to come.

¹⁴⁸ As we saw in the I chapter, the term Government can have a narrow meaning in the sense of only elected politicians holding office, that is, ministers; or it can have a broad sense and include not only ministers but also the whole range of public organizations, such as departments, agencies, along with the civil servants and other officials. We shall use it in the latter meaning throughout this chapter.

¹⁴⁹ In accordance with Part 2 of the Constitutional Reform Act 2005, the Lord Chancellor is no longer a judge nor exercises any judicial function.

¹⁵⁰ Part 2 of the Constitutional Reform Act 2005.

¹⁵¹ Part 4 of the Constitutional Reform Act 2005. The Judicial Appointments Commission was created on 3 April 2006.

¹⁵² Cf. A. Le Sueur, "New Labour's next (surprisingly quick) steps in constitutional reform", *Public Law*, Autumn, 2003, pp. 368-377. R. Masterman, "A Supreme Court for the United Kingdom: Two Steps Forward, but One Step Back on Judicial Independence", *Public Law*, 2004, pp. 48-58; V. Lay, "A Small

The executive power in the UK is in the hands of the government departments, as policy-making bodies and agencies, whose role is to implement government policy and advise ministers. Ministers are individually accountable and responsible for the work of their departments and agencies to Parliament and have a duty to report to Parliament on their policies, decisions and actions.¹⁵³ Britain has a disciplined two party (perhaps now three party) system, in which Government has quite a strong power to implement its policies.

Bearing in mind that our research is focused on the central Government level, we shall define the “who is accountable” dimension of accountability by defining the scope of the British central Government level. This is not an easy task, largely due to substantive changes which the British public sector experienced under the 18 years of Conservative Government (1979-1997), transforming it from a welfare to a contract model.¹⁵⁴ Aiming to reduce public expenditure, the Conservatives undertook excessive privatisation and increased private and voluntary provision of public services. In central Government, executive functions have been largely “hived off” from central departments to Next Step agencies.¹⁵⁵ At the same time, in order to attain their economic objectives, the Conservatives had to create a strong central Government which would be able to effectively carry out its policies. Therefore, a whole range of new, non-democratically elected public bodies (so called – quangos) was appointed.¹⁵⁶ Since 1997 the structure of

Sense Behind the UK Constitutional Reform”, <http://ezinearticles.com>; Lord Windelsham, The Constitutional Reform Act 2005: Ministers, Judges and Constitutional Change, *Public Law*, 2005, pp. 806-822.

¹⁵³ It should be noted that the constitutional accountability of ministers is based on convention of ministerial responsibility, which should be distinguished from Ministers’ managerial accountability. Cf: D. Woodhouse: “The Reconstruction of Constitutional Accountability”, *Public Law*, Spring, 2002. pp. 73-90.

¹⁵⁴ S. Horton, D. Farnham, “The Politics of Public Sector Change”, in S. Horton, D. Farnham (eds), *Public Management in Britain* (MacMillan Press Ltd.), p. 3.

¹⁵⁵ At the moment there are more than 100 such bodies, employing around 75 per cent of all civil servants.

¹⁵⁶ Cf. M. Flinders, M. Smith (eds.), *Quangos, Accountability and Reform* (Palgrave, MacMillan), 1999; D. Farnham, S. Horton, “Managing Public and Private Organisations”, in S. Horton and D. Farnham (eds.), *Public Management in Britain*, (MacMillan Press Ltd.), 1999. pp.26-29. However, it should also be noted

the British Government has undergone further profound changes, since legislative and administrative authorities have been devolved to regional institutions of Scotland, Wales and Northern Ireland. The processes of devolution and closer European integration, have further added to the complexity of the British Government organisation.¹⁵⁷ All these developments have undoubtedly added to the complexity of the ways in which public services are provided and funded and therefore have strong implications for audit and financial accountability.

The term which has often been used to embrace the great diversity of British public sector is “public bodies”. However, it seems that even this notion is not broad enough to encompass all the expanding variety of organisations. The vast and complex range of new organisations which government has invented to carry out public functions together with the great number of private or voluntary bodies which provide public services are not recognised as public bodies.¹⁵⁸ The picture gets even more confused when taking into account the mergers of bodies and the change of organisational status of a number of bodies within the public sector as well as outside of it.¹⁵⁹ Furthermore, criteria for classifying public bodies are not straightforward and clear-cut, albeit the Cabinet Office has made an effort to assist departments to identify the likely classification of new and existing bodies that fall within their remit, by instructions given in its Guidance on classification of public bodies.¹⁶⁰

that the use of arm’s length bodies to deliver public services has a long history, for some of them dating back to XIX century.

¹⁵⁷ N. Burrows, *Devolution*, (Sweet and Maxwell), 2000; J. Greenwood *et al.*, *New Public Administration in Britain*, (Routledge, 2002), p. 19.

¹⁵⁸ S. Weir, W. Hall (eds.), *Democratic Audit – Extra-governmental Organisations in the United Kingdom and their accountability*, (the Charter 88 Trust, 1994), pp. 6-7.

¹⁵⁹ *Ibid.*

¹⁶⁰ Cabinet Office Guidance for Departments, *Classification of Public Bodies*, August 2005.

http://www.civilservice.gov.uk/other/agencies/publications/pdf/classification_guidance_aug05.pdf

Although there is a number of provisional classifications of British public sector organisations,¹⁶¹ the officially accepted one is of the Office of National Statistics which is done with the reference to ESA95.¹⁶² A body is classified into a public or private body depending on who controls the general corporate policy of the body concerned. Once the Office of National Statistics has classified a body as public sector it is then classified to a particular sub-sector based on its characteristics.¹⁶³

According to the Office of National Statistics, the UK public sector is comprised of the following sub-sectors:

- Central Government (CG): includes Government Departments and their Agencies; the devolved administrations in Scotland, Wales and (when reinstated) Northern Ireland, Non-Departmental Public Bodies and any other non-market bodies controlled and mainly financed by them;
- Local Government (LG): those types of public administration that only cover a specific locality and any non-market bodies controlled and mainly financed by them;
- Public Corporations (PC): market bodies controlled by either Central Government or Local Government. These can include government-owned companies and trading funds.¹⁶⁴

Relying on this definition of the British public sector, we shall restrict our research to the first element of the public sector, which is perceived to constitute a central Government level: government departments, government agencies and non-departmental public bodies (quangos) and any other non-market bodies controlled and mainly financed by them.

¹⁶¹ S. Horton, D. Farhnam, op. cit., pp.3-4; L. Sharman of Redlynch, "The Review of Audit and Accountability for Central Government", February 2001, www.hm-treasury.gov.uk; Times Books, 1995, *Times Guide to the British State*, London: Times Books.

¹⁶² European System of Accounts 1995,
<http://forum.europa.eu.int/irc/dsis/nfaccount/infor/data/esa95en.htm>

¹⁶³ Cabinet Office Guidance for Departments, *Classification of Public Bodies*, *ibid.*

¹⁶⁴ *Ibid.*

However, the devolved administrations in Scotland and Wales, shall, due to distinctiveness of the financial accountability mechanisms operating in this sphere of governance, be excluded from our research. Local Government institutions shall also be left out from our sphere of interest, due to the separate financial accountability regimes under which they operate. Public Corporations, on the other hand, shall be the subject of our research, provided that they are controlled by the Central Government level.

Concept of “stewardship” of public money in UK

There are two main conceptual categories which could be subsumed under the notion of “stewardship” of public money in the British context. Stewardship firstly encompasses basic financial requirements of regularity, propriety and probity of the public expenditure. Secondly, stewardship involves requirements related to issues of value for money in the use of resources and compliance with principles of economy, efficiency and effectiveness. Although these two categories of public money “stewardship” are usually perceived as quite separate matters, one dealing mainly with questions of conformity with relevant rules and legislation and another examining productivity of the use of public funds, there have been some tendencies which have brought these two categories together, not only in everyday practice of auditors and accountants, but also in the terrain of administrative law. Before examining this issue further, we shall look closer at each of the elements of the concept of “stewardship” of public money in the British Government.

According to the Treasury's Government Accounting Guide,¹⁶⁵ regularity is seen as a "requirement for all items of expenditure and receipts to be dealt with in accordance with legislation authorising them, including any applicable delegated authority and the rules of the Government Accounting."¹⁶⁶ This means that all expenditure and receipts have to be authorised by Parliament in the first place and then also comply with Treasury rules, set out in the Government Accounting Guide. When talking about parliamentary authorisation of expenditure, it may be argued that there are two elements of control. Firstly, expenditure must conform with the ambit of the relevant Parliamentary Vote of the Appropriation Act, which is legally binding. The expenditure, however, does not rest solely on the authority of the Appropriation Act. While the Appropriation Act represents a quantitative allocation of money between Government's priorities, it may be argued that permanent legislation provides a qualitative framework for the purposes to which government can spend requested money.¹⁶⁷ If, however, there is a conflict between the Appropriation Act and permanent legislation, two possible options exist. The first one is that the terms of the Appropriation Act will prevail and spending under the Appropriation Act will be regular (although not necessarily *proper*), notwithstanding that restrictions of

¹⁶⁵ The Treasury's *Government Accounting: A guide on accounting and financial procedures for the use of government departments*, is a large guide on wide variety of issues relating to the proper handing and reporting on public money, which is regularly updated with amendments (London: HMSO, 1989 and several amendments 1989-05). While in formal terms the Government Accounting guide represents Treasury's own rules (rules made by administration), it also derives support and legitimacy from other sources, such as Parliament and especially the Public Accounts Committee. The Government Accounting is thus quite wide in scope and encompasses variety of legislative requirements (much of the guidance concerning the use of the Contingencies funds, trading funds, the role of the National Audit Office and the Comptroller and Auditor General) and practices of parliamentary procedure that Parliament has adopted over the years for handing public money as well as specific agreements reached between the Treasury and Parliament (e.g. advice on the 1932 Concordat between the PAC and the Treasury). It further contains rules and practices that have been laid down only by the Treasury, which are mainly designed to secure good financial control, promote high standards of propriety, improve value for money throughout the administration. Cf. <http://www.government-accounting.gov.uk/current/frames.htm>

¹⁶⁶ Government Accounting, *supra*, n. 3, 6.2.14.

¹⁶⁷ F. White, K. Hollingsworth, *Audit, Accountability and Government*, (Clarendon Press, Oxford, 1999), pp. 65-66.

permanent legislation are not respected.¹⁶⁸ This understanding, however, has been challenged by the Courts, which held that voted funds in the Appropriation Act cannot cure the invalidity of the permanent legislation authorising the expenditure.¹⁶⁹ Therefore, it may be inferred that expenditure must conform both to the ambit of the relevant Vote and permanent legislation in order to be regular.

Finally, regularity requires expenditure be authorised by the Treasury. The principle is that no expenditure or commitment can be undertaken without Treasury approval, even after being voted by Parliament and included in an Appropriation Act. This requirement has been put on a statutory footing by the Government Resources and Accounts Act 2000.¹⁷⁰ In practice, the Treasury delegates to departments the authority to spend within defined limits, as will be discussed in more depth later.

The next requirements of public money stewardship are propriety and probity. Propriety is defined by *Government Accounting* as a “further requirement that expenditure and receipts should be dealt in accordance with Parliament’s intentions and the principles of Parliamentary control, including the conventions agreed with Parliament”.¹⁷¹ It could be noticed that this definition is very similar to one of regularity. However, propriety is wider than regularity and is concerned more with the standards of conduct, behaviour, fairness and integrity (avoidance of personal profit from public business, even-handedness in the appointment of staff, open competition in the letting of contracts etc.)¹⁷² Questions of propriety, as previously mentioned, could be raised when the terms

¹⁶⁸ Cf. Public Accounts Committee Concordat, 1932, *Government Accounting* 8/94, Amendment No. 6; T. Daintith, “The Legal Effects of the Appropriation Act”, *Public Law* [1998], pp. 552-557.

¹⁶⁹ Cf. Fire Brigades Union case (*R v Secretary of State for the Home Department, ex parte Fire Brigades Union and others*, 2 AC 513, [1995] 2 All ER 244, [1995] 2 WLR 464).

www.cicap.gov.uk/case_law/documents/Procedure/r_v_secretary_of_state_ex_parte_fbu.pdf

¹⁷⁰ Subsection 2(b), section 3 of the Government Resources and Accounts Act 2000.

¹⁷¹ *Government Accounting*, supra, n. 3, 6.2.14.

¹⁷² Auditing Practice Board’s Practice Note 10, Audit of Central Government Financial Statements in the United Kingdom.

of the Appropriation Act are in conflict with permanent legislation. In that case, spending will be *proper* only if Parliament has been expressly notified of the intention and effect of the vote by an appropriate note in the estimate and if the strict temporal restrictions on the use of this device are respected.¹⁷³ Lastly, the requirement of “probity” appears to go beyond regularity and to overlap with notions of propriety to include a standard of honesty and integrity.

It is quite interesting, especially for a lawyer, to note that the concept of stewardship of public money in the UK does not recognise the principle of ‘legality’. This raises important concerns. There is no doubt that the requirement that spending be authorised by legislation is a legal requirement.¹⁷⁴ Therefore, it does not seem to be plausible that a requirement for “all items of expenditure and receipts to be dealt with in accordance with legislation authorising them” defined in Government Accounting as “regularity” is not covered by and generally used as a principle of “legality”. Confusion between the two principles can be misleading both to the executive and the public, who may believe that shortcomings in safeguarding public funds are of far lesser importance (*irregular* instead of *illegal* expenditure). Therefore, it would be important to distinguish and clearly stress the legality elements in the control of public expenditure.

Nevertheless, it is hard to believe that the public money stewardship requirement of legality will soon get the place it deserves. This is due to nature of the control of public expenditure, which is mainly in the hands of accountants (from the National Audit Office) and only to a minimal extent exercised by the Courts (as will be pointed out later). Therefore, it should not be surprising that the concept of legality has not been fully developed and that the accountancy term ‘regularity’ very much prevails over the lawyers’ usual obsession with the ‘rule of law’ issues. Or as some would argue: “It is a

¹⁷³ T. Daintith, *op. cit.*, pp. 552-557.

¹⁷⁴ I. Harden, F. White, K. Hollingsworth, “Value for Money and Administrative Law”, *Public Law*, 1996, pp. 677-678.

language of the auditor's certificate, not of the judge's opinion".¹⁷⁵ Only if Courts start playing more important role of control of public expenditure (as is the case with the UK local level) could it to be expected that the principle of legality will obtain a much more prominent place within the concept of stewardship of public money.

The second broad category of requirements of public money stewardship is one dealing with issues of value for money: economy, efficiency and effectiveness. Whereas the National Audit Act make explicit reference to these requirements, it is silent as to the exact meaning of these terms and to date no court has given a legal definition of it. However, academic discussions and audit practices have provided some deeper insight into the meaning of these concepts which could be depicted as follows:

- 1) economy – minimising the cost of resources used or acquired – spending less. A lack of economy could occur, for example, when there is overstaffing or when overqualified staff or overpriced facilities are used;
- 2) efficiency – the relationship between the output from goods or services and the resources used to produce them – spending well. Efficiency seeks to ensure that the maximum output is obtained from the resources devoted to a department (or programme), or alternatively, that only the minimum level of resources are devoted to a given level of output.¹⁷⁶
- 3) effectiveness – the relationship between the intended and actual results of public spending – spending wisely.¹⁷⁷ Studies which focus on effectiveness look at the difference between the intended and actual results of public spending and the quality of service delivered.¹⁷⁸ Effectiveness indicates whether results have been achieved, irrespective of the resources used to achieve those results.

¹⁷⁵ T. Daintith, A. Page, *The Executive in the Constitution: Structure, Autonomy and Internal Control*, (Oxford University Press), 1999, p. 172.

¹⁷⁶ J. Glynn, *Value for Money Auditing in the Public Sector*, (Institute of Chartered Accountants in England and Wales), 1985.

¹⁷⁷ NAO annual report 1999 – Helping the Nation to Spend Wisely. www.nao.gov.uk

¹⁷⁸ NAO annual report 2000. www.nao.gov.uk.

The question which we would like to raise at this point is the relation between the requirements of value for money and the rule of law. As we have discussed earlier, most of the elements of the basic financial requirement of regularity can be subsumed under the principle of legality while requirements of propriety and probity seem to have broader meaning and cannot be identified with strictly legal issues. Should, furthermore, value for money principles be perceived as indicators of legality of public expenditure? Should public expenditure be deemed illegal if economy, efficiency and effectiveness in the use of public funds have not been attained?

This question has rarely been raised either in practice or in academic writing, due to traditional non-interference of the common law courts in the process of control of public expenditure. However, the challenge of public money spending before the court occurred in the case *R. v. Secretary of State for Foreign Affairs, ex parte World Development Movement Ltd, the Pergau Dam Case*,¹⁷⁹ when the World Development Movement (WDM) sought judicial review of the Foreign Secretary's decision to spend money from the overseas development budget on the Pergau Dam project in Malaysia.¹⁸⁰ This has opened a number of controversies when different elements of public money stewardship are at issue.

¹⁷⁹ [1995] 1 WLR 886, [1995], 1 All ER 611.

¹⁸⁰ The agreement between Foreign Secretary and Malaysian government was made in July 1991. In 1994, the Secretary refused to abandon the scheme, despite the negative advice given by the Overseas Development Administration. The applicant was challenging both the initial 1991 agreement and 1994 Secretary's decision. Cf. I. Hare, "Judicial Review and the Pergau Dam", *The Cambridge Law Journal*, Volume 54, part 2, 1995, pp. 227-230. Cf. White, I. Harden, K. Donnelly, "Audit, accounting officers and accountability: the Pergau Dam affair", 1994, *Public Law*, 526; P. Cane, "Standing up for the Public", *Public Law*, 1995, 276 – 287; Overseas Development Institute, *Changing Policies of the Major Donors: UK case study*, October 2003.

The Pergau Dam project was funded under the Overseas Development and Co-operation Act 1980, which provides that:

“The Secretary of State shall have power, for the purposes of promoting the development or maintaining the economy of the country... or the welfare of its people, to furnish any person or body with assistance, whether financial, technical or of any other nature.”

The judicial review was based on the argument of the applicant that the Act assumed sound development purposes, although the word “sound” was not used in the legislation. The Court accepted the reasoning, holding that the project was so economically unsound that there was no argument in favour of it. Hence, it declared the decision unlawful.

There have been two possible interpretations of the judgement. The first, supported by the Government and external auditors, is that the decision in the Pergau Dam project was dependent on the particular statutory context of the Overseas Development and Cooperation Act 1980 and that there are no more general implications of the judgement. The second is that the Pergau Dam case represents the application of a general principle of public law that public spending should represent value for money.¹⁸¹ This view finds its support in the provisions of the National Audit Act 1983 and numerous waves of “new public management reforms”, which emphasise the importance of the achievement of the 3 Es throughout the public sector. Proponents of this view argue that testing whether value for money for use of public funds has been attained could be done by using familiar categories of judicial review of administrative action, i.e. application of Wednesbury test: proposed expenditure is unlawful if, in relation to the object for which the money has been provided by Parliament, no reasonable minister could think that it represented value for money.¹⁸²

¹⁸¹ I. Harden, F. White, K. Hollingsworth, op. cit., pp. 661-679.

¹⁸² Ibid.

In our opinion, there is no doubt that the Court has based its judgement on a broader interpretation of the Overseas Development and Co-operation Act 1980. However, the fact that the court has interpreted legislation in such a sense, implies quite a strong case for the general application of the value for money principle by the courts in the future. The question, again, remains to which extent the courts will interfere in the control of public expenditure and if they would, whether they are equipped to make the complex economic judgements required to decide whether a particular decision represents value for money.¹⁸³

All in all, the Pergau Dam decision has confirmed the importance of value for money issues when stewardship of public money is in question and proved that traditionally clear lines between the issues of regularity and propriety of public expenditure on the one hand and value for money on the other hand are being unequivocally blurred. Attainment of value for money in the use of public funds is no longer of secondary importance, but constitutes an equally significant part of the public money stewardship requirements. And this is something which all the involved actors of the British system of financial accountability should bear in mind constantly.

Mechanisms of Financial Accountability

The British system of financial accountability is based on parliamentary accountability. For several centuries, the British Parliament, assisted with its Committees and, later on, greatly supported by professional bodies, such as the National Audit Office (NAO) has been holding the executive to account for the stewardship of public money. The National Audit Office, as the supreme audit institution of the UK, is headed by the Comptroller and Auditor General (C&AG), who is the officer of the House of Commons and thus naturally reports to the Parliament. The key accountability link between the Parliament

¹⁸³ Ibid.

and the Executive is established through the work of Parliamentary Public Accounts Committee (PAC), which, supported by the work of the NAO, detects irregular and improper expenditure and investigates achievement of value for money, by calling government officials to account for the use of public money.

In spite of its strong focus on parliamentary accountability, the UK financial accountability system very much relies on strong interlinks between the internal and external financial accountability mechanisms. The key executive financial department, the Treasury, holds the departments to account through numerous internal, managerial accountability mechanisms. Notwithstanding its powers of internal expenditure control, the Treasury, however, does not have any audit capability and therefore is dependent on the C&AG and NAO, to provide assurance on the reliability of departmental accounts. The second basic link between external and internal accountability mechanisms is provided in the role of an accounting officer, who is simultaneously involved in several accountability relationships. While his/her civil service position requires him/her to be loyal to the minister, his/her role of accounting officer makes him/her accountable directly to both the Treasury and the Parliament.¹⁸⁴ The whole system of financial accountability is based on trust and consensus of all the involved institutions and actors, which equally share the interest of securing public funds and where additional, external means of control are superfluous.¹⁸⁵

It is still interesting to note that the Courts have only rarely interfered with this long-lasting “self-contained” system of financial accountability. A direct challenge of public expenditure issues at the central Government level remains an exception to the rule.

¹⁸⁴ It is further interesting to note that accounting officers are not any longer personally liable for misuse of public funds. The last recorded instance of accounting officials personal liability appeared to have happened in 1920, when an accounting officer was called to repay the amount of misused public money.

¹⁸⁵ I. Harden, F. White, K. Hollingsworth, *op. cit.* pp. 670-671.

There have been only a few cases of direct challenge of public expenditure decisions¹⁸⁶ and a few which only indirectly affect public spending.¹⁸⁷ Whereas the scope for judicial intervention in public expenditure decisions at the local level has been quite wide, the role of the courts in controlling the public expenditure in Britain has up to now been minimal.¹⁸⁸ Major issues of public finance appearing before the courts have been only those of taxation¹⁸⁹ while the public spending have stayed aside of the court's agenda. This is partly a corollary of a long absence of a distinct system of administrative law and administrative courts in Britain¹⁹⁰ and partly the consequence of constitutional understanding of authorisation of expenditure.¹⁹¹ While the constitutional requirement of legislative authorisation of taxation is based on individual private rights that are enforceable through the courts, there is no such correlate when legislative authorisation of government expenditure is in question. This has also contributed to the establishment of self-monitoring system of financial control in British central government, relying on trust between involved actors.¹⁹²

Finally, it should be noted that the UK financial accountability legal framework has recently experienced notable changes through the adoption of the Government Resources and Accounts Act 2000,¹⁹³ which the Treasury considers as the "biggest reform and modernisation programme in the management of the country's public finances since the

¹⁸⁶ Already mentioned Pergau Dam case and case *Auckland Harbour Board v. The King* [1924] (A C 318 at pp. 326-327) where it was found that payments made out of the Consolidated Fund without parliamentary approval were illegal. Cf. J. McEldowney, *Public Law*, (Sweet and Maxwell), 3rd ed., 2003, pp. 371.

¹⁸⁷ For example *Metzger and others v. Department of Health and Social Security*. [1978] 1 W.L.R. 1046; [1977] 3 All E.R. 444 at 451.

¹⁸⁸ M. Elliott, "The Control of Public Expenditure", in J. Jowell, D. Oliver (eds.), *The Changing Constitution*, (Oxford University Press, 2000), pp.201- 203.

¹⁸⁹ *Woolwich Building Society v. Inland Revenue Commissioner* (No. 2) [1992] 3 All ER 737; *Pepper v. Hart* [1993] 1 All ER 86.

¹⁹⁰ Cf. C. Harlow and R. Rawlings, *Law and Administration*, (Butterworths), London, 1997.

¹⁹¹ Cf. I. Harden, F. White, K. Hollingsworth, op. cit, pp. 670-671.

¹⁹² Ibid.

¹⁹³ Government Resources and Accounts Act 2000, available at <http://www.hmso.gov.uk/acts/2000/00020--b.htm>

Gladstone era”.¹⁹⁴ The importance of this Act is that it has put on a legislative basis the governments’ proposals for introduction of resource (accrual) accounting and resource budgeting into central Government.¹⁹⁵ The key objective of the introduction of resource accounting and budgeting is to improve the planning and control of Government spending as well as to improve departments’ accountability to Parliament through more comprehensive financial information it will provide.¹⁹⁶ However, it is important to note that the passage of the Government Resources and Accounts Act has not in any way disturbed the operation of traditional financial accountability actors in the UK, as it occurred in some other systems in the last couple of years by adoption of the new legislation (notably in France, by the adoption of the LOLF in 2001; in the EU, by the adoption of new Financial Regulation in 2002 and in Serbia, by the Budget System Law in 2002, as will be discussed in the following chapters). The expected effect of this Act is rather only to enhance the efficiency and effectiveness of already existing balance between internal and external financial accountability mechanisms.

Internal Financial Accountability Mechanisms

It may be argued that during the previous century Britain has developed a regular and coherent system of financial accountability, primarily based on strengthening the control of the Treasury over spending departments. Thus, some authors claim that, instead of the

¹⁹⁴ H.M. Treasury News Release 195/99. Cf. F. White, K. Hollingsworth, “Public finance reform: The Government Resource and Accounts Act 2000”, *Public Law*, 2000, pp. 56-61.

¹⁹⁵ Whereas the nationalised industries and local governments in UK have been using the accruals accounting for more than 20 years now, the central Government departments have expressed much more resistance to such a change in accounting approach. Cf. J. Perrin, “From Cash to Accruals in 25 Years”, *Public Money & Management*, April-June 1998, pp. 7-10.

¹⁹⁶ J. Chan, “Government Accounting: An Assessment of Theory, Purposes and Standards”, *Public Money & Management*, January 2003, pp. 13-20. D. Heald, “The Implementation of Resource Accounting in UK Central Government”, *Financial Accountability & Management*, 21 (2), 2005, pp. 163-189.

other way around, Parliament became the Treasury's ally in a system of financial control, in which Executive largely polices itself.¹⁹⁷

The Treasury regulates the work of departments primarily through its own rules and regulations,¹⁹⁸ in particular through the already mentioned guide, *Government Accounting*, which is regularly amended and contains a number of financial control conventions, practices and statutory arrangements.¹⁹⁹

The Treasury holds government departments to account primarily through a fairly flexible *ex ante* controls of public expenditure. The first *ex ante* role of the Treasury relates to the process of issuance of public funds to Departments. This process commences by the requisition of the Treasury to the C & AG to allow monies to be released from the Consolidated Fund and the National Loans Fund.²⁰⁰ The Treasury then has the role to distribute the requested money to Departments.²⁰¹ At this stage, it is the responsibility of both the C & AG and the Treasury to make sure that the issued amounts conform to the respective legislative authority.²⁰² The system of *ex ante* control is further

¹⁹⁷ I. Harden, "Money and the Constitution: Financial Control, Reporting and Audit", *Legal Studies* 16, [1993], pp. 18-19.

¹⁹⁸ These are so-called Rules made by the Administration, Cf. P.P. Graig, *Administrative Law*, (Sweet and Maxwell), 1994, pp. 270-277.

¹⁹⁹ The latest Government Accounting amendments were made in 2005 (No. 4/05).

<http://www.government-accounting.gov.uk/current/frames.htm>

²⁰⁰ The Consolidated Fund, established in 1787, is the government's account at the Bank of England into which all public revenues (taxes, duties, etc.) flow and from which all funds for the supply of public services are taken. The National Loans Funds, established in 1968, is the Government's principal borrowing account. Both Funds are operated by the Bank of England and the Treasury. Cf. F. White, K. Hollingsworth, op. cit. p.57; NAO, *General Report of the Comptroller and Auditor General 2004-2005*, www.nao.gov.uk

²⁰¹ Cf. Section 13 (for services charged directly to the Consolidated funds), and sections 14 and 15 (for issuance of funds for services which are subject of appropriation) of 1866 the Exchequer and Audit Departments Act.

²⁰² T. Daintith, A. Page, op. cit. pp. 117-118.

secured through the earlier mentioned regularity/legality requirement that no expenditure or commitments can be incurred without the approval of the Treasury.²⁰³ However, in practice the Treasury delegates to departments authority to enter into commitments and to spend within defined limits²⁰⁴, as it would be impossible for it to control every detail of expenditure.²⁰⁵ In order to secure some degree of control over departmental spending, the Treasury has concentrated on defining the sensitive expenditures which could be subject to irregularity and impropriety, such as: exceeding sub-heads within the votes, increase of establishment, salary or cost of services and additional works or new services.²⁰⁶ One of the main mechanisms of internal accountability in this respect is the *virement* process, in which the Departments are required to get Treasury's approval for transfers within the sub-heads of the votes.

The last decade, however, has witnessed further reduction of Treasury *ex-ante* control and increase of the responsibilities of departments coupled by firmer Treasury monitoring over expenditure aggregates and management systems. One of the steps in this direction has been the simplification of estimates by reduction of the number of votes and sub-heads within the votes which occurred in 1996.²⁰⁷ This resulted in the simplification of the *virement* process and relaxation of the Treasury's powers, as Treasury approval is now needed only for transfers between expenditure lines and not between numerous sub-heads as required before the changes.²⁰⁸ Given that there are around 550 expenditure lines in comparison to earlier existing 2000 sub-heads, it is obvious that the control of the

²⁰³ Subsection 2(b), section 3 of the Government Resources and Accounts Act 2000.

²⁰⁴ Cf. paragraphs 2.4.3, 2.4.5 to 2.4.11, Amendment No. 6, *Government Accounting*.

²⁰⁵ Treasury's general view on its authority to control ordinary expenditure has been set out early on in a Treasury Minute of April 1868 (Roseaveare 1973: 172-3; Epitome I: 20-1). It's position was that control of ordinary expenditure was beyond its functions and that only in exceptional cases it should sanction departments. Cf. T. Daintith, A. Page, op. cit. pp. 177-183

²⁰⁶ Ibid.

²⁰⁷ T. Daintith, A. Page, op. cit. pp. 159-164.

²⁰⁸ Cf. Treasury and Civil Service Committee Fourth Report, *Simplified Estimates and Resource Accounting*, HC 212, 1994-1995.

Treasury towards departments has been technically and substantially reduced.²⁰⁹ Although relaxation of ex-ante Treasury approval has raised concerns within the Parliament on the loss of accountability, the Treasury has strongly argued that the accountability to Parliament will only improve, as Departments will take over full responsibility for spending of public money and will not be able to place the blame on Treasury for making their expenditure decisions.²¹⁰ The potential 'loss of accountability' the Treasury has compensated by introducing requirements on the methodology of expenditure decision-making, such as: checks on the quality of decisions, techniques for investment appraisal, project evaluation, electronic information management and the overall system of control of public expenditure through the running costs control.²¹¹

As mentioned earlier, a key element of accountability for public money is the role of the Accounting Officer. The Treasury appoints the most senior official in a department as the Accounting Officer to be responsible for departmental expenditure. A departmental accounting officer is also normally the permanent secretary of the department. The responsibilities of an accounting officer are defined and promulgated in a document of constitutional importance – the Accounting Officer Memorandum.²¹² An accounting officer is responsible for the performance of a number of functions: signing the accounts (authorising payments and making commitments), ensuring propriety and regularity of the public finances; keeping proper accounts; for prudent and economical administration; the avoidance of waste and extravagance; and for the efficient and effective use of all available resources.²¹³ It is also possible that in some departments other senior managers responsible for particular activities to be appointed as additional Accounting officers.²¹⁴

²⁰⁹ F. White, K. Hollingsworth, *Audit, Accountability and Government*, (Clarendon Press, Oxford, 1999), pp. 50-51.

²¹⁰ T. Daintith, A. Page, op. cit. pp. 178-179.

²¹¹ Ibid.

²¹² *Government Accounting*, Amendment No. 4, 4/1992, HMSO, 1989.

²¹³ *Government Accounting*, 6.7, Amendment No 7, 3/97, HMSO, 1989.

²¹⁴ Ibid, 6.3.

An accounting officer is under a general duty to ensure that Ministers receive appropriate advice on all matters of financial propriety and regularity as well as regarding economical administration, efficiency and effectiveness.²¹⁵ Until recently, two distinct regimes were applied when provision of advice to Ministers was in question, depending on whether the addressed matters were those of propriety and regularity or economy, efficiency and effectiveness of use of public money. Thus, where a Minister plans a course of action which the accounting officer considers would infringe the requirements of propriety or regularity, the accounting officer is obliged to forward his/her objections to the Minister in writing. In the case his advice is overruled, the accounting officer has a duty to inform the C&AG. If, furthermore, a minister decides to proceed with the expenditure despite communicated objections, the accounting officer has to seek written instruction from the minister before making the payment. At the same time, he/she has to inform the Treasury and C&AG on the developments without undue delay.²¹⁶ If, on the other hand, the issue in question is one of economy, efficiency and effectiveness, the accounting officer is under a duty to draw the relevant factors to the attention of the Minister. However, if his advice is overruled, there is no duty that his findings be communicated with the Treasury or the C&AG.²¹⁷

It is interesting to note that the Pergau Dam case, which we analysed in more detail earlier, has brought about significant changes when provision of advice to ministers on value for money issues is in question. The accounting officer involved in the Pergau Dam project did object to the minister's decision to undertake the investment, but treated the issue as one of efficiency and effectiveness and not of regularity and propriety. Therefore, there was no requirement for the matter to be addressed to the Treasury and the C&AG and hence the case was not subject to wider financial scrutiny. In the wake of the Pergau Dam case, this stance has been changed and the Accounting Officer Memorandum has been amended requiring an accounting officer to inform the Treasury

²¹⁵ F. White, I. Harden, K. Donnelly, op. cit., pp. 526-534.

²¹⁶ *Government Accounting*, Amendment No. 4, 4/1992, HMSO, 1989.

²¹⁷ F. White, I. Harden, K. Donnelly, op. cit. pp. 528-529.

and to communicate to the C&AG without undue delay the papers relating to all cases where ministers issue instructions on matters involving prudent administration and economical administration, efficiency and effectiveness.²¹⁸ In this way, the constitutional responsibilities of the key actor of managerial financial accountability, the accounting officer, has been increased and the importance of prudent and productive use of public money in the British central Government context strongly underlined.

The question which, however, may be posed is whether a single person at the top of an organisation can be really held accountable for every financial activity in a public body? Isn't this just a replication of the doctrine of ministerial responsibility, which has been criticised on a number of occasions?²¹⁹ Although there is no doubt that accounting officers bear an extensive burden of the financial accountability role, Lord Sharmans' report on audit and accountability of Government conducted in 2001 strongly supports the view that the role of accounting officers is of continuing salience.²²⁰ In the discussions the Sharman team lead with the accounting officers, the accounting officers themselves found their role as a source of strength both in their relationships with ministers and ability to manage their departments and understood it as a "personal responsibility to safeguard the interests of the taxpayer".²²¹ Such a personal nature of accountability, or better to say, responsibility for public money stewardship on the part of an accounting officer is regarded as essential to produce necessary incentives to ensure value for money of the use of public funds is achieved.²²² The accounting officer's responsibility for stewardship of public funds has also been perceived as vital from the parliamentary perspective, as it establishes a clear line of accountability between the executive and the parliament. It may be argued that avoidance of political waters of Ministerial responsibility and the emphasis on comprehensive 'administrative' aspects of

²¹⁸ *Government Accounting* 6.1.5, December 1994.

²¹⁹ Cf: D. Woodhouse, op. cit, pp. 73-90.

²²⁰ L. Sharman of Redlynch, *The Review of Audit and Accountability for Central Government*, February 2001, www.hm-treasury.gov.uk, p. 20.

²²¹ Ibid.

²²² Ibid.

accountability for stewardship of public funds entrusted to experienced civil servants, instead of politicians, generate much lesser potential for politicisation of issues of public spending and bring about much better results in safeguarding the tax-payers money.

Nevertheless, it is understandable that the accounting officer cannot carry out his/her financial tasks well without support of other actors, such as the internal audit services.²²³ Internal audit services do not constitute part of the Treasury, but are parts of departments, although their operation is regulated by the Treasury's Audit Policy and Advice unit through different guides, such as *Government Internal Audit Standards* and *Internal Audit Training and Development Handbook*.²²⁴ The main role of the internal audit units is to provide advice and assurance to the accounting officer on the adequacy and effectiveness of the internal control systems, not only in financial matters, but also on other operational aspects of work. Over the last decade, internal audit is increasingly shifting its focus to financial issues and development of 'risk management' approach aimed at examination of various kinds of risks to the organization and reviewing the adequacy of the underlying activities to manage those risks.²²⁵ In order to provide adequate conditions for the work of audit units, it is very important to secure their independence of operation. Although their independent status has not been legally guaranteed, this does not seem to pose serious problems in their operation.²²⁶ One of the ways to strengthen their independence would certainly be establishment of a closer relationship with external auditors and continuous exchange of information between the two. In recent years, public bodies have started incorporating audit committees within their arrangements, whose role is to communicate directly to internal audit units and

²²³ It should also, however, be noted that some departments also contract out their internal audit functions, Cf. F. White, K. Hollingsworth, op. cit. pp.52-53.

²²⁴ <http://www.hm->

[treasury.gov.uk/documents/financial_management/governance_government/gg_index.cfm](http://www.hm-treasury.gov.uk/documents/financial_management/governance_government/gg_index.cfm)

²²⁵ L. Sharman of Redlynch, op. cit. p. 23; NAO, *General Report of the Comptroller and Auditor General 2004-2005; 2003-2004*, www.nao.org.uk

²²⁶ F. White, K. Hollingsworth, ibid.

Accounting Officers, advising and reporting on audit and internal control issues.²²⁷ This has further strengthened the overall system of managerial financial accountability.

This analysis of internal financial accountability mechanisms has underlined the links between the internal and external accountability mechanisms in UK. In order to obtain the overall picture of the UK system of financial accountability, we shall attempt to reveal the ‘heart’ of financial accountability relationship in UK, by turning our attention to external financial accountability mechanisms which encompass the complex web of accountabilities established between the executive and the Parliament.

External financial accountability mechanisms

Parliamentary accountability

Parliament’s “power of the purse” is a basic principle of the British constitution and had an important role to play in establishment of the British Parliamentary system (see Annex 1).²²⁸ It traditionally consists of three elements: the right to give prior approval to the raising of finance through taxation, the right to approve the total and allocations of expenditure of public funds and the right to control the execution of the expenditure.²²⁹ Since Government must have money in order to function, this principle theoretically provides a powerful way for the House of Commons to control government spending.²³⁰

For a mainland European lawyer, the first interesting feature of the British ‘power of the purse’ is a separation of procedures of Parliament’s approval of the taxation and expenditure. Whereas the revenue side of the Government plans is presented separately

²²⁷ L. Sharman of Redlynch, op. cit. p. 22.

²²⁸ A.V. Dicey, *Introduction to the Study of the Law of the Constitution* (19th edn, Macmillan, 1960), p. 447.

²²⁹ D. Coombes et al., *The Power of the Purse*, (London George Allen & Unwin Ltd), 1976, p. 386.

²³⁰ I. Harden, “Money and the Constitution: Financial Control, reporting and audit”, *Legal Studies* 16, [1993], pp. 16-17.

though the Budget document, expenditure side is presented in a separate document, as will be explained in more detail later.²³¹ This is in contrast to the mainland Europe where the ‘unity’ of presentation of revenue and expenditure (unity of budget) represents one of the key features of the budgetary process. This, however, does not pose a problem to our research, which is, as defined in the first chapter, solely focused on the expenditure side of the financial cycle.

UK Parliament authorises most public money to be spent through the supply process.²³² Each year the Government's request for resources is presented in the form of 'supply estimates'. These set out for each broad area of planned activity, the public funds the Government needs to pursue its policies. The estimates are approved by the Commons, but its formal acceptance is given by the whole of Parliament through the annual Consolidated Fund (Appropriation) Act (usually called Appropriation Act).²³³

It is easy to note that the Parliament's expenditure element of the “power of the purse” does not involve its right to actually make spending decisions. On the contrary, the policy objectives on which the money is spent are almost solely determined by the Government of the day. Parliament is thus unable to initiate its own expenditure on its own behalf, but only to reduce it, which again happens very seldom.²³⁴

²³¹ It is interesting to note that from 1993 to 1996 the Government presented a ‘unified Budget’ comprising both planned revenues and expenditures, but the new Labour Government moved back to the old system from 1997.

²³² In addition to supply services, there are Consolidated Fund Standing Services, as payments for services, which Parliament has decided by statute, once and for all, to be met direct from the Consolidated Fund and they are therefore made independently from annual authorisation of expenditure. These are for example: issues to the Contingencies fund, payments to European Committees, civil list salaries, salaries and pensions of judges, office of Comptroller and Auditor General etc. Cf. *Government Accounting*, op. cit. Sections 1.1.7., 3.2.8.

²³³ T. Daintith, A. Page, op. cit. pp. 156-157.

²³⁴ J. McEldowney, “The Control of Public Expenditure”, in J. Jowell, D. Oliver, *The Changing Constitution*, (Oxford University Press, 2000), pp. 197-198.

In reality little substantial scrutiny is involved in a supply procedure, one of the reasons being that exhaustiveness of the issue makes complete and detailed discussion of the state expenditure impossible. Almost a century ago, the government and the Commons have observed a tacit agreement permitting the Opposition to decide which chapter of the estimates will be submitted to parliament to debate; the other chapters are adopted without debate or are voted together.²³⁵ Some authors are therefore of the opinion that the chapters designated by the Opposition are used only as an excuse for holding some general plenary debates on general policy, since, at the end, state expenditure is approved almost automatically.²³⁶ The House of Commons has also for many years tried to achieve some control over public spending through its Estimates Committees.²³⁷ However, the work of the Estimates Committees has generally proven to be unsatisfactory and detailed estimates control left to the full executive's command. Furthermore, since 1982 the time available for discussion on estimates has been restricted to 3 days between the presentation of the estimates and the summer recess, which has further lessened the opportunity of the Commons to get into serious discussion on the Government expenditure plans.²³⁸ During the XX century the Commons have never rejected the Government estimate. Indeed, the statement that "as far as the control of the estimates is concerned, the government of Britain is a constitutional dictatorship"²³⁹ unfortunately still appears to be true.

²³⁵ S. Walkland, "Parliamentary Control of Public Expenditure in Britain", in D. Coombes et al, *The Power of the Purse*, (London George Allen & Unwin Ltd), 1976, pp. 179-197.

²³⁶ J. Molinier, "Parliament's financial powers: a comparison between France and Britain", in D. Coombes et al, *The Power of the Purse*, (London George Allen & Unwin Ltd), 1976, p. 170.

²³⁷ Cf. B. Chubb, *The Control of Public Expenditure – Financial Committees of the House of Commons*, (Oxford at the Clarendon Press) 1952; A. Robinson, *Parliament and Public Spending*, (Heinemann, London), 1978; V. Flegmann, *Public Expenditure and the Select Committees of the Commons* (Gower) 1986.

²³⁸ T. Daintith, A. Page, op. cit. pp. 156-157.

²³⁹ P. Einzig, *The Control of the Purse – Progress and Decline of Parliament's Financial Control*, (London, Secker & Warburg, 1959), p. 13.

The most often cited reason for a minimal role of the Parliament in the supply procedure is a strong party control over the members of the House of Commons.²⁴⁰ The general influence of Ministers where the government has a majority in the House of Commons substantially reduces the House of Commons' powers of control in practice. Although this argument certainly has some weight, the question which still remains is why the debate on the detail of taxation, in spite of the mentioned party-political limitations, continues to be lengthy and effective while the debate on the Government spending plans attracts so little attention of the MPs and the general public. The answer to this question perhaps lies in the higher degree of political controversy of taxation issues, which have a direct bearing on the citizens, where the spending decisions on the already collected money are further removed from the interest of the public and from their representatives in the Parliament.

Further concerns over the role of the Parliament in the financial control of the executive have been raised in relation to important exceptions to the constitutional rule of obligatory authorization of expenditure. An example of a gap in Commons control over expenditure is the Contingencies Fund, which Government, without prior Parliamentary approval, may use to finance urgent expenditure.²⁴¹ The total expenditure of the Contingency fund, as a reserve fund intended to meet unforeseen items of expenditure, is considerable. However, the control of the fund is placed strictly on the system of internal Treasury control and audit.²⁴² No Parliamentary committee directly monitors the use of the Fund and there are no satisfactory means to inquire into the policy behind the government's use of the Fund prior to the Fund being used.²⁴³

²⁴⁰ A. Lovell, "Notions of Accountability and State Audit: A UK Perspective", *Financial Accountability & Management*, 1996, pp. 263-265.

²⁴¹ J. McEldowney, "The Control of Public Expenditure", op. cit. pp. 200-201.

²⁴² *Government Accounting: A Guide on accounting and financial procedures for the use of Government Departments*, Her Majesty's Stationery Office, London, 1989.

²⁴³ As we have previously seen, the use of money from the Contingencies Fund has up to now created substantive difficulties. In 1994, the fund was used to fund the Pergau Dam project following the decision of the divisional court declaring the aid to be *ultra vires*. It should be noted that the doubts about the

The above discussion undoubtedly raises the question of possible ways of enhancement of key democratic institution in holding the Government to account for public spending. In that sense, it could be argued that the traditional rules on parliamentary financial control (the right to give prior approval to the budget, the right to approve allocations of expenditure, and the right to control the execution of the budget) are clearly not enough on their own to give parliament effective or meaningful influence over the scope, content and administration of modern public finance.²⁴⁴ In order to address these longstanding issues, several positive changes have been introduced, such as: providing the House of Commons with better access to information about the assumptions on which budgetary decisions are based, in particular by the move towards accrual (resource) accounting and supporting its powers of scrutiny by the work of parliamentary committees.²⁴⁵

Nevertheless, despite many advances in the procedures of financial control through improved transparency it remains uncertain to what extent the Parliament has and could enhance its role regarding financial accountability. A decrease of general Parliamentary power against the executive in the previous decades is usually explained by the generally dismissive and occasionally contemptuous attitude adopted by the Thatcher as well as, at

legality of the fund were raised by MPs and members of the Treasury and Civil Service Select Committee in 1983, but have been seemingly resolved and the Fund therefore assumed to be legal. Since then, Parliament has never raised this issue again.

²⁴⁴ D. Coombes et al, op. cit, p. 386; H. Hecló, A. Widlavsky, *The Private Government of Public Money*, (1973); Hague et al., *Comparative Government and Politics* (The MacMillan Press Ltd.), 1992.

²⁴⁵ Over the years the presentation of the Estimates has become more attractive and readable and today they contain economic information and there are cross-references to the Departmental Report. In March 1998 the Treasury published *The Code for Fiscal Stability*, (received statutory authority through the Finance Act 1998), which provides key information on Government introduction of new monetary policies, with the aim to bring “openness, transparency and accountability” over monetary policy and improve MP’s knowledge on economic and fiscal assumptions. On the other hand, the role of the Parliamentary Committees in controlling public spending, especially one of the Committee of Public Accounts, has in the last two-three decades substantially improved. Cf. J. McEldowney, “The Control of Public Expenditure”, op. cit. pp. 226-228.

times, Blair governments towards Parliament.²⁴⁶ This was undoubtedly facilitated by the massive Commons majorities in both cases, which surely had an adverse effect on the Parliament's possibilities of effective executive control. However, previous years have witnessed lessening of the Labour party unity, which could enhance more effective Parliamentary control of the executive. In order for Parliament to make executive more accountable, it should try to utilize the full range of different means at its disposal in a coordinated fashion and in this way regularly demonstrate its independence from the restrictions of the party managers.²⁴⁷

A key weapon of the parliament in securing financial accountability is the work of its most senior and most formidable committee, the Public Accounts Committee. Its role is to examine whether public money voted by Parliament has been spent in accordance with Parliament's intentions, and with due regard to issues of regularity, propriety and value for money. Work of the Public Accounts Committee is substantively supported by the external audit institution, the National Audit Office, without whose professional assistance the Committee's control would be almost impossible. On the basis of the NAO reports, the Public Accounts Committee calls officials to account for misuse of public money and reports its findings to the House of Commons. The Committee's reports and the government's responses to them are debated in an annual debate in the Commons and may be raised by MP's at other times.

It should be noted, however, that the debates on the Public Accounts Committee's reports are not very popular parliamentary occasions, with attendance usually limited to frontbench spokesmen, members of the committee and members with a constituency interest in its reports.²⁴⁸ Some authors are of the opinion that this does not undermine the importance of parliamentary based scrutiny of public money spending. An annual debate

²⁴⁶ J. Greenwood et al., op. cit., pp. 182-183.

²⁴⁷ Ibid.

²⁴⁸ J. Bates, "The Scrutiny of Administration", in M. Ryle, P. Richards, *The Commons under Scrutiny*, Routledge, 1988.

of this sort is considered to be a privilege not granted to other select committees and a reflection of the importance which is accorded to the work of the PAC.²⁴⁹

It may, therefore, be concluded that the key financial accountability relationship is established not so much between the Parliament itself and the executive, but has been delegated by Parliament to PAC, which, on Parliament's behalf, keeps the Executive accountable for the stewardship of public money. Since the Public Accounts Committee and National Audit Office are the main institutions of the British system of financial accountability, we shall examine their roles and operations in more detail in the following discussion.

Committee of Public Accounts (PAC)

The PAC is the senior select committee of the House of Commons, with almost a century and half long tradition (see Annex 1). It was established in 1861 by Standing Order 122 (now standing order 148). PAC consists of fifteen Members of Parliament, selected proportionally to the composition of the House. The work of the Committee is to be non-partisan. Impartiality and independence of the Committee is partly secured by the constitutional convention that the President of the Committee is always a member of the opposition. The Committee's remit covers all central Government departments, executive agencies and NDPBs, the National Health Service and a wide range of other public bodies.²⁵⁰ The Committee carries out its investigations based on the accounts, reports and memoranda presented to Parliament by the C&AG. After examination of senior public officials responsible for the expenditure or income under examination, PAC produces its own reports, in which it sets out its recommendations to the public body in question.²⁵¹

²⁴⁹ F. White, K. Hollingsworth, op. cit., pp. 123-125; V. Flegmann, "The Public Accounts Committee: A Successful Select Committee?", *Parliamentary Affairs*, Vol 23, No. 1, 1980, pp. 166-172.

²⁵⁰ L. Sharman of Redlynch, op. cit. pp.39-41.

²⁵¹ Ibid.

The majority of PAC's hearings and reports are based on value for money (*vfm*) examinations.²⁵² The PAC does not nowadays spend much time on matters of financial irregularity or constitutional impropriety. There are not many of them, and most which do occur are not of sufficient seriousness to warrant intervention by the Committee.²⁵³ Most of the PAC's work is based on the C&AG *vfm* reports on financial management, which are conducted in the areas of trade, industry, agriculture, overseas services, transport and health as well as various other public services. The choice of the study depends on the nature of the Government's actual programmes, likely interest of the subject to the Committee and the prospect of useful recommendations for improvement arising from their inquiries.

The PAC hearings are usually based on an NAO report, either on the accounts of a department or public body or, more often on a *vfm* study.²⁵⁴ The PAC usually decides on which case it will choose for further investigation on the basis of the briefing by the NAO and any independent research that a particular member may undertake. The members of the Committee are not individually in charge for any specific portfolio according to their particular interest or expertise, but are responsible for every NAO report. However, personal interest and expertise of members can have important impact on the choice of the case examined.²⁵⁵

The accounting officer of the respective public body in question is the main witness at the hearing. In addition to an accounting officer, the PAC can call anyone else to appear

²⁵² V. Flegmann, op. cit., pp. 166-172.

²⁵³ D. Henley, A. Likierman, J. Perrin, M. Evans, I. Lapsley and J. Whiteoak, *Public Sector Accounting and Financial Control*, (Chapman & Hall) 1992.

²⁵⁴ F. White, K. Hollingsworth, op. cit, p. 49.

²⁵⁵ The latest PAC reports are: *Channel Tunnel Rail Link* (4 May 2006), *The refinancing of the Norfolk and Norwich PFI Hospital* (3 May 2006), *Tackling the complexity of the benefits system* (27 April 2006), *Inland Revenue Standard Report: New Tax Credits* (25 April 2006) etc. All of them can be obtained at the PAC website: www.publications.parliament.uk/pa/cm/cmpublic.htm

before it, except ministers.²⁵⁶ The PAC also invites the C&AG and Treasury Officer of Accounts, or their deputies, to attend every hearing.

It may be argued that the proceedings conducted by the PAC are of a quasi-judicial nature, since witnesses are put in the position of defendants and are called to account for their actions.²⁵⁷ However, although the Committee can invoke personal responsibility of the accounting officer, it has lost a formal power to impose sanctions on him/her.²⁵⁸ Sanctions available to the PAC are mainly of an informal nature, which, interestingly enough, does not undermine its effectiveness.

The important question which arises in this respect is what sanctions may be imposed on a public official in relation to a PAC hearing? Firstly, if PAC comes across some serious irregularities, the official can become the subject of criminal investigation (fraud, corruption etc.). Secondly, irregularities in dealing with public funds may have impact on the approval of the following year's budget of the public body in question. Furthermore, there is a possibility of requiring compensation from the public official for the improper handling of public money. However, the sanction of compensation does not have sufficient weight, since the required amounts are usually fairly symbolic.²⁵⁹ Lastly, it seems that the main PAC's sanction from the public official's point of view is the mere fact of being summoned before the Committee. It has always been a matter of great importance to spending Departments to avoid giving an account to PAC on any question of regularity or propriety in its stewardship of public money, since it is perceived as an indication of misconduct, implying strong criticism on the departmental administration.

²⁵⁶ F. White, K. Hollingsworth, op. cit., pp. 122-125.

²⁵⁷ J. Molinier, "Parliament's Financial Powers: A Comparison between France and Britain", in D. Coombes, *The Power of the Purse*, (London George Allen&Unwin Ltd.), 1976.

²⁵⁸ The last recorded case when the sanction of personal liability was imposed on an accounting officer was in 1920.

²⁵⁹ In 1984, NAO investigated the case of fraud in the procurement of the defence case. The accounting officer in charge was obliged to contribute a symbolic 10 pounds.

Moreover, appearance before the Committee requires lots of extra work and, if, repeated, may have far-reaching consequences for the career of the person involved.

Unanimity in the work of the PAC is seen as very important for its effective work. The standard practice is that there must be unanimous support within the PAC for a report before it can be published.²⁶⁰ This is due to the fact that a unanimous report very much adds strength to the Committee's influence. In the past, some reports have been held back until unanimity was obtained. This means that the timing of the publication of the final report after the hearing can vary. The PAC report will encompass the recommendations of the Committee, based on the hearing.

It should be noted that there is no automatic route for the implementation of the PAC's conclusions and recommendations.²⁶¹ The Government responds to the PAC's report in the form of a Treasury Minute issued as a White Paper, which explains how it intends to follow up the committee's suggestions.²⁶² This is published usually 2-3 months after the PAC report and it outlines which of the PAC's recommendations the government accepts and will act on, and those which it simply notes (that is, which will not be acted on). Departmental replies to the Committee's reports and recommendations thus provide quite a good evaluation of the impact which PAC has on the government administration.²⁶³ If the department or body in question does not accept any PAC recommendations, the Committee can return to the issue at some later point. If the PAC is not satisfied with the Government's response, it may make further investigations and hence produce another report, which happens in practice only rarely.

²⁶⁰ F. White, K. Hollingsworth, op. cit, p. 50.

²⁶¹ S. Roberts, C. Pollitt, "Audit or Evaluation? A National Audit Office VFM Study", *Public Administration*, Vol. 72, 1994.

²⁶² Cf. F. White, K. Hollingsworth, op. cit. pp. 132-132.

²⁶³ Forty-five percent of departmental replies between 1966 and 1978 contained statements of the public bodies in question that certain actions are taken as a result of the PAC's recommendations. Cf. V.Flegmann, op. cit., p. 169.

Although the PAC has the reputation of being one of the most formidable and successful parliamentary committees, its role in the control of public expenditure is undoubtedly limited and its achievements are not often spectacular.²⁶⁴ One criticism of the PAC is that *ex post facto* review may be too late to be effective. The money is spent, the waste has occurred and inevitably it is difficult to trace and recover money. Related to that is the problem that PAC reports are published long after the event in question, when those responsible are no longer in the department and, thus, cannot be called to account.²⁶⁵ Furthermore, PAC is at times criticised for lack of willingness to get into the true substance of the presented case, trying instead to “grab the headlines” and attract the audience of the MP’s.²⁶⁶ Its reports are therefore at times assessed as “eccentric, over-enthusiastic and possibly subversive.”²⁶⁷ Some officials consider PAC too critical of any failures, however small, even in cases when projects were generally successful. Furthermore, it has been suggested that the fear from PAC’s censure discourage officials from considering more innovative projects.²⁶⁸

Although all the mentioned shortcomings in the work of PAC certainly have some weight, they should not be overestimated. Whereas the *ex post* nature of PAC’s work may be criticised for its ineffectiveness, *ex post* accountability, as we have seen in a previous chapter, always has an important preventive function. Although in general the Committee attracts little attention in Parliament and its modern role is not as influential as its nineteenth century role of setting good public-sector accountancy practice, its reports do get quite wide publicity and certainly have a strong impact on public bodies’ financial decision-making and accountability.²⁶⁹ Delays in reporting could also not be taken as

²⁶⁴ B. Landers, “Encounters with the Public Accounts Committee: a Personal Memoir”, *Public Administration*, 2000, pp. 195-213.

²⁶⁵ F. White, K. Hollingsworth, op. cit., p. 132.

²⁶⁶ B. Landers, *ibid.*

²⁶⁷ J. Garrett, “Developing State Audit in Britain”, *Public Administration*, Vol. 64, 1986, 425.

²⁶⁸ L. Sharman of Redlynch, op. cit. p. 40.

²⁶⁹ J. Bates, “The Scrutiny of Administration”, in M. Ryle and P. Richards (eds.), *The Commons under Scrutiny*, (Routledge), 1988.

serious shortcoming, especially that the PAC, accustomed to work within the framework of an annual timetable, completes its inquiries and presents its reports more speedily than a number of other parliamentary committees and is regarded by many as the hardest working Committee of the Commons.²⁷⁰ The criticism related to expertise and neutrality of PAC members, however, should not be too easily dismissed. It may well be the case that the PAC reports are made with the attempt to attract attention of the Parliament as well as wider public as their key audiences, and therefore tend to overemphasise certain shortcomings, while not addressing less visible and more delicate administrative weaknesses.

Finally, the key limitation of the PAC is that its 15 members, who hold two hearings per week when Parliament is in session, cannot handle the abundance of auditors work in modern times. The NAO already produces more reports than the PAC can examine. Possible ways forward in this respect could be subdivision of the PAC to subcommittees or delegation of PAC's work to departmentally related select committees.²⁷¹ Another solution is that PAC focuses its attention on broader issues and outputs and not be concerned with minor matters and processes. In order to reduce its workload, PAC could still get involved with examination of issues of lesser importance, but would not need to hold oral hearings on them. This would also help dismiss the arguments that PAC focuses too much attention on smaller failures and thus discourages innovation. In relation to this, it has been recommended that PAC use its position of a cross-cutting committee to consider issues which go beyond the limits of individual departments, taking an overall, strategic view of the stewardship of public money (such as for example, risk management, corporate governance, performance measurement, fraud).²⁷² It is expected that production of such kind of comprehensive high-level reports will bring about an

²⁷⁰ V. Flegmann, op. cit., p. 169; A. Adonis, *Parliament Today*, (Manchester University Press), 1993, pp.184-185.

²⁷¹ Cf. F. White, K. Hollingsworth, op. cit. pp. 131-137.

²⁷² L. Sharman of Redlynch, op. cit. pp. 39-41.

increase in overall financial management standards throughout the various British public sector organisations.

There is no doubt that the PAC has a major advantage over any other select committee because it relies on the work of the NAO. The good continuous cooperation with the Comptroller and Auditor General as auditor of public expenditure has thus been regarded as essential for the success of the PAC's work.²⁷³

The Comptroller and Auditor General and the National Audit Office

Status and structure

The Comptroller and Auditor General (C&AG) and the National Audit Office have a long history of development, which is analysed in Annex 1. Their current status and functions are governed by three fairly different Acts: the 1866 Exchequer and Audit Departments Act,²⁷⁴ the 1921 Exchequer and Audit Departments Act²⁷⁵ (which repealed and amended most of the provisions of the 1866 Act) and the National Audit Act of 1983²⁷⁶ (which also repealed and amended a number of provisions of the previous two Acts).

The role of the C&AG and the NAO is to provide independent assurance and advice to Parliament on the proper accounting for, and regularity and propriety of central Government expenditure, revenue and assets. It is also to provide independent reports to Parliament on the economy, efficiency and effectiveness with which Government departments and other bodies use their resources. These reports form the basis for PAC hearings. The C&AG is responsible for the audit of a total of some £800 billion revenue

²⁷³ A. Harrison, *The Control of Public Expenditure 1979-1989*, (Policy Journals), 1989.

²⁷⁴ The Exchequer and Audit Departments Act 1866, 29&30, Vict.3.39 of 28 June 1866.

²⁷⁵ The Exchequer and Audit Departments Act 1921, 11 and 12 Geo.5, c52 of 19 August 1921.

²⁷⁶ The National Audit Act 1983, c.44 of 13 May 1983.

and expenditure each year, along with assets of much greater value and audits the accounts of some 600 bodies and prepares around 60 value for money reports a year.²⁷⁷

The 1983 Act is quite rigorous with regard to the independence of the C&AG against the Government. Thus, subsection 1(2) first establishes the status of the C&AG as an officer of the House of Commons. Subsection 1(1) requires the agreement of the Chairman of the Committee of Public Accounts to the appointment of the C&AG, which additionally secures independence of the C&AG since the Chairman of the PAC is always a member of the opposition. Functional independence of the C&AG was provided by subsection 1(3) of the NAO 1983 Act, which gives the C&AG complete discretion in the discharge of his/her functions concerning value for money studies. Financial independence was furthermore secured by the establishment of a Public Account Commission, which has a responsibility for approving the estimates of the NAO and also appointing an accounting officer for preparing the accounts of the NAO together with an independent auditor to audit the accounts of the NAO.²⁷⁸

The NAO does not have the status of a government department and its staff are placed formally outside the civil service. The C&AG is given a wide discretion regarding the staffing of the NAO. Subsections 3(2) and (3) of the 1983 Act give the C&AG the authority to appoint such staff as he considers necessary for assisting him/her in the discharge of his/her functions, on such remuneration and other terms as he/she may determine. Although the placement of the NAO staff outside the civil service undoubtedly underlies the independence of the NAO staff towards the executive, it may be argued that C&AG's authority over its staff is too wide and could lead to administrative instability. It therefore may be argued that more stability and possibly higher quality of work would be attained by giving the NAO staff the privilege of civil service tenure.

²⁷⁷ NAO Annual Report 2005, *Helping the Nation Spend Wisely*, www.nao.gov.uk

²⁷⁸ Sections 2 and 4 of the NAO 1983 Act.

The Office's audit staff are recruited as university graduates. At least an upper second class honours degree is required for entering the service. Graduates are trained as professional accountants. The Office employs around 800 staff, most of which, around 600, are professionally qualified accountants, technicians or trainees. Each year NAO recruits around 70 graduates and trains them as professional accountants.²⁷⁹ NAO also employs other specialists, such as economists, statisticians, corporate financiers, operational research specialists and sectoral specialists, which are often employed on short-term contracts, particularly for value for money studies.²⁸⁰

NAO is divided into six units. A central unit offers administrative support to the other five audit units. Remaining units are responsible for both the financial and value for money audit within particular areas: Unit B, for example, covers environment, home affairs, agriculture, inland revenue, customs and excise, transport and finance.²⁸¹ Each unit is headed by an Assistant Auditor General appointed by the C&AG.

Functions of the C&AG

The C&AG has two main functions: that of Comptroller General and Auditor. As Comptroller General, the C&AG authorises the issue of public monies from the Consolidated Fund and the National Loan funds to Treasury, which then distributes it to government departments and other public sector bodies, as explained earlier.²⁸² The Comptroller function is essentially an *ex ante* checking, or financial control function. It is quite interesting that the C&AG has retained this *ex ante* checking role, which is one of the main features of some other supreme audit institutions in Europe.²⁸³ However, it

²⁷⁹ NAO Annual Report 2005, pp. 34-35.

²⁸⁰ Cf. F. White, K. Hollingsworth, op. cit. p. 48.

²⁸¹ Ibid.

²⁸² Cf. *Government Accounting*.

²⁸³ This is, for example, the case with the Italian Corte di Compti, which performs *ex-ante* audit of all public funds issues. G. Paovic-Jeknic, *Budzetska kontrola – jugoslovensko i italijansko pravo* [Control of the Budget – Yugoslavian and Italian Law], University of Montenegro, Podgorica, 2000.

should be noted that this C&AG's function, in comparison to other European Supreme Audit Institutions, is quite restrictive and relates largely to checking of whether the requested amounts conform to the ambit of respective votes.

In order to understand the function of the Comptroller General better, more should be said about the process of issuance of public funds, which could be depicted as follows. Treasury requests granting of the monies of the public funds from the C &AG. The amount sought is checked by the Comptroller section of the NAO to ensure that it comes within the total voted or, in case of standing services, such as judicial pensions or EU funds, to ensure its conformity with the legislation.²⁸⁴ Provided the above criteria are met, credits are rarely refused. The only occasions when the C &AG refuses granting a credit are in cases when the Treasury requisitions accidentally exceed the monies voted by Parliament, or if there is an error in quoting the authorising legislation.²⁸⁵ In the course of 2004-2005, a new payment system has been introduced, requiring on-line authorisation for payments from the public Funds from the C&AG. The Treasury and the C&AG managed to complete the transition to the new process successfully.²⁸⁶

The second and main function of the C&AG is of auditor general of the central Government accounts. As an auditor general, C&AG is responsible for checking the legality, regularity, propriety and value for money of the spending *ex post*. There are, thus, two basic strands of C&AG's work: financial audit and value for money audit. As we could see earlier, there is a close connection between these two types of audit, especially from the administrative law point of view. Looking from a more practical perspective, an overlap between these two functions can also be found, since findings in financial audit can provide a basis for value for money audit and *vice versa*.²⁸⁷ However, financial audit and value for money audit are generally perceived as distinct disciplines,

²⁸⁴ F. White, K. Hollingsworth, op. cit. pp. 47-48.

²⁸⁵ Ibid. pp. 58-59.

²⁸⁶ NAO, General Report of the Comptroller and Auditor General 2004-05, www.nao.gov.uk

²⁸⁷ F. White, K. Hollingsworth, op. cit. pp. 60-61.

and are performed by NAO as strictly separate exercises. Therefore, we shall devote closer attention to each of them separately.

Financial audit

The basis for the financial audit of the C&AG are provided in the Exchequer and Audit Departments Act 1921, subsection 1(1):

“Every appropriation account shall be examined by the Comptroller and Auditor General on behalf of the House of Commons and in examination of such accounts the Comptroller and Auditor General shall satisfy himself that the money expended has been applied to the purpose or purposes for which the grants made by Parliament were intended to provide and that the expenditure conforms to the authority which governs it.”

Financial audit, traditionally called certification audit, thus involves two basic kinds of examination:

- whether the figures in the account are properly stated (requirement of accuracy of the accounts) and
- whether the payments and receipts accord with Parliament’s intentions and relevant legislation and other regulations (requirement of regularity/legality and probity of the accounts).

In addition to these examinations, the C&AG investigates whether accounts comply with the requirements of propriety and probity, which we have discussed earlier. If the account contains material misstatements and does not satisfy the above requirements, the auditor shall qualify its opinion on it.²⁸⁸ Qualified opinion is always followed by a report, which

²⁸⁸ In 2004-2005 fiscal year, the NAO has qualified its opinion on only two sets of departmental resource accounts compared to four qualifications in the prior year. It has further qualified its opinion on eleven sets

provides the background and the reasons for the qualification.²⁸⁹ If, however it does not find any irregularities, NAO shall produce a clear opinion or a clear opinion and a report (in the case that it wants to bring some matter which has arisen in the course of the audit to the attention of Parliament and into the public domain). After the process of audit is finalised, the C&AG issues a certificate of audit, where he/she confirms that audit has been undertaken and expresses his/her opinion on the accuracy, legality, regularity, propriety and probity of the accounts. When the audit is completed and the account has been examined, certified and reported upon, the C&AG signs-off the account, which cannot be reopened afterwards.²⁹⁰

At least theoretically, the C&AG is statutorily responsible for forming an opinion on all the accounts. Practically, of course, the work necessary to form that opinion is delegated to a team of auditors, usually comprising of a director, an audit manager, and a principal auditor who may be assisted by other junior staff.²⁹¹ The size of the team, naturally, depends on the accounts of a particular audited body.

Nowadays, NAO practices two basic audit approaches: system based audit and ‘risk-based’ approach. System based audit focuses on testing samples of individual transactions, on the basis of which the conclusions on reliability of the internal controls or systems established within the public body are made.²⁹² The risk-based approach involves a more comprehensive understanding of an audited body’s business, the risk it faces and the controls in place to manage those risks.²⁹³ It consists of provision of advice to the audited body on accounting issues and financial controls, commenting where

of accounts of other public bodies. See: *General Report of the Comptroller and Auditor General, 2004-2005*. www.nao.gov.uk, pp. 10-13.

²⁸⁹ F. White, K. Hollingsworth, op. cit, pp. 73-74.

²⁹⁰ Ibid., pp. 63-64.

²⁹¹ Ibid., pp. 58-59.

²⁹² Ibid., p. 28.

²⁹³ *General Report of the Comptroller and Auditor General, 2004-2005*. www.nao.gov.uk, pp. 25-27; NAO Annual Report, 2001, *Focusing on Success*.

appropriate on possible improvements in accounting and financial control systems which have been identified during the audit. Where the C&AG considers that a significant breakdown in financial control has occurred, he/she will report this matter to Parliament by means of a qualified audit opinion and a report, while other weaknesses identified during the C&AG's examination are brought to the attention of management of the body. In many instances this is done through day-to-day contact with audited public bodies, but more important issues are usually addressed formally in letters to management.²⁹⁴ It is interesting to note that reporting of its findings in the form of management letters puts NAO in the interesting position of more a Government management consultant than external auditor, since a direct connection between the NAO and auditee is established, without elements of democratic, parliamentary accountability.²⁹⁵

Lastly, when talking about financial audit, we shall address the issue of C&AG institutional jurisdiction. C&AG's financial audit jurisdiction is determined by the 1866 and 1921 Act. Besides, C&AG's jurisdiction over public bodies can be established by a specific statute or an agreement. Thus, the core financial audit work of C&AG is directed at three main groups of accounts:

- 1) central government departmental appropriation accounts audited under the terms of the 1866 Act;
- 2) agency resource accounts audited under the 1921 Act or the Government Trading Funds Act 1973; and
- 3) the accounts of other bodies audited under the terms of a specific statute or by agreement.

²⁹⁴ See for example: NAO Annual report, *Helping the Nation to Spend Wisely*, 1999. Management letters can have quite an important effect on central government bodies. In 1999 NAO have sent 514 management letters, prompting the bodies it audits to make over 1.300 changes to their systems in response. NAO has estimated that in total, 94 per cent of the recommendation it made in management letters were accepted and implemented by audited bodies.

²⁹⁵ F. White, K. Hollingsworth, op. cit. pp. 128-129.

Such institutional jurisdiction was not satisfactory, as it was not brought up to date to reflect the changes in the delivery of central government services. Namely, when the 1866 and 1921 Acts were passed, the central Government consisted mainly of Government departments, which gave the C&AG the right of access to all public money. As the organisation of central Government has drastically changed in the last century, the statutory provisions of the 1866 Act were obviously obsolete, as they did not include a number of different public bodies created at the central Government level in the previous decades. For example, due to strong resistance from their lobbies, nationalised industries and statutory public corporations have never been subject to C&AG's jurisdiction. A large number of diverse executive non-departmental public bodies (NDPB's) were excluded from the C&AG's jurisdiction.²⁹⁶ Moreover, C&AG was not allowed to audit companies established by central government bodies, basically due to legal problems imposed by the Companies Act 1989, which envisages that only a registered auditor can audit a body established as a limited company.²⁹⁷ Lastly, the ability of the NAO to follow public monies into private contractors' hands and local public spending bodies was also significantly constrained.²⁹⁸

These concerns were expressed in one of the reports of the Committee of Public Accounts,²⁹⁹ which stressed that a number of publicly funded bodies were audited by auditors appointed by, and reporting to, Ministers, rather than Parliament's own officer - C&AG. In February 2000, the Chief Secretary to the Treasury announced a review of audit and accountability arrangements in central government in response to Committee's concerns. The Review was led by Lord Sharman of Redlynch and its findings endorsed

²⁹⁶ Labour Government has provided that all executive NDPB's created since May 1997 have had the C&AG appointed as their statutory auditor. Previous to this, where an executive NDPB was newly established and the C&AG was not the appointed auditor under relevant legislation, this was a matter largely within the remit of the parent department.

²⁹⁷ L. Sharman of Redlynch, *ibid.*

²⁹⁸ F. White, K. Hollingsworth, *op. cit.* pp. 86-87.

²⁹⁹ PAC, *Report on Government Resources and Accounts Bill*, 9th Report 1999-2000 HC 159.

by the Committee of Public Accounts quickly.³⁰⁰ The key recommendations of the report were the following:

- as a matter of principle, the C&AG should be the auditor, on behalf of Parliament, of all non-departmental public bodies,
- the C&AG's access rights should be formalised where they are currently based on negotiated agreement or conventions;
- the C&AG should be able to audit companies owned by a department, or which are subsidiaries of a non-departmental public body.

The Government has swiftly positively responded to the Review's recommendations on institutional jurisdiction of the C&AG.³⁰¹ Thus, the Treasury has made seven orders under the Government Resources and Accounts Act 2000 (GRAA) extending the C&AG statutory rights of access to all NDPBs. These orders came into force on 23 May 2003, extending the C&AG jurisdiction to most NDPBs and is working on coverage of all NDPB's within the C&AG remit.³⁰² As for the audit of companies, the progress on Lord Sharman's review has been slower, due to the need to change the existing legislation on companies. At the moment, the Government is preparing the Company Law Reform Bill, which should enable the C&AG to audit government owned companies. The NAO has already started working on the preparation for the implementation of such measures, in continuous consultation with the Institute of Chartered Accountants in England and Wales and the Department of Trade and Industry and the Treasury.³⁰³

³⁰⁰ 6th Report, Session 2000-01, HC 260.

³⁰¹ *Audit and Accountability in Central Government, The Government's response to Lord Sharman's report "Holding to Account"*, March 2002, <http://www.hm-treasury.gov.uk>

³⁰² NAO, *Financial Auditing and Reporting, General Report of the Comptroller and Auditor General 2004-2005*, www.nao.gov.uk, p.22.

³⁰³ Ibid. p.6.

Value for Money Audit

It is often argued that the C&AG concern for issues of economy, efficiency and effectiveness has for quite some time constituted a part of public sector auditor's responsibilities.³⁰⁴ However, the existing practice of value for money studies was formally recognised only recently, by Part II of the 1983 Act. Thus, Section 6 provides that the C&AG may "carry out examinations into the economy, efficiency and effectiveness with which any department, authority or other body to which this section applies, has used its resources in discharging its functions". Section 6(3) specifies the C&AG jurisdiction in conducting value for money studies to:

- any department required to prepare an appropriation account under the 1866 Act;
- any body required to keep accounts under section 98 of the National Health Service Act 1977 or section 86 of the National Health Service (Scotland) Act 1978;
- any authority or body whose accounts are required to be examined and certified by, or are open to the inspection of the C&AG by virtue of any enactment including an enactment passed after this Act; and
- any authority or body whose accounts are required to be examined and certified or are open to the inspection of the C&AG by virtue of any agreement made, whether before or after the passing of this Act, between the authority or body and a Minister of the Crown.

Furthermore, section 7 (1) prescribes that if the C&AG has reasonable cause to believe that any authority or body has in any of its financial years received more than half of its income from public funds, he may carry out an examination into the economy, efficiency and effectiveness with which it has in that year used its resources in discharging its functions. However, section (4) specifies that this refers only to bodies which are appointed by the Crown and explicitly excludes remaining nationalised industries and

³⁰⁴ D. Dewar, "Value for Money Audit: The first 800 years", *Public Finance and Accountability*, 1985.

some statutory public corporations from C&AG's institutional remit. Section 8, furthermore, provides the C&AG a right of access at all reasonable times to all documents in the custody or under the control of the department, authority or other body being audited, as he may reasonably require to conduct a value for money examination. Finally, section 9 stipulates that the C&AG may report to the House of Commons the results of any value for money investigation.

Since 1983, the NAO has produced about 40-60 value for money reports each year, covering a wide range of government activities. Value for money studies usually focus on a specific topic, such as introduction of new government policies, implementation of a new programme or the management of a service or a crisis.

Although each study is unique, several stages in the production of value for money reports can be discerned. The first stage involves a research and study selection. Topics are identified by audit staff from close monitoring and analysis of the risks to value for money across various public services.³⁰⁵ A study can also originate from other sources, including members of the Parliament, departments themselves, or the public.³⁰⁶ The PAC has a particular statutory role in relation to study selection. Section 1(3) of the 1983 Act provides that in determining whether or not to carry out a value for money study, the C&AG must take into account any proposals made by the PAC. After the initial identification of the study and approval by the C&AG, full investigation can be undertaken. The report is usually conducted by the audit team, comprising one director, one audit manager and one or two principal or senior managers. The following stage is a production of a draft report by the audit team and its presentation to the auditee, who is given about four weeks to respond. This process of sending the draft report to the auditee is known as clearance. Its objective is to reach an agreement between the NAO and auditee on the facts of the case, making sure that both sides agree that all materials and

³⁰⁵ NAO Annual Report, 1999.

³⁰⁶ Cf. F. White, K. Hollingsworth, *op. cit.*, pp. 74-76.

relevant facts have been included in the report and that their presentation was fair.³⁰⁷ Where a common ground does not exist, both views can be reflected in the report. The last phase is publication of the *vm* report, which will generally include recommendations to the auditee.³⁰⁸

It should be noted that as NAO has moved further away from the account-based approach and has found its higher profile role examining value for money of Government programmes, it has experienced some problems in relationships with the executive. After some initial misunderstanding of what was expected, efforts have been made to work out acceptable forms of words going beyond the purely factual element in a report. However, as seen from the executive, the NAO has been pushing at the frontiers of its remit and encroaching on policy issues, which needs to be strongly discouraged. This has provoked substantial problems when conduct of value for money studies is in question.

It has been argued that among three Es, effectiveness, concerned with the extent to which outputs of goods or services achieve policy objectives, although undoubtedly most controversial, has the greatest potential for bringing about change and saving public funds, while maintaining the quality of service provision.³⁰⁹ However, most authors and NAO auditors agree that up to now relatively few genuine audits of effectiveness have been carried out.³¹⁰ Audit offices are criticised for concentrating too much on ensuring

³⁰⁷ This convention was formalized following a Committee of Public Accounts hearing in 1986 when NAO and auditee, Department of Education and Science, disagreed on the facts of the *vm* report. PAC refused to arbitrate between the NAO and departments and asked for process to be reviewed and agreement on facts to be made. Cf. J. Keen, "On the Nature of Audit Judgements: The Case of Value for Money Studies", *Public Administration* 1999, 77, 509-525.

³⁰⁸ Cf. F. White, K. Hollingsworth, *op. cit.* p. 77.

³⁰⁹ H. Gordon, "Effectiveness Audit in the Audit Offices", *Public Money & Management*, 1998, pp. 5-6; J. Glynn, *Value for Money Auditing in the Public Sector*, (Institute of Chartered Accountants in England and Wales), 1985.

³¹⁰ *Ibid*; M. Pendelbury, O. Shreim, "UK Auditors' Attitudes to Effectiveness Auditing", *Financial Accountability & Management*, 6(3), 1990.

that the existing rules, regulations and systems are appropriately applied, without giving sufficient consideration whether they are the best available option to achieve policy aims.

There are several reasons why effectiveness audit is rarely carried out in NAO practice. One is that it is very difficult to determine the effectiveness of public services. Objectives of government policies are often vague and ambiguous, and even more so is the measurement of their achievement.³¹¹ Furthermore, effectiveness is a particularly sensitive matter because it has the potential to question the merits of policy objectives.³¹² Since policy decisions-making is in exclusive competence of the executive, any interference of the auditor in policy matters is deemed unacceptable and is forbidden by the 1983 Act. Thus, subsection (2) prohibits the C&AG from questioning the merits of the policy objectives of any department, authority or body in respect of which an examination is carried out.

Although it is not disputed that an auditor should not judge the policy objectives, he/she has to be allowed access to policy information, in order to establish the policy aim and hence assess whether it has been achieved. Only after establishing what policy objectives are, can an auditor examine the means by which the policy is put into effect and consider alternative strategies which could achieve the same results at lesser costs.³¹³ Therefore, if effectiveness audit is to be carried out, the first step is to enable auditors to get familiar with policy issues, having access to information and papers so that the auditor can gain in-depth knowledge of the main components of the relevant policies.³¹⁴

It seems however that fear of interfering with policy objectives prevents auditors from carrying out effectiveness examinations at all. It often happens in practice that financial aspects of the policy are identified with the policy itself. Thus, Departments usually

³¹¹ Ibid.

³¹² Cf. F. White, K. Hollingsworth, op. cit, pp. 74-76.

³¹³ H. Gordon, op. cit.

³¹⁴ D. Dewar, "The Auditor General and the Examination of Policy", *International Journal of Government Auditing*, 1986, pp. 10-12.

defend their positions by claiming that auditors are interfering with issues of policy, in the cases when auditors attempt to examine only its financial implementation aspect.³¹⁵

This discussion raises several criticisms when conduct of value for money studies by NAO is in question. Although NAO has a guaranteed constitutional independence, it looks as if it is too reluctant to undertake more radical measures when examining whether public bodies have achieved value for money for the use of allocated resources. One of the problems is that the NAO reports are usually extensively cleared with the audited bodies concerned. This procedure can take quite a long time, involve lots of compromise and result in a more biased than truly independent study. As a corollary, NAO reports often yield fairly general and polite recommendations, simply pointing out that particular management aspects of the body in question require “continuing attention”³¹⁶ or “review”,³¹⁷ instead of providing more detailed measures which the audited body should take in order to improve unsatisfactory segments of its work.³¹⁸ The problem is that the more controversial and open to argument the NAO’s recommendations, the less authoritative they will be, especially if the findings are to be unfair, and the more likely is that they will not be accepted.³¹⁹ Furthermore, as previously mentioned, auditors are rather hesitant to undertake serious efficiency studies, not wanting to interfere with questions of policy in any way.

The explanation of such a position of NAO when conducting value for money investigations may be sought for in the ultimate dependence of the NAO on the Public Accounts Committee and Parliament. Although NAO’s independence towards both Parliament and PAC is constitutionally supported, NAO’s position of “Parliamentary assistant” requires him to pay attention to the needs of its main audiences, members of

³¹⁵ H. Gordon, op. cit., pp. 5-6.

³¹⁶ See for example NAO vfm report: “The BBC: Collecting the Television Licence FEE”, 2001-02.

³¹⁷ See for example NAO vfm report, “Government on the Web II”, 2001-02.

³¹⁸ S. Roberts, C. Pollitt, “Audit or Evaluation? A National Audit Office VFM Study”, *Public Administration*, Vol. 72, pp. 527-549.

³¹⁹ A. Harrison, *The Control of Public Expenditure 1979-1989*, (Policy Journals), 1989.

the PAC and Parliament. In this sense, NAO has to make sure that its reports will, firstly, raise interest of the members of the PAC, otherwise their usefulness could be put in question. NAO is thus criticised for conducting “headline hunting” studies, which would undoubtedly attract PAC’s attention, instead of producing more demanding reports, based on complex societal issues. Secondly, and more importantly, NAO’s work is constrained by its need to balance opposing views on more sensitive political issues, taking care not to provoke partisanship among its “political” audience.³²⁰ Therefore, it may be expected that if NAO would tackle some of the more sensitive Government policies, this could divide PAC on political lines and question the authority and legitimacy of both PAC and NAO. In this way, the basis of the British system of financial accountability would be substantively disturbed.

It may be argued that the above critics overemphasise some of the inherent weaknesses of the British financial accountability system. It should be stressed that the 1980s have undoubtedly brought about a substantial improvement in the arrangements made for the external audit of the public sector, strengthening the independent position of the NAO towards the PAC and the Parliament. Since its institutional independence was established in 1983, the C&AG has not hesitated to investigate areas which the Government of the day might consider sensitive, as, for example, was the case with introduction of the financial management initiative into central government Departments, Ministry of Defense’s purchasing policies and number of other cases which reflected badly on the Government’s management of Departmental resources.³²¹ NAO also became the first national audit institution to examine the variety and complexity of privatization sales.³²² More recent NAO studies have focused on some of the key British societal issues, such as, for example, the national health service system, which has for quite a while been the

³²⁰ S. Roberts, C. Pollitt, op. cit., pp. 546-547.

³²¹ A. Harrison, *ibid.*

³²² National Audit Office, HC 645, Session 1995-6; *The Work of the Directors of Telecommunications, Gas Supply, Water Service and Electricity Supply.*

subject of a great number of NAO's critical reports.³²³ NAO has also quickly responded to crises which occurred at various public service areas.³²⁴ Lastly, in recent years NAO, together with PAC, has started producing high-level overview reports on thematic subjects.³²⁵ The objective of these reports is to draw out lessons from a number of more detailed reports on similar subjects and disseminate good practice throughout central Government. In this way, NAO has started developing a new function as Government advisor.

The final question which remains to be answered is how can the implementation of the recommendations of the NAO be secured and strengthened? The present situation is that the Government formally responds to each PAC report, which means at least that each recommendation is looked at. One step forward in that respect is to require explicit acknowledgement of the relevance of the auditor's main findings and a statement of the action taken in response to them. A further step would be to give NAO and PAC reports even wider publicity in the media and thus increase the pressure of the public on the Government. Although this influence has up to now been considerable, it is essential that the public is informed of NAO findings timeously and extensively. Therefore, one of the conclusions may be that in a long run, the effectiveness of the NAO will depend not only on the expertise and quality of the NAO's work, but also and even more on the general

³²³ See recent NAO reports on NHS: *The NHS Cancer Plan – A Progress Report*, HC 343, 2004-2005; *Tackling Cancer: Improving the Patient Journey*, HC 288, 2004-2005; *Darent Valley Hospital: The PFI Contract in Action*, HC 209, 2004-2005; *Patient Choice at the Point of GP Referral*, www.nao.org.uk

³²⁴ Cf. NAO reports: *Reducing Crime: The Home Office working with Crime and Disorder Reduction Partnership*, HC 16, 2004-2005; *London Underground: Are the Public Private Partnerships likely to work successfully?* HC 644, 2003-2004; *Regeneration of the Millennium Dome and Associated Land*, HC 178, 2004-2005; *Shadow Strategic Rail Authority: Action to improve passenger rail services* (1999-00). www.nao.gov.uk

³²⁵ Cf. NAO reports: *Good Practice in Performance Reporting in Executive Agencies and Non-Departmental Public Bodies*; *Examining the Value for Money of Deals under the Private Finance Initiative*; *Supporting Innovation: Managing Risk in Government Departments*.

climate within which they work, i.e. the general level of public interest in the questions they examine.³²⁶

The Government Accounting System

Public accounts in the United Kingdom have traditionally been prepared on a cash basis, but in recent years there has been a substantial shift towards accruals accounts. This has been provided by the Government Resources and Accounts Act of 2000. The key objective of the introduction of resource accounting and budgeting, as we could see, is to improve the planning and control of Government spending as well as to improve departments' accountability to Parliament through more comprehensive financial information it will provide. We shall analyse in more detail sections of the Act which are, in our opinion, most relevant for audit and accountability.

Section 5 of the Resources and Accounts Act 2000 reinforces the 1866 and 1921 Exchequer and Audit Departments Acts' provisions that the Treasury prescribes the form in which the accounts are laid. However, it also requires the Treasury to, in determining the content of accounts, have regard to any relevant guidance issued by the Accounting Standards Board³²⁷ and include in the accounts contents: statement of financial performance, statement of financial position and a cash flow statement.³²⁸ Section 5 (6) puts on a statutory basis the appointment of accounting officers, who shall be responsible for the preparation of the department's resource accounts and their transmission to the Comptroller and Auditor General.³²⁹ Sections 6 and 8 furthermore deal with authorities of the C & AG in examination of accounts. Subsection 6 (1) prescribes that in examining

³²⁶ A. Harrison, *ibid.*

³²⁷ The body responsible for setting accounting standards under the companies legislation. Its independence is strengthened by the Act by requiring the Treasury to consult the C&AG in the process of selection of its members.

³²⁸ s. 5(4)a and b.

³²⁹ s. 5(7).

any resource accounts, the C & AG must satisfy him/herself that: a) the accounts present a true and fair view, b) that *money* provided by Parliament has been expended for the purposes intended by Parliament, c) that *resources* authorised by Parliament to be used have been used for the purposes in relation to which the use was authorised, d) that the department's financial transactions are in accordance with any relevant authority. While the first paragraph (a) reflects the change from cash to accrual accounting requiring provision of the opinion usually given by auditors on company accounts, the remaining items may be subsumed under the regularity requirements of cash accounts and legality requirements when looked from the legal point of view.

The Resources and Accounts Act 2000 has also provided for the preparation and audit of consolidated accounts for the whole of the public sector (Whole of Government Accounts- WGA). The Treasury has been introducing the WGA gradually, by making preliminary central government sub-consolidations for the financial years 2001-2002 and 2002-2003 and more complete central government consolidation account for the financial year 2003-2004, which has been subject to the NAO audit. At the moment the Treasury is working on inclusion of the local authorities, health trusts and public corporations within the WGA, which will add a great number of public bodies to the consolidation process and will require harmonisation of accounting policies.³³⁰ It is expected that the whole of government account will provide Parliament with an overall picture of the financial state of the public sector, allowing in this way more effective scrutiny of the government's economic policies.³³¹

The introduction of the resource accounting and budgeting as well as the whole of government account has undoubtedly brought about improvements in accountability arrangements of the central Government, providing Parliament and other interested actors

³³⁰ NAO, *Financial Auditing and Reporting, General Report of the Comptroller and Auditor General 2004-2005*, pp. 20-21.

³³¹ F. White, K. Hollingsworth, "Public finance reform: The Government Resource and Accounts Act 2000", *op. cit.*, pp. 56-61.

with more sophisticated financial information on the basis of which accountability standards are measured. Encouraging results of reforms are to be thanked first to the Treasury, which has designed a very good strategy of gradual introduction of resource accounting in the central Government.³³² However, full success and effectiveness of these reforms will greatly depend on the ability of its users to understand and efficiently use the information provided.³³³ In this sense, it is essential that the Parliament's support to the resource accounting project is strengthened and that the members of the PAC are provided further education and training on how the new financial informational base can be used for enhancing accountability of the executive for the public money stewardship to Parliament and the public.

Summary and Conclusion

Despite some inherent weaknesses, the British system of financial accountability can be depicted as well-trying and effective. It is based on external, parliamentary accountability, where Parliament, through the work of its Public Accounts Committee, based on the expertise of NAO, holds the executive to account for the legal and productive use of public money. The other key chain of accountability is managerial, established between the Treasury and accounting officers of public bodies, where *ex ante* financial control tasks have been delegated from the former to the latter. Accounting officers represent the key link between these two lines of accountability, since both the Parliament and the Treasury can call them to account for stewardship of public money.

The developments in the accountability system have had an important impact on the basic systematic premises, such as one of the concept of public money stewardship. In that sense, it should be noted that traditionally clear lines between the issues of legality and regularity of public expenditure on the one hand and value for money on the other hand

³³² This is contrast to Australia and New Zealand which undertook a rapid approach to resource accounting implementation. Cf. D. Heald, "The Implementation of Resource Accounting in UK Central Government", op. cit., pp. 11-12.

³³³ F. White, K. Hollingsworth, *ibid.*

have been unequivocally blurred. Hence, attainment of value for money in the use of public funds in Britain is no longer of secondary importance, but constitutes an equally important standard against which financial accountability is measured.

The UK system of accountability has further been significantly enhanced by extending the jurisdiction of the C&AG to other public bodies, especially NDPBs, and a gradual introduction of resource accounting and budgeting and. It is expected that the new way of financial reporting, contained in the application of resource accounting and budgeting introduced through The Resources and Accounts Act 2000 will substantially improve both internal and external financial accountability. New accounting practices are perceived to enhance departmental management as well as bring about better value for money in the use of resources. More importantly, new financial reporting should provide Parliament with high quality information on the basis of which it could, on behalf of the citizens, more efficiently exercise both its *ex ante* and *ex post* democratic accountability title.

Chapter III

Financial Accountability in France

The objective of this chapter is to analyse the financial accountability system of France. Following the structure of the previous chapter, we shall examine the way that financial accountability, as a relationship established between the citizens, as accountors, and the state, as accountee, where citizens are holding the state to account for the stewardship of entrusted public money, is operationalised in the French state context. In this sense, we shall first analyse the ‘*who* is accountable’ dimension of accountability, attempting to provide an overview of the structure of the French state. This will be followed by an examination of the ‘*for what*’ financial accountability dimension, which should reveal the complexity of the concept of “stewardship” of public money in France. However, the focus of our inquiry, again, will be placed on the fourth financial accountability dimension – mechanisms *through which* the accountability relationship operates. Throughout our research we shall especially focus on the impact that the Law Regulating the Public Finance in France, so called – LOLF³³⁴ has had on the financial accountability framework in France in the last couple of years.

Another Highly Complex Accountee – the French Central Government

Constitutional background

Unlike Britain, France has possessed a strong administrative state tradition since at least Napoleonic times.³³⁵ After many hundreds of years of monarchy, a variety of political

³³⁴ *La Loi Organique Relative aux Lois de Finances (LOLF)*, Constitutional bylaw No. 2001-692 of 1 August 2001 on budget acts, ‘French Official Journal’ No. 177 of 2 August 2001, p. 12480.

³³⁵ The differences between the Anglo-Saxon and continental traditional perception of the state are certainly corollary of different historic paths of the British Isles and the continent from XVII onwards. The supremacy of Parliament in Britain has been already established after the revolution in 1688 and sovereignty had been vested in Parliament instead of the monarch. At the same time, the continent

systems followed: First Republic (1792-1804), First Empire (1804-1815), Restored Monarchy (1815- 1830), Liberal Monarchy (1830-1848), Second Republic (1848-1852), Second Empire (1852-1870), Third Republic (1870-1940), Fourth Republic (1946- 1958). The current Fifth Republic was proclaimed in 1958.

France's republican status is enshrined in the Constitution. The Fifth Republic has increased the power of the executive in order to promote strong and stable government. The constitutional and political reinforcement of the executive led to a corresponding reduction in the powers of the parliament. Thus, many of the important laws passed in Parliament are so-called *lois d'orientation*, laws which present only the general outlines and guidelines of legislation.³³⁶ The Constitution, in turn, vests in the executive strong powers to regulate by decree (*décrets*).³³⁷

The French Parliament is comprised of the National Assembly and the Senate. Deputies of the National Assembly are elected by direct elections, and represent the people of territorial units of the Republic. The Senate members, in turn, are elected by indirect election and represent French nationals settled outside France.³³⁸

Revision of the Constitution in 1962 provided for a powerful President and the creation of a so-called 'semi-Presidential' political system. The President is elected by direct popular vote for a five-year term.³³⁹ The President appoints the Prime Minister, appoints

experienced at least another century of absolutist state development, which brought about alienation between the state and the citizens. Cf. C. Knill, *The Europeanisation of National Administrations*, (Cambridge University Press, 2001), p. 74.

³³⁶ V. Wright, *The Government and Politics of France*, London, Routledge, 1994, pp. 100-101.

³³⁷ L. N. Brown, J. Bell, *French Administrative Law*, (Clarendon Press, Oxford), 1993, pp. 8-9.

³³⁸ Article 24 of the French Constitution.

³³⁹ From 1962 to 2002, the President was chosen for the seven year term. However, referendum of 2000 has changed President's mandate to 5 years, since it was out of step with the five-year lifetime of parliament, and three times in the past 14 years that has produced paralysing "cohabitations" between presidents and prime ministers of different political persuasions that have effectively stymied major institutional change.

senior civil servants and military commanders and oversees observance of the constitution.³⁴⁰ He promulgates laws passed by Parliament and has the power, although seldom used, to refer laws back to the Parliament.³⁴¹ As in every parliamentary democracy, Government is responsible to the National Assembly (the lower house of Parliament) and must resign if it loses a vote of confidence. The resignation has not always been accepted by the President, who may maintain the Prime Minister in office and call for new general elections after dissolution of the National Assembly.³⁴²

In order to secure balance between the judicial and legislative power, draftsmen of the 1958 Constitution have established a new institution, the Constitutional Council (*Conseil Constitutionnel*).³⁴³ The basic function of the Constitutional Council is adjudication upon the validity of presidential, parliamentary elections and referenda³⁴⁴ and checking the constitutionality of laws approved by the Parliament.³⁴⁵

The French political system cannot be classified fully either as “majoritarian” or consensual. Cabinets are usually one-party or a minimal coalition, but these majoritarian characteristics are counterbalanced by the existence of a multi-party system and a strong President.³⁴⁶ During the period since 1980 there has been a fairly frequent alternation of the parties in office. In the majority of cases the President and the Government came from the same political party, but there were periods when this was not the case (the periods of cohabitation – Jospin government under President Chirac, 1997-2002, for example).

³⁴⁰ Article 7 of the French Constitution.

³⁴¹ Article 10 of the French Constitution.

³⁴² V. Wright, *The Government and Politics of France*, (London, Routledge) 1994.

³⁴³ Articles 56 – 63 of the French Constitution.

³⁴⁴ Articles 58, 59 and 60 of the French Constitution.

³⁴⁵ Cf. L. N. Brown, J. Bell, op. cit., pp. 14-15.

³⁴⁶ C. Pollitt, G. Bouckaert, *Public Management Reform – A Comparative Analysis*, (Oxford University Press 1999), p. 227.

France can furthermore be depicted as a “legal model” state (*rechtsstaat*).³⁴⁷ The state activity is overtly regulated by legal rules and the state administration conceived as an autonomous domain apart from civil society. France has a well-developed system of administrative law (*droit administratif*), largely created by precedents of the *Conseil d'Etat*, which had an immense influence on evolution of administrative law concepts.³⁴⁸ And while in the United Kingdom conflicts between public authorities and the ordinary citizens are solved by the ‘ordinary’ courts, France has a number of specially constituted administrative courts, which exclusively exercise control over Government bodies.³⁴⁹ In this way, the French legal founders wanted to achieve a full separation between legislative, administrative and judicial power.

It is interesting to note that the French administrative system also recognises a strict legal division of the civil service into a large number of corps, each with its own educational entry requirements and its own set of hierarchically arranged posts, defined by a general civil service law.³⁵⁰ The state power is mainly situated at the *grands corps* of the state, comprised of: the *Inspection des finances* (financial inspectorate), the *Conseil d'Etat* (Supreme Administrative Court) and the *Cour des Comptes* (The Court of Accounts, hereinafter the Court). All these bodies recruit their members from the prestigious *Ecole Nationale d'Administration*.

Despite its ‘rigid’ traditional structure, the French state has undergone significant reforms during the last several decades. There have been a series of reform initiatives by different governments, focusing on decentralisation/deconcentration and privatisation. Thus, in 1982, under the socialist Mitterrand’s Government, a significant transfer of power from

³⁴⁷ L. N. Brown, J. Bell, op. cit., p. 7.

³⁴⁸ G. Braibant, *Administrativno pravo Francuske [French Administrative Law]*, (Sluzbeni list SRJ, CID Podgorica) 2002, pp. 403-426, translation of G. Braibant, *Le Droit Administratif Francais* (Presse de la fondation nationale des sciences politiques & Dalloz), 1992.

³⁴⁹ Ibid.

³⁵⁰ This feature of the French administrative system has been interpreted as one of the sources of considerable rigidity and resistance to public management reforms. C. Pollitt, G. Bouckaert, op. cit., p. 231.

central to regional and local government occurred.³⁵¹ Furthermore, during the period of the socialist government (1981-86) extensive nationalizations were undertaken (exactly the opposite of the trend which was beginning to develop in the UK). Shortly afterwards, however, the neo-liberal government of Chirac (1986-88) has started excessive privatisation, which resumed in a more moderate way in 1993, after the right regained power. This trend continued by the following socialist Government resulting in privatisation of a great majority of state corporations. Therefore, in the last 25 years the central Government in France witnessed significant reduction of its scope.

Variety of public bodies

The French central Government comprises a number of fairly different bodies, which, similar to the UK, seem to be continuously diversifying over the time. One of the possible general classifications of great variety of public bodies would encompass: central government departments; public bodies called *établissements publics (EPs)*; (semi) independent public bodies - *Autorité Administrative Indépendante (AAI)* and state owned corporations. Regional and local government bodies shall be excluded from our research interest, since they fall under a distinct financial accountability regime.

Core central Government comprises ministries, as policy making bodies, and *établissement public (EP)*, as policy implementation bodies.³⁵² There are no pre-existing criteria to determine whether a given activity is to be performed by a Government

³⁵¹ France (without overseas departments and territories) is divided into 22 administrative regions.

³⁵² The EPs were actually created by case administrative law precedents rather than enacted into statutes or issued as regulations. The concept of the EP's was defined by the *Conseil d'Etat* already in mid 19th century (1856) and is based on the following criteria: an agency has to be a separate legal and public law entity, need to have a specific object of activity, have administrative and financial autonomy and be under the supervision of the national/regional/local Government. The concept of EPs developed by case law over the decades along with the very notion of public service (understood as the services of national economic and social interest). Cf. L. Digi, *Preobrazaj javnog prava* [Transformation of Public Law], (Geca Kon, Belgrade), 1929. Cf. S. Touchon, D. Tommasi, "Country Report France", in *Financial Management and Control of Public Agencies*, SIGMA Paper No.32, OECD, Paris, 2002.op. cit. pp. 43-44.

Department or an EP, although there is a political consensus that those tasks which are a "royal" prerogative (defense, police, justice and foreign affairs) must be handled directly by the central government Ministry.³⁵³

EP's are by far the most frequent form of public bodies (autonomous organizations) within the French state due to their fairly flexible structure and can be divided into three broad categories: administrative, industrial and commercial. Administrative EPs (around 1000 of them) are the most common form of organization which are used for provision of government services (e.g. national employment agency, universities, museums etc). The number of industrial and commercial EPs is smaller (around 80) and has often been established as a corollary of gradual transfer of functions from the core executive to more flexible forms of organizations.³⁵⁴ Whereas the administrative EPs are subject to public law rules and budgeting and accounting regulations similar to those of Government departments, the industrial and commercial EPs, which enjoy somewhat greater autonomy and were designed to operate as commercial companies, are subject to private law rules, but are required to use public law accounting regulations.³⁵⁵

It should be noted that social security funds also fall under the category of EPs. Although they have a particular management structure composed of representatives of both employers and employees, the Government and the Cour have in the last decades started exerting much tighter control of the use of their funds.³⁵⁶

³⁵³ Cf. S. Touchon, D. Tommasi, *op. cit.*, pp. 43-73.

³⁵⁴ Industrial and commercial EPs are for example big public enterprises (electricity, railways companies), the Paris opera, the French Foreign Trade Centre etc.

³⁵⁵ It is interesting to note that most of the industrial and commercial EPs apply government accounting regulations, but are not the subject of the a priori financial control of the Government. Cf. S. Touchon, D. Tommasi, *ibid.*

³⁵⁶ The Constitutional amendments of 1996 have thus enabled the Cour to audit social security funding institutions, Article 147(1) of the French Constitution.

Questions are also being raised about the need to tighten the financial control over all EPs.³⁵⁷ Although the Ministry of Finance itself has created a number of EPs, it has developed a generally negative attitude towards the increase of number of the EPs, since their operation generate additional public spending, partly due to difficulties in imposing proper financial supervision. In order to avoid difficulties related to supervision of EPs, over the last decade the Government started creating a new type of public body called "bodies with nation-wide jurisdiction" (*Services à caractère national — SCN*), which are not separate legal entities and could provide an alternative solution to the continued creation of EPs.³⁵⁸

Semi-independent public bodies - *Autorité Administrative Indépendante* (AAI) constitute another important category of public bodies, having a nature of a regulatory agency. AAIs thus regulate "sensitive" Government sectors of their area of competence, such as, for example, broadcasting, freedom of information, protection of consumers and other citizens' rights etc.³⁵⁹ AAIs are usually created by statute voted by Parliament and are not subject to any supervisory authority. Therefore, it is argued that their members are independent from both the executive and the Parliament.³⁶⁰ However, unlike EPs, AAIs do not have a status of legal person separate from the State, which again questions their complete independence from the executive. Being a part of the state administrative structure, AAIs are subject to control of administrative courts. Most AAI are not subject to the *a priori* financial control of the Ministry of Finance discussed below, but are still subject to government accounting regulations and audit by the Cour.

All this variety of public bodies coupled with the privates ones receiving considerable public funds constitute a rather complex and comprehensive financial accountability

³⁵⁷ Cf. S. Touchon, D. Tommasi, op. cit., p. 49.

³⁵⁸ The first SCN was created in 1997, Ibid.

³⁵⁹ Examples of AAIs created by statute are: Broadcasting High Council, responsible for appointing the Presidents of the television and radio state-owned companies; National Commission for Information and Freedoms (*Commission Nationale de l'Informatique et des Libertés*).

³⁶⁰ S. Touchon, D. Tommasi, op. cit. 47-49.

accountee, which is constantly evolving. In order to follow up this evolving nature of the accountee, proper financial accountability mechanisms need to be defined and adjusted to the new circumstances, so that the central Government administration can be effectively held to account, or as the French people would rather say - so that state would be adequately *controlled* in the use of the public funds.

Systemic reforms of the financial accountability framework through LOLF

The overview of the gradual reduction of scope of the French central Government presented at the outset of this chapter demonstrates that the French public sector reforms, in comparison to its Anglo-Saxon counterparts, have been implemented in a fairly piecemeal way in the last two decades of the 20th century. Although the pace of the reforms has been slower, the structure of administration did experience substantial overhaul, which resulted in the transfer of a number of central Government functions either to the local level or to the private sector. Interestingly enough, these structural changes have for several decades not been accompanied by reforms in the financial accountability framework, which has remained almost intact for more than 40 years.

The budget and financial accountability was governed for more than 40 years by a Constitutional Bylaw of 1959, the so-called French “Financial Constitution”.³⁶¹ The budget framework under the 1959 Financial Constitution is characterised by a strong role of the executive in determining the overall scope and allocation of expenditure, fairly centralised control by the Ministry of Finance and quite weak powers of the Parliament both in the process of budget approval and in the later phase of accountability. In spite of numerous attempts at changing a fairly outdated budget framework (around 38 initiatives altogether), the executive has constantly refused to reform the budget process. This resistance to change is usually explained by strongly entrenched values of a strong

³⁶¹ L’ordonnance N 59-2 du 2 janvier 1959, which ceased to be in effect from 1 January 2005.

administrative state and structure of strong *Grands Corps* that appear to have stayed in control of most of the reforms, with their central roles not been seriously undermined.³⁶²

However, the very beginning of the 21st century has witnessed a substantial reform of the budgeting, accounting and financial accountability framework enabled through the adoption of the new “Financial Constitution”, so-called LOLF (*la loi organique relative aux lois de finances*) in 2001.³⁶³ The LOLF attempts to attain several objectives: increase accountability of managers, create a more active role for Parliament and improve the transparency of expenditure allocation and Government’s performance. The law was adopted in the wake of the discovery of a tax fraud affair in 2000, which brought to bear significant pressure from the Parliament on the Government to overhaul the budgetary process.³⁶⁴ Furthermore, it may be argued that the requirements of the EU economic and monetary union have also had an impact on the need to improve public management and reduce fiscal deficit and provided an additional impetus for reforming the budgeting and financial accountability framework.³⁶⁵ Finally, it is interesting to note that the LOLF was adopted in France only a year after the UK Parliament adopted the Government Resources and Accounts Act (2000), which, as we could see in the previous chapter, the UK Treasury considers as the “biggest reform and modernisation programme in the management of the country’s public finances since the Gladstone era”.³⁶⁶ However, although the importance of this Act for the enhancement of financial accountability in

³⁶² C. Pollitt, G. Bouckaert, op. cit., p. 230.

³⁶³ Constitutional bylaw No. 2001-692 of 1 August 2001 on budget acts, ‘French Official Journal’ No. 177 of 2 August 2001, p. 12480.

³⁶⁴ F. Waintrop, C. Chol, “France: The Challenge of a Systemic Reform”, paper presented at the EGPA meeting of the Study Group on Productivity and Quality in the Public Sector, “Performance Measurement and Public Management Reform”, in Ljubljana, Slovenia, September 2004.

³⁶⁵ R. Hertzog, “Une grande premiere: la reforme du droit budgetaire de l’Etat par le Parlement”, *Revue Francaise de Finances Publiques*, No. 73, January 2001, pp. 7-18; H. Enderlein, “Adjusting to EMU, The Impact of Supranational Monetary Policy on Domestic Fiscal and Wage-Setting Institutions”, *European Union Politics*, Volume 7 (1), (Sage Publications), 2006, pp. 113-140.

³⁶⁶ H.M. Treasury News Release 195/99. Cf. F. White, K. Hollingsworth, “Public finance reform: The Government Resource and Accounts Act 2000”, *Public Law*, 2000, pp. 56-61.

UK cannot be disputed, the reforms undertaken by the LOLF have much more substantially changed the French financial accountability framework than it occurred under the Government Resources and Accounts Act 2000 in UK, as pointed out in the previous chapter.

The LOLF provides the basis for the introduction of programme budgeting in the French central Government, which has started to be fully implemented in the current 2006 budget. Unlike in the previous system, where each body was assigned the budget based on different types of expenditure (operational, capital etc.), in the new system the expenditure is based on missions which correspond to the Government's key public policies (security, education, research, etc). Each Mission consists of a number of programmes, which are further divided into sub-programmes (actions) as operational means to implement the Programme.³⁶⁷ This introduces much more transparency and flexibility in the system. Namely, in the new system appropriations may be freely re-allocated within the programmes and their breakdown according to sub-programmes is now purely indicative, which allows for much more flexibility for the organisation's management.³⁶⁸ Such developments go hand in hand with the British reforms of enlarging the sub-heads within the votes, as pointed out in the previous chapter. In exchange for the high degree of autonomy they now have, programme managers in public bodies have to be fully committed to their goals and held accountable for their management acts via results indicators and target values.³⁶⁹

The reform introduced by the LOLF, as a second French Financial Constitution have unsurprisingly affected all elements of the French financial accountability framework, starting from the concept of the stewardship of public money and extending to internal and even more external accountability framework, with an increasingly important role

³⁶⁷ Article 7, paragraph 1 of the LOLF. Cf. Ministère de l'Economie des Finances et de l'Industrie, *Budget Reform and State Modernisation in France*, available at www.minefi.gouv.fr or www.lolf.minefi.gouv.fr

³⁶⁸ Personnel expenditure is the only exception to the globalisation principle: it cannot be topped up with other appropriations and payrolls have to be capped, cf. Article 7, paragraph III of the LOLF.

³⁶⁹ Article 48 item 4 of the LOLF Chapter V, Information and Audit of Public Finances.

given to democratic accountability forms of the French Parliament, as will be explained in the course of the ensuing analysis.

Stewardship of Public Money – from compliance to performance?

The concept of stewardship of public money is not explicitly defined in the French legal system. Instead of providing a detailed definition of what may be subsumed by the concept of stewardship of public money, the French legislator has regulated this area in a fairly vague manner, providing the external accountability actor, the Cour des Comptes (hereinafter the Cour) substantial freedom of interpretation of this concept. Nevertheless, the Cour's basic framework of control is explicitly regulated by the *Code des juridictions financiers*, which authorises the Cour to conduct three major areas of financial accountability investigations:

- 1) accuracy of the accounts (*contrôle de la régularité comptable*),³⁷⁰ where the Cour has to be assured that figures in the accounts are properly stated;
- 2) regularity of financial operations (*contrôle de la régularité de la gestion*),³⁷¹ where the Cour checks whether receipts and payments accord with relevant budgetary legislation and, in the case of public bodies, relevant administrative legislation; in the case of public enterprises - relevant commercial law; or in the case of subsidised organisations – relevant civil law.³⁷²
- 3) quality of management, assurance of “good use of public funds” (*bon emploi des fonds*)³⁷³ and “verification of the accounts and management of public enterprises”

³⁷⁰ Article L III – 1 of the Code des juridictions financiers.

³⁷¹ Article L III – 3 of the Code des juridictions financiers.

³⁷² Within the control of financial operations, an auditor also checks whether rules of fiscal and criminal law are respected, although this does not represent his/her major preoccupation. Cf. C. Deescheemaeker, *La Cour des Comptes*, (La Documentation Française, Paris), 1998, pp. 61-62.

³⁷³ Article L III – 3 of the Code des juridictions financiers.

(*la verification des comptes et de la gestion des entreprises publiques*)³⁷⁴ which would generally correspond to British value for money requirements – attainment of economy, efficiency and effectiveness in the use of public funds.

There is certainly a similarity between the definition of a concept of stewardship of public money in the British and French central Government. Although the French system does not regulate different public money stewardship requirements in greater detail, as is the case with British regulations, both systems explicitly stress the importance of regularity of financial operations, in addition to the requirement of account's accuracy. Furthermore, it is interesting to note that both systems use the term “regularity” instead of “legality” which, in our opinion, would be more appropriate and legally “correct” term in this case. Lastly, there is surely some similarity in which the third financial accountability requirement, the requirement of achieving “value-for-money” in the UK, and the French imperative of *bon emploi des fonds* are defined. The reforms undertaken through the LOLF will bring about even greater proximity between these two national concepts.

In this respect, it is interesting to note that an absence of the clear meaning of the *bon emploi des fonds* in France has never been perceived as a problem for the French financial accountability system. Lack of a precise definition of this notion has enabled the Cour to develop its own concept of what this principle means in practice. This does not, in any case, mean that the Cour has not taken this role seriously or that the freedom of interpretation has undermined the assessment of the good use of the public funds. Thus, relatively recent research conducted on the performance audit conducted by the Cour has demonstrated that there is a wide range of criteria which the Cour's auditors apply in their performance management inspections. These are: economy, efficiency, effectiveness, goal attainment, good management practice and good governance, depending on the context and purpose of the particular audit.³⁷⁵ However, it is also not in

³⁷⁴ Article L III - 4 of the Code des juridictions financières.

³⁷⁵ C. Pollitt et al, *Performance or Compliance? Performance Audit and Public Management in Five Countries*, (Oxford University Press), 1999, p. 84.

dispute that a lack of a clearly set objectives and targets of financial performance in the French administration has generated significant difficulties in the Cour's attempts to assess efficiency and effectiveness of financial operations. Due to these limitations, many auditors have kept their activities within a more narrowly defined framework of controlling the regularity and consistency of the audited body's decisions, stability of its operations and investigating any specific problems that came to the auditor's attention.³⁷⁶

It is expected that the introduction of programmatic budgeting, with clear setting of objectives and indicators, will even more enhance the importance of values of efficiency and effectiveness in the use of the public funds in France. As the programme budgeting has been introduced only this year (2006) it is still not possible to judge its results and impact on the concept of the stewardship of public money. However, the first pilot ministries which have undergone this process, have experienced difficulties when attempting to reorient budgets to the performance budgeting framework.³⁷⁷ This is partly due to difficulties in defining clear targets and objectives of the programmes for the first time, and partly due to strong *rechstaat* legal tradition of the French administration, in which most Government activities are already closely regulated by detailed framework of law and do not leave much space for managerial freedoms. It will, therefore, be very interesting to see how and to what extent the French legal culture based on Weber's classical bureaucratic values of regularity and compliance will be able to embrace strong New Public Management values of performance orientation and management flexibility. This issue will surely be tested through the ongoing introduction of a more flexible internal control management framework.

³⁷⁶ Ibid.

³⁷⁷ F. Waintrop, C. Chol, op. cit. p. 11.

Internal financial accountability mechanisms

Financial control posts and General Inspectorate of Finance

There are three key posts in the French government internal control system. These are the *ordonnateur* (authorising officer), the *contrôleur financier* (financial controller) and the *comptable* (or public accountant).

Ordonnateur holds the power over the budget of a public body, by being authorised to enter into commitments (*engage*), issue contracts and orders, verify deliveries and invoices (*liquide*) and authorize payments (*ordonne*).³⁷⁸ The authorising officer in the Ministry is the line Minister (or for EPs the head of the EP), who usually delegates this responsibility to other members of staff, such as General Directors (heads of Sectors).

Comptables make the payments authorised by the *ordonnateur* (and later approved by the *contrôleur financier*). They are accountants by profession, but of a very special kind, which makes them a sort of a ‘national phenomenon’ that has no real counterpart elsewhere in the world.³⁷⁹ Thus, *comptables* are personally responsible for the decisions taken and liable for the sums involved should a payment be made without appropriate authorisation or without legal authority in the budget.³⁸⁰ Such an emphasis on personal liability of *comptables* can be traced back to the beginning of the XIX century, when they obtained a key position in the process of judicial financial accountability. As Napoleon wanted to create a strong state with an efficient executive, he simply exempted Ministers (*ordonnateurs*) from judicial audit of the Cour, placing the burden of financial accountability solely on *comptables*.³⁸¹ This ‘imbalance’ in accountability lines was addressed in 1948, by creation of the Court of Budgetary and Financial Discipline (*La*

³⁷⁸ S. Touchon, D. Tommasi, op. cit. p. 59.

³⁷⁹ Cf. Normarton, *The Accountability and Audit of Governments*, (Manchester University Press, 1964), pp. 18-19.

³⁸⁰ Cf. J. Magnet, *Les comptables publics*, (L.G.D.J, Paris), 1995, pp. 105-137.

³⁸¹ Cf. Normarton, *ibid*.

Cour de discipline budgétaire et financière), which has the authority to decide on the cases of irregular action of commitments officers or other persons involved in financial matters other than *comptables*.³⁸²

Comptables are responsible for verifying the regularity of payment orders, to issue the payment through the Treasury Single Account (or the EP's account at the Treasury) and keep the accounting books. There are around 55,000 *comptables* in the French administration, operating in central, regional and local government.³⁸³ They are internally supervised by the General Directorate of Public Accounting (as part of the Ministry of Finance), and externally account for their actions to the Cour, which carries out detailed audits of their accounts.

Contrôleur financier is an official of the Ministry of Finance placed in each Ministry/other body, who supervises financial operations within that body and ensures that spending does not exceed prescribed limits. *Contrôleurs financiers* perform ex-ante control of financial operations and are obliged to attach a visa (indicating approval) at two different stages in the expenditure procedure: at the stage of commitment and at the stage of payment. They must verify that there is an appropriation available and the commitment fits the purpose of the appropriation, performing in this way an ex-ante control of regularity of financial operations.³⁸⁴

For an outside observer, the function of *contrôleur financier* appears to be redundant, as a great degree of ex-ante control of payments is already performed by *comptables*. The main logic behind the introduction of *contrôleur financier*, however, seems to be the wish of the Ministry of Finance to more strongly and directly control line ministries and agencies by placing their officials all throughout the administration. It should also be

³⁸² Cf. J. Magnet, *La Cour des Comptes les institutions associées et les chambres régionales des comptes*, 4th edition (Berger-Levrault, Paris), 1996, pp. 313-329.

³⁸³ National Audit Office, *State Audit in the European Union*, 2005, pp. 89-90, available at www.nao.gov.uk

³⁸⁴ E. Devaux, *Finances Publiques*, (Breal Editions, 2002), pp. 266-268.

noted that in addition to their role of controlling the regularity of operations, *contrôleur financiers* also carry out an advisory function. They thus report regularly to the Minister of Finance and give opinions upon all the financial projects of the ministry, including the preparation of the budget.³⁸⁵

The function of *le contrôleur financier* was introduced as early as in 1890 and gradually developed to modern times.³⁸⁶ The Minister of Finance has the authority to appoint the *contrôleur financier* in each public body and to have direct supervisory power upon them. In order to strengthen their independent position, the Law of the 21 of March 1947 provided that *contrôleur financier* could not be recruited from the Ministry they are situated at, but need to be brought from another public body or outside of the administration.³⁸⁷ Usually, *contrôleurs financiers* are experienced civil servants, without express political affinity, at the end of their career.³⁸⁸ Therefore *contrôleur financiers* are often perceived as alien elements imposed by the Ministry of Finance in order to strengthen the already existing framework of internal financial accountability established between *ordonnateur* and *comptable*.

The French internal financial accountability system firmly establishes the principle of incompatibility/segregation of functions between the *ordonnateur* and *comptable*.³⁸⁹ This principle ensures that the same person cannot at the same time make orders, verify deliveries and make payment. The principle of incompatibility therefore provides that the *comptable* does not report to the *ordonnateur*. He/she is empowered to reject any irregular payment orders issued by the *ordonnateur*. This principle is applied for both expenditure and revenue (since revenue assessment is separated from revenue collection). Subsequently, the *comptable* is responsible for communicating all transactions through the Treasury's accounts. In exceptional circumstances, however, the *ordonnateur* can

³⁸⁵ Cf. Normarton, op. cit. 92-93.

³⁸⁶ E. Devaux, op. cit., pp. 266-268.

³⁸⁷ Ibid.

³⁸⁸ The final status of *contrôleur financiers* has been regulated by a Decree of January 23, 1956.

³⁸⁹ Cf. J. Magnet, *Les comptables publics*, op. cit, p. 10.

impose a “requisition order” onto the “public accountant”, to authorise a payment order that the accountant had previously rejected. When this occurs, the requisition order is reported to the Cour by the Ministry of Finance and accountability shifts from the *comptable* to the *ordonnateur*.³⁹⁰ Although the principle of segregation of duties is a fundamental principle of French financial accountability, which has been further spread to other systems (such as the EU one, as will be discussed in the next chapter), it has recently been criticized for slowing down the introduction of costing procedures, separation of management from accounting and weakening managers’ awareness of overall budgetary performance.³⁹¹

When a relationship between the *comptable* and *contrôleur financier* is looked at more closely, it seems that the role of both actors correspond to the role which the UK Treasury performs in the UK. As pointed out in the previous chapter, one of the key principles of internal control in the UK is that no expenditure or commitments can be incurred without the approval of the Treasury. However, as we could see, in the UK model the Treasury is not able and does not want to control every detail of expenditure. Instead, it delegates the financial responsibilities to departments, while it concentrates only on potentially sensitive financial issues (increase of establishments, salary cost etc.). In contrast, the traditional French internal control model is highly centralised, emphasising a strong controlling role of the Ministry of Finance, exercised through *contrôleurs financiers* and *comptables*.

Another internal accountability mechanism in France is provided by operation of the General Inspectorate of Finance, based in the Ministry of Finance (*L’inspection Generale des Finances*). The Inspectorate was set up in 1816 and, as pointed out earlier, together with the Cour and the Conseil d’Etat, represents one of the three senior bodies of French administration, so called ‘Grands Corps de l’Etat’.³⁹² It has a staff of some 350 inspectors

³⁹⁰ S. Touchon, D. Tommasi, op. cit., 59-60.

³⁹¹ Ibid, p. 60.

³⁹² Its staff is normally recruited from the prestigious ENA.

who are authorised to make on the spot checks and access documents in ministries and any institution or enterprise that spends or receives public funds.³⁹³ The nature of their control is mainly preventive, as there are no real direct sanctions that the Inspectorate can impose. The report on performed control is, however, sent to the Finance Minister for information, and he alone can decide on eventual sanctions, as, for example, on the personal liability of the accountant or his/her suspension.³⁹⁴ It should also be pointed out that the General Inspectorate has gradually developed a role of a consultative body producing reports and audits of public bodies and public policies. Its reports can be made public and its recommendations about procedures or the performance of individuals are usually well received and accepted.

Gradual reform of the internal control framework

In spite of a satisfactory level of operation of the internal control structures in the French administration, the system of internal accountability can be criticised on several grounds.

The first obvious criticism may be directed towards numerous levels of financial control within the executive, which undoubtedly have an adverse effect on administrative flexibility in the use of the public funds. The existence of numerous levels of control and detailed regulation of available items of expenditure prescribed by budget expenditure items, do not leave enough flexibility for managers to use public money in the most efficient and effective way, but force them to move within a fairly restrictive legally defined framework. In such a system, values of compliance indeed dominate over the values of performance.

The second strand of criticism may be directed towards ambiguous accountability lines established between different control post actors. Although *ordonnateurs* are generally responsible for financial management of a public body, this responsibility is to quite an

³⁹³ E. Devaux, op. cit. 271-273; NAO, *State Audit in the European Union* op. cit, p. 90.

³⁹⁴ E. Devaux, *ibid.*

extent devolved to the financial *controlleurs* and *comptables*. Both actors, especially financial *controlleurs*, who actively control the *ordonnateurs* in their every day work, in this way assume considerable level of responsibility for financial management, which brings about a blurring of accountability lines within the organisation.

Third, it may be argued that within the concept of separation between the *ordonnateur* and the *comptable*, too much emphasis is placed on the role of *comptables*, who are personally liable for the proper execution of authorised payments and held to account for their operation before the Cour. Although the role of *comptables* is certainly important, it is also true that their overall involvement in the financial process is fairly technical and implementary, as they represent basically cashiers of an organisation they operate within. This is in contrast to the level of responsibility of the management of an organisation. And whereas *comptables* face continuous high level of scrutiny by the Cour, management of an organisation faces lesser amount of pressure, imposed primarily by the Court of Budgetary Discipline, which has not achieved great results in its work so far and does not enjoy the prestige of the Cour in the French administration. It is also true that *ordonnateurs* may also face criticisms presented in the annual or special reports of the Cour, but difficulties in following up the Cour's recommendations undermine the effects of such a scrutiny.

The LOLF has tried to address the weaknesses of the existing model primarily through providing more strength and flexibility to *ordonnateurs* in the use of the public money. The enlargement of budget appropriations through the introduction of programmes will allow for much more flexible management, as managers in charge of individual programmes will be able to freely reallocate appropriations between sub-programmes or types of expenditure. This will not only strengthen the role of *ordonnateurs*, but also substantively lessen the importance of the role of *controlleurs financiers*, whose *ex-ante* controls of expenditure will become redundant, due to significant enlargement of votes. Although the LOLF does not explicitly address this issue, the French Government is making plans for a gradual change of a function of *contrôleur financier* from *ex ante*

control to ex-post internal audit,³⁹⁵ which is in line with the existing models of internal accountability in the Anglo-Saxon world. In this way, the French model of internal control is, at least to some extent, moving towards the UK accounting officers model.

It is, however, interesting to note that the role of *comptables* has remained almost intact in the new legal framework, in spite of systemic changes in the public expenditure management. It does not seem very likely that this traditional role of *comptables* will change in the near or distant future. It even may be argued that the LOLF has strengthened the position of *comptables*, by pointing out that *comptables* responsible for keeping and drawing up their accounts need to ensure faithful accounting and compliance with procedures, especially in the view of the introduction of accrual accounting.³⁹⁶ This demonstrates that, in spite of the strong influence of New Public Management ideas based on performance logic and the doctrine of enhanced managerial freedoms, the French financial accountability system will not easily let go its traditional values based on primary respect for legal rules and compliance with established procedures.

Finally, in the light of strengthening the role of *ordonnateurs*, the question which naturally arises is how to ensure accountability for increased level of their responsibilities? As regards assurance of internal accountability, managers at different levels of public bodies will have to establish results (performance) indicators and target values, which will provide benchmarks for assessing their performance. Strengthening of external accountability mechanisms, on the other hand, can be achieved by two possible options. The first would be to enhance the effectiveness of the Court of Budgetary and Financial Discipline³⁹⁷ or to possibly allow the Cour des Comptes additional powers when dealing with senior officials. The second course of action would go towards substantial increase the role of the French Parliament in the scrutiny of the use of public

³⁹⁵ NAO, op. cit., p. 90.

³⁹⁶ Article 31 of the LOLF.

³⁹⁷ S. Thebault, "L'imperieuse reforme de la Cour de discipline budgetary et financiere", *Revue Francaise de Finances Publiques*, No. 75, Septembre 2001, pp. 171-185.

money. The French MPs have given quite a clear answer to this question, opting strongly for the latter option.

Enhancement of Parliamentary Accountability

Historical background

The right of Parliament to scrutinise public finances in France was established only at the beginning of the XIX century, following the development of a parliamentary system in France. The foundations of the Parliamentary control over finances were set up almost a century and half later than in Britain, during the period of Restoration (1814-30), often in an attempt to imitate well established practices that existed in the British Isles at that time (see Annex I).³⁹⁸ Thus, the Restoration law of 15 May 1818, for the first time stipulated the right of Parliament to pass two kinds of financial laws: *loi de finances*, which contains both envisaged revenues and expenditure of the Government for the next year, and *loi de reglement*, which comprises the consolidated government accounts (financial statements), prepared on the basis of the actual execution of the *loi de finances*, as an ex post control of government financial operations. At this time, this was of great political importance, since it enabled the Parliament to control the actions of the executive.³⁹⁹

During the III and IV Republics the means of control of Parliament over the executive were oscillating from rather strong position of the Parliament over the executive under the III republic and gradual lessening of its powers under the IV republic. Under the III Republic (1875-1940), Parliament was endowed with very real powers enabling it to influence the contents of the budget and thus control the Government. The debate on the

³⁹⁸ P. Lalumiere, "Parliamentary Control of the Budget in France", in D. Coombes et al., *The Power of the Purse*, (London George Allen & Unwin Ltd), 1976, pp. 126-127.

³⁹⁹ L. Saidj, "La loi de reglement et le deceloppement du controle parlementaire de la Restauration a nos jours", *Revue Francaise de Finances Publiques*, n 51, 1995, pp. 172-173.

proposed *loi de finances* allowed the Parliament to obtain extensive information about the policies of the government and to influence its activities in a desired direction.⁴⁰⁰ However, during the IV Republic Parliament was gradually losing its powers over finance, which resulted in further formal restrictions imposed after the establishment of the V Republic.⁴⁰¹

As pointed out earlier, the Constitution of the V Republic deliberately reduced the power of the Parliament, as a reaction to its omnipotence of previous times, which resulted in great instability of successive French Government cabinets. This has had a direct effect on the reduction of the Parliament's financial powers. Although the decline in Parliament's role arises from the provisions of the 1958 constitution, Parliament's 'power of the purse' was even more undermined by the 'organic' Constitutional Bylaw of 1959, earlier mentioned as the French "Financial Constitution".⁴⁰² The main problem with the 1959 'Financial Constitution' lay in its requirements that Parliament must either accept or reject the *loi de finances* as a whole without ever getting into details of its provision. The budgetary debate was actually limited only to the "new measures" to be introduced in individual ministries, which amounted to around 10% of the overall budget.⁴⁰³ This has deprived the Parliament of real powers of political control. Similar situation was to be found for the discussion on the consolidated government accounts, presented in the *loi de reglement*, which was not perceived as a genuine instrument for scrutinising the executive or bringing any additional power to the Parliament and therefore provoked an even lesser degree of interest of the French MPs.

Enhancing Parliamentary Scrutiny through UK recipe – creation of MEC

In the 1990s, due to growing international dialogue with other countries and within the EU, French parliamentarians have started to become increasingly aware of the need to

⁴⁰⁰ P. Lalumiere, *ibid.*

⁴⁰¹ *Ibid.*

⁴⁰² L'ordonnance N 59-2 du 2 janvier 1959, which ceased to be in effect from 1 January 2005.

⁴⁰³ F. Waintrop, C. Chol, *op. cit.*, p. 3.

introduce substantive changes in their system of parliamentary financial accountability. The first natural reaction of the French parliamentarians was to look up at the UK model of accountability to try to find solutions that would fit the existing restrictive legislative framework. Thus, in 1998, a parliamentary report on reforming scrutiny of financial legislation was produced, devoted considerable attention to a study of the House of Commons Public Account Committee (PAC).⁴⁰⁴ This led a year later to the establishment of a “Mission d’Evaluation et de Controle”, MEC, as a sub-committee of the Parliament’s Finance Committee, modelled on the UK PAC.⁴⁰⁵

The main objective of the MEC is to examine the cost effectiveness of public policies and to give the government the incentive needed to shift from efforts to accumulate resources to a culture based on spending results.⁴⁰⁶ In order to perform its tasks effectively, the French have introduced basic rules of operation of the UK PAC with some slight modifications.

The MEC is comprised of the members of both ruling party(ies) and opposition and relies in its work on the expertise of the Cour. Unlike the UK PAC, the composition of the MEC does not rest on the proportional representation of the political parties in the parliament. Instead, in order to minimise possibilities of partisanship, political parties have equal representation on the committee.⁴⁰⁷ Furthermore, the MEC is co-presided by

⁴⁰⁴ Assemblée Nationale, Groupe de travail sur l’efficacite de la depense publique et le controle parlementaire, Rapport, 1998. Cf. H.B. Street, “MPs Attitudes towards Scrutiny in Britain and France”, draft prepared for the ECPR workshop on the renewal of Parliaments, March 2002, Turin (permission to quote obtained from the author), p. 3.

⁴⁰⁵ Assemblée Nationale, *Rapport de la Commission des Finances, de l’Economie Generale et du Plan en conclusion des travaux d’une mission d’évaluation et de controle constituee le 3 fevrier 1999*, Repport, No. 1781, July 1999.

⁴⁰⁶ D. Migaud, “Des progres incontestables en droit et dans la pratique du controle parlementaire sous la XI legislature. La Mission d’évaluation et de controle: un exemple parmi d’autres”, *Revue Francaise de Finances Publiques*, No 77, 2002, pp. 47-54.

⁴⁰⁷ SIGMA papers 33: *Relations between Supreme Audit Institutions and Parliamentary Committees*, OECD/SIGMA, Paris, 2002, pp. 36-37.

the President of the Finance Committee or his/her representative, who comes from the majority party and one representative of the opposition parties. According to the initial agreement, the Cour pays close attention to work of the MEC and its representatives are continuously present at the MEC's meetings. Work of the Cour is thus perceived as one of the key elements for successful functioning of the Committee.⁴⁰⁸

The statute establishing the MEC stipulates that MEC members conduct their investigations not only on the basis of written evidence, which has been the case with the Finance Committee, but also can hold hearings of responsible administrators.⁴⁰⁹ This kind of examination requires again the assistance of the Cour in preparation of its hearings. MEC also cooperates in its work and communicates its findings to other parliamentary committees (especially the Financial Committee), so that all the institutionalised parliamentary bodies can be involved in the process of financial scrutiny.

The MEC examination methods have demonstrated the ambition of MEC to examine use of public funds on a regular basis, assessing not only the regularity of expenditure, but also efficiency and effectiveness of public spending. This has been proved by the majority of MEC's reports, in which questions of efficiency and effectiveness investigations occupy the most prominent place.⁴¹⁰ The MEC members have also ensured that their work is open towards media and the public and its reports regularly published and represented in the broadcasting media, which should facilitate effective follow up on its findings and recommendations.

⁴⁰⁸ J.D. Charpantier, "L'assistance de la Cour des Comptes au Parlement", (Institut d'Etudes Politiques de Grenoble Université Pierre Mendès France), 2000, pp. 173-175.

⁴⁰⁹ Ibid.

⁴¹⁰ For example cf. Assemblée Nationale, *Rapport d'Information par la Commission des Finances, de L'Economie Générale et du Plan en conclusions des travaux de la Mission d'évaluation et de contrôle (MEC) sur la gouvernance des Universités dans le contexte de la LOLF*, Rapport No. 3160, Juin 2006, all MEC reports are available at the website of the French National Assembly: <http://assemblee-nationale.fr>

Although the first years of MEC's operation have shown satisfactory results, serious challenges still remain to be faced. This is primarily due to overall attitude of the French Parliament which perceives itself mainly as a legislator and much less as a scrutiniser of Government activity, which does not provide a good environment for the MEC's work. The MEC has, naturally, still not achieved the prestige of the UK PAC and will need time to impose itself as an important guardian of public money. Furthermore, the cooperation between the MEC and the Cour has not been satisfactory, as will be pointed out in more detail later. Although there is no need that the Cour establish too close a relationship with the Parliament, modelled on the NAO/House of Commons, a high degree of cooperation will be necessary in order for MEC to function properly. Furthermore, it is very important for MEC to enhance collegial work within its membership in order to reduce possible political partisanship and be able to more effectively convey its findings both to the Parliament and citizens.⁴¹¹

Substantive reforms of parliamentary accountability through LOLF

The passage of the LOLF in 2001 (which made the earlier 1959 bylaw largely defunct) has substantively increased the role of the Parliament holding the executive accountable for the use of the public money. Under the new legal framework, MPs are given the right to make amendments to the budget framework, as they will now be able to reallocate appropriations between the various programmes which constitute a particular mission, in accordance with the Article 43 of the LOLF. Parliament will thus be playing a much more substantial role in outlining public finance expenditure strategy and setting priorities of policy objectives. In order to strengthen the link between budget execution and parliamentary authorisation, Parliament will also have the right to supervise the

⁴¹¹ Assemblée Nationale, *Rapport de la Commission des Finances, de l'Economie Generale et du Plan en conclusion des travaux d'une mission d'évaluation et de contrôle constituée le 20 décembre 2000*, Rapport No. 3664, 2002.

movements of appropriations, such as credit transfers, carry-overs to the next budget year, advances or cancellations or particular expenditure items.⁴¹²

The enhancement of Parliament's role in financial matters should also be improved by providing MPs with much better information on the overall economic, social and financial situation in the country at the time the *loi de finances* is discussed. Thus, the LOLF requires that the Government, in addition to the list of missions, programmes and performance indicators for the following year's *loi de finance*, provide Parliament with several reports: an analysis of economic, social, financial situation and outlook; a description of its economic and fiscal policy guidelines with regard to France's European commitment and medium term evaluation of the State's resources and charges broken down by main functions.⁴¹³ All this should enhance Parliament's understanding of the complex and comprehensive issues of Government finances.

It is important to note that the scrutinising role of the Parliament has also been very strongly emphasised in the LOLF. In accordance with Article 57, the Finance Committees of both Assemblies of the Parliament will have greater investigative and hearing powers. They will have the right to conduct on-the-spot investigations on particular matters and refer them to the Cour and other bodies as part of their control and assessment remit. Article 57 also explicitly requires public officials to attend the Committee's hearings, if requested by the Committee's chairman, in order to account for the results achieved with the resources allocated to them.⁴¹⁴ In this way, the current position of the MEC in making its own investigations and hearings will certainly be reinforced.

⁴¹² Ministère de l'Economie des Finances et de L'Industrie, *Budget Reform and State Modernisation in France*, available at www.minefi.gouv.fr

⁴¹³ Article 48 and Article 50 of the LOLF.

⁴¹⁴ Minister of the Economy, Finance and Industry et al, *The Performance-Based Approach: Strategy, Objectives, Indicators – A methodological guide for applying the Constitutional bylaw of August 1st 2001 on budget acts*, available at <http://www.minefi.gouv.fr/lolf>.

The first effects of the LOLF have been experienced through the adoption of the *loi de finances* for 2006, the first French budget based on the introduction of programme budgeting and with substantively reformed powers of the Parliament. As expected, the Parliamentary debate on the basis of the LOLF was much more substantial than in the previous years and have prompted a significant reaction of the French MPs, who have submitted around 1100 amendments to the *loi de finances* proposal, 400 being related to the revenue issues and around 700 regarding issues of expenditure.⁴¹⁵ The debate on the *loi de finances* was held over around 30 sessions of the Parliament (14 of them related only to issues of expenditure),⁴¹⁶ which provided room for detailed analysis of particular missions and definitely revived the Parliament's 'power of the purse' in France.

Whereas the first signs of the LOLF implementation have been encouraging (as regards the Parliamentary power to approve expenditure and revenue), it still remains to be seen whether the Parliament will have enough strength and capacity to effectively keep the executive to account for the effective implementation of the modernised expenditure framework. Attainment of true Parliamentary accountability will, of course, require much more than changing the legislation. It will definitely necessitate the change of culture in the French parliament from the legislative role towards strengthening its scrutinising role, which has been widely suppressed throughout decades in the fear of reestablishment of the fragile III French Republic.

Against such a background, it will be essential to further strengthen the role of the MEC in the overall accountability framework. It needs to be ensured that the MEC members are adequately trained to perform their investigative duties and to impose their work to members of Parliament as well as the wider public. In this sense, it would be helpful if the MEC would obtain the status of the standing Committee of the French Parliament,

⁴¹⁵ Assemblée Nationale, *Loi De Finances Pour 2006 (No 2540) Deuxieme parties, Amendments*, Available at http://assemblee-nationale.fr/12/pdf/amendments/adts_PLF2.pdf

⁴¹⁶ Assemblée Nationale, *Calendrier de la discussion en séance publique de la second partie du projet de loi de finances pour 2006*. http://www.assemblee-nationale.fr/12/dossiers/loi_finances_2006-calend2.asp

instead of its current status of the Financial Committee sub-committee, which has to some extent kept the operations of the MEC in the shadow of its Finance Committee big brother. Furthermore, it is essential to establish good working relations between the MEC and the Cour, which highly professional staff would be able to continuously provide the MEC with reliable information on the Government's financial performance. This, however, will not be such an easy task, as it may look at the first sight, the reasons of which will be examined in the next section.

La Cour des Comptes (The Cour) – a traditional guardian of the ‘public’ purse

Historical background

Similar to Britain, France has a long history of institutionalised scrutiny of public money. The oldest audit body established for the purpose of overseeing the royal receipts and payments dates back to 1190.⁴¹⁷ At the beginning of the XIV century the Royal Chambers of Accounts (*Chambres des comptes*) were established in most provinces. At that time the separation between financial control posts (*ordonnateurs* and *comptables*) also occurred.⁴¹⁸ The eighteenth-century crises of accountability resulting in the famous Revolution brought about abolition of the Royal Chambers. Following the principles of the 1789 Declaration of the rights man and the citizen,⁴¹⁹ two clear opposing tendencies appeared: one, which favoured the examination of the accounts by the National Assembly

⁴¹⁷ C. Deescheemaeker, *La Cour des Comptes*, (La Documentation Francaise, Paris), 1998, p.8-10.

⁴¹⁸ J. Magnet, *La Cour des Comptes les institutions associees et les chambers regionales des comptes*, op. cit, p. 29.

⁴¹⁹ As mentioned earlier, Article 14 of the Declaration of the Rights of Man and Citizen, 1791 proclaimed that “All citizens have the right to ascertain, either in person or through their representatives, the necessity for public taxation, to consent freely thereto, to observe its expenditure and to determine its apportionment, its assessment, its collection and its duration.”

Article 15 “Society has the right to require of every public agent an account of his administration”.

itself and another, which proposed the establishment of a body independent both from the legislative and executive power.⁴²⁰ The latter option undoubtedly prevailed.

It was not until the beginning of the 19th century that the auditing of public accounts was formalised by Napoleon I, who established the *Cour des Comptes* (the Cour) in 1807. After the Bourbon Restoration and consequently Orleanist monarchy the Cour started cooperating more closely with the Parliament, underpinning the legislative control of the budget. However, the Cour has never become a close ally of the representative body as is the case in Britain. Its essential characteristic is strong judicial independence, dedicated to a task of financial control, as the servant of neither the executive nor legislature, but only of “the nation”.⁴²¹

Article 47 of the French Constitution of 1958 proclaims that “The Cour assists Parliament and the Government in the control of the execution of *loi de finances*.” Constitutional establishment of the Cour demonstrates its high status and prestige in the French constitutional and institutional framework. Article 47 was amended in 1996 (Article 47-1), giving a basis for the Cour’s annual report on the yearly Social Security Finance Acts.

The structure and staffing of the Cour

According to the Law of 16th September 1807, the Cour was composed from “a Premier President, three Presidents, 28 *maitres des comptes, référendaires*, which number is established by the Government, one *procureur général* and one *greffier en chef*”.⁴²² Although the composition of the Cour has naturally been changing over the last two centuries, its main structure has remained the same to modern times. Thus, according to Article L. 112-1 of the Financial Courts Code (Code des juridictions financières) the

⁴²⁰ C. Deescheemaeker, *ibid*.

⁴²¹ E.L. Normanton, *The Accountability and Audit of Governments*, op. cit, p. 19.

⁴²² J. Magnet, *La Cour des Comptes les institutions associees et les chambers regionales des comptes*, op. cit. 73.

Cour is composed of “a Premier President, Presidents of chambers, *conseillers maitres*, *conseillers référendaires* and auditors.” The Cour is headed by a Premier President, who is appointed by the President of the Republic, and has significant management responsibilities as will be analysed further in the text. However, it should be noted that in spite of a relatively strong position of the President, the Cour in its essence is a body of a collegiate nature, as pointed out in the above legal provisions.

The Cour has quite a good system of career development of its staff. Auditors of the Cour are chosen from the best graduates of the prestigious *Ecole National d'Administration* and appointed by the President of the Republic. After several years of working experience and positively assessed work abilities, an auditor can be promoted to the post of *conseiller référendaire* and consequently to the post of *conseiller maître*. Their roles shall be examined in more detail later in the text. At this point, it is interesting to note that around two thirds of *conseillers maitres* have taken their positions after occupying one of the lower levels posts of the Court's hierarchy while one third comes from outside of the court (other civil service positions). Similarly, three quarters of the *conseillers référendaires* were previously auditors of the Cour while the remainder are generally selected from the wider civil service, particularly the Ministry of Finance. As the scope of performance is increasing, the Cour has shown interest in recruiting people with experience in social, scientific and industrial walks of life.⁴²³

It may be argued that the accumulating experience of the Cour's staff obtained outside of the Cour's work increases the Cour's appreciation of the practical management problems in the bodies they audit and increases their credibility with those subject to their examination.⁴²⁴ In addition, many magistrates have worked in the internal control environment of ministries, sometimes even as *comptables*, which surely enhances their expertise. Once appointed to a *chambre*, staff tend to stay within one area and build up considerable competence. Furthermore, magistrates are also encouraged to assume

⁴²³ C. Pollitt at al, op. cit., p. 61.

⁴²⁴ Ibid.

responsibilities in the wider public sector. It is thus, not an unusual practice for the magistrates of the Cour to leave the Cour and start a political career, or go to and work in the civil service and come back to the Cour at some later stage of their career.⁴²⁵ Therefore, it is often argued that the staff of the Cour and the civil service (especially the Ministry of Finance) represent a joint elite, sharing the same objective of stewardship of public money.⁴²⁶

Like all other French courts, the Cour is assisted by the *Parquet*, headed by Procureur Général (Chief Prosecutor), appointed by the Government. The key functions of the Procureur Général are internal coordination of the activities of the individual Chambers and external coordination between the Cour and other state bodies.⁴²⁷ One of his/her key roles in this sense is to ensure rendering of the accounts by the *comptables* and to follow up on the implementation of the findings and recommendations of the Cour, as will be discussed in more detail later.

The Cour is divided into seven chambers each headed by a *President de Chambre*, who is chosen by Government from among a list of *conseillers maîtres* prepared by the Premier President. Each chamber employs approximately thirty magistrates and examiners, together with specialised support of senior civil servants and engineers on secondment.⁴²⁸

Chambers of the Cour are quite independent in their work. After consultation with the Presidents of Chambers and a Procureur Général, the Premier President makes a formal decision on the work of each chamber.⁴²⁹ Presidents of Chambers further allocate tasks to

⁴²⁵ It is interesting to note that the President Chirac has started its career in the Cour.

⁴²⁶ I. Harden, F. White, K. Donnelly, "The Court of Auditors and Financial Control and Accountability in the European Community", *European Public Law*, Volume 1, issue 4, pp. 559-662.

⁴²⁷ Cf. website of the Cour des Comptes: <http://www.ccomptes.fr>

⁴²⁸ Ibid.

⁴²⁹ Since 12 September 1997, the work-load of the Cour has been distributed between the seven Chambers as follows: First chamber: Ministries and public bodies in charge of Finance and the Budget; Second chamber: Ministries and public bodies in charge of defence, industry, energy, foreign and domestic trade;

Chamber teams headed by a *conseiller maître*. It is important to note that each Chamber has total independence in establishing its findings on the accounts of the government departments and the associated governmental bodies within their sphere of operation. Each chamber proposes to the First President, on an entirely independent basis, an annual work programme and a medium term programme. On the basis of these proposals from the chambers, the Premier President decides on the annual programme of the Cour as a whole.

The Cour is very proud of its independence in deciding on its own programme and regarding its operation in general. As pointed out earlier, the Cour is not closely linked either with the Parliament or with the Government, but represents a prestigious judicial institution in its own right, being accountable directly to citizens.

This independent feature of the Cour, has, however, been seriously challenged by the adoption of the LOLF. Namely, in their desire to improve the role of the Parliament in the scrutiny of public money, MPs have introduced a provision in the LOLF (Article 58, paragraph 1) which requires the Cour to submit its annual working programme to the Parliament's Financial Committees (one of the National Assembly and one of the Senate) for their opinion.⁴³⁰ This provision has provoked serious protests from the Cour, which claimed that its independent status accorded by the Constitution was grotesquely violated. The story has got its epilogue in the decision of the *Council Constitutionnel*, which proclaimed the disputed provision unconstitutional, in violation of the Article 47 of the

Third chamber: Ministries and public bodies responsible for education, culture and research; the public broadcasting; Fourth chamber: Ministries and public bodies in charge of justice, interior, foreign affairs as well as appeals against rulings of the *Chambres Régionales des Comptes*; Fifth chamber: Ministries and other public bodies in charge of employment, Labour, professional training, housing and social affairs; charitable organisations; Sixth chamber: Ministries and other public bodies in charge of health and social security; social security bodies; Seventh chamber: Ministries and other public bodies in charge of infrastructure, transport and urban planning, agriculture and fishery, the environment and tourism.

⁴³⁰ B. Cieutat, "La Cour des comptes et la réforme", *Revue Française de Finances Publiques*, No. 76, Novembre 2001, pp. 107-122.

Constitution.⁴³¹ In this way, the Cour has won an important battle in securing its independence from the Parliament. However, it looks as if the war has not been yet won, as the Parliament is continuing to put increasing pressure on the Cour to respond to its requests and needs, as will be analysed in more depth later.

Institutional jurisdiction of the Cour

The Cour institutional jurisdiction is quite wide. Most of the Cour's institutional remit was established in a law passed in 1967, which provides for the audit of all ministries and public bodies. The audit of public enterprises and nationalised industries was added in 1976 when the bodies previously responsible for their audit were merged with the Cour.⁴³²

Institutional jurisdiction of the Cour can be mandatory or optional.⁴³³ Mandatory examinations are those where the Cour is the only body authorized by primary legislation⁴³⁴ to audit the accounts of the bodies concerned. *Code des Juridictions Financieres* (Code on Financial Jurisdiction) establishes general mandatory jurisdiction of the Cour over all central Government bodies: central government departments, ministries and agencies; *établissements publics nationaux*, semi-independent public

⁴³¹ Le Conseil constitutionnel decision no 2001-448 DC du 25 Juillet 2001.

⁴³² Thus, the Cour took on duties that had previously been allocated to the *Commission de vérification des comptes des entreprises publiques* (*The Nationalised Industries Accounts Commission*). The Commission was set up in 1948 to examine the accounts of public corporations and nationalised industries and audit their accounts, and was affiliated to the Court of Accounts. Cf. J. Bertucci, "Le droit de controle des juridictions financiers", *Revue Francaise de Finances Publiques*, No. 75 2001, 95-101.

⁴³³ Cf. the website of the Cour des Comptes, <http://www.ccomptes.fr>

⁴³⁴ Primarily by the Code on Financial Jurisdiction (Code des juridictions financieres) in which the laws and regulations about the Cour des Comptes and the 'chambres regionales des comptes' (regional chambers of audit) have been merged in. Courts mandatory jurisdiction is provided in the Articles L. 111-1, 111-3, 131-1, 133-1, 133-2.

bodies (*Autorité Administrative Indépendante* -AAI); since 1950, social security bodies; and, since 1976, public corporations and nationalised industries.⁴³⁵

The Cour has only optional jurisdiction over private bodies, as their accounts are audited regularly by other organisations and the examination of the Cour is only discretionary. However, involvement of the Cour in audit of these bodies is important, due to significant amounts of public money which may be invested in the work of these bodies. The organisations under which the Cour exercises only optional jurisdiction are:

- private sector companies where a majority of the voting rights or capital is held by one of the public sector bodies listed above, who are subject to the mandatory jurisdiction of the *Cour des Comptes*, or where such a public sector body has a decisive influence over decision-making and management within the company;
- private sector organisations (including the voluntary sector, charities and other non-profit organisations) which receive support from the public sector;
- charitable organisations funded by contributions from the general public (since 1991);
- organisations which receive funds from the European Union (Art. 45 of Act No. 96-314 of 12 April 1996).⁴³⁶

It is obvious that institutional jurisdiction of the Cour is rather wide. Such a broad remit of the Cour brings about comprehensiveness in the audit of public monies, defined in their broadest sense.

Functional jurisdiction of the Cour

The Cour is, at least in form, a court of law, whose primary task is to make judgement on accuracy and regularity of public accounts. Nowadays, however, the role of the Cour has

⁴³⁵ Article L. 111-1. of the *Code des juridictions financières*.

⁴³⁶ Cf. the website of the Cour des Comptes, <http://www.ccomptes.fr>

evolved towards an audit body which performs a much wider scope of activities than judging the accounts. In fact, the Cour's judicial powers have gradually been weakened and delegated to other institutions,⁴³⁷ and its 'accessory' role as an auditor of financial management of public funds has been significantly strengthened.

Evolution of the Cour can easily be followed through legislation which regulates its material jurisdiction. Material jurisdiction of the Cour has for a long time been defined by the Law of 16 September 1807, which laid down two distinct roles for the Court: principal and accessory. The principal role of the Cour was stipulated by Article 11, which provided for the Cour the right and duty to judge the enumerated public accounts. The second, accessory, or extra-judicial role of the Cour was stipulated by Article 16 which provided for the Cour the role of examining financial irregularities that it has discovered during the control of the accounts and consequently presenting them in an annual report containing general observations from the examination of the accounts (Article 22).⁴³⁸

It should be noted that although judicial and extra-judicial functions of the Court seem to be distinct, they are not necessarily separate. Thus, while exercising its judicial function, the Court naturally examines the regularity of the procedures which the administration employs in its everyday work and subsequently reports on its findings. Unlike in the British system where controls of financial audit and value for money audit are separated both substantially and organisationally, in the French system all kinds of control are exercised simultaneously. Reporters are thus obliged to devote equal attention to all the aspects of financial control and management.⁴³⁹

⁴³⁷ Thus, as a result of decentralization reforms in 1983 some of the Cour's competences were transferred to regional audit bodies (*chambres régionales des comptes*).⁴³⁷ On the other hand, the highest administrative court, the Conseil d'Etat has overtaken its role of imposing fines on accountants and has become a Court of Cassation for the decisions of the Cour.

⁴³⁸ J. Magnet, *La Cour des Comptes les institutions associees et les chambers regionales des comptes*, op. cit., pp. 73-74.

⁴³⁹ C. Descheemaeker, op. cit., pp. 61-62.

Depending on the nature of the audited bodies in question (whether they fall under the Cour's mandatory or optional jurisdiction), the Cour performs its control in a slightly different manner:

- 1) for bodies under the public accounting rules regime (falling under the mandatory audit), the Cour exercises both judicial and extra-judicial functions;
- 2) for bodies under the private accountancy regime (optional audit of the Cour) the Cour does not have authority to exercise its judicial functions and therefore exercises only extra-judicial powers, communicating its findings to the audited bodies and provides different kind of reports.⁴⁴⁰

Although the Cour does not distinguish operationally and organisationally between regularity and financial management audit, we shall examine Cour's distinct roles in more detail separately, hoping to provide more clarity in the Cour's complex audit remit. In addition to the role of the Cour as a judge of accounts and as an auditor of financial management, we shall also separately examine the new role the Cour obtained under the LOLF, which could be described as assistance to Parliament.

The Cour as a judge

The judicial function of the Cour is usually expressed in the following definition: "*La Cour juge les comptes et non les comptables* [The Cour judges the accounts and not the accountants]." This definition was originally designed to express limitations of the competence of the judge of the accounts, but has been abusively extended to the

⁴⁴⁰ Ibid.

definition of its jurisdiction, as there have been many misunderstandings concerning this issue.⁴⁴¹

On the one hand, the phrase that the Cour is judging the accounts means that it judges the regularity of financial operations. However, as the Cour cannot annul irregular operations or correct the accounts that have been rendered, this statement does not accurately depict reality. On the other hand, the statement that the Cour cannot judge the *comptable* is not completely true, it is contrary to the law of 1807 (Article 13), which provides that the Cour definitely establishes with its judgment on whether *comptables* have done their work accurately/regularly, or have surplus or are in arrears. In the first two cases the Cour will discharge the *comptables*, and in the third one, it will sentence the *comptables* to settle their arrears.⁴⁴² Thus, by necessity, when the Cour is making a judgment on accounts, it also makes a judgment on *comptables* as well, especially in the case when the Cour sanctions the *comptables*. Such a judgment is not simply a declaratory statement, but represents a legally enforceable act against a *comptable*.⁴⁴³ This is in contrast with the UK system of financial audit where the NAO just provides a clear or a qualified opinion on the accounts. The NAO's opinion on the accounts is a simple declaratory statement that does not imply any personal liability of the person who prepared these accounts.

In this sense, it is important to point out that the Cour does not base its judgment solely on the material elements of the case, but takes into account any personal circumstances that could justify one's behaviour, such as, for example existence of *vis maior*, which may justify the action of the accountant and thus discharge him/her of his/her responsibility. The best interpretation of this issue has been given by the Cour itself. It thus states:

⁴⁴¹ J. Magnet, "Que juge le juge des comptes?" *Revue Française de Finances Publiques*, 1989, no. 28, pp. 115-124.

⁴⁴² J. Magnet, *La Cour des Comptes les institutions associées et les chambres régionales des comptes*, op. cit., pp. 147-148.

⁴⁴³ Ibid.

“The task/mission of the judge charged with checking the regularity of the accounts is to understand the responsibility of the comptable and his position, in the view of the whole situation of the accounts.”⁴⁴⁴

Therefore, if the judge finds that a *comptable* is in arrears and that there is no good justification for his/her behaviour (such as e.g. *vis maior*), the judge will establish personal financial liability of the accountant (law of 23 February 1963, Article 60-VI) in its judgment, which will be enforced against the *comptable*.⁴⁴⁵ All judgments emanating from auditing the accounts are also communicated to the Minister, in order to avoid repetition of errors. In 2004, the Cour made 333 judgments on the accounts of the *comptables*.⁴⁴⁶

It should be noted that the Cour does not only judge accounts kept by ‘official’ *comptables*, but also examines the accounts of any person who has improperly become involved in handling public monies. In this case, the Cour can declare the existence of *gestion de fait* (de facto management). If the person is found to be a *de facto* public accountant, it consequently becomes subject to the same obligations and formal legal responsibilities as a *comptable*.⁴⁴⁷

The Cour as an auditor of financial management

Since its very establishment, the Cour has been authorized to exercise its powers only towards *comptables*, who were held personally and financially responsible for use of public money, while the ministers and higher officials qualified to order payments (*ordonnateurs*) were exempted from any form of accountability. Napoleon’s 1807 law was quite explicit in this respect. Thus, Article 18 of the 1807 Act prescribed that: “The

⁴⁴⁴ Cour des Comptes, 10 August 1880, commune de Frasne (Doubs), p. 8.

⁴⁴⁵ J. Magnet, *La Cour des Comptes les institutions associees et les chambers regionales des comptes*, op. cit., 191-194.

⁴⁴⁶ NAO report, op. cit. p. 94.

⁴⁴⁷ Cf. J. Magnet, “La regularisation de la gestion de fait”, *Revue Francaise de Finances Publiques*, No. 66, 1999; R. Hertzog, “La necessaire reforme de la procedure de gestion de fait”, *Revue Francaise de Finances Publiques*, No. 66, 1999. C. Descheemaeker, *La Cour des comptes*, op. cit. 119-133.

Cour may not, in any case whatever, claim any jurisdiction over *ordonnateurs*”.⁴⁴⁸ This prohibition can be interpreted as a clear wish of the executive to protect its absolutist executive power. It may be argued that it is due to this legal situation that the indirect control, through the public accountants, was evolved and encouraged by the Cour.⁴⁴⁹

It is interesting to note that the Cour is still not authorized to judge elected officials or civil servants entitled to order payments and receipt of public moneys. As mentioned earlier, enforcement of personal responsibility for *ordonnateurs* was instead given to a new body, the Court of Budgetary Discipline, founded in 1948.⁴⁵⁰ However, since it is far more difficult to impose personal responsibilities upon administrators than upon cashiers, additional ways of imposing accountability towards *ordonnateurs* were sought. One of the ways of putting pressure on *ordonnateurs* was to give the Cour the right to examine their performance, i.e. efficiency and efficacy of the use of public funds. Thus, the Law of 22 June 1967 introduced a new role for the Cour, which is defined in the current Article L 111-3 of the Code on Financial Jurisdiction which provides that the Cour is to “ascertain the good use of public funds” (*'bon emploi des fonds'*), and that it shall verify the accounts and management of public enterprises (Article III-4). These provisions have provided a basis for examination of value-for-money aspects of financial management, as pointed out earlier in the course of discussion on the concept of stewardship of public money. In this way, the Cour has indirectly started reviewing the work of elected officials and civil servants entitled to authorize payments. The Cour performs this role either during its examination of the accounts of government departments and other State bodies produced by the public accountant, or by directly reviewing the work of *ordonnateur*.

It is difficult to estimate the share of performance audit in overall work of the Cour, since the Cour’s investigations generally combine judiciary work and financial management

⁴⁴⁸ C. Descheemaeker, op. cit. 119-133.

⁴⁴⁹ Ibid.

⁴⁵⁰ J. Magnet, *La Cour des Comptes les institutions associees et les chambers regionales des comptes*, op. cit., 313-329.

audit. However, according to some estimates, two-thirds of the resources of the Cour are nowadays devoted to the audit of financial management or performance.⁴⁵¹

Within the Cour, performance audit is carried out by each chamber. Thus, each chamber selects topics for performance audit, on the basis of the annual plan and in accordance with level of public interest, possible risks involved and experience of the concerned area.⁴⁵² After the subjects of the audit have been determined by the chamber, the process of planning of the work commences, in accordance with the detailed rules of the decision-making process of the Cour.

The rules of the decision-making process

The decision-making process of the Cour in both judicial proceedings and financial management audit (as they are performed together) can briefly be described as follows. The audit is performed by an auditor, who carries out his audit alone and remains free to express his/her own opinion on the accounts, even if he is part of a team.⁴⁵³ After finalisation of the initial version of report, an auditor submits his/her work to a *conseiller maître* (contrerapporteur). The role of the *conseiller maître* is to study the report together with all supporting documents and to submit his/her assessment of the report to the committee of other *conseillers maîtres* of the chamber. The reporter's report and the *conseiller maîtres* remarks are given to the members of the chamber, which can require that more details on the report are provided. This review considers all the aspects of the report: its scope, methodology, findings and conclusions.⁴⁵⁴ After thorough examination, the members of the chamber collegially decide if they will accept the report. All the members of the chamber vote for the report, except for the reporters, who are usually not allowed to vote. In order to avoid influence of the older magistrates, younger magistrates

⁴⁵¹ NAO report, op. cit, p. 94.

⁴⁵² Ibid.

⁴⁵³ Article 22 of the Decree 11 February 1985.

⁴⁵⁴ Cf. website of the Cour, <http://www.ccomptes.fr>

vote first, while the president of the chamber votes last. In the case of a balance of votes, a president's vote is decisive.⁴⁵⁵

The following phase of the procedure is based on the right of reply. In the case of judicial proceedings the results of the collegial hearing are forwarded as an interim ruling to the *comptable*, who is then required to submit a formal response. In the case of audit of financial management, an audit report is sent to the auditee, who is required to comment on the report. Only after submission of an *comptable*/auditee's formal response is the Cour allowed to reach the verdict/adopt the final report.⁴⁵⁶ In the case of financial management reports, the Cour generally attempts to obtain an agreement with the auditee on the substance of the report. However, if no agreement between them is reached, the Cour will annex the auditee's comments to the Report and publish it all together.⁴⁵⁷

The decision-making process of the Cour undoubtedly has many advantages, which are primarily based on the right of reply and collegiality of decision-making. The right of reply protects the democratic value of providing an auditee the opportunity to express his/her view on the alleged irregularities. Collegiality of the decision-making, on the other hand, undoubtedly contributes to the high quality of decision-making. Two key control mechanisms – cross-examination by the *conseiller maître*, in the first instance and collective examination of the chamber in the second, certainly add to the high level standards of the Cour's reports. In this way the experience of other experts in the field is widely used and quality of the final decisions secured.

After the completion of judicial decision-making process, a *comptable* does not have the right to appeal against the decisions of the Cour. Nevertheless, there are two

⁴⁵⁵ J. Magnet, op. cit. p. 110.

⁴⁵⁶ In the case of a production of a report, a Chamber also needs to approve that revisions to the report are made following the organisation's comments. Cf. website of the Cour des comptes, <http://www.ccomptes.fr>

⁴⁵⁷ For example, in the case of the Cour's report on museums and collections (1997), the commentaries were almost half as long as the text produced by the Cour itself (Cour des Comptes, 1997).

extraordinary remedies which can be used to challenge the judgments of the Cour: revision and cassation.⁴⁵⁸

Revision is based on allegations of errors of fact, in which case the Cour is the competent body to decide on it. The basis for revision are thus the facts which could not have been known to the judge when he made the judgment (e.g. new circumstances, facts - additional facts). The revision proceedings can be initiated on the request of the accountant, or the Procureur Général, the Minister of Finance, other relevant Ministry or legal representative of other public bodies.⁴⁵⁹

The case for cassation, on the other hand, can be based only on breach of the rules of the first instance procedure. Reasons for cassation could thus be lack of competence and/or misuse of power. A request for cassation is submitted to the *Conseil d'Etat*, which is the Court of cassation for the decisions of the Cour. However, it should be noted that cassations are very rare and those who succeed are even rarer. From 1807 to 1995, 67 requests were introduced, and only 19 were accepted.⁴⁶⁰

Follow up on the audit process

After the completion of an overall audit process, the Cour has to communicate its general financial audit or performance audit findings to the public bodies that have undergone the audit process. There are several different types of communication between the Cour and audited bodies, depending on the seriousness of financial management issue and the rank of addressee. Less significant problem issues are communicated through letters of presidents of the chambers to directors of the audited bodies (Article 35 of the Decree 20 September 1968). Furthermore, usual correspondence between the Cour and audited bodies goes through the *Procureur Général* (Article 4 of the Decree 11 February 1985).

⁴⁵⁸ J. Magnet, *La Cour des Comptes les institutions associees et les chambers regionales des comptes*, op. cit. pp. 273-280.

⁴⁵⁹ Ibid.

⁴⁶⁰ Ibid.

The *Procureur Général* issues notes, in which he lists irregularities and suggests ways to improve them. The addressees are obliged to provide an answer to the note, but are not generally obliged to apply the proposed recommendations.⁴⁶¹ More serious, especially recurrent financial management irregularities, are in charge of the *Premier Président* of the Cour (Article L 135-1).⁴⁶² Following the general procedure, the *Premier Président* sends the *référé* containing the overview of the findings together with recommendations for improvement to a minister. The Minister is obliged to give his/her reply in the period of six month. If the Cour does not receive a satisfactory answer within that time, it sends the *référés* to Parliament.⁴⁶³

It is interesting to note that most of the Cour's audit work is not published nor distributed to the broader audience.⁴⁶⁴ Although this may raise concerns for the transparency of the operation of the Cour and the executive, it seems to be in line with the modern trends that external audit institutions should move away from the pecuniary, sanctioning function they exercised during past centuries and instead work on development of their advisory and partnership function with the Government. This also corresponds to the emerging advisory function of the NAO, which, as we could see in the previous chapter, communicates its numerous findings through management letters directed solely to the executive, without any interference on the side of the PAC. However, it is very important to find a balance in this advisory exercise, as the democratic nature of modern external audit institutions requires that findings of the audit, especially those addressing serious systematic flaws, be disseminated to the Parliament and the general public.

⁴⁶¹ J. Magnet, *La Cour des Comptes les institutions associées et les chambres régionales des comptes*, op. cit. p. 137.

⁴⁶² On average seven hundred reports are produced every year, all of which involve correspondence with the audited body's parent organisation and its senior managers. Around two hundred letters from the *Procureur General* are sent to departmental heads and directors, while around three hundred letters are signed by the *Presidents* of the seven Chambers. Cf. website of the Cour, <http://www.ccomptes.fr>

⁴⁶³ Thus, Article 135-5 of the Code provides the possibility for the Cour to communicate its findings to Finance Commission of the Parliament.

⁴⁶⁴ C. Pollitt et al, op. cit. 181.

Public Annual Reports of the Cour represent an important means of direct communication between the Cour and the public. The significance of the Public Annual Reports is established by Article L. 136 of the Code, which provides that: “The Cour informs the President of the Republic and Parliament of its audit findings in an annual report”. It is the responsibility of the Premier Président to ensure that its drafting and presentation are satisfactory. Although Public Reports generally contain extracts from other unpublished audit reports, they often address complex financial management issues, which, in Cour’s opinion, require substantive reforms, underpinned by changes of legislation and regulations.⁴⁶⁵ Implementation of such reforms undoubtedly necessitates strong public support and Parliamentary support in order to be properly followed up.

Recommendations of financial management audits can also be presented in special studies, concerned with specific, mainly performance issues (*rappports publics particuliers*).⁴⁶⁶ These reports basically correspond to the NAO’s value for money studies. Since 1991 the Cour has published two or three reports a year on specific performance matters.⁴⁶⁷ The reports are addressed to the Ministers concerned, to the head of the audited body, or to the appropriate legal authorities. Copies of the report are also sent to the President of the Republic and Parliament. The *rappports publics particuliers* are also sent to newspapers and receive considerable attention in the media.

However, it seems difficult to assess the Cour’s influence on the audited bodies. This is primarily the corollary of the Cour’s huge confidential correspondence with auditees and the fact that it publishes only a small section of its overall work. Unlike the majority of its counterparts in other countries, the Cour does not systematically survey the implementation of recommendations arising from its work which makes any impact

⁴⁶⁵ Ibid.

⁴⁶⁶ The Cour has been authorized by the Council of Ministers decision of 1991 to conduct specific public reports. Cf. C. Pollitt at al, op. cit., p. 154.

⁴⁶⁷ The Cour’s reports could be found on the Cour’s website, <http://www.ccomptes.fr>

evaluation difficult. In recent years, however, the Cour has included in its Annual Public Report details of the follow-up of previous evaluations, which are occasionally publicly cited.⁴⁶⁸ However, this is far from the practice of regular accounting and publication of overall impact indicators, exercised on the regular basis by most of other Supreme Audit Institutions in Europe.⁴⁶⁹

The need for more effective follow-up of the Cour's recommendations has, in recent years, attempted to be addressed through the establishment of a closer working relationship between the Cour and the Parliament. As pointed out in the previous sections, the LOLF has provided the Parliament with much stronger means of holding the executive to account, through various instruments it accorded to the Parliamentary Finance Committees (MEC), modelled on the UK example of NAO/PAC. It is expected that such cooperation will be able to address the existing weaknesses in the follow up of the Cour's recommendation and provide a synergy of action directed towards holding the managers of public bodies strongly to account for their organisation's financial performance. In this sense, it could be argued that the Cour is moving away from its strictly independent position from the Government and Parliament and is becoming more and more an assistant of the Parliament. This contention certainly deserves to be addressed in the final section of this chapter.

The emerging role of the Cour - an assistant to the Parliament?

Although it may look as if the LOLF has not been able to introduce any changes in the traditional operation of the Cour, this has not been the case. Not surprisingly, the MPs have addressed the need for a changing the role of the Cour, pointing out two major aspects of reform. The first is a requirement that the Cour more actively respond to the

⁴⁶⁸ For example, in 1997, *Premier President* introduced the annual report to the members of Parliament pointing out different cases of Cour's impact on the audited bodies. Cf. C. Pollitte, op. cit. p. 181.

⁴⁶⁹ C. Pollitt, H. Summa, "Reflective Watchdogs? How Supreme Audit Institutions Account for themselves", *Public Administration*, Vol. 75, summer 1997, pp. 313-336.

requests of the Parliament in carrying out its audits. The second is an obligation of the Cour to provide MPs with additional sources of information on execution of the new budgetary framework, especially on the state of the Government accounts.

The LOLF has defined the need for a more proactive assistance of the Cour to the Parliament in scrutinising the implementation of the *loi de finances* through the following requirements:

- 1) the obligation of the Cour to respond to assistance requests from the chairman and the general rapporteur of each assembly's finance committee for the audit and evaluation mission (MEC);⁴⁷⁰
- 2) the obligation of the Cour to carry out any investigation requested by the National Assembly and Senate financial committees on the managements of agencies or bodies it supervises. The conclusions of these investigations must be communicated within eight months of the formulation of the request to the committee issuing the request, which rules on their publication.⁴⁷¹

In spite of a clearly defined legal framework, the cooperation between the Parliament and the Cour is not functioning well. This should perhaps not been surprising as these provisions of the LOLF do infringe the Cour's independence in defining its own work, which has been the traditional feature of this prestigious institution. In order to 'defend' its independence, the Cour has consistently refused to respond to Parliamentary request for carrying out specific investigations. This has provoked strong reaction from the MP's and especially the President of a Finance Committee (who is at the same time the President of MEC) who have characterised the Cour's refusals for cooperation as 'shocking'.⁴⁷² It is further argued that although the Cour should certainly have

⁴⁷⁰ Article 58, paragraph 1 of the LOLF.

⁴⁷¹ Article 58, paragraph 2 of the LOLF.

⁴⁷² Cf. Assemble Nationale, "Rapport d'Information par la Commission des Finances, de l'Economie General et du plan sur le suivi de preconisations de la Cour des comptes et de la Mission e'evaluation et de controle," Report No. 2298, of May 2005., available at <http://assemblee-nationale.fr>, p. 61.

independence in carrying out its duties, this independence must have its limits, especially in relation to an institution of democratic audit, such as the Parliament. In the President's own words: "The democracy requests the controllers also to be sometimes controlled".⁴⁷³

The adversarial relation between the Parliament and the Cour is certainly not a good sign for the future development of the French financial accountability system. Clearly, contrary to the presupposed intention of the LOLF to develop strong working relations between the Cour and the Parliament, the opposite is happening at the moment, which may have an adverse effect on both functioning of the Parliament as a scrutiniser of the executive's behaviour and the Cour's ability to follow up on its recommendations. Therefore, we again reiterate the need for establishment of a more cordial relationship between the Cour and the Parliament in their day-to-day work.

As regards the second sets of obligations of the Cour towards the Parliament, the LOLF further requires the Cour to provide the Parliament with three annual reports: the preliminary report on developments in the national economy and public finance trends,⁴⁷⁴ (which is to assist the Government to prepare for the Parliamentary discussion on the *loi de finances* for the next year)⁴⁷⁵; the report regarding the consolidated financial statements of the Government, which in particular, analyses the utilisation of appropriations by mission and by programme; and report on certification that the State's accounts are lawful, faithful and present a true and fair view.⁴⁷⁶ This certification will be annexed to the *loi de reglement* (law on consolidated Government accounts) and will be accompanied by the report on the audits conducted.⁴⁷⁷

Whereas the request for presenting the first two kinds of annual reports is obviously in line with the desire to enhance the role of the Parliament in holding the executive to

⁴⁷³ Ibid.

⁴⁷⁴ Article 58 paragraph 4 of the LOLF.

⁴⁷⁵ Article 48 of the LOLF.

⁴⁷⁶ Article 58, paragraph 6 of the LOLF.

⁴⁷⁷ Article 58, paragraph 5 of the LOLF.

account for better financial performance, one may wonder what is the logic behind requesting the Cour to provide the certification/assurance that the Government accounts present a fair view. This requirement may seem a bit surprising, as the Cour has lately not experienced any significant problems with respect to accuracy of the public accounts. It is interesting to note that the concept of provision of certification/assurance of the accuracy and fairness of accounts has for some time been present in the framework of the EU financial management, as will be analysed in more detail in the next chapter. The European Court of Auditors has for the last 11 years been request to provide statement of assurance (*déclaration d'assurance-DAS*) on reliability of the EU accounts and its underlying transactions. This is one of example of how EU concepts and instruments affect areas of traditional national competence. However, whereas the reasons for the introduction of the DAS in the EU system stem from complexities and weaknesses of the EU financial accountability framework, the logic behind the introduction of certification in the French system is certainly different.

Reasons for requiring the Cour to produce certification of the accounts become quite apparent when one takes into account the LOLF's intention to introduce resource accounting in the French Government. Introduction of resource accounting, as a part of overall changes introduced by the LOLF, represents a big challenge to the French Government, as faithful representation of transactions and events under the resource accounting requirements will be much more complex and demanding. Although the budget of 2006 has elements of resource accounting, the transition towards the introduction of a true accrual accounting is a long-term project and will take at least another 5 years to be fully successfully implemented.⁴⁷⁸ This will require lots of efforts on the side of *comptables*, but also on their management.

Furthermore, it may be argued that the imposed request to the Cour to carry out certification of the accounts may have a much deeper meaning than it may look at first

⁴⁷⁸ International Federation of Accountants, "The Modernisation of Government Accounting in France: the current situation, the issues, the outlook, January 2003", available at <http://www.ifac.org>

sight. Although the concept of the certification itself is not fully clear, it does imply a sort of technical examination of the accounts, rather than deciding on a personal responsibility of accounts.⁴⁷⁹ And although elements of personal responsibility of accountants are still very much present in the French system and not denied in the LOLF, requesting the Cour certify the accounts will certainly enhance the Cour's already existing advisory role. In this way, the Cour should be further moving away from its sanctioning role and become an important Government (and hopefully Parliament's) advisor.

Conclusion

This chapter provides a very clear example on how a national financial accountability system can be reformed in a relatively short period of time under increasing inside and outside pressure. The introduction of LOLF in 2001 has made quite a revolution in the financial operations of the French Government, putting in place a completely new legislative framework for the operation of financial accountability in France.

The strengthening of the role of the Parliament, through enhancement of its powers to decide on the allocation of expenditure as well as to scrutinise its implementation through specialised Parliamentary Committees (MEC), demonstrates the recognition of all French authorities of the importance of democratic financial accountability mechanisms. However, the relations between the key guardian institutions of financial accountability, the Parliament and the Cour are still not functioning well, which may have an adverse affect on the effectiveness of the overall financial accountability system. Therefore, it will be important to work on establishing better working relations between different financial accountability actors.

This analysis of reform of financial accountability system in France also demonstrates that, in spite of strong influence of New Public Management ideas based on performance

⁴⁷⁹ P. J-R. Alventosa, "La nouveau role de la Cour des comptes," *ENA mensuel*, June 2002, No. 322, pp. 9-11.

logic and the doctrine of enhanced managerial freedoms, the French financial accountability system will not let go easily its traditional values based on primary respect for legal rules and compliance with established procedures. But it could, perhaps, provide an affirmative example on how traditional values of compliance could be well coupled with modern ideas of performance.

Chapter IV

Financial Accountability in the EU

This chapter shall examine financial accountability at the supranational level of the EU. Following the structure of the previous chapters, we shall first analyse the key supranational accountor of the EU level – EU institutions. We shall then examine the concept of stewardship of public money in the EU. Significant attention shall again be placed on both internal and external financial accountability mechanisms that operate at the EU level.

Furthermore, in this chapter we shall attempt to comprehend the nature of financial accountability at the supra-national level of the European Union. There is no doubt that the establishment of a democratic financial accountability, in the most general sense of a relationship between the EU citizens and EU institutions, is even more complex than at the national level. This is primarily because the EU expenditure is managed largely by the Member States and only in small part by the Commission and other EU institutions. In order to be able to comprehend the financial accountability relationship in the EU context we will have to comprehend the nature of the EU itself. Therefore we shall discuss the main theories attempting to explain the nature of the EU integration and its basic features. This will provide us with a basis for drawing general conclusions on the nature of the financial accountability relationship.

Finally, the focus of our attention shall be laid on the requirements for the acceding countries in the area of financial accountability. We shall especially focus on the EU basic standards in the area of internal financial control and standards related to external audit and the protection of the EU financial interests.

Unique Supranational Financial Accountability Accountor - EU institutions

The EU has an exceptional governmental structure, which at first sight resembles that of a national system. The EU has a Council, a Commission, a Parliament, and a Court of Justice, institutions which, on the surface, correspond to a national government's executive, legislature and judiciary. Although there are certain elements of similarity, they may be quite misleading. Thus, the Council consists of Member States' government ministers and instead of executive function, mainly performs the legislative one. This legislative function is shared with the directly elected Parliament, whose functions are therefore much more limited than in the national contexts. It may be argued that only the European Court of Justice, consisting of judges appointed by the Member States, approximates to its national counterpart.⁴⁸⁰

The Council of the European Union - formerly known as the Council of Ministers - is the main legislative and decision-making body in the EU. It brings together the representatives of the Member State governments, which are elected at national level. It is the forum in which the representatives of national governments can assert their interests and reach compromises. They meet regularly at the level of working groups, ambassadors and ministers. The European Council which decides major policy guidelines is composed of Heads of State or Government.⁴⁸¹

The European Parliament is intended to represent the peoples of the Community. The members of the European Parliament were for a long time selected by the national legislatures and it was only in 1976 that agreement was reached on direct elections. The European Parliament (EP) is now directly elected every five years and attempts to provide the democratic voice of the peoples of Europe.

The Council and the European Parliament set the rules for all the activities of the European Community (EC), which forms the first "pillar" of the EU. It covers the single

⁴⁸⁰ D. Dinan, *Ever Closer Union, An Introduction to European Integration*, Macmillan, 1999, pp. 205-229.

⁴⁸¹ www.europa.eu.int

market and most of the EU's common policies, and guarantees freedom of movement for goods, persons, services and capital. They also share competence in EU budget issues. In addition, the Council is the main institution responsible for the second and third "pillars", i.e. intergovernmental cooperation on common foreign and security policy and on justice and home affairs.⁴⁸²

The key executive organ of the Community is the European Commission, which has no analogue in national governmental systems. Although the Commission members are appointed by national governments, they must be approved by the Parliament and are pledged to act in the EU's interests. The Commission has exclusive right to initiate legislation in the first pillar, makes sure that EU decisions are properly implemented and supervises the way EU funds are spent. It also makes sure that everyone abides by the European treaties and European law.⁴⁸³ Assisted by around 24000 multinational civil servants, the Commission lies at the heart of the EU supranational system.⁴⁸⁴

The Commission consists of a number of Directorates General (DGs), which resemble the structure and functions of national ministries. Although no formal hierarchy exists within the Commission's services, it may be argued that the DGs which are directly involved in policy development enjoy more prestige than those which are primarily concerned with policy implementation or with horizontal activities such as financial coordination.⁴⁸⁵ Each Directorate General is headed by a Director General, who is responsible to the relevant Commissioner. There are also a number of specialized services, such as the Legal service, which gives legal advice to all Directorates General and represents the Commission in legal proceedings.⁴⁸⁶

⁴⁸² www.europa.eu.int

⁴⁸³ T.C. Hartley, *The Foundations of European Community Law*, Clarendon Press Oxford, 1999, pp. 12-17.

⁴⁸⁴ D. Dinan, *ibid.*

⁴⁸⁵ N. Nugent, "At the Heart of the Union", in N. Nugent, *At the Heart of the Union*, (London: Macmillan) 1997, pp. 1-26.

⁴⁸⁶ *Ibid.*

In addition to the above institutions, the EU has a number of other institutions and supporting bodies, such as: the European Court of Justice, the European Economic and Social Committee, Committee of the Regions, European Central Bank, European Investment Bank and European Ombudsman. The EU also has a Court of Auditors (hereinafter ECA), which has a special importance for our financial accountability research and will be examined in greater detail later.

It should be pointed out that the EU institutions operate in a fairly diverse and dynamic multicultural and multinational environment. Such an environment is much more unstable than the national one, given the frequency of Treaty changes in the Union since the mid 1980s. The Union structure is further characterized by peculiar institutional rivalry, as most EU institutions consistently follow the objective of enlarging the scope of their competence. Institution building in the EU is therefore usually quite pragmatic and incremental, as each institution seeks to enhance its formal legal competence and obtain a more important place in the Union's institutional structure.⁴⁸⁷ This has brought about a significant alteration in the balance between institutions over time, which generally resulted in a gradual enhancement of the Parliament's power at the expense of the power the EU Commission.⁴⁸⁸ This movement was also reflected in the area of financial accountability, which experienced different stands of reforms in the last couple of years.

Background of reform of EU financial accountability framework

Just like national governments, the EU supranational government is, through different mechanisms, financed by the EU citizens and therefore requires the existence of effective financial accountability mechanisms by which the EU citizens would hold it to account

⁴⁸⁷ Cf. B. Laffan, "Becoming a 'Living Institution': the Evolution of the European Court of Auditors", *Journal of Common Market Studies* (1999), Vol. 37, No. 2, pp. 251-268.

⁴⁸⁸ Cf. J.P. Jacque, "The Principle of Institutional Balance", *Common Market Law Review* 41, 2004, Kluwer Law International, pp. 383-391; A. Dashwood, A. Johnston, "The Institutions of the Enlarged EU under the Regime of the Constitutional Treaty," *Common Market Law Review* 41, 2004. pp. 1481-1518, Kluwer Law International.

for the stewardship of their money. Many efforts have been made in order to strengthen the financial accountability at the EU level, primarily by establishing an effective accountability relationship between the European Parliament and the Commission and by enhancing the role of key external accountability mechanism of the ECA.

In spite of these efforts, handling of public money in the EU kept attracting significant attention of EU citizens and Member States, especially during the last decade. There has been a quite high incidence of financial irregularities, waste and fraud in the management of EU financial resources, which has provided Euro sceptics with additional arguments against the EU and further integration processes.

The occurrence of a series of cases of mismanagement in handling of EU resources led to the resignation of the Santer Commission in 1999, as the first case when the entire Commission resigned in the history of the EU.⁴⁸⁹ The resignation was preceded by the Report of the Committee of Independent Experts, which examined the allegations of fraud, mismanagement and nepotism in the Commission. The Committee of Independent Experts further published its second report analyzing the then current financial management practices and laying proposals for tackling mismanagement, irregularities and fraud in the EU.⁴⁹⁰

The reports of the Committee of Independent Experts and the subsequent Commission White paper on reforming the Commission (2000)⁴⁹¹ have led to substantive changes in the regulation of the EU public expenditure management. The Community budget and financial procedures are traditionally governed by secondary legislation, embodied in the

⁴⁸⁹ A. Tomkins, "Responsibility and Resignation in the European Commission", (1999), 62 MLR 744.

⁴⁹⁰ Committee of Independent Experts, Second Report on Reform on the Commission, Analysis of current practice and proposals for tackling mismanagement, irregularities and fraud, Volume II, September 1999.

⁴⁹¹ Commission's White Paper: "Reforming the Commission", COM (2000)200, Brussels, 5.4.2000.

Council Financial Regulation, adopted in 1977.⁴⁹² In June 2002, the Council has substantially amended the 1977 version of the Financial Regulation, adopting the new Regulation on the Financial Regulation applicable to the general budget of the European Communities⁴⁹³ (hereinafter Financial Regulation), followed by the Commission Regulation of 23 December 2002, which laid down more detailed rules for the implementation of the Financial Regulation. Both Regulations came into force in January 2003. These Regulations have had a significant impact on the various financial accountability mechanisms in the EU context and will be explored in more details in the course of the ensuing analysis.

Concept of Stewardship of Public Money

The concept of stewardship of public money in the EU resembles the concepts found in the Member States and consists of two main components – requirements of reliability of accounts, legality and regularity of financial transaction on the one hand and ‘value for money’ principles on the other hand. The only reference to the stewardship of public money provided in the Treaty relates to the mandate of the Court of Auditors, which stipulates that the Court should examine “whether all revenue has been received and all expenditure incurred in a lawful and regular manner and whether the financial management has been sound.”⁴⁹⁴ The concepts of reliability, legality and regularity of

⁴⁹² Council Financial Regulation of 21 December 1997 applicable to the general budget of the European Communities, OJ No L 356, 21.12.1997, p.1; Regulation as last amended by Regulation (EC, ECSC, Euratom) No 762/2001 (OJ L 111, 20.4.2001, p.1).

⁴⁹³ Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities, OJ L 248/1, 16.9.2002; Commission Regulation (EC, Euratom) No 2342/2002 of 23 December 2002 laying down detailed rules for the implementation of Council Regulation (EC, Euratom) No 1605/2002 on the Financial Regulation applicable to the general budget of the European Communities, OJ L 357/1, 31.12.2002.

⁴⁹⁴ Article 248 (ex Article 188c) EC.

accounts have been developed by the Court of Auditors itself and could be defined as follows:

- Reliability of accounts assumes that all revenue, expenditure, assets and liabilities have been properly recorded and that the annual accounts faithfully reflect the Community's financial position at the end of the year;⁴⁹⁵
- Legality and regularity require that all transactions must conform to applicable laws and regulations, and that they are covered by sufficient budgetary appropriations.⁴⁹⁶

Whereas the concept of reliability of accounts is quite straightforward, the conceptual distinction between the requirements of legality and regularity of expenditure is not very clear. There seems to be no clear reference to meaning and using of one of these principles separately. Instead, they are always used together, e.g. that "expenditure is incurred in a lawful and regular manner" and "transactions are legal and regular" etc.⁴⁹⁷ This, however, should not be surprising, as the distinction between principles of legality and regularity of expenditure, as pointed out in the previous chapters, is not clear in the national contexts either. It seems that the concept of regularity of financial transactions holds sway over the principle of legality in international practice, although it has the same meaning as the principle of legality (conformity with laws and regulations). In order to avoid confusion and point out the importance of the principle, we have, in the previous chapters, suggested that principle of legality is used instead of regularity. However, until this issue is resolved at the international level, usage of both concepts of legality and regularity of financial transactions at the Union level seems to be acceptable.

Similarly to Member States contexts, the notion of legality and regularity in the EU encompasses two elements – an element of quantitative allocation of money expressed through the EU budget and an element of qualitative allocation of money expressed

⁴⁹⁵ Brochure of the ECA, *Improving the financial management of the European Union*, 2004, www.eca.eu.int.

⁴⁹⁶ Ibid.

⁴⁹⁷ ECA's annual Report concerning the financial year 2004.

through various procedural or substantive regulations which govern spending of the public money in the EU. In this sense, Advocate General Mancini in Case 204/86 stated that the European Court of Auditors (ECA) has the power and duty to verify not only that transactions comply with the provisions relating to the budget which are contained in the Treaties or in Financial Regulation, but also with any provision belonging to the Community legal order in so far as it has an effect on expenditure.⁴⁹⁸ Thus, in practice, any legal provision affecting revenue or expenditure provides a point of reference for examination of legality and regularity.⁴⁹⁹

The second component of the concept of stewardship of public money, a principle of sound financial management (or value for money requirement), has provoked many controversies both in EU and the Member States.

New Financial Regulation of 2002 clearly defines the principle of sound financial management, which encompasses the well-known principles of economy, efficiency and effectiveness. Special attention is given to the principle of economy, which is defined by the Regulation as the requirement that “the resources used by the institution for the pursuit of its activities shall be made available in due time, in appropriate quantity and quality and at the best price”.⁵⁰⁰ The principle of efficiency is defined in a usual way, as “the best relationship between resources employed and results achieved.” Effectiveness is

⁴⁹⁸ Different view on the authorities of the ECA was presented in the case *Les Verts v Parliament*, 294/83 of the Court of Justice, where the Court had to pronounce on an action for annulment filed against the EP by one of its political groups, and it remarked that the ECA only has power to examine the legality of expenditure with reference to the budget and the secondary provision on which the expenditure is based (commonly called ‘the basic measure’). However, it is important to note that the issue in question here was not the concept of legality of expenditure itself, but potential overlap and conflict of competences between the Court of Justice and the ECA in this case. In this sense, the Court of Justice has argued that the ECA’s powers of review under Article 206a do not preclude any review by the Court of Justice. J. Inghelram, “The European court of Auditors: Current Legal Issues”, *Common Market Law Review* 37: 129-146, 2000, Kluwer Law International, pp. 133-134.

⁴⁹⁹ Ibid.

⁵⁰⁰ Article 27, paragraph 2 of the Financial Regulation No 1605/2002 .

naturally concerned with “attaining the specific objectives set and achieving the intended results.”

In order to enhance the principles of sound financial management and enable their easier implementation and control, the Regulation introduces elements of performance management and programme evaluation. It requires all sectors of the activity covered by the budget to set specific, measurable, achievable, relevant and timed objectives. Achievement of those objectives should be monitored by performance indicators for each activity and spending authorities should provide such information to the budgetary authority.⁵⁰¹ Furthermore, the Regulation requires all the institutions to undertake both *ex ante* and *ex post* evaluations of their programmes and activities which entail significant spending. Evaluation procedures are regulated in more detail in Article 21 of the Commission Regulation, which further elaborates the requirements of the evaluation process.⁵⁰²

Despite obvious improvements (discussed below) of the regulation of principle of sound financial management, the question remains as to what extent the changes in regulation are having an effect on the actual enhancement of financial management in the EU. A glance over the reports of the Court of Auditors shows that the EU expenditure management is still primarily concerned with compliance with the principles of reliability, legality and regularity and to a lesser extent with sound financial management.⁵⁰³ The question which therefore may be posed is why ‘value for money’

⁵⁰¹ Article 27, paragraph 3.

⁵⁰² Commission Regulation (EC, Euratom) No 2342/2002 of December 2002 laying down detailed rules for the implementation of Council Regulation (EC, Euratom) No 1605/2002 on the Financial Regulation applicable to the general budget of the European Communities.

⁵⁰³ Cf. ECA, Annual Report concerning the financial year 2003 and Annual Report concerning the financial year 2004; Special Report No 8/2004 on the Commission's management and supervision of the measures to control foot and mouth disease and of the related expenditure; Special Report 3/2003 on the invalidity pension scheme of the European institutions, together with institutions' replies. www.eca.eu.int.

principles and examinations have not been sufficiently grasped by the EU institutions, even after the reform of its regulatory framework?

It may be argued that one of problems with the application of a principle of sound financial management in the EU stems from the remaining vagueness of the objectives of some of the EU policies. As we could see earlier, achieving the principle of sound financial management presupposes the existence of clearly defined and coherent objectives and operational targets.⁵⁰⁴ If the objectives of a policy are vague, self-contradictory or unidentifiable, it is very difficult to obtain the value-for-money principle. This has especially been the case with the rolling, complex nature of the EU Common Agricultural Policy, which contains a set of policies, which are often at odds with each other. At the same time, the CAP is taking a substantive part of the EU budget and has proved very difficult to be reformed.⁵⁰⁵ In such circumstances, it is very difficult to obtain and measure soundness of financial management, especially since policy makers are likely to accuse the auditors of interfering with political issues and can easily dismiss any criticism on their expenditure management.⁵⁰⁶

Furthermore, it may be argued that the lack of sufficient budget restraint in the EU undermines the achievement of sound financial management.⁵⁰⁷ Without a firm budget constraint, there is little incentive for those responsible for spending to engage in a serious attempt to achieve value for money. Some others argue that instead of attempting to contain public spending, the EU institutions seem to regard expansion of the EU budget as per se a good thing, because it represents a growth of European competences.

⁵⁰⁴ Cf. I. Harden, F. White, K. Donnelly, "The Court of Auditors and Financial Control and Accountability in the European Community," *European Public Law*, Volume 1, Issue 4 (Kluwer Law International), 1995.

⁵⁰⁵ R. Levy, *Implementing European Union Public Policy*, (Edward Elgar), 2000, pp. 69-96.

⁵⁰⁶ The Commission has thus tended to resist the ECA's increasing focus on value for money issues, claiming that these raise policy questions which are for the Commission and Council (The Court's Stuttgart Report, Report in Response to the conclusions of the European Council of 18 June 1983 OJ C287/1 1983). Cf. I. Harden, F. White, K. Donnelly, *ibid*.

⁵⁰⁷ *Ibid*.

This has resulted in the overly ambitious budgeting, which, coupled with the inability of Member and beneficiary States to absorb EU funds have brought about budget surpluses in subsequent years.⁵⁰⁸ Furthermore, the difficulties experienced in recent discussions on the 2007-2013 EU budget show that the Coombes assertion that “the national Ministers of finance who meet to decide budgetary questions in the Council are concerned more with keeping their own country’s contributions down, or at least with maximizing its return on the principle of *juste retour*, than with getting the best value for Community’s expenditure as a whole” is still valid.⁵⁰⁹ This implies an overall tendency towards ‘spending culture’ rather than setting of priorities and achieving sound financial management.⁵¹⁰

Lastly, it should be borne in mind that around 80% of the EU budget is implemented not in the EU institutions, but in the EU Member States, which have quite different understanding of the concept of stewardship of public money. The decentralized nature of implementation of the EU budget is therefore very much dependent on the financial control and accountability systems of the Member States and their comprehension of the public money stewardship concept, which has, in most EU countries been largely based on principles of legality and regularity and has only relatively recently started embracing the value for money considerations.⁵¹¹ Moreover, the quite high incidence of breaches of concepts of legality and regularity in EU’s financial management, especially in the implementation of resources managed by Member States, have necessitated that much

⁵⁰⁸ For 2003 budget surplus totalled 5500 million euro. While still large in absolute terms, this represents a fall compared with 2002 and 2001 (7400 million euro and 15000 million euro respectively). European Court of Auditors, *Annual Report Concerning the Financial Year 2003 and Annual Report Concerning the Financial Year 2002*, www.eca.eu.int.

⁵⁰⁹ D. Coombes, *The Power of the Purse in the European Communities*, (London, Chatham House: PEP), 1972, p. 69.

⁵¹⁰ Cf. I. Harden, F. White, K. Donnelly, op. cit. pp.615-616.

⁵¹¹ Cf. C. Pollitt at al, *Performance or Compliance? Performance Audit and Public Management in Five Countries*, (Oxford University Press), 2002.

more attention is paid to respect for these basic principles, instead of giving more weight to achieving value for money in the use of the public money.

Reform of internal financial accountability mechanisms

Until the adoption of the Financial Regulation amendments in 2002, the EU system of internal financial accountability mechanisms in many respects resembled the French system of internal control. Since the use of English terms for the main internal control actors (financial controller and accounting officer) may be misleading, as their functions do not correspond to their English counterparts,⁵¹² we shall use the French terms to denote their functions.⁵¹³ The system was based on the distinction of three key posts: *ordonnateur* (authorizing officer), *contrôleur financier* (financial controller) and *comptable* (accounting officer). As in French system, the *ordonnateur* is in charge of authorizing expenditure, i.e. entering into financial commitments and issuing payment orders. The *contrôleur financier* monitors the commitment and authorization of all expenditure and gives visa for the operation requested by the *ordonnateur*. And finally, the *comptable* is responsible for the proper execution of payments and is liable for disciplinary action and payment of compensation in the cases of financial misconduct. As in France, the system was based on the separation between the three functions, meaning the *ordonnateur*, *contrôleur financier* and *comptable* had to be different individuals.⁵¹⁴

⁵¹² This is especially the case for accounting officer, who (as was pointed out in II chapter) is normally a permanent secretary of the Department, while in the French law ‘comptable’ (as pointed out in chapter III) has strictly determined financial and accounting responsibilities. The word ‘controller’ could also be misleading, since, as pointed out in chapter I ‘contrôle’ in the French language denotes a check rather than a power to manage, as would be assumed by the English term “control”.

⁵¹³ We should, however, point out that the EU ‘comptable’ does not naturally have exactly the same status as the French ‘comptable’. For more details on French *comptables* see Chapter III.

⁵¹⁴ Article 29 of the “Financial Regulation on 21 December 1977 applicable to the general budget of the European Communities (OJ No L356 of 21.12.1977, p.1).

The *contrôleur financier* was envisaged to be the key person in charge of securing financial accountability within the EU institutions. Each institution had to appoint a *contrôleur financier*, a completely independent person, to be responsible for *ex ante* checking of all commitments and expenditure incurred by granting *visas* for each operation.⁵¹⁵ Although an institution who appointed its *contrôleur financier* also had the right to dismiss him/her, the *contrôleur financier*'s independence was nevertheless secured through a complex system of relations with other EU bodies (such as the Court of Auditors, the Court of Justice, the Commission, Council and Parliament).⁵¹⁶ It should be noted that the *contrôleur financier* function for the Commission was centralised in DG XX. This meant that DG XX performed ex-ante checking of all transactions of the Commission bodies (around 60,000 commitments and 300,000 payment approvals each year).⁵¹⁷

Despite its seemingly well designed system, the internal EU financial accountability mechanism based on the traditional French model proved to be ineffective in practice.⁵¹⁸ In its analysis of the Commission's internal control system, the Committee of Independent Experts was of the opinion that the multiplicity of modern financial transactions do not allow that all the financial proposals are genuinely and thoroughly checked. Due to the impossibility of universal testing, there is a move towards a sampling system, where only few sample transactions are thoroughly checked, while the rest usually receive automatic approval, i.e. *visa*.

Furthermore, the Committee found that the existence of centralized *ex ante* controls takes away the responsibility for financial management from the person who manages expenditure to the person who approves expenditure. Such a displacement of responsibility easily brings about a situation where no one seems to be ultimately

⁵¹⁵ Article 39 of the Financial Regulation.

⁵¹⁶ Articles 42-43 of the Financial Regulation.

⁵¹⁷ Cf. I. Harden, F. White, K. Donnelly, op. cit. pp. 606-607.

⁵¹⁸ Committee of Independent Experts, *ibid*.

responsible for financial management.⁵¹⁹ Therefore, many European countries are moving away from rigid *ex ante* control systems, and adopting firmer *ex post* control, as is the case with France itself. It may further be argued that shifting the emphasis from the ex-ante control, concerned mainly with legality and regularity of transactions, to stronger *ex post* control, leads to the establishment of a more complex system of accountability, with higher degree of interest for attaining value for money principles.⁵²⁰

The new Financial Regulation gives legal force to these ideas, with an emphasis on decentralization and taking responsibility of department management for overall financial control framework. In this sense, the Regulation first proclaims the principle of segregation of duties between *ordonnateur* and *comptable*. Then it merges the function of *ordonnateur* and *contrôleur financier*, providing the *ordonnateur* with full responsibility for financial management, i.e. for entering into commitments and authorising payments. In this way, the *ordonnateur* has obtained a central role in the internal financial accountability.⁵²¹ This has been confirmed by quite strict and lengthy provisions on the *ordonnateur*'s liability for misconduct in the discharge of his/her duties.⁵²² The role of the *comptable*, on the other hand, has not been substantially changed, as the *comptable* has remained responsible for actual making of payments and keeping the accounts and liable to disciplinary sanction and payment of compensation in the case of mismanagement of public funds.⁵²³

Each institution performs the duties of *ordonnateur*⁵²⁴ through the delegation of the *ordonnateur*'s duties to staff of an appropriate level. The delegation is regulated by internal rules of an institution, which specify the scope of the powers delegated and the

⁵¹⁹ Ibid.

⁵²⁰ OECD Policy Brief, *Public Sector Modernisation: Modernising Accountability and Control*, 2005., www.oecd.org/publications/pol_brief.

⁵²¹ Cf. P. Craig, "A New Framework for EU Administration: the Financial Regulation 2002", 68 *Law & Contemp. Probs.* pp. 107-133, <http://www.law.duke.edu/journals/lcp/articles/lcp68dwinter2004p107.htm>.

⁵²² Chapter 4, Articles 64-66 of the Financial Regulation, 2002.

⁵²³ Article 67 of the Financial Regulation, 2002.

⁵²⁴ Article 59, paragraph 1, Financial Regulation, 2002.

possibility for sub-delegation.⁵²⁵ The person who is given the authority of *ordonnateur* (or so-called authorising officer by delegation) makes budget and legal commitments, validates expenditure, and authorizes payments.⁵²⁶ When adopting a budget commitment and authorizing payment, he/she must make sure that the appropriations are available, that the expenditure conforms to the relevant legal provisions and is also responsible for implementing expenditure in accordance with the principles of sound financial management.⁵²⁷ *Ordonnateur*'s function is performed by Directors General (and exceptionally Directors)/Heads of Services, which have to report annually on the overall activity of the Directorate-General/Service and in particular on the management of its resources.⁵²⁸

Although the *ordonnateur* has full responsibility for managing expenditure, certain level of additional control is secured by providing the members of staff other than the person who initiated the operation the right to verify the operational and financial aspects of the transaction, before and after authorization of expenditure (so called *ex ante* and *ex post* verification).⁵²⁹ Furthermore, any member of staff involved in the financial management and control of transactions who considers that a decision he/she is required by his/her superiors to apply or to agree to is irregular or contrary to the principles of sound financial management of the professional rules, is required to inform the *ordonnateur* by delegation in writing, and, if the latter fails to take action, to other authorized institutions.⁵³⁰ More detailed regulation of rights and obligations of all financial actors has been provided in the Commission Regulation laying down detailed rules for the implementation of the Financial Regulation.⁵³¹

⁵²⁵ Article 59, paragraph 2.

⁵²⁶ Article 60, paragraph 3.

⁵²⁷ Article 60, paragraph 1.

⁵²⁸ http://ec.europa.eu/reform/2002/selection/chapter1_en.htm#1_3

⁵²⁹ Article 60, paragraph, 4.

⁵³⁰ Article 60, paragraph 6.

⁵³¹ Cf. Commission Regulation (EC, Euratom), No. 2342/2002 of 23 December 2002 laying down detailed rules for the implementation of Council Regulation (EC, Euratom) No 1605/2002 on the Financial

The strengthening of internal audit capacity is also central to the reform package. The idea was strongly advocated by the Committee of Independent Experts and endorsed by the Commission's White Paper. In accordance with these ideas, the new Financial Regulation provided for a creation of internal auditor services in all Directorates-Generals, now called Internal Audit Capabilities (IACs). They provide assurance and consultancy services to director generals of the DGs on reliability of financial control framework.⁵³² Furthermore, the central Internal Audit Service (IAS) was created in 2001 to strengthen the coordination of work of individual IACs. IAS auditors advise the institutions about proper budgetary procedures and the quality of their management and control systems.⁵³³ They are intended to help *ordonnateurs* by providing a check on the overall systems adopted.⁵³⁴

It is quite interesting to note that the reformers of the internal accountability mechanisms in the Commission have abandoned a variant of the traditional French model of centralized internal control, based on ex-ante control of financial operations by the officials of the Ministry of Finance (DG XX in the then EU system). Instead, they have moved towards establishing principles of the new French internal accountability framework, which is a variant of the UK model of decentralized managerial internal control, based on responsibility of a UK accounting officer. The authorities of the EU *ordonnateur* (to authorize payments, make commitments etc.) and his/her full

Regulation applicable to the general budget of the European Communities, OJ L 357/1, 31.12.2002, In May 2005, the Commission decided to amend this Regulation and has prepared the draft amendments, mainly of technical nature. Cf. Draft Commission Regulation (EC, Euratom) amending Regulation (EC, Euratom) No 2342/2002 laying down detailed rules for the implementation of Council Regulation (EC, Euratom) No 1605/2002 on the Financial Regulation applicable to the general budget of the European Communities, Brussels 12.10.2005. SEC(2005) 1240 final.

⁵³² Cf. "A New Stage of Reform: The European Commission's recently appointed internal audit Chief says his organisation must continue to work toward modernisation and progress", *Internal Auditor*, 2004.
<http://www.theiia.org/?act=iia.internalAuditor>.

⁵³³ Cf. http://europa.eu.int/comm/dgs/internal_audit/geninfo_en.htm.

⁵³⁴ Financial Regulation, *supra* note 5, Art. 85-86

responsibility for financial management are almost identical to the new responsibilities the French *ordonnateurs* have obtained under the LOLF and very much correspond to responsibilities of a UK accounting officer. The similarity is even more striking when one takes a look at the actual delegation of responsibility of the *ordonnateur* in the Commission. In most cases it is performed by the Commission's Director-Generals or Heads of Services, which constitute a rough equivalent to the British Permanent Secretary post and General Directors (managers) posts in the French administration. The difference between these models, however, lies in a thoroughly regulated role of the *comptable* in the French system and to a lesser extent in the EU system as well, which is in contrast and the UK system, which does not recognise the role of a *comptable* as such. Furthermore, whereas the EU system has fully abolished the post of the *contrôleur financier*, the French system has kept it, gradually changing its role towards the *ex-post* audit. Therefore, it may be concluded that the EU model of internal financial accountability still remains an interesting mixture of both UK and the French model.

The change of the model of the system of internal accountability in the EU has undoubtedly brought about positive results, enhancing the legality and regularity of the transactions which are subject to direct management by the Commission.⁵³⁵ However, as noted by the European Court of Auditors in its 2004 report, progress is still required in terms of actual implementation, since the extent of implementation and effective operating are not yet satisfactory.⁵³⁶ Additional efforts are still needed to be made in strengthening of internal control systems in order to provide reasonable assurance as to the legality and regularity of the underlying transactions and to further support the shift from a compliance to an effectiveness approach. Furthermore, it is necessary to strengthen the coordination of work programmes and harmonise audit methodologies and reporting structures within the Commission. In this sense, the Commission has obliged

⁵³⁵European Court of Auditors, Annual Report Concerning the Financial Year 2003, 2004. www.eca.eu.int; National Audit Office, "Financial Management of the European Union", HC 289 Session 2004-2005, and HC Session 2005-2006, www.nao.org.uk.

⁵³⁶ European Court of Auditors, Annual Report concerning the financial year 2003, 2004. www.eca.eu.int.

the IACs to systematically send their final reports to the IAS and in this way reinforce the relations between the IAS and IACs.⁵³⁷

Towards an Integrated Internal Control Framework

Although the Commission management of expenditure has been enhanced as a result of the recent reforms, the European Court of Auditors has not been satisfied with the level of effectiveness of the overall Community financial management especially in areas in which the Community and Member States share the management of programmes.⁵³⁸ Due to continuing excessive criticisms of the Community financial management, the Barroso Commission has therefore made a strategic objective to strive for a positive assessment of legality and regularity of the Community financial operations.⁵³⁹ The key issue in question here is how to ensure a sound implementation of the EU budget at the central level when 80% of the budget is presently implemented by Member States? Decentralised nature of the budget implementation implies a relatively long control chain with a high number of actors involved and the corresponding difficulty to maintain common levels of application of rules. Therefore, it is essential that Member States take an active part in obtaining the Commission's objective.

In order to address this complex issue, and following the initiative of the European Court of Auditors,⁵⁴⁰ the Commission adopted a communication on a roadmap to an integrated internal control framework on 15 June 2005.⁵⁴¹ The purpose of this document was to

⁵³⁷ European Court of Auditors, Annual Report concerning the financial year 2004. www.eca.eu.int.

⁵³⁸ Ibid.

⁵³⁹ Cf. Commission Communication *Strategic Objectives 2005-2009, Europe 2010: A Partnership for European Renewal, Prosperity, Solidarity and Security* - COM(2005) 12, 26.1.2005.

⁵⁴⁰ European Court of Auditors Opinion No 2/2004, OJ C107/1 of 30.4.2004 ("Single Audit" opinion).

⁵⁴¹ Commission Staff Working Paper, *A gap assessment between the internal control framework in the Commission Services and the control principles set out in the Court of Auditors 'proposal for a Community internal control framework' opinion* No 2/2004, 07/07/05.

initiate a process which should lead to an agreement between the Commission, the Member States and acceding countries on how this framework could be improved in order to get reasonable assurance on the regularity and legality of financial transactions.

After discussing the communication document with all relevant actors, the Commission has adopted an Action Plan towards an Integrated Internal Control Framework on 17 January 2006.⁵⁴² The Action Plan defines 16 specific actions to be implemented during 2006 and 2007, such as: simplification of management of EC funds, adoption of common internal control principles, issuing management declarations and synthesis reports at the national level, sharing results and prioritising cost benefit etc.⁵⁴³ The Plan requires all relevant actors, i.e. the European Parliament, the Court of Auditors, the Member States and the Commission to contribute to the implementation of these actions.

A need for institutionalisation of an integrated control framework has been addressed through the preparations of amendments of the existing Community legislation, i.e. Financial Regulation. According to its Article 184, the Financial Regulation is subject to review every three years, or whenever it proves necessary to do so. In compliance with this obligation, on 3 May 2005 the Commission adopted a proposal for its revision. In line with the Commission's Action Plan, a new budgetary principle is to be added in Chapter 9 of the Title II - the principle of effective and efficient internal control. This new principle underlines the importance of improvement of the implementation of the budget, the effectiveness and efficiency of the operations, the reliability of financial reporting, the protection of the financial interests of the Communities and the management of the risks relating to the legality and regularity of the underlying transactions.

⁵⁴² *Communication from the Commission to the Council, the European Parliament and the European Court of Auditors, Commission Action Plan towards an Integrated Internal Control Framework*, {SEC(2005) 49}, Brussels, 17.1.2006 COM(2006) 9 final.

⁵⁴³ Ibid.

It is expected that the joint action of all relevant actors of financial accountability in the EU context, with a special emphasis on the Member States internal and external financial accountability mechanisms, will provide a much needed synergy in addressing the inherent weaknesses of complex multi-layered financial accountability system of the EU. Although it is not very likely that this initiative will yield positive and concrete results in the short term, or even in the mid term, it is very important that the Commission has started tackling the problems of shared/decentralised budget implementation. In order for this initiative to work in the long run, it is necessary that the EU institutions provide a continuing leadership throughout this process. In this sense, an important role in further enhancement of the overall financial accountability framework will certainly be accorded to the Commission, but equally so to the Commission's external observers, the European Parliament and the European Court of Auditors.

External financial accountability mechanisms in the EU

The establishment of first external financial accountability mechanisms of the EU dates back only to the early 1970s. It may be argued that the development of external financial accountability mechanisms was the consequence of the transition from the budget system of national contributions to the establishment of an autonomous EC budget based on 'own resources'⁵⁴⁴ in the 1970 Budget Treaty.⁵⁴⁵ Integration in the sphere of own revenue resources naturally created a pressure for further integration in the control and accountability for their use. Hence, a more supranational EU budget necessitated an independent EU audit body, such as the European Court of Auditors.⁵⁴⁶ Moreover, there

⁵⁴⁴ Community revenue is based on several sources: 'traditional own resources', such as: customs, agricultural duties and sugar levies and resources based on value-added tax (VAT) and gross national income (GNI).

⁵⁴⁵ B. Laffan, "Becoming a 'Living Institution': The Evolution of the European Court of Auditors", op. cit., p. 254.

⁵⁴⁶ B. Laffan, "Financial Control: The Court of Auditors and OLAF", in J. Peterson and M. Shackleton (eds.), *The Institutions of the European Union*, (Oxford University Press), 2002, p. 235.

was a growing pressure for further advancement of democratic control of Community expenditure and calls for granting the European Parliament a right of a 'discharge' to the Commission on its execution of its previous year's budget.⁵⁴⁷ However, it was obvious that the Parliament would not be able to exercise this right without the assistance of an expert institution. These interrelated factors led the signing of the 1975 Treaty which both gave the Parliament power to discharge the budget and created the European Court of Auditors, and thus provided a basis for the establishment of key EU external financial accountability mechanisms.

Parliamentary accountability – granting the discharge to the Commission

Parliamentary financial accountability of the EU finances is peculiar in many ways. Unlike in nation states, budgetary authority in the Community does not rest solely with the Parliament, but is generally shared between the Council and Parliament. Whereas the Council has the key role in determining the scope of EU revenue, the Parliament has an important role in the control of the EU expenditure, which resembles the role Parliaments play in Member States. In order to understand the overall context of the external financial accountability and especially Parliamentary accountability in the EU, it is necessary to gain some insight into the EU budgetary process.

The budgetary process in the EU could briefly be described as follows. The scope of Community revenue is decided by a unanimous decision of the Council. All Member States must agree with the revenue decision in conformity with their respective constitutional requirements.⁵⁴⁸ The Budget Directorate General of the Commission is responsible for preparing the Commission's budget proposal (the preliminary draft budget). Similar to the process of budget discussion between the Ministers of Finance and

⁵⁴⁷ The wise chair of the Budget Committee published an influential report in 1973, entitled "The Case for a European Audit Office", in which he called for the establishment of a new institution, the Court of Auditors.

⁵⁴⁸ Article 269 (ex Article 201) EC.

spending ministries in the nation state, such a draft is then discussed with other directorate generals and other EU institutions. The Commission's preliminary draft is subsequently sent to the Council which by a qualified majority determines the draft budget. The draft budget is then forwarded to the Parliament, which has the right to amend it. After Parliamentary discussion and approval, the draft budget is sent back to the Council. It should be noted that approximately half the budget is spent on 'compulsory expenditure' (mostly agriculture). Whereas in the case of dispute over 'compulsory expenditure' between the Council and Parliament, the view of the Council prevails, the Parliament will have the final say on the non-compulsory expenditure. Finally, the Parliament adopts the budget acting by a majority of its members and three fifths of the votes cast. After the budget has been approved, the EU Commission bears overall responsibility for its implementation.⁵⁴⁹

In contrast to its rather accessory role in determining the EU budget, the EU Parliament has a more prominent role in holding the Commission to account for spending of EU citizens' money. Since 1977, the Parliament, acting on a recommendation from the Council, grants a discharge to the Commission for implementation of the budget.⁵⁵⁰ The Parliament's discharge to the Commission is a formal act, which marks the final closure of the accounts. It could further be argued that the discharge also represents a political verdict on the overall performance of the Commission.⁵⁵¹

Although the discharge procedure seems to be clear, it has provoked certain controversies. The key question is what would happen if the Parliament would refuse the discharge to the Commission? Up to now, the Parliament has refused to give a budgetary discharge on three occasions and threatened to do so on others, and has withheld approval

⁵⁴⁹ For more details on the budgetary procedure see:

http://europa.eu.int/comm/budget/budget/index_en.htm.

⁵⁵⁰ Article 276 (ex Article 206) EC.

⁵⁵¹ C. Kok, "The Court of Auditors of the European Communities – the other European Court in Luxemburg", *Common Market Law Review* 26: 345-367 (1989).

of the budget for 1984 before discharging the budget implementation for the 1982.⁵⁵² At that time, the Commission was very close to the end of its term and Parliament did not take any steps to dismiss it. The discharge was later given to the newly appointed Commission. This case points to the fact that the key Parliamentary sanction in the case of refusal of discharge may just be a postponement of such an action, rather than calling the Commission to resign.⁵⁵³ This could also be confirmed by the later and even more serious case of the 1996 budget, when the European Parliament delayed giving the Commission a discharge following one of the critical reports of the ECA. The Commission survived a motion of censure only because a special Committee of Independent Experts was appointed to investigate the charges of mismanagement and the ultimate result was the resignation of the entire Santer Commission. Nevertheless, it could also be argued that refusal of granting of discharge to the Commission could prompt a call for Commission's resignation in accordance with the Article 201 of EC Treaty. The problem, however, may arise if this right would be used too frequently, as it could bring about adverse political consequences on stability and efficiency of EU governance processes.

In order to find a good compromise solution that would balance the need for strong Parliamentary powers in the process of discharge and the potential problems that may be faced in the case of a refusal of the discharge, some authors are of the opinion that instead of focusing on the discharge of the Commission as a collective body, the Parliament should bring pressure to bear on one or more specifically responsible members of the Commission, which would ultimately result in their resignation.⁵⁵⁴ This further triggers a wider debate on whether the collegiality principle on which the Commission grounds its operation should be maintained. The strict application of the collegiality principle might have seemed necessary at the early stage of development of the EU in order to prevent confrontations that could arise due to a Commissioner's loyalties to their Member States.

⁵⁵² R. Levy, *Implementing European Union Public Policy*, op, cit., pp. 16-17.

⁵⁵³ Cf. I. Harden, F. White, K. Donnelly, op.cit. pp. 620-622.

⁵⁵⁴ C. Kok, op. cit., p. 352.

However, with the development of a genuine supranational structure and an increasingly prominent role of individual commissioners, the principle of collegiality may strongly be disputed. The key issue here is that the collegial structure of accountability for individually assigned portfolios may lead to a conceptual “diffusion of responsibilities”,⁵⁵⁵ which undoubtedly has an adverse effect on the principle of accountability, as exemplified by the recent need for reform of the Commission’s internal accountability mechanisms.

The question which should be raised, however, is whether the Commission should fully be held to account through the discharge procedure, since the process of EU budget implementation is performed largely by the Member States themselves. The Commission’s accountability for the implementation of the budget in the system of divided budget implementation management makes sense only if all Member States have the administrative capacity for sound financial control and management and if the Commission would have sufficient levers to make them use it.⁵⁵⁶ For this reason, the Commission has a very strong interest that all Member States and potential Member States which are receiving the EU accession funds have good and reliable systems of financial accountability and has taken a number of measures in this respect, as pointed out earlier in the text. Only if the Member States and potential Member States would achieve adequate implementing capacity the Commission would be able to fully take on the burden of key *accountee* of financial accountability.

As in nation state context, the EU Parliament would have serious problems in holding the Commission to account if it would not be supported by other bodies, primarily by its committees and by work of the EU supreme audit institution, the Court of Auditors. Therefore, we shall devote our further attention to the functions of the Parliament’s

⁵⁵⁵ V. Mehde, “Responsibility and Accountability in the European Commission”, *Common Market Law Review* 40, 2003 Kluwer Law International, pp. 423-442.

⁵⁵⁶ C. Kok, *op. cit.*, p. 352..

committees and the Court of Auditors, which shall be analysed in the overall context of EU financial accountability.

The Budgetary Control Committee – the EU PAC/MEC?

In 1973, the European Parliament approved the creation of a new Parliamentary sub-Committee on the budget of the Communities, responsible for the budget implementation. The idea was to establish a body that would provide a link between the external auditor that was planned to be established and the Parliament. However, the work of this sub-committee was quite ineffective in the mid 1970s. Therefore, it was decided in 1979 that the sub-committee should be upgraded to a status of a separate Budgetary Control Committee⁵⁵⁷ (generally called "COCOBU" -according to its name in French: *Commission du Contrôle Budgétaire*).

COCOBU has a key role in the discharge process, as it invites the Parliament to grant, postpone or refuse the discharge of the budget implementation. Similar to the British PAC and the more recently established French MEC, the COCOBU often bases its own work on reports made by the external auditor, the European Court of Auditors. However, the COCOBU also responds to proposals and reports from the Commission⁵⁵⁸ and produces its 'own' initiative reports, which provides it a rather broad basis for the final decision. It should be noted that the COCOBU adopted its last report in which it invites

⁵⁵⁷ Cf. I. Harden, F. White, K. Donnelly, op. cit., pp. 622-625.

⁵⁵⁸ Following the Commission's White Paper on reform, the number of reports and materials available from the Commission has substantively increased. One of the most important Commission reports is the Synthesis report and the individual Commission DG's activity reports, which aim at giving a global picture of the internal management issues raised in the DGs' reports and to draw conclusions on how to address the identified problems.

the Parliament to discharge the implementation of the EU budget for 2004 on 21 March 2006.⁵⁵⁹ This report is expected to be adopted by the Parliament shortly.

Like the British PAC, the COCOBU provides an added value in exercising parliamentary control by trying to ensure that problems identified in audits by the Court of Auditors and in investigations by the Anti-Fraud Office (OLAF) are given political prominence and addressed in a timely manner.⁵⁶⁰ However, it should be noted that the COCOBU has not enjoyed the status and the prestige of the British PAC. Attendance of its members has been quite low and most of them have not been substantially interested in following up the European Court of Auditor's reports.⁵⁶¹ Furthermore, the attendance of the plenary sessions of the Parliament when the European Court of Auditor's report and the COCOBU's draft discharge resolution are discussed has also been low, which has further undermined the effectiveness of the EU financial accountability system, based on the UK model.

It should, however, be noted that the COCOBU's profile has begun to rise as a result of the prominence accorded to the 'fight against fraud' over the last couple of years. The COCOBU has spent significant amount of time on issues of legality and regularity, especially on fraud, payments under CAP and Commission virements between accounts.⁵⁶² Given the complexity of EU budgetary matters, individual members of the committee during the previous parliamentary term specialised in particular EU policy areas, preparing a Parliament's response to special reports by the Court of Auditors in their field, often in the form of working documents, which has had a positive effect on the

⁵⁵⁹ Committee on Budgetary Control, *Report on the Discharge for implementation of the European Union general budget for the financial year 2004*, 27.3.2006,

http://www.europarl.eu.int/comparl/cont/adopt/discharge/2004/default_en.htm.

⁵⁶⁰ Committee on Budgetary Control, *Handbook 2004 for New Members*,

http://www.europarl.eu.int/comparl/cont/guide/default_en.htm.

⁵⁶¹ Cf. I. Harden, F. White, K. Donnelly *ibid*.

⁵⁶² Cf. R. Levy, *Implementing European Union Public Policy*, *op. cit.* 25-25.

efficiency of its work.⁵⁶³ Nevertheless, the Committee is still experiencing difficulties especially as it has to protect its own field of competence against other committees which want to set up inquiries in areas that the COCOBU would normally cover, making use of the power which the TEU has provided to the Parliament to conduct *ad hoc* investigations.⁵⁶⁴

This discussion points out the difficulties which may be faced when attempting to transplant financial accountability mechanisms from one system to another and may be quite useful when we start examining the possible introduction of different financial accountability mechanisms in Serbia.

The European Court of Auditors (ECA)

Historical background

The ECA is the key external accountability mechanism operating within the EU financial accountability system. The 1975 Budget Treaty provided the legal basis for the establishment of the ECA and it began to work in 1977, replacing the then existing Audit Board and the Auditor of the European Coal and Steel Community.

The main incentives for the establishment of the ECA could be sought in two major developments. The first is the earlier mentioned change of the EU financing based on “own resources” in the 1970 Budget Treaty, which has greatly enhanced the limited budgetary powers of the European Parliament.⁵⁶⁵ The second is the admission of new

⁵⁶³ Committee on Budgetary Control, *Handbook 2004 for New Members*, http://www.europarl.eu.int/comparl/cont/guide/default_en.htm.

⁵⁶⁴ Cf. R. Levy, *Implementing European Union Public Policy*, *ibid*.

⁵⁶⁵ The vice-chair of the Budget Committee published a report in 1973, entitled *The Case for a European Audit Office*, which had exerted significant pressure for the establishment of the ECA. B. Laffan, “Becoming a ‘Living Institution’: The Evolution of the European Court of Auditors”, *op. cit.* p. 251.

Community Member States- Denmark, Ireland and UK in 1973.⁵⁶⁶ As all these countries have a strong tradition of independent public sector auditing, they from the outset imposed considerable pressure for the creation of the stronger Community accountability framework, which was able to satisfy their needs.⁵⁶⁷

The Treaty of Maastricht (1992) enhanced the ECA's formal status, moving it from the category of 'other bodies' to the status of a full institution. This was clear recognition of the need to enhance the authority of the Court and to elevate it to a status equivalent to those institutions over which it had auditing power.⁵⁶⁸ Enhancement of the ECA's status has extended ECA's audit powers to the second (Common Foreign and Security Policy) and third (Cooperation in the fields of Justice and Home Affairs) pillars of the Union.

The Treaty of Amsterdam (1997) and Treaty of Nice (2001) have further strengthened the status of the ECA. The Treaty of Amsterdam has emphasized the Court's role in respect of irregularities and measures to combat fraud. Furthermore, it confirmed the Court's right to bring actions before the Court of Justice to protect its prerogatives with regard to the other EU institutions. In the view of the EU enlargement, the Treaty of Nice provided that the Court of Auditors should be composed of one member from each Member State (instead of 15 members). It also emphasized the importance of the cooperation between the Court and the supreme audit institutions of the Member States.⁵⁶⁹

Organisation and Structure of the ECA

The structure and procedures of the Court have changed over time, aiming at enhancing the coherence and effectiveness of the Court's activities. As confirmed by the Treaty of Nice, and in accordance with the principle of national representation, the ECA consists of

⁵⁶⁶ N. Price, "The Court of Auditors of the European Communities", in *Yearbook of European Law*, vol. 2, pp. 240, Oxford, 1982.

⁵⁶⁷ Ibid.

⁵⁶⁸ J. Inghelram, op. cit., pp. 129-146.

⁵⁶⁹ Cf: http://www.eca.eu.int/eca/treaty/docs/disp_cdc_en.pdf.

one Member from each Member State. The Members are appointed by the Council, acting unanimously after consultation with the European Parliament, on the basis of nominations made by individual Member States. The Members' term in office is six years and is renewable.⁵⁷⁰ The members are required to perform their duties in complete independence and in the general interest of the EU.⁵⁷¹

Although it is naturally headed by the President, the ECA operates primarily as a collegiate body, with its members adopting audit reports and opinions by majority vote. The President is elected by the members with a three years renewable mandate.⁵⁷² The President's role is that of *primus inter partes*. He/she chairs the ECA's meetings, ensures that its decisions are implemented and that overall activities are well managed.

The ECA regulates its structure and procedure by its own Rules of Procedure, which are submitted for approval to the Council. Nowadays, the structure of the ECA consists of audit groups comprising a number of specialized divisions which cover the different areas of the budget. Each member of the ECA is assigned to a group. The groups are chaired by a "Dean", elected by the members of the group for a renewable two-year term. The Dean is responsible for overall operation of the group and its divisions. There are around 800 staff in the ECA, who have a broad range of professional backgrounds and experience from both the public and private sector. The ECA employs nationals from all Member States in order to ensure a sufficient spread of linguistic and professional skills within its workforce.⁵⁷³

The organization of the ECA, however, has been the subject of heavy criticism. This especially relates to the large composition of the ECA's membership, appointed in line

⁵⁷⁰ Article 247, paragraph 3, items 1, 2 of the EC Treaty.

⁵⁷¹ Article 247, paragraph 4 of the EC Treaty.

⁵⁷² Article 247, paragraph 3, item 3 of the EC Treaty. Hubert Weber, from Austria, was elected President in January 2005.

⁵⁷³ The European Court of Auditors, "Improving the Financial Management of the European Union", op.cit. p. 10. www.europa.eu.int

with the principle of national representation. Whereas there is nothing wrong with the principle of national representation itself, the fact is that with each enlargement the number of ECA's member significantly increases, which questions the effectiveness of collegiality.⁵⁷⁴ It furthermore appears that each enlargement reduces the workload of its members, questioning the necessity of their high position in the ECA's hierarchy.⁵⁷⁵ The second, and the key related question is how to ensure the comprehensiveness of the ECA's work given the variety of external audit traditions of its numerous members, which has negatively affected the uniformity of the ECA's work. Therefore, there have been calls for the reduction of the number of the ECA's members and possible abandoning of the collegiate structure and introduction of a single head organisation, modelled on the UK C&AG.⁵⁷⁶ Whereas the latter solution may be too extreme for an institution of a supranational governance, the former solution would most probably increase the efficiency and effectiveness of the ECA's work and would prevent potential problems of inflation of its membership in the case of future enlargements.

Mandate of the ECA

Article 248 of the EC Treaty sets out the mandate of the ECA. According to Article 248, the ECA has the following competences:

- audits the accounts of all the revenue and expenditure of the EU and, unless otherwise specified, of all bodies established by the Union;
- examines whether all EU revenue and expenditure has been received or incurred in a lawful and regular manner and whether the financial management has been sound;

⁵⁷⁴ This is particularly obvious in the case of the last enlargement, when the number of the ECA's members have increased for 10 new members.

⁵⁷⁵ N. S. Groenendijk, "Assessing Member States' Management of EU Finances: an empirical analysis of the annual reports of the European Court of Auditors, 1996-2001", *Public Administration* Vol. 82 No.3, 2004, pp. 701-725.

⁵⁷⁶ Ibid; I. Harden, F. White, K. Donnelly, op. cit., pp. 627-628.

- produces an Annual Report containing its observations on the execution of the EU budget for each financial year, including a Statement of Assurance (DAS) on the reliability of the EU accounts for that year and the legality and regularity of the underlying transactions;
- may submit observations on specific topic of its choice at any time, particularly in the form of Special Reports;
- in cases of irregularity or suspected fraud detected in the course of its audit work provides formal opinions on proposals for EU legislation of a financial nature;
- is consulted on any proposal for measures in the fight against fraud;
- assists the discharge authority – the European Parliament – in exercising its powers of control over the implementation of the budget of the European Union through the publication of audit reports and opinions.

The listed competences show that ECA has no legal powers of its own. Therefore the name of the Court is somewhat misleading, since the ECA's does not judge the accounts (as the French *Cour des Comptes*) but performs general audit functions (like the British NAO) without judicial competences. If auditors discover fraud or irregularities in their investigations they inform the European Anti-Fraud Office - OLAF.

Similar to national supreme audit institutions, the ECA issues an annual report, published in the autumn of each year for the preceding year and a number of special reports on particular institutions, policy programmes or financial processes and Opinions when requested by the Council or observations on the initiative of the ECA.⁵⁷⁷

Very early on, the ECA decided not to limit its investigations to compliance of legality and regularity, but started examining whether financial management has been sound. The European Parliament has characterized the value for money controls as being “the most

⁵⁷⁷ www.europa.eu.int

important work of the Court”,⁵⁷⁸ as it has on numerous occasions pointed out to the waste of using of resources in various EU institutions. The majority of ECA’s special reports consist of value for money audits of the Union’s internal policies with a particular emphasis on the CAP and structural expenditure.⁵⁷⁹ However, in the last couple of years the ECA’s special reports also have focused very much on the sound financial management in the pre-accession aid and measures to prepare the candidate countries to manage Community funds.⁵⁸⁰

When the ECA obtained the status of a full institution (by the Maastricht Treaty in 1992), it got a major new responsibility, known as a statement of assurance or DAS (from the French term *declaration d’assurance*). This task, the origin of which is a British proposal, means that in addition to the Annual Report and special reports, the Court must provide the Council and the Parliament with a statement of assurance as to “the reliability of the accounts and the legality and regularity of underlying transactions”.⁵⁸¹ This is quite a demanding exercise, as it requires the ECA to move from its traditional ‘system based approach’⁵⁸² to sample based detailed financial audit checks of all underlying transactions

⁵⁷⁸ D. O’Keefe, “The Court of Auditors”, in *Institutional dynamics of European integration: essays in honour of Henry G. Schermers*, vol. II (1994), p. 177-194 in the *Liber Amicorum* for Professor Henry G. Schermers, 1994, Kluwer/Martinus Nijhoff, p.187.

⁵⁷⁹ Cf. Special Report No 3/2004 of the Court of Auditors concerning the recovery of irregular payments under the Common Agricultural Policy, 10 June 2004 OJ C 269, 4.11.2004; Special Report No 7/2004 of the Court of Auditors concerning the common organisation of the market in raw tobacco 21 July 2004; Special Report No 14/2003 of the Court of Auditors on the measurement of farm incomes by the Commission 4 December 2003 OJ C 45, 20.2.2004; Special Report No 8/2004 of the Court of Auditors on the Commission's management and supervision of the measures to control foot-and-mouth disease and of the related expenditure, 21 July 2004, being published.

⁵⁸⁰ Cf. Special Report No 5/2004 concerning Phare support to prepare candidate countries for managing the Structural Funds, OJ C 15, 20.1.2005; Special Report No 2/2004 of the Court of Auditors concerning pre-accession aid - Has SAPARD been well managed? OJ C 295, 30.11.2004.

⁵⁸¹ Article 248EC

⁵⁸² The system-based approach assumes examination of different areas of revenue and expenditure over a four-year cycle. Cf. Kok, op. cit. note 4.

down to the level of the final beneficiary. In the last couple of years statement of assurance is given on the specific parts of the Community revenue and expenditure (CAP, structural measures, internal policies, external actions, pre-accession aid, administrative expenditure and financial instruments and banking activities).⁵⁸³ The Court gives an assurance that the accounts representing financial transactions were reliable and if it feels that they were not reliable, it states why this was not the case.⁵⁸⁴ It should be noted that the ECA has not issued a positive DAS on the EU expenditure in each of the last eleventh years, although it has noted some general improvements in specific areas.⁵⁸⁵

However, the ECA's has been criticised for the limited impact of its DAS findings and its work overall. The information resulting from the DAS is often too general and not overly useful for its audiences.⁵⁸⁶ Furthermore, the ECA's reports, naturally, do not have any legally binding effect. Therefore, a negative statement of assurance, does not oblige the European Parliament to refuse the discharge to the Commission, which further questions the usefulness of this instrument.⁵⁸⁷ Nevertheless, it should be noted that the repeated negative DAS assessments have prompted the reaction of the Commission and other actors in creating a common framework for enhancing the framework of internal control (as discussed earlier in the chapter) which demonstrates the ECA's potential for providing constructive feedback arising from the DAS examinations.

⁵⁸³ ECA, Annual Report concerning the financial year 2002, Annual Report concerning the financial year 2003, Annual Report concerning the financial year 2004, www.eca.eu.int.

⁵⁸⁴ Ibid.

⁵⁸⁵ The ECA has found that the transactions underlying the accounts for 2004 were legal and regular with respect to revenue, commitments, administrative expenditure, expenditure on the pre-accession strategy (!) and areas of expenditure under the CAP covered by the Integrated Administration and Control Systems. However, it was not able to provide the positive assessment for the remaining four (out of six) main areas of expenditure.

⁵⁸⁶ N. S. Groenendijk, op. cit. p. 702.

⁵⁸⁷ J. Inghelram, op. cit. pp. 132-133.

The EC Treaty gives the ECA a right of access to any information it requires to undertake its tasks. According to Article 248(3) EC, the audit shall be based on records and, if necessary, performed on the spot in the other institution. Article 248(3) further provides that the other institutions shall also forward to the ECA, at its request, any document or information necessary to carry out its tasks. However, the ECA has experienced problems with enforcement of its right to access information. Although the ECA had the possibility of filing an action for failure to act against another institution under the Article 232 EC since it became an institution under the Maastricht Treaty, this right was restricted as it was possible to file an action only if the defending institution has not defined its positions within two months of being called upon.⁵⁸⁸ In response to ECA's request for strengthening the right of freedom of access to information, the Amsterdam Treaty provided the ECA an additional instrument to enforce its right to access information. In accordance with the Amsterdam Treaty, the ECA has the right to file an action for annulment of the decision by which an institution refuses to grant an access to information before the Court of Justice under Article 230(3) EC for the purpose of protecting its prerogatives. If this Court of Justice finds that the refusal of the access is not justified, it will annul such a decision and provide the ECA access to necessary documents.

Relationship between the ECA and other EU institutions and Member States

In the beginning of its operation, the ECA had quite conflictual relations with the Commission, was largely ignored by the Council of Ministers and the European Council, but instantly established good relations with the European Parliament, which has accepted it as an important ally in its power struggle with the Council and the Commission.⁵⁸⁹ Relations between the ECA and the Commission especially deteriorated during Jacques Delors' tenure in Brussels. In contrast to the situation during Delors' tenure in the Commission, Jacques Santer invested considerable efforts in improving

⁵⁸⁸ Ibid, p. 137.

⁵⁸⁹ D. O'Keeffe, *ibid*.

relations with the ECA and acknowledged the many managerial weaknesses highlighted by the Court in its reports.⁵⁹⁰ The tone of Commission-ECA relations changed from hostility to a shared approach towards sound financial management and a sense that the key issue in the longer term is to address the weaknesses not in the financial management of the Commission, but in the Member States. Internally in the Commission, it was felt that the ECA was strong enough to criticize the Commission but was still unwilling to take a tougher stance on the Member States.⁵⁹¹

It seems that the ECA is now more sympathetic to the management difficulties of the Commission and is more willing to identify problems with the Member States. The Parliament and the ECA continue to share a joint concern about the management of EU monies, although the ECA is less subservient to the EP. As it grew in confidence, it has started pointing out to growing financial management difficulties in the Member States and not just in the Commission.⁵⁹²

In the last couple of years, the ECA has especially pointed out various risks in the area of pre-accession strategy on implementation of all programmes carried out in the candidate countries, although the overall area of management of the EU pre-accession funds has been assessed as satisfactory. Thus, for example, in its 2003 and 2004 Annual Reports, the ECA has pointed out to numerous shortcomings in the supervisory systems and controls in the case of pre-accession aid, which had already been identified in the previous years and resulted in errors and greater risks affecting the legality and regularity of the transactions. The errors detected during the ECA's audits of transactions in 2003 have revealed system weaknesses and the need to further improve the supervisory systems and controls in order to limit the risk of irregular payments.⁵⁹³

⁵⁹⁰ Cf. B. Laffan, "Becoming a 'Living Institution': The Evolution of the European Court of Auditors", *op. cit.*, pp. 256-263.

⁵⁹¹ *Ibid.*

⁵⁹² *Ibid.*

⁵⁹³ ECA, Annual Report concerning the financial year 2003.

The ECA has been trying to establish co-operative relations with national audit offices so that it can also rely on their findings in its work. Following a British proposal, the Amsterdam Treaty specified that the ECA shall perform the audit on the spot in the Member States, including on the premises of any natural or legal person in receipt of payments from the budget. Such audit is carried out in liaison with the national audit bodies or competent departments. In the Treaty of Amsterdam (Article 248-3)⁵⁹⁴ it was agreed that “the Court of Auditors and the national audit bodies of the Member States shall cooperate in a spirit of trust while maintaining their independence.” Proposed by the German delegation, this provision reiterates the general obligations of cooperation between the Community institutions and the Member States under Article 10 EC.⁵⁹⁵

However, it is interesting to note that the EU Treaty has kept the last sentence of the Article 248(3) that national audit bodies or departments “shall inform the Court of Auditors whether they intend to take part in the audit.” This indicates that they are free not to participate and has placed the onus on national audit authorities to make a decision concerning their involvement in the statement of assurance process. This sentence also confirms the autonomous nature of the ECA’s audit rights in the Member States.⁵⁹⁶

In order to balance the autonomous nature of the external audit institutions in the Member and candidate States and cooperation with the ECA, the Nice Treaty has included a Declaration on the Court of Auditors by which the ECA and the national audit institutions have been called to improve the framework and conditions for cooperation, while maintaining the autonomy of each. To that end, it has been advised that the President of the Court of Auditors should set up a contact committee with the chairmen of the national audit institutions.⁵⁹⁷

⁵⁹⁴ Amended Art. 188c of the TEU, Treaty of Amsterdam.

⁵⁹⁵ Cf. I. Inghelram, *op. cit.* p. 140.

⁵⁹⁶ *Ibid.*, p. 139.

⁵⁹⁷ http://www.eca.eu.int/eca/treaty/docs/dispcdc_en.pdf.

For several years now, the Contact Committee, comprising the heads of the external audit institution (which includes the President of the ECA), the Committee of Liaison Officers and working groups on specific audit topics has been operating rather successfully. The heads of the national external audit institutions and the ECA meet once a year and their meetings are prepared by the liaison officers who themselves meet usually twice a year. It should also be noted that the ECA, together with the Contact Committee has set up a parallel liaison structure with the external audit institutions of the candidate countries to help facilitate their integration into the EU after accession. Although the Member States are still under no obligation to carry out controls on behalf of the Court, the cooperation between the ECA and national external audit institutions has undoubtedly improved under this framework.

Similarly to the Member States contexts, the key issue in ensuring an effective external audit in the EU is a provision for adequate follow-up procedures in the case of recommendations by the ECA. The critical importance of follow-up procedures has now been widely recognized by requiring the Commission to comment on the ECA's annual report and any relevant special reports and to state how the ECA's recommendations are being met.⁵⁹⁸ However, the question is how the ECA's audit powers could be enforced not only in the Commission, but also in the Member States. Some authors are of the opinion that the ECA's powers towards the Member State could be enforced through an action for infringement of the Treaty via the Commission.⁵⁹⁹ However, this could be an unsatisfactory solution since the Commission (under Article 274 EC) and the Member States are jointly responsible for the implementation of the budget and it is not plausible that one would go directly against another in this process. The better solution could perhaps be giving the ECA the right to bring an action directly to ECJ against the Member States, in order to protect the institutional balance between both the Community institutions and Community institutions and the Member States.⁶⁰⁰

⁵⁹⁸ Annual Report concerning the financial year 2004, www.eca.eu.int.

⁵⁹⁹ J. Inghelram, *op. cit.*, p. 140.

⁶⁰⁰ *Ibid*, pp. 140-141.

Fight against fraud and OLAF

The establishment of OLAF in 1999 can be traced back to 1988 when the Delors Commission felt compelled to establish UCLAF in response, notably, to repeated requests from the European Parliament to the Commission to enhance its fight against fraud. In 1998, in anticipation of the coming into force of Article 280 of the Treaty of Amsterdam on protecting the EU's financial interests, the Commission proposed that an independent anti-fraud office should replace UCLAF. However, the real impetus for creating OLAF came from continuing criticisms of the Commission's financial management and a very critical report by the ECA and UCLAF itself.

While emphasizing the importance of OLAF's investigative function, the Commission entrusted the Office with a wide range of activities related to the protection of the European Union's financial interests. These activities cover the following:

- the assistance that the Commission gives to the Member States in the fight against fraud;
- the development of a strategy for fighting fraud within the framework of its policy on the protection of financial interests (Article 280 of the Treaty);
- the preparation of the Commission's legislative and regulatory anti-fraud initiatives;
- technical assistance, especially in the field of training, to the other Community bodies and institutions and to the national authorities concerned with the protection of the Community's financial interests.⁶⁰¹

OLAF issued its first annual report in June 2000. When presenting its first report OLAF's director pointed out the continuing problems arising from the differences in national legal systems which prevent the emergence of EU wide anti-fraud rules and common penalties for offenders.⁶⁰²

⁶⁰¹ Decision 1999/352/EC, ECSC, Euratom, Article 2(3) to (7).

⁶⁰² B. Laffan, "Financial Control: The Court of Auditors and OLAF", pp. 247-248.

OLAF is still a young institution, which is in the process of establishing its internal structures, procedures, processes. Like the ECA, it is part of the Union's accountability structure with a specific remit to combat fraud and crime. Its remit is based on the clear recognition that there is an important transnational dimension to budgetary fraud in the EU. Similar to the ECA, there is a clear recognition that OLAF has to work with and through national investigative channels.

In 2005, the ECA produced a special report on the operation of OLAF, pointing out the difficulties it has faced in its first years of operation and giving recommendations for its future work.⁶⁰³ The report reveals that the preparation and follow-up of investigations have frequently been rudimentary. The investigators objectives are still vague as regards the evidence to be obtained and the resources to be used. Apart from the customs sector, cooperation with Member States still calls for serious effort in both areas that are managed directly and where management is shared with the Member States.⁶⁰⁴

OLAF is independent in its investigations, but subject to the Commission as far as its other duties are concerned. This hybrid status has not affected its independence in its investigative functions. The fact that it is attached to the Commission has enabled it to benefit not only from extended administrative and logistical support, but also from the same regulatory anti-fraud provisions as Commission departments. Therefore there are no proposals to change the Office's status.⁶⁰⁵ The key issue to be addressed instead is the need for OLAF to focus its investigative function, so that better use is made of its resources, notably with a view to opening investigations that target areas in which the risk of fraud is considered greatest, as suggested by the ECA's special report.

⁶⁰³ The Court of Auditors, Special Report No 1/2005 concerning the management of the European Anti-Fraud Office (OLAF) together with the Commission's replies. OJ C 202/1 of 18/8/2005.

⁶⁰⁴ Ibid.

⁶⁰⁵ Ibid.

Nature of the EU and financial accountability at the EU level

After analysing the key elements of financial accountability at the EU level, the question which arises is what is the nature of financial accountability at the EU level? Is the accountability relationship established between the EU institutions and EU citizens the same as in the nation state context? Is there a difference between two levels of accountability and if so, what are then the consequences of such a difference?

In order to be able to comprehend the financial accountability relationship in the EU context we will have to comprehend the nature of the EU itself. Therefore we shall discuss the main theories attempting to explain the nature of the EU integration and its basic features. This will provide us a basis for drawing general conclusions on the nature of financial accountability relationship.

Theoretical basis for EU integration

There are several theories which attempt to explain the nature of the EU. The most prominent ones are: neo-functionalism, inter-governmentalism and multi-level governance. Although all these theories seem to provide quite different determinants and postulates of supranational integration, they in fact emphasise different aspects of the EU integration process and operation. We shall briefly analyse the main features of these theories, which should provide a basis for understanding of financial accountability at the EU level.

Neofunctionalists have for many years provided the framework for understanding EU integration. The key tenet of neo-functionalism is that different social groups (including bureaucratic actors at state level, societal interest groups and multi-national cooperations) within Member States have particular interests in the integration processes. These interests are mainly of economic nature and cross the borders of nation states due to strong interconnectedness of national economies. The promotion of economic interests

leads to certain degree of integration, which is then by 'spill-over' effect spread to other areas of integration. The main idea is thus that integration in one sphere creates pressure for integration in other areas. Economic integration naturally leads to certain degree of political integration, which is further spread by spillover effect to different sectoral areas. In order to attain their integration objectives interest groups concentrate their attention both on the national institutions and EU institutions, applying the pressure on those who have the regulatory power.⁶⁰⁶

Neofunctionalism has been facing numerous criticisms. The main problem of this theory seem to lie in its relative simplicity, which could well serve to explain gradual strengthening of integration processes but could not account for difficult periods in the EU context, featured by serious crises in the EU development in the 1970s as well as those experienced relatively recently, with rejection of the EU Constitution by some of the Member States and budget disputes. As Community integration had not proceeded in the manner predicted by neofunctionalists, the initial neofunctionalists theoretical framework was modified and become much more complex. Notwithstanding these modifications, the neofunctionalists were not able to explain the causal links of various shifts and changes in the EU integration process. Furthermore, the lack of more advanced ideas on Community democratic features and accountability represent the weak points of this theory, which seems to be well-suited to explain the early EU integration process, but fails to provide insight into its more advanced stage of development.⁶⁰⁷ In spite of these critics, neofunctionalist theory certainly has its values and could be well used to provide at least partial explanation of the development of financial accountability mechanisms in the EU context. Neofunctionalism could thus be well used to explain the emergence of the European Court of Auditors, as has been pointed out earlier.

⁶⁰⁶ Cf. P. Craig, G. de Burca, *The Evolution of EU Law*, (Oxford University Press, 1998), pp. 3-7; J.

Peterson, M. Shackleton, *The Institutions of the European Union*, (Oxford University Press), 2001, pp.5-6

⁶⁰⁷ P. Craig, G. de Burca, *op.cit.*, p.4.

The next theory which attempts to explain the EU integration is intergovernmentalism. Intergovernmentalism represents a state-centric theoretical framework which tries to explain the nature of the EU on the basis of a rational choice theory, overtaken from economic liberalism. The key argument of intergovernmentalism is that increasing transborder flows of goods, services, factors or pollutants create “international policy externalities”, which create costs and benefits for the groups outside national jurisdictions. In order to overcome possible disputes and individual interstate bargains and in this way reduce the costs of externalities, the states have created a supranational structure, which should provide a stable institutional setting for the resolution of possible disputes and bargains. In this sense, the states have either pooled their sovereignty, through qualified majority voting or delegated power to semi-autonomous institutions, which should be able to deal efficiently with all the issues arising from the integration process.⁶⁰⁸

The core of the intergovernmentalist argument is that, despite certain level of delegation of power to supranational institutions, the Member States remain key determinants in the integration process, unlike the Community institutions which have little, if any, independent impact on the integration process. Intergovernmentalists contend that the existence of democratic institutions and mechanisms in the EU is fully contingent upon the consent of the States, which are the driving forces behind integration. Supranational actors act mainly at their behest and exert almost no influence on the pace of integration. The significant powers of the Commission and the European Court of Justice intergovernmentalists explained by use of delegation and agency theory.⁶⁰⁹

Intergovernmentalists have been heavily criticized for over-simplification of the driving forces for integration and their reduction to pure economic calculus. Furthermore, their contention that Community institutions have no genuine impact on the integration process is highly disputable. Nevertheless, insights of intergovernmentalism are certainly

⁶⁰⁸ Ibid, pp. 9-15.

⁶⁰⁹ Ibid.

useful for explaining some of the key features of the EU integration and will be used to some extent in our financial accountability research, as will be pointed out later.

As a reaction to the intergovernmentalists' overstressing of the importance of Member States in the integration process, a new theory of multilevel governance has emerged, emphasising the importance of the EU institutions in the policy-making process. The theory of multi-level governance draws on the new institutionalist thinking, which stresses the importance of the design of political institutions on the society. Advocates of multi-level governance argue that although national governments are major players in the policy process, they do not have a monopoly of control. Supranational institutions, including the Commission, the European Parliament and European Court of Justice, have genuine, independent influence on policy making process that does not stem from and cannot be explained by individual national interests.⁶¹⁰

Multi-level governance theory sees the rationale for integration in the wish of the Government leaders to transfer decision-making power either because the political benefits may outweigh the costs of the loss of political control, or because of the advantages obtained by shifting the responsibility for unpopular decisions from the national to supranational level. Their main argument is that once competence over a certain subject matter has been transferred to the Community level individual states have only a limited degree of control of supranational decision making process. Ability of the Member States to control the EU institutions is limited by a range of factors, including the 'multiplicity of principals, the mistrust that exists among them, impediments to coherent principal action and by unintended consequences of institutional change.'⁶¹¹

Stone, Sweet and Sandholtz have made an interesting attempt at combining the intergovernmentalism with new institutionalism (i.e. multilevel governance). They argue

⁶¹⁰ Ibid, pp. 16-23.

⁶¹¹ G. Marks, L. Hooghe, K. Blank, "European Integration from the 1980s: State-Centric v. Multiple-Level Governance", (1996) 34 JCMS pp. 341-342.

that these two theories could be placed at two opposite ends of the continuum. At the one end of the continuum, there is pure intergovernmental politics where the states are the central players who bargain in order to attain commonly acceptable policies. In such matters, the role of a Community is one of a passive observer, who can only try to enhance the efficiency of such interstate bargain. At the other end of the spectrum there is supranational politics which covers the areas of competence which, due to pressure of different societal actors, have been transferred to the Community decision making level. In these matters, the Community institutions take precedence, greatly limiting the influence of the Member States. Stone, Sweet and Sandholtz therefore believe that different areas of Community policy could definitely be located at different points along the spectrum. The location of a policy area at a particular point on the continuum is dependent on the levels of cross-border transactions and the consequential need of different societal actors for supranational coordination within that area.⁶¹²

In a similar vein Weiler argues that there are three modes of governance operating at the Community level: the international, the supranational and the infranational. International governance is concerned with macro-level matters, such as the fundamental rules of the system and issues of high political sensitivity. The key actors of the international mode of governance are the states and especially state executives. Supranational governance, on the other hand, deals with the passage of the primary legislative agenda of the Community, including the principal harmonization measures. In the supranational context, states are also important players, but so too are the Community institutions, such as the Commission and the EP. Weiler furthermore adds an important third dimension of the Community governance - infranational governance, which includes executive and implementing measures. At the infranational level of governance, the key actors are neither the states executives nor the Community institutions, but administrations,

⁶¹² A. Stone Sweet and W. Sandholtz, "European Integration and Supranational Governance", 1997 4, JEPP, p. 297.

departments, private and public associations and certain interest groups of both Union and member state levels.⁶¹³

Theoretical model of EU financial system and financial accountability

We find the models of Stone, Sweet and Sandholtz and especially the Weiler model most useful to explain the dynamic and fairly complex policy-making process operating within the Community, and in particular its financing. These models provide quite a good framework for understanding of the complexity of the EU budget issues and financial accountability.

If we apply the Stone Sweet and Sandholtz model to the EU financial system, we may argue that at the one end of the intergovernmental continuum (international governance in Weiler's model) there are politically sensitive issues of the EU budget, in which the Member States are the key players of the game. Relatively recent fierce disputes over the British rebate which triggered the question of the reform of the common agricultural policy have demonstrated the delicacy of budget issues for the individual Member States and underlined the existence of the right of the Member States to veto budget proposals which do not satisfy their national interests.

Furthermore, it may be argued that the process of budget preparation and allocation falls somewhere in the middle of the two ends, between intergovernmental and supranational levels of governance. The Commission is responsible for budget preparation while the Council and Parliament are in charge of its approval. As we could see earlier, approximately half of the Union's budget is spent on 'compulsory expenditure' (mostly agriculture). In the event of disagreement between the Council and Parliament over the compulsory expenditure the Council's view prevails.⁶¹⁴ This keeps the budget allocation pendulum towards the intergovernmentalist end. On the other hand, other half of 'non-

⁶¹³ P. Craig, G. de Burca, *The Evolution of EU Law*, op. cit. pp. 29-30.

⁶¹⁴ I. Harden, F. White, K. Donnelly, op. cit. pp. 602-603.

compulsory' expenditure the final word rests with the Parliament.⁶¹⁵ Therefore, the issue of expenditure allocation is slightly reversed towards the supranational end of the spectrum. It may in any case be argued that both cases generally fall within the Weiler's supranational governance model.

The above discussion implies that our key concept of democratic financial accountability, defined in the Chapter 1, understood as a relationship between the Government and its citizens, where the citizens have entrusted their money to the Government and consequently are holding it to account for its stewardship, cannot be easily transferred to the supra-national context of the EU. The key problem is that the main democratic relationship between the EU citizens and the EU, established through the European Parliament, is still fragile. The European Council, as the main forum of Member States interest, still wields a preponderance of power in the decision-making process on public expenditure issues. This points to the intergovernmentalist nature of the game.

Furthermore, for the purposes of the more in depth understanding of the general conception of financial accountability at the EU level, it is also important to look at the revenue side of the EU budget. Although the financing of the budget is ensured by the EU rules which are binding for all Member States there is no direct link to citizens or taxpayers. Instead, the financing of the budget relies on transfers from national treasuries.⁶¹⁶ Therefore the citizens of the EU do not feel that they have directly delegated their money to the EU. Instead it is the Member States who are in charge of providing the money to the EU budget and subsequently they are the key actors in the process of the budget allocation, approval and, as will be pointed out later, implementation. With the current overwhelming weight of the gross national income (GNI) resources in the EU budget, Member States themselves tend to judge EU policies and initiatives exclusively in terms

⁶¹⁵ Ibid.

⁶¹⁶ Commission of the European Communities, "Financing the European Union, Commission report on the operation of the own resources system", Brussels, 14.7.2004. COM(2004) 505 final.

of their national allocation and with little regard to the substance of policies.⁶¹⁷ This all again implies a strong case for intergovernmentalist thinking, which clearly undermines financial accountability established directly between the EU citizens and EU institutions. In order to strengthen this relationship and provide more transparency in the EU budgeting process, the European Commission has recently started giving thought to changing the system of the EU financing, which should address the key weaknesses of the present system.⁶¹⁸

If we, however, look at a more specific concept of financial accountability, understood as a phase in the public expenditure management process in which a government has to account for the money spent, we may see that the area of financial accountability is characterised by multiple levels of operation, which could perhaps best be placed towards the neofunctionalist end of the spectrum and Weiler's infranational governance model. On the side of the EU, there are a number of the EU institutional financial accountability mechanisms established for the purpose of securing the financial accountability at the EU level. However, the fact that the EU budget is not implemented solely by the EU institutions, but largely by the Member States, places the burden of financial accountability not only on the EU institutions but even more so on the financial accountability mechanisms of the Member States, which are the key safeguards of the EU money. The area of financial accountability would furthermore correspond quite well within Weiler's third infranational dimension of EU governance, concerned with execution and implementation measures taken at both international and national levels of governance.

It may be therefore concluded that financial accountability in its more specific sense in the EU context is a relationship established not only between the EU citizens and EU

⁶¹⁷ Ibid.

⁶¹⁸ The Commission has been considering introduction of a new tax-based resource replacing the current statistical VAT-based resource and has proposed three main candidates as possible future fiscal own resources: a resource based on energy consumption, national VAT bases and corporate income.

institutions, but also between the EU citizens and their own nation states, where the citizens are holding both layers of governance to account for the stewardship of public money. Financial accountability is ensured through a number of different financial accountability mechanisms which exist both at the EU and the national level.

Due to its complex, multi-level governance nature, the area of financial accountability is characterised by constant interaction between the EU and national financial accountability institutions and mechanisms. As we could see, the Member States have established the financial accountability mechanisms at the Union level (Court of Auditors etc.) to oversee their agent, the Commission, in its management of EU monies. In the process of establishment of the EU financial accountability mechanisms, the EU policy makers found their inspiration in their national contexts, which made an undisputed impact on the design of the EU institutions. However, over time the EU institutions, due to complexity and shared competence in the budget execution had to start scrutinizing the functioning of the financial accountability mechanisms of the Member States as well as the countries acceding to the EU. Therefore, the national financial management came under increasing scrutiny of the EU institutions. This has contributed to an enhancement of the norm of sound financial management in the EU and to creating a web of rules around the control of the EU expenditure, which started having a reverse affect on financial management of national institutions.⁶¹⁹ All this points to the supranational nature of the financial accountability in the EU context and proves the new-institutionalist argument that the form and shape of institutions have a powerful impact on the policy-making process in most of the EU spheres of competence, including the area of financial accountability.

The remainder of this chapter shall examine the influence the EU system of financial accountability on countries which have expressed the wish to become members of the EU.

⁶¹⁹ B. Laffan, "Financial Control: the Court of Auditors and OLAF", *op. cit.*, pp. 249-251.

Financial Accountability as a condition for the EU accession

The EU key challenge – process of enlargement

The expansion of the European Union of 1st of May 2004 which took in eight Central and East European countries (CEECs) and two Mediterranean countries to the EU has marked a new momentum in the European integration process. On the side of the EU, the enlargement is conceived as a “historic opportunity”⁶²⁰ for bringing the European continent together. It should provide greater security and stability of the continent and economic prosperity for all the European nations.⁶²¹ Although enlargement denotes investment of sufficient financial resources into the CEECs economies,⁶²² it also creates bigger and more dynamic market for the benefit of all of its members. For the new members, on the other hand, the accession into the EU means becoming part of the long desired “West”, with blooming economy, prosperity and world without frontiers. It signifies an era of greater freedom and respect for human rights, based on European democratic values.

The EU’s readiness to accept the CEECs as potential candidate states was explicitly expressed for the first time at the Copenhagen European Council (1993), which declared that:

“the associated countries in central and eastern Europe that so desire shall become members of the European Union. Accession will take place as soon as an associated

⁶²⁰ Cf. European Commission, “Agenda 2000. For a stronger and wider Union”, *Bulletin of the European Union*, Supplement 5/97, 13, 1997.

⁶²¹ Cf. Regular Reports from the Commission on Progress towards Accession by each of the candidate countries, November, 2000.

⁶²² The Commission has estimated that the enlargement will cost the Union up to 75 billion ECU. Cf. D. Dinan, *Ever Closer Union*, (Lynne Rienner Publishers) 1999, p. 198.

*country is able to assume the obligations of membership by satisfying the economic and political conditions required”.*⁶²³

In June 2000, the Santa Maria de Feira European Council agreed that all the countries in the region are “potential candidates” for the accession to the EU. This perspective should help each country to accelerate the pace of reform and to begin to align its laws and structures with those in the EU.⁶²⁴ While Bulgaria and Romania hope to join the EU in 2007, Croatia, Macedonia and Turkey have the status of candidate countries and Serbia and Montenegro, Bosnia and Herzegovina and Albania have the status of potential candidate country. The increased EU co-operation with the countries of Western Balkans and the anticipation of their accession to the Union are expected to bring about greater stability of the whole region.

Conclusions of Thessaloniki European Council of June 2003, reiterate the determination of the EU to support the European perspective of the Western Balkan countries. The Council explicitly states that the Western Balkan countries are to become members of the EU “once they meet the established criteria”.⁶²⁵ Although the prospects of further EU enlargement have been seriously questioned after the 2005 stalemate with the EU Constitution, the EU Commission has still not changed its rhetoric and intentions and seems to be determined to enable the comprehensive economic and political unification of the European continent in the years to come.

Setting up the EU membership criteria

In order to help the candidate states achieve the objectives of accession to the EU, the Commission outlined the strategy for preparing the Central and East European states for

⁶²³ European Commission, “PHARE 1994 Annual Report”, COM(95) 366 final, 14.

⁶²⁴ Cf. Enlargement Strategy Paper, Regular Reports from the Commission on Progress towards Accession by each of the candidate countries, November 8, 2000.

⁶²⁵ Presidency Conclusions of the Thessaloniki European Council, 19 and 20 June 2003.

membership, providing significant political and financial support. The pre-accession strategy generally consists of several distinct parts: priority setting, discerned through Accession Partnerships, financial assistance, Association agreements, participation in Community Programmes and preparation of the negotiations through analytical examination of the candidate country's achievements. The Commission has also set up a number of conditions which need to be met in order to join the EU. Therefore, the accession to the EU should be perceived as a long-term process, rather than a simple agreement of contractual parties, which was a feature of most of the previous enlargement waves.

The question which should be raised is why did the Commission adopt such an approach and imposed quite wide accession conditions upon the candidate countries, especially since similar conditions were not imposed during the previous EU enlargements?

To answer this question, several important factors should be taken into account. The main one is that the accession of the countries of Central and Eastern Europe to the European Union is in many respects different from all the previous European Union enlargements. First, the number of countries applying for membership was much greater than was the case with the previous waves of enlargement. Second, CEECs democratic systems were rather fragile at the beginning of the accession process and the level of economic development is still substantially below the European average.⁶²⁶ Third, the European Union is in a much more advanced stage of integration than it was in the previous enlargement waves, which necessitates meeting of certain standards before entering in the European space. Early accession to the EU, without meeting certain standards, would be

⁶²⁶ Average GDP per head in the ten new member countries is only 46% of the EU15 average. Although one new member country, Slovenia, is richer than the poorest 'old' member, Greece, the poorest new country, Latvia, has a GDP per head of only 39% of the EU average. According some estimates, it will take Poland approximately 59 years to achieve the EU average of GDP per head. Cf. *The Economist*, May 1st 2004, Volume 371, Number 8373.

likely to undermine the process of further European integration and smooth functioning of the Union. Therefore, there seem to be many arguments to support the necessity of meeting certain number of conditions in order to join the EU.

The conditions for the EU membership set up by the European Council and developed by the European Commission's Opinions are mainly of a political and economic nature. The EU requires the prospective candidate States to attain certain level of democratic and economic development, so that they would be able to sustain the obligations of membership without major difficulties. In that sense, the EU also requires CEECs to adopt voluminous *acquis communautaire*. Changes in law are therefore conceived as a basic tool for the process of political and economic integration.

However, the EU is quite aware that changes of law alone cannot bring about significant reforms in political and economic systems of the candidate states, especially when most of the acceding countries suffer from the discrepancy between the legal system and legal order. Quite often very good laws are enacted, but the degree of their implementation remains pretty low. Therefore the Commission insisted that candidate states work very hard on the strengthening of their administrative and judicial capacities. One of the important aspects of the administrative capacity of candidate states is financial accountability.

Financial accountability - a valid EU membership criterion?

The first time financial accountability was used as a criterion for accession in its own right were the Commission Opinions issued in July 1997. From 1997 and on, the European Commission started regularly checking the candidate states' administrative abilities and providing advice and solutions, in its opinions of the progress of the

candidate states towards accession.⁶²⁷ In these opinions references were not only made to administrative capacities to deal with the absorption of specific elements of *acquis communautaire*, but also to the need to develop adequate financial accountability system, based on effective internal and external financial control.

The issue which may arise in this respect is whether the Commission, i.e. the EU, has the legal right to demand the candidate States to comply with certain financial accountability standards? This question appears to be problematic, especially having in mind that there are only few provisions in European Treaties and secondary European legal sources which contain provisions of general application to financial accountability of EU funds. Although the EU has started taking a more proactive stance in this regard in the last couple of years (as pointed out earlier), the area of financial accountability still falls within the principle of subsidiarity and the EU has no competence interfering with the organization and operation of the financial accountability institutions of its Member States. But what then gives it the legal right to impose public financial accountability standards on the countries which are still not its members?

Although there is no direct legal basis which gives the EU power to require certain institutional standards from the candidate countries, it could, however, be argued that there are some indirect sources which provide the EU with such a right. The most important is Article 10EC, which requires the Member States to take all the necessary measures to fulfill the obligations arising of the EU membership. This implies that Member States must have adequate capacity to be able to ensure the timely implementation of the EU policies and managing the EU funds. This is especially important in the view that the EU does not have its own administration outside Brussels and thus heavily depends on national, regional and local governments for the

⁶²⁷ Cf. Regular Reports from the Commission on Progress towards Accession by each of the candidate countries, 1997, 1998, 1999, 2000, 2001, 2002; The EU Commission reports on Bulgaria, Romania and Turkey's progress towards accession, 2004; The EU Commission Comprehensive Monitoring reports on Bulgaria and Romania, October 2005, http://europa.eu.int/comm/enlargement/index_en.htm.

implementation of its policies. As it has been pointed out a several times by now, 80% of the EU budget is implemented by the Member and potential Member States and only around 20% by the EU institutions themselves. Therefore, Member States have to ensure efficient and effective management of the EU funds provided under the numerous EU programmes, such as Common Agricultural Policy, the Regional Development fund, European Social Fund etc.

The issue of the candidate States financial accountability has not been only the concern of the EU institutions, but also of the current Member States, especially those who significantly contribute to the EU's budget. If a new Member State lacks capacity to comply with the Community rules and does not have proper financial control mechanisms, other Member States may be put at risk. Although the financial accountability systems of the current Member States are not ideal and do suffer from various shortcomings and weaknesses (as pointed out in the ECA reports), acceptance of generally fragile systems of financial accountability of the candidate/acceding countries may generate additional burdens on the control institutions, the Commission and the ECA.

On the other hand, the establishment of effective financial control mechanisms will be of great importance for the candidate countries own administrative developments. The establishment of effective systems of financial control should provide better value for money of public funds, as well as decrease the possibilities of fraud, corruption and financial irregularities, as one of the candidate countries greatest public administration problems.

The above discussion leads us to conclude that the EU has the general right to require the candidate countries to have reliable and effective financial accountability systems. The way they organize their financial accountability systems is still left to themselves, but

they must assure that such a system will be able to properly manage and control the use of EU funds.⁶²⁸

Defining the European standards of financial accountability

The next question which should be raised is whether there are unique European standards of financial accountability to which the candidate countries should aim? And if these standards exist, what is the best way of achieving them?

As we could see, the Treaty establishes only general obligations of the Member States in specific financial accountability areas, such as fight against fraud. It also provides the basis of its own financial accountability system, setting out the responsibilities of the Commission and for the ECA. Many other detailed requirements are set out in other regulations and directives, etc. on how the processes of management and control of EU funds and resources should be designed and function. However, what seems to be missing are the general standards of operation of financial accountability systems and guidance on how to achieve the standards and develop required financial accountability requirements for accession.

In response to this need, the European Commission has developed a special negotiation Chapter 32 (before 2005 Chapter 28) which comprise *acquis* in the area of financial control and accountability. The *acquis* requirements for public financial control under Chapter 32, cover a limited number of Regulations related to the financial management and control of EU funds.⁶²⁹ Instead of relying on detail legal regulation in specific areas

⁶²⁸ J. Fournier, "Governance and European Integration – Reliable Public Administration", Preparing Public Administration for the European Administrative Space, SIGMA papers No 23, CCNM/SIGMA/PUMA (98)39.

⁶²⁹ First, there are already discussed regulations on the general management of the EC budget: The Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities, OJ L 248/1, 16.9.2002; Commission Regulation (EC, Euratom) No 2342/2002 of 23 December 2002 laying down detailed rules for the implementation of

of management of EU funds, the *acquis* in the area of financial accountability are based on general European and internationally agreed principles of sound financial management.

In order to develop the requirements of this and other negotiation chapters in more depth, the European Commission SIGMA programme,⁶³⁰ provided a useful instrument in the assessment process by producing the “baseline” criteria. Baselines are designed in accordance with the EU legislation, but they also incorporate good or best European practices in six core functions that public management systems are expected to fulfill effectively.⁶³¹ They were prepared in close co-operation with various Directorate Generals of the Commission and the European Court of Auditors. In many cases, candidate countries have also given contributions for the design of these baselines. SIGMA regularly revises the baselines in order to keep them up to date with the new EU legislation and developments. Since 1999, the European Commission has produced its

Council Regulation (EC, Euratom) No 1605/2002 on the Financial Regulation applicable to the general budget of the European Communities, OJ L 357/1, 31.12.2002. Furthermore, key regulations on financial management, control and audit of EU pre-accession funds are: Council Regulation (EC) No. 1266/1999 of 21 June 1999 on coordinating aid to the applicant countries in the framework of the pre-accession strategy and amending regulation (EEC) No. 3906/89, OJ L 161/68; Council Regulation (EC) No. 1267/1999 of 21 June 1999 Establishing an Instrument for Structural policies for Pre-accession (*ISPA*), OJ L 161/73, Council Regulation (EC) No. 1268/1999 of 21 June 1999 on Community Support for pre-accession measures for agriculture and rural development in the applicant countries of Central and Eastern Europe in the pre-accession period (*SAPARD*), OJ L 161 (with 2003 and 2004 amendments) . Key regulations on financial management, control and audit of EU structural and cohesion funds are: Council Regulation (EC) No 1260/1999 of 21 June 1999, laying down general provisions on the Structural Funds, OJ L 161/1; Commission Regulation (EC) No 438/2001 of 2 March 2001 laying down detailed rules for the implementation of Council Regulation (EC) No 1260/1999 as regards the management and control systems for assistance granted under the Structural Funds, OJ L 63/21.

⁶³⁰ SIGMA programme is mainly funded by the EU PHARE programme and represents one of the main instruments of the European Commission in promoting capacity development in public administration in Central and Eastern Europe, as well as a technical assistance service to the candidate states..

⁶³¹ On policy management, civil service, internal financial control, public expenditure management, external financial control and procurement

regular Progress Reports on the basis of the SIGMA baselines. In this way, the Commission has created a well-defined tool for administrative capacity assessment.

However, it should be noted that although the key objective of the SIGMA's baselines is to assess administrative readiness for EU membership, they have been used widely beyond the direct EU accession context as a basic benchmarking system for establishing whether public administration and financial accountability systems meet minimum institutional and legal standards and have contributed to a broad discussion on what constitute 'European Values' of public administration and financial accountability.⁶³²

There are four main elements of EU financial accountability requirements that have been envisaged by the EU negotiations instructions and further developed by the SIGMA baseline criteria: public internal financial control, external audit, EU pre-accession funding and future structural actions and the protection of the EU's financial interests.⁶³³ The vast majority of these requirements are based on the existing EU regulations and practices.

Public Internal Financial Control

Public Internal Financial Control (PIFC) requirements refer to the entire public sector financial internal control systems in an accession country, disregarding their possible involvement in dealing with the EU funds. PIFC requirements consist of two key components: financial management and control (FMC) and internal audit. Under the

⁶³² Dimitrova, A. (2002), Enlargement, Institution-Building and the EU's Administrative Capacity Criteria. *West European Politics*, Vol. 25. No 4. 171-190.

⁶³³ Cf. European Commission Directorate-General Enlargement: Enlargement of the European Union, Guide to the Negotiations, Chapter by Chapter, December 2004, <http://europa.eu.int/comm/enlargement/negotiations/chapters/index.htm>

PIFC model, all public income and spending centres should be subject to PIFC and all control and audit systems should be integrated in the system.⁶³⁴

The Commission assesses the progress of PIFC development through monitoring a series of steps to be taken by the central authority responsible for the development of PIFC. The first step is the drafting and adoption of a *PIFC Policy or Strategy Paper* in which a gap analysis is provided of the present control systems that leads to a number of recommendations for upgrading the systems taking into account internationally accepted control and audit standards. The second step is the *drafting and adoption of framework and implementation laws* relating to internal control and internal audit. The third step is the *establishment of operational and well staffed organizations* like decentralized internal audit units, adequate financial services in income and spending centres, and central harmonization units for both functions (FMC and internal audit). The fourth step is the *establishment of sustainable training facilities* for financial controllers and internal auditors.⁶³⁵

These requirements have further been developed by the SIGMA Baselines on Public Internal Financial Control, in line with the existing EU system of internal control as defined by the Financial Regulation 2002 (discussed earlier in this chapter). The Baselines thus require the acceding countries to have an adequate management control systems and financial control procedures in place. This means that management of organization must have the responsibility for adequate financial management and control systems, including ex ante controls of commitments and payments and recovery of unduly paid amounts.⁶³⁶

The next set of baselines requires the establishment of a functionally independent internal audit/inspectorate mechanism with relevant remit and scope. The Commission does not require any specific organization structure of such a body, but insists it should be

⁶³⁴ Ibid.

⁶³⁵ The World Bank draft Report, *Serbia – Fiduciary Assessment Update*, July 2005, p.31.

⁶³⁶ Public Internal Financial Control Baselines, SIGMA baselines, October 1999.

functionally independent, have an adequate audit mandate (in terms of scope and types of audit) and use internationally recognised auditing standards.⁶³⁷

The Commission also insists that there should be appropriate co-ordination and supervision of the applied audit standards and methodologies. This means that there should be an organization responsible for the coordination and harmonization of the implementation of PIFC throughout the entire public sector. Usually, there are two central harmonization units: one for managerial accountability and another for internal audit.⁶³⁸

External Audit

The nature and functioning of external audit is not as such part of the *acquis communautaire*. However, following the criteria laid down by the Copenhagen Summit, the new Member States will need to adhere to the additional political and economic conditions which require, amongst others, that the candidate has achieved stability of institutions guaranteeing democracy and the rule of law. This includes the existence of an effective supreme audit institution (SAI). In a more practical manner, the EC Treaty is in fact implying the existence of such institutions and their capacity to co-operate with the European Court of Auditors (Articles 246-248). Moreover, general financial control standards for the management of EU-funds and own resources in the candidate countries as well as in the Member States require an effective external audit of all public sector resources and assets, and that this should be carried out in a continuous and harmonised manner. The external audit could also have a crucial role in the evaluation of and reporting on how the financial control systems are implemented and function.

The SIGMA baseline requirements on external audit require the SAI to have a clear authority to satisfactorily audit all public and statutory funds and resources, bodies and

⁶³⁷ Ibid.

⁶³⁸ The World Bank draft Report, *Serbia – Fiduciary Assessment Update*, *ibid.*

entities, including EU resources. If the SAI is not the sole provider of public sector external audit, then any assessment should also refer, as applicable, to the alternative arrangements made and in particular to any gaps in audit coverage.⁶³⁹ The SAIs are further required to carry out full range of regularity and performance audit in compliance with INTOSAI auditing standards.⁶⁴⁰

A special emphasis is laid on the necessity of having operational and functional independence. This should be ensured by providing the SAI the right to decide what work it will carry out and to make the results of its work directly available to the public and the Parliament. The Parliament, e.g. its designated committee should be also obliged to consider SAI's reports and the Government should be obliged to formally and publicly respond to the published reports. It is further important to ensure an effective follow-up on whether its and parliament's recommendations are implemented. The SAI should also adopt internationally and generally recognised auditing standards compatible with EU requirements and must be appropriately aware of the requirements of the EU accession process.⁶⁴¹

The Commission is, however, aware that in addition to the criteria described above, the capacity of a country to bring public sector external audit into line with European standards and international best practice, and to maintain those standards, will depend on a number of factors including the capability and capacity to develop and make change, existence of a strategy for development and its effective implementation and commitment to the change and development process. The Commission therefore recommends that, subjective and objective indicators should be assessed to try sum up the impact and effectiveness of the SAI.

⁶³⁹ Public Sector External Audit Baselines, SIGMA baselines, October 1999.

⁶⁴⁰ Cf. INTOSAI: *Lima Declaration on Guidance on Auditing Precepts*,
http://www.intosai.org/Level1/1_defaue_new.html

⁶⁴¹ Public Sector External Audit Baselines, SIGMA baselines, October 1999.

EU Pre-accession funding and future Structural Action and Protection of the EU financial interests

In addition to requirements of well functioning PIFC and external audit systems, the Commission naturally pays special attention to the correct use, control, monitoring and evaluation of EU funding, which constitute an important element in assessing the Candidate Countries ability to apply the *acquis* under the Chapter 32. The Commission requests the acceding countries to apply the PIFC procedures (ex-ante financial control as well as internal audit) in the same way to all the public funds irrespective of their source, as there should be no distinction made in terms of control for the national budget and for EU resources. With reference to the internal control procedures related to the EU pre-accession funds, the Commission requests the acceding countries establish the appropriate ex ante control and functionally independent internal audit mechanisms, to make available experienced and qualified staff resources and to produce procedure manuals as well as audit trails for each pre-accession instrument. One of the important indicators is the existence of the procedure for the recovery of lost EU funds.⁶⁴²

Furthermore, protection of the EU financial interests assumes the ability to implement the relevant EC Regulations by the accession, namely Regulation on the protection of the EC financial interests and Regulation on the on-the-spot checks carried out by the Commission in order to protect the EU financial interests against fraud and other irregularities.⁶⁴³ The acceding countries are also requested to designate a single contact point for co-operation with OLAF and to ensure the development of the administrative capacity necessary to implement the *acquis*, including the capacity of the law

⁶⁴² Cf. European Commission Directorate-General Enlargement: *Enlargement of the European Union, Guide to the Negotiations, Chapter by Chapter*, December 2004,

⁶⁴³ Regulation (EC) No. 1073/1999 of the European Parliament and the Council of 25 May 1999 concerning investigations conducted by the European Anti-Fraud Office (OLAF), Council regulation (EURATOM) No. 1074/1999 of 25 May 1999 concerning investigations conducted by the European Anti-Fraud Office (OLAF).

enforcement bodies and judiciary to address cases where EU financial interests are at stake.⁶⁴⁴

Finally, in accordance with article 164 of the Financial Regulation, the Commission may decide to entrust project implementation management of its pre-accession funds to authorities of beneficiary countries, under the so-called decentralised management framework. This takes place after having established that the beneficiary third country or countries are in a position to apply in whole or part a number of predefined criteria for financial management and control, and in particular: (a) Effective segregation of the duties of authorizing officer and accounting officer; (b) existence of an effective system for the internal control of management operations; (c) for project support, procedures for the presentation of separate accounts showing the use made of Community funds; and for other forms of support, an officially certified annual statement for the area of expenditure concerned to be made available to the Community; (d) existence of a national institution for independent external auditing; (e) transparent, non-discriminatory procurement procedures ruling out all conflicts of interest.

The European Commission closely monitors EU acceding countries' progress in preparing and implementing a new regulatory framework for public financial control. As the requirements under Chapter 32 are largely based on EU and internationally accepted standards, the practical interpretation and implementation of these standards can in some cases pose a significant challenge to acceding countries, especially since the financial accountability standards are not static values, but are themselves of evolving nature. That is why DG Budget and DG OLAF in co-operation with DG Enlargement attach high importance to the monitoring and cooperation process.

Summary and Conclusions

This chapter has pointed out the great complexities of financial accountability relationship established at the supra level of governance such as the EU. Numerous levels at which financial accountability operates in the EU context has resulted in weakening of

⁶⁴⁴Cf. European Commission Directorate-General Enlargement: *Enlargement of the European Union, Guide to the Negotiations*, *ibid.*

the direct financial accountability relationship between the EU citizens and institutions which use the tax-payers money, creating a general feeling of distrust towards the EU governance system.

Over the last couple of years, in response to serious criticisms on its financial management, the EU has made an important progress in improving the overall financial accountability framework. The reform of internal accountability mechanisms, coupled with strengthening of the powers of the ECA and creation of OLAF have undoubtedly had a positive effect on firming up the financial accountability relationship. However, further efforts are still needed in order to fully implement the well-designed reforms and keep the reform momentum.

In the light of the ongoing reforms of the EU institutions, the EU accession process has initiated discussion on another important dimension of reform – definition of European standards and values in financial accountability to which acceding countries need to adhere in order to join the EU. This discussion has influenced not only acceding countries, but also the Member States, as the completion of the Internal Market and Monetary Union requires further harmonization of legislation and practices in various fields, including financial accountability matters. This is exemplified in the recent initiative for the creation of a common framework for internal financial control of the EU, focusing on the need for active participation and reform of internal control systems of the Member States themselves.

The evolving nature of the EU standards in financial accountability and other *acquis* has made it more difficult for the acceding countries to get to know the EU standards in financial control and audit. In response to this need, the Commission's benchmarking systems elaborated in the chapter 32 of negotiations and SIGMA's baselines have established a much more clear sense of what kind of financial accountability system is needed and is likely to provide a continuing impetus for states to measure progress in establishing high standards of financial accountability.

The value of this chapter is therefore not only in the analysis of the EU accountability system as such and identification of its links with other Member States, but even more so in providing benchmarks against which we shall compare the development of the Serbian system of financial accountability and identify the steps which need to be made in order to reach the European standards of financial accountability.

Chapter V

FINANCIAL ACCOUNTABILITY IN SERBIA

The objective of this chapter is to analyse the Serbian financial accountability system. Analysis of the current Serbian financial accountability system should provide a basis for comparison with other systems of financial accountability, which should yield recommendations for the improvement of the institutional setting and functioning of the current Serbian system and its alignment with the EU standards, as will be discussed in the concluding chapter.

In accordance with our earlier established theoretical framework, we shall firstly analyse the *who* is accountable dimension of accountability. We shall provide a short overview of the transformation of the Serbian ‘state’ during the last two centuries and analyse the current structure of the Serbian central Government. We shall also point out the European integration component in the Serbian development and outline key medium term standards on financial accountability which have been set up by the EU as benchmarks for further integration.

The remainder of the chapter will focus on the examination of the *for what* financial accountability dimension of public money stewardship and mechanisms *through which* the accountability relationship operates. The development of a normative concept of “stewardship” of public money will be analysed through examination of a newly adopted legal framework. The focus of our inquiry, however, will be placed on the fourth financial accountability dimension – mechanisms *through which* the accountability relationship operates. As with Britain, France and the EU, we shall identify the key internal and external financial accountability mechanisms, pointing out their strengths and weaknesses. This will provide us a good starting point for an in depth comparative analysis of different systems of financial accountability and examination of ways of achieving European standards of financial accountability, to be discussed in the concluding chapter.

The Serbian state – a short historical overview

Although the first foundations of Serbian statehood could be traced back to the XII -XIV century, the modern Serbian state was created only in the XIX century. After nearly five centuries under the Ottoman Empire, Serbia first gained its limited independence in 1804 and started developing its state structure under strong European influence.⁶⁴⁵ The first steps towards full independence were laid in the mid 1830s, when Serbia obtained a limited form of autonomy from the declining Turkish Empire.⁶⁴⁶ In the late 1850s Serbia gained full autonomy under the Turks, and not much later full sovereignty at the Berlin congress in 1878.

Being strongly influenced by the neighbouring political and legal systems, Serbia established a system of parliamentary monarchy, with Governments formed by the majority party or coalition.⁶⁴⁷ The Serbian legal system also developed under the strong influence of continental Austrian, German and French legal tradition, where the extensive legal regulation satisfied the need for a strict rule of law and an orderly bureaucracy, as a means of overcoming the legacy of the decaying Ottoman Empire.

After the collapse of the Austro-Hungarian Empire in WW I in 1918, the Kingdom of Serbs, Croats and Slovenians was established by unifying the small Balkan kingdoms of

⁶⁴⁵ Although being ruled by the Turks for centuries, Serbia managed to save its identity mainly due to the strong influence of the Serbian Orthodox Church and relatively weak rule of the Turks, who were mainly interested in collecting taxes and providing public order. Cf. Z. Sevic, "Politico-Administrative relations in Yugoslavia", in T. Verheijen (ed.) *Who Rules? Politico-Administrative Relations in Central and Eastern Europe*, (NISPAcee, Bratislava), 2000.

⁶⁴⁶ The first and rather advanced Serbian Constitution, so-called Sretenjski Constitution (Sretenjski Ustav) was proclaimed in 1835. However, only 3 years later in 1838, it was replaced by the new, so-called Turkish Constitution, which gave more power to the monarch and better reflected the needs of the then Ottoman Empire.

⁶⁴⁷ Nevertheless, the role of the monarch was at times substantial, going beyond his formally established authorities.

Serbia, Montenegro with the south-Slav provinces of the ex Austro-Hungarian Empire (Croatia, Slovenia and Vojvodina) that were at last freed from foreign occupation. The country changed its name to Yugoslavia (so-called first Yugoslavia) in 1921, when the Vidovdanski Constitution of the new common state was proclaimed. The first Yugoslavia was also a parliamentary monarchy, ruled by the Serbian heirs.

After WW II, the “Second Yugoslavia” was established as a Socialist Republic under the domination of the USSR. However, in 1948, Yugoslav President Marshall Tito broke away from the USSR and began a cautious journey towards a market society.

The introduction of ‘workers self-management’ in 1950 with the “social property” of enterprises and limited private ownership was another turning point in Yugoslavia’s development. The system of a full command economy was abandoned, which has provided a positive incentive and enhanced Yugoslav economic growth. However, while the Communist Party retained mild control over society, it preserved pretty strong control over state and party bureaucracies. This curtailed the introduction of stable and sustainable political development and hindered the introduction of full market economy. Nevertheless, the existence of moderate socialism enabled Yugoslavia to achieve much higher level of economic and political development in comparison to its Eastern Block neighbours. The openness of the country towards the West and its willingness for cooperation has been expressly acknowledged by the European Community, which, in the mid-1960s, started the negotiation process for the accession of Yugoslavia to the EC.⁶⁴⁸

However, during the late 60s and 70s, the country suffered from stagnation and stubborn defense of the communist party monopoly in the name of the country’s unity. As a consequence of this resistance to change, social conflicts grew into complete ethnic

⁶⁴⁸ Cf. D. Kavran, A. Rabrenovic, D. Milovanovic, “Public Administration Education in Yugoslavia”, in T. Verheijen, J. Nemec (eds.), *Building Higher Education Programmes in Public Administration in CEE Countries*, (NISPAcee & EPAN), 2000, pp. 303 – 321.

intolerance. This has resulted in the breaking up of the country in unfortunate military conflict.

The Federal Republic of Yugoslavia, or so-called third Yugoslavia, was formed in 1992 out of the Republics of Serbia and Montenegro, as the former Socialist Federal Republic of Yugoslavia (SFRY) was breaking up in civil conflict. Although the 1992 Yugoslavian Constitution prescribed a number of competences for the federal authorities, many of them had never been exercised. From 1990, the Republics were gradually transferring powers from the federation, thus obtaining many features of independent states. At the time when the new federation was established, a number of competences were already obtained by the Republics, as centres of core political and economic power. Federal authorities, in turn, mainly played a role of rather passive observer, obediently following instructions from the Republics.

In March 2002, an agreement on the new state status of Yugoslavia between Serbia and Montenegro was reached. In accordance with the agreement, Serbia and Montenegro, as two semi-independent states, entered a union called “Serbia and Montenegro” on 4th February 2003. The new state with *sui generis* con-federal features, however, only had a transitory nature. Upon the expiration of a period of three years, the member states were entitled to institute proceedings for a change of the state status.

The Montenegrin referendum of 21 May 2006, at which most of people of Montenegro voted for independence, has finally resulted in the creation of two independent states of Serbia and Montenegro, as consequently proclaimed by their National Assemblies. The establishment of two independent states is expected to provide a more stable political background for their further economic development and facilitate their smoother integration in the EU.

The Serbian Government - Overcoming the Flaws of a Democratic Transition Failure

More than ten years of poor economic management, regional conflicts and international isolation have resulted in a serious decline of the Serbian economy and overall deterioration of the state institutions and society. At the end of the 1990s, the Serbian administrative system suffered from wide-spread corruption practices and a high degree of state capture.⁶⁴⁹ The economic legacy of the previous regime left Serbia a number of state and socially-owned enterprises, loss-making and deeply mistrusted banks, and over-committed, poorly functioning social safety nets that make economic recovery fairly difficult. The process was even more difficult due to large and mounting fiscal pressures, huge external debt, weakened governance, and post-conflict challenges such as rebuilding damaged infrastructure.⁶⁵⁰

Since 2001, Serbia has made commendable economic and social progress in a number of areas. Substantial reforms have been underway in different sectors: restoring macro-economic stability, restoring the viability of the banking sector, privatisation of the extensive sector of socially-owned enterprises, rehabilitation of the energy sector, restructuring public utilities, reforming inefficient systems of pension and social security etc.⁶⁵¹ Despite significant advancement, major efforts still have to be made to fully open the country to foreign trade and investment and establish a market economy.

The reform progress slowed considerably in 2003, following the assassination of Prime Minister Djindjic. However, reform momentum was regained after the instalment of the new Government of Serbia in March 2004. A significant number of laws in economic and financial field have been adopted since then. Further progress in many areas of the

⁶⁴⁹ Cf. Kostic V. "Korupcija u Srbiji – fenomen zarobljene drzave" [Corruption in Serbia – Phenomenon of State Capture], *Monitor*, www.monitor.cg.yu, 2003.

⁶⁵⁰ Cf. The World Bank report, *Serbia and Montenegro – Public Expenditure and Institutional Review*, Volume Two: Serbia, February 2003, pp.2-6.

⁶⁵¹ Cf. The World Bank Report prepared for the Donor Coordination Meeting of November 18, 2003.

reforms, however, will depend largely on the reform of the public sector, whose institutions are critical for the implementation of the overall reform agenda.

Key central Government institutions are still fragile and cannot adequately respond to the imposed transitional challenges. There is still a visible discrepancy between the *legal system* and *legal order*, which means that the level of law implementation is low and often discriminatory.⁶⁵² Furthermore, international surveys indicate that Serbia still suffers from a high level of corruption.⁶⁵³ This raises the feeling of legal insecurity and uncertainty and has an adverse effect on very much needed foreign investments. Although the process of reform of both public administration and judiciary has commenced, it has still a long way to go until satisfactory situation in these fields is reached.

The Serbian legal system is based on a continental legal tradition. Both the French and German legal systems had an important impact on the development of the Serbian legal culture.⁶⁵⁴ Similarly to their administrative systems, the Serbian Government structure and functions are regulated by a special body of administrative law. The state administration is thus perceived as an autonomous domain apart from civil society. The structure of the state administration is based on a hierarchical bureaucratic model with strong emphasis on legality and proper fulfilment of regulatory functions. This 'over-legalisation' poses problems for the functioning of the system which lacks flexibility in its operation, as the 'rules of the game' can often be changed only by Parliamentary amendments.

⁶⁵² Cf. Z. Sevic, "The Political Economy, Economics and Art of Negotiation and Reconciliation: The Production of Law and Legal Order in a Polycentric Federation of Yugoslav Type", paper presented at the 9th Maastricht Workshop in Law and Economics, Maastricht: University of Limburg, 1996.

⁶⁵³ In the Transparency International Report for 2005, Serbia scored 2.7 out of 10 (97th out of 146 countries) on the basis of corruption perception index, Transparency International, *Global Corruption Report 2005*, p. 202-205. www.globalcorruptionreport.org

⁶⁵⁴ This is mainly due to the fact that many leading Serbian intellectuals of that time had obtained their education in France and Germany.

One of the key reform issues is adoption of the new Constitution. General political instability and high degree of polarization between key political actors have adversely affected the possibilities for disentanglement of key Serbian constitutional issues. Milosevic's malfunctioning 1990 Republican Constitution is still in force, partially preventing enactment of new legislation, based on modern legal concepts and principles (especially in the field of structural reforms).

According to the current Constitution, Serbia is a parliamentary democracy with a relatively strong role of the President of the Republic, who is elected by direct votes of the citizens for the period of five years. Serbia has a unicameral Parliament, called the National Assembly, which holds the Government to account for its operations. Over the last decade, all Serbian Governments have been coalition Governments, which has undermined the cohesion of designed policies, effective implementation of initiated reforms and possibilities of reaching a firm general consensus on the country's future.⁶⁵⁵

Serbia's winding path to the EU

Interestingly, one of the rare issues of general national consensus is the Serbian peoples' wish to become members of the European Union. According to the latest public opinion poll conducted in September 2005, 64% of the population strongly supports the idea of accession to the EU, 12% are against it, while 16% are undecided.⁶⁵⁶ All key Serbian political parties also proclaim EU accession as one of their and country's main objectives. The European Union, on the other hand, has given important signals to Serbia that it

⁶⁵⁵ Cf. A. Rabrenovic, "Politico-Administrative Relations under the Coalition Government in Serbia", in G. Peters, T. Verheijen, L. Vass (eds.), *Coalitions of the Unwilling? Politicians and Civil Servants in Coalition Governments*, (NISPAcee, Bratislava) 2005, pp. 146-177.

⁶⁵⁶ Opinion poll conducted by Strategic Marketing in September 2005, [www.smmri.co.yu;](http://www.smmri.co.yu;www.seio.sr.gov.yu/code/navigate.asp?Id=89)
www.seio.sr.gov.yu/code/navigate.asp?Id=89

wishes to accept it in its European family of nations when the time is right and the all EU accession conditions met.

Shortly after the democratic changes in Serbia, the Copenhagen Council of December 2002 and Thessaloniki European Council of June 2003 confirmed the European perspective of state union of Serbia and Montenegro and underlined the European Union's determination to support its efforts to move closer to the European Union.⁶⁵⁷ In April 2005 the European Commission approved a Feasibility Report that assessed positively the readiness of Serbia and Montenegro to negotiate a Stabilisation and Association Agreement.⁶⁵⁸ Negotiations for a Stabilisation and Association Agreement started in October 2005, symbolically marking 5 years from democratic change in Serbia. However, due to the failure of the Serbian Government to extradite General Ratko Mladic to the Hague Tribunal, the EU negotiations were suspended in May 2006 and will be continued only if full cooperation with the Hague Tribunal is established.

The Thessaloniki European Council has introduced the European Partnership as one of the means to intensify the stabilisation and association process. The Council has been authorised to decide, by qualified majority and on the proposal of the Commission, on the principles, priorities and conditions to be contained in the European Partnership.⁶⁵⁹ On June 14 2004, The Council adopted a first European Partnership with Serbia and

⁶⁵⁷The Thessaloniki European Council explicitly states that the Western Balkan countries are to become members of the EU "once they meet the established criteria". Cf. Presidency Conclusions of the Thessaloniki European Council, 19 and 20 June 2003, www.europa.eu.int

⁶⁵⁸ Commission Staff Working Paper, *Report on the preparedness of Serbia and Montenegro to negotiate a Stabilisation and Association Agreement with the European Union*, Brussels, 12.04.2005, SEC(2005) 478 final.

⁶⁵⁹ Regulation (EC) No 533/2004, OJ L 86, 24.3.2004.

Montenegro including Kosovo as defined by the UN Security Resolution 1244.⁶⁶⁰ The implementation of the European Partnership priorities was examined through annual progress reports presented by the Commission which assesses progress made against established principles and conditions and notes areas where the country needs to increase its efforts.⁶⁶¹

In early 2006, the European Partnership was updated in order to identify renewed priorities for further work on the basis of the findings of 2005 Commission progress reports.⁶⁶² It is important to note that Community assistance under the stabilisation and association process to Serbia is conditional on further progress in satisfying Copenhagen criteria as well as progress in meeting the specific priorities of this European Partnership.⁶⁶³

It should be noted that the funds from the EU are currently managed directly by the European Agency for Reconstruction (EAR), as an independent agency of the European Union, and not by the Serbian Government. The EAR was established in 2000 and is accountable to the Council and European Parliament and overseen by a Governing Board composed of representatives from the EU Member States and the European

⁶⁶⁰ Council Decision of 14 June 2004 on the principles, priorities and conditions contained in the European Partnership including Kosovo as defined by the UN Security Council Resolution 1244 of 10 June 1999, (2004/520/EC), OJ L 227/21, 26.6.2004.

⁶⁶¹ Commission Staff Working Paper, *Serbia and Montenegro Stabilisation and Association Report 2003*, Brussels, 26.3.2003, SEC(2003) 343; Commission Staff Working Paper, *Serbia and Montenegro Stabilisation and Association Report 2004*, Brussels, SEC(2004) 376. www.europa.eu.int.

⁶⁶² Council Decision of 30 January 2006 on the principles, priorities and conditions contained in the European Partnership with Serbia and Montenegro including Kosovo as defined by the UN Security Council Resolution 1244 of 10 June 1999 and repealing Decision 2004/520/EC, (2006/56/EC), OJ L 35/32, 7.2.2006.

⁶⁶³ Paragraph 5 of Serbia and Montenegro, including Kosovo: 2005 European Partnership, Annex to the Council Decision of 30 January 2006, *ibid*.

Commission.⁶⁶⁴ The European Commission has not yet indicated that it would be prepared to consider any degree of decentralization of management of aid until it gets an assurance that Serbia possesses a reliable system of financial accountability in accordance with the benchmarks set out in the Chapter 32 of the *Acquis* (before 2005, Chapter 28).

European Partnership priorities in the area of financial accountability

The priorities listed in the 2006 European Partnership have been selected on the basis that it is realistic to expect that Serbia can complete them or take them substantially forward over the next few years. A distinction is made between short-term priorities, which are expected to be accomplished within one or two years and medium-term priorities which are expected to be accomplished within three to four years. The priorities concern both adoption of legislation and its effective implementation.

Several medium term priorities identified in the European Partnership concern the area of financial accountability. These medium-term priorities are:

“Develop and implement the principles of decentralized managerial accountability and functionally independent internal audit in accordance with the internationally accepted standards and EU best practice.

Strengthen the operational capacity and functional as well as financial independence of the Supreme Audit Institution.

⁶⁶⁴ The objectives of the EAR are: to support good governance, institution building and rule of law; to continue supporting the development of market economy and to support social development and strengthening of civil society. The Agency recently shifted away from reconstruction projects to projects of a more “institutional” and reform based nature. Cf. *EAR Annual Report to the European Parliament and the Council*, January to December 2003, Thessaloniki, June 2004.

*Develop procedures and administrative capacities to ensure effective protection of the EU financial interest.”*⁶⁶⁵

Since the key aim of our research is to provide recommendations on how the existing financial accountability system of Serbia can be improved so that it satisfies the EU requirements, there is a need for an in-depth analysis of the features of the current financial accountability system. Following the pattern of the previous chapters, we shall start our analysis by focusing on the scope of the Serbian central Government and place a special emphasis on key financial accountability concepts and mechanisms.

Ongoing reforms of the Serbian central Government

Over the last couple of years, the Serbian Government has started the process of overall public administration reform. The first step was adoption of a comprehensive Public Administration Reform strategy in October 2004.⁶⁶⁶ The strategy is anchored in European principles of professionalisation, depoliticisation, rationalization and modernisation. In 2005, a new legal framework on Government's organization has started to emerge through the adoption of several key public administration laws: Law on Government,⁶⁶⁷ Law on State Administration,⁶⁶⁸ the Civil Service Law⁶⁶⁹ and Law on Public Agencies.⁶⁷⁰

⁶⁶⁵ Council Decision of 30 January 2006 on the principles, priorities and conditions contained in the European Partnership with Serbia and Montenegro including Kosovo as defined by the UN Security Council Resolution 1244 of 10 June 1999 and repealing Decision 2004/520/EC, (2006/56/EC), OJ L 35/32, 7.2.2006.

⁶⁶⁶ The Government of the Republic of Serbia, *Public Administration Reform Strategy*, November 2004.

⁶⁶⁷ Law on Government, “Official Gazette of the RS”, No. 61/05. The Law on Government clarifies structures and relations at the Centre of Government (COG). The policy development and strategy role of the COG is strongly emphasized, as opposed to its mainly technical role exercised in the communist and, to some extent, current system. The law further clarifies some key elements of the central organization of the government (cabinets of the prime minister and deputy prime minister, general secretariat and government services) and the relationship between the government and Parliament.

⁶⁶⁸ Law on State Administration, “Official Gazette of the Republic of Serbia” No. 79/05.

⁶⁶⁹ Civil Service Law, “Official Gazette of the RS”, No. 79/05.

The rapid process of legislative drafting was justified by the urgent need to adapt much of the systemic legislation in Serbia, as much of it is outdated and, because of frequent amendments, incoherent.

The new Laws on State Administration and Civil Service provide a framework for the depoliticisation of the civil service, in particular the senior civil service levels. The key senior civil service positions in the Serbian administration are a Secretary of the Ministry and Assistant Minister. Whereas a Secretary of the Ministry is in charge of running the day-to-day operations of the Ministry and coordinating the work of Ministerial departments (which could correspond to the post of the Permanent Secretary in the UK system and Director Generals in the French and EU systems), Assistant Ministers are the heads of sectors in charge of special Ministerial portfolios. Up to now all senior civil service positions were subject to Government appointment based mainly on political grounds and have therefore been removed from their positions with each change of Government, or Government reshuffle, which had an adverse affect on the continuity of the work in the Ministry. The new Civil service Law, however, sets out the overall firm conditions for competitive recruitment of senior civil servants and provides limited grounds for their dismissal. This is an encouraging development, which should provide conditions for depoliticization and professionalization of the core civil service and could also have implications for internal financial accountability mechanisms.

In accordance with the Constitution and the Law on State Administration, state administration activities are performed by state administration organs, which can be established as ministries and special organisations. Whereas ministries perform state administration activities, special organisations carry out specific expert activities, and exceptionally, state administration activities, when stipulated by law.⁶⁷¹ Ministries may also have internal organs which perform administrative, inspection and related

⁶⁷⁰ Law on Public Agencies, "Official Gazette of the RS" No. 18/05.

⁶⁷¹ Article 1, paragraph 2 of the Law on State Administration, "Official Gazette of the RS", No. 79/05.

professional activities, if the nature or number of activities require broader independence than the sector within the Ministry.⁶⁷²

In addition to ministries and special organisations, the Serbian central Government structure comprises a number of regulatory agencies, whose status is regulated by the Law on Public Agencies.⁶⁷³ The Law provides a common legal framework for the establishment, management, and dissolution of regulatory agencies and represents an important step in clarifying the status of numerous government agencies created by the previous Government. It also highlights the independence of agencies and provides a clear scope for the creation of independent regulatory bodies, at arms length from the executive branch.

When organisation of the Serbian central Government is looked through the budgetary prism, the distinction between different state bodies is made between direct budgetary users (DBBs) and indirect budgetary users (IBBs). All state administration organs (ministries and special organisations) and regulatory agencies are direct budgetary users, as they receive funds directly from the budget. Indirect budgetary users, in turn, are the second tier users receiving budgetary funds indirectly, through the direct budgetary users. Thus for example, whereas the Ministry of Education, the Ministry of Health and the Ministry of Labour, Employment and Social Policy are direct budget user, indirect budget users are educational institutions (schools, institutes etc.), health institutions (primary, secondary and tertiary health care institutions) and social security institutions, which receive their funds through respective ministries of education, health, employment and social policy and social insurance funds.⁶⁷⁴ The judiciary is also an indirect budget user as it receives funds through the Ministry of Justice.

⁶⁷² Article 28, of the Law on State Administration, "Official Gazette of the RS", No. 79/05.

⁶⁷³ Public Agencies Law, "Official Gazette of the RS" No. 18/05.

⁶⁷⁴ Judiciary is also an indirect budget user as it receives its money through the Ministry of Justice.

In addition to DBBs and IBBs, Serbian central Government encompasses mandatory social security institutions, such as: Health Insurance Fund, Labour Market fund, Employees' Pension fund, Self-Employed Pension and Farmers' Pension Fund.⁶⁷⁵ Their financing comes mostly from mandatory payroll taxes, with republic budget financing being limited to the financing of the poor and for the clearance of arrears. Social Security funds are currently also undergoing significant reforms, which should bring about sustainability in their operation and efficient and effective performance of their duties.

It should be pointed out that the scope of the Serbian central Government is fairly large, especially due to overt centralization processes during the 1990s. Excessive public spending is undermining the country's economic growth potential, decreasing the opportunities for private investment.⁶⁷⁶ Therefore, there has been a pressing need to reduce the scope of the public sector and central Government in particular in order to generate savings for structural reforms and create better social safety net for those affected by reforms.⁶⁷⁷ To this aim, the Government has started implementing a diversified public employment reduction strategy which includes: privatisation, voluntary redundancy programmes, contained external recruitment, staff redeployment initiatives etc.⁶⁷⁸ The Government has also started working on the design of decentralization of delivery of services from the central to local level which should result in significant reduction of the scope of the central Government in Serbia in the years to come.

⁶⁷⁵ Cf. Cf. World Bank report, *Serbia and Montenegro – Public Expenditure and Institutional Review*, Volume Two: Serbia, 2003, p. 2.

⁶⁷⁶ The World Bank, *The Serbia Economic Memorandum (2004): An Agenda for Economic Growth and Employment*, p. 14., <http://siteresources.worldbank.org/INTSERBIA/Resources/300803-1121188888161/serbia-sem-complete.pdf>

⁶⁷⁷ IMF Country Report No 05/232, Serbia and Montenegro: Selected Issues and Statistical Appendix, July 2005, <http://www.imf.org/external/pubs/ft/scr/2005/cr05232.pdf>.

⁶⁷⁸ Cf. Ministry of Health of the Republic of Serbia, *Human Resource Strategy, Interim Report on phase I, 2006-2007*, May 2006.

In conclusion, the Serbian Government has made important strides in putting in place an overall framework for public administration reform and creating a smaller and more efficient public sector. However, effective implementation of well-designed reform framework will require firm and continuous efforts of all the involved factors. Serbia is undoubtedly a country in transition, which in itself is a very difficult and slow process that cannot yield obvious results in a short amount of time. Experience from other transitional countries show that the overall reform process can be sustained only if there is continuous consensus among all the main stakeholders and a firm political commitment.⁶⁷⁹ While both elements have been present in some aspects of reform, they have been clearly lacking in other, more sensitive, institutional matters. The field of financial accountability has fallen somewhere between these two ends of a continuum, with the stubborn intention of staying closer to the latter end. Nevertheless, important reforms have been commenced in all financial accountability elements, including the concept of stewardship of public money.

Firming up the Concept of Stewardship of Public Money

The concept of stewardship of public money is not unknown in the ex-Yugoslavian region. This concept existed to some extent in Serbia and Yugoslavia, primarily due to the functioning of an external audit institution, so called “Supreme Control” up to the II World War and “Social Accounting Service” during the communist/socialist rule. The Social Accounting Service was in many ways an exceptional, *sui-generis* institution, which carried out control of financial flows in both public and private sector, as will be discussed in more detail later in the text. At this point it should only be noted that its role of an external auditor comprised two main functions: control of the accuracy of accounts and control of legality of financial operations.⁶⁸⁰ A similar function was performed by the

⁶⁷⁹ Cf. D. Coombes, “Re-building the Capacity to Govern: Setting Priorities for Public Administration Reform in Serbia”, draft discussion paper for the round table ‘Priorities for Institutional Development in the Reform Process in Serbia’ Belgrade, March 2003.

⁶⁸⁰ Cf. Social Accounting Service Act, “Official Gazette of the SFRY”, No. 15/77.

internal unit of the Ministry of Finance, called - budgetary inspection, which conducted an administrative control of spending of public funds.⁶⁸¹ Therefore, it may be inferred that the post second-world-war Yugoslavia and the Republic of Serbia as its constitutive part, did legally recognise a narrowly defined concept of stewardship of public money, based exclusively on certification (financial) audit, without elements of performance audit.

During the 1990s, however, the concept of stewardship of public money was grossly undermined and devalued. The external audit function was abolished, and a concept of a certification audit sustained only in a segment of administrative control of public money, i.e. budgetary inspection, which influence was fairly limited.⁶⁸² Public money was blatantly misused by high officials and key political figures who dissipated public funds, using them for their private needs and purposes. Financial embezzlements and excessive use of public money became a commonplace of the system which did not entail a concept of public money stewardship and financial accountability.⁶⁸³

The first democratic Serbian Government has early recognised the importance of developing a concept of stewardship of public money. The significance of this concept was for the first time explicitly recognised by the new Budget System Law,⁶⁸⁴ which introduces the concepts of both financial and performance audit.

According to the Budget System Law, the budget inspection of the Ministry of Finance shall hold the users of public money (i.e. DBBs and IBBs) to account for:

⁶⁸¹ Cf. G. Paovic-Jeknic, *Budžetska kontrola – jugoslovensko i italijansko pravo* [Control of the Budget – Yugoslavian and Italian Law], University of Montenegro, Podgorica, 1999.

⁶⁸² Ibid.

⁶⁸³ Cf. D. Antić et al., *Korupcija u Srbiji* [Corruption in Serbia], (Centar za liberalno-demokratske studije), Belgrade, 2001.

⁶⁸⁴ Budget System Law, “Official Gazette of the Republic of Serbia”, No. 9/2002, 87/02, 66/05.

- 1) The *legality* of the use of public funds, which encompasses control of conformity with financial management legislation as well as assurance that the money was spent in conformity with the intentions of the Parliament, i.e. Budget law;⁶⁸⁵
- 2) The *economy, efficiency and effectiveness* in the use of public funds;⁶⁸⁶
- 3) The *legality, adequacy and effectiveness* of internal control and monitoring systems.⁶⁸⁷

Whereas the concept of legality as conformity of financial transactions with existing legislation seems to be quite straightforward, the concepts of economy, efficiency and effectiveness are not well developed in the law and therefore there is a scope for their different interpretation in practice.

This deficiency has, however, been addressed in the recently adopted Law on State Audit Institution,⁶⁸⁸ which defines three basic principles of public money stewardship:

- *principle of accuracy of financial statements*, as a requirement that all revenue, expenditure, assets and liabilities have been properly recorded and truly and objectively present the financial position of an auditee;⁶⁸⁹
- *principle of regularity* of transactions, which requires that all financial transactions be carried out in conformity with law, other delegated legislation and regulations and are used for the planned purposes;⁶⁹⁰
- *principle of purposefulness* denotes a request that funds be used in accordance with principles of economy, efficiency and effectiveness as well as in compliance with the planned goals.⁶⁹¹

⁶⁸⁵ Article 68, paragraph 1, item 3 of the Budget System Law.

⁶⁸⁶ Article 68, paragraph 1, item 4 of the Budget System Law.

⁶⁸⁷ Article 68, paragraph 1, item 1 and 2 of the Budget System Law.

⁶⁸⁸ The Law on State Audit Institution (LSAI), Official Gazette of the Republic of Serbia No 101/05.

⁶⁸⁹ Section 2, paragraph 1 of Article 2 of the LSAI.

⁶⁹⁰ Section 3, paragraph 1 of the Article 2 of the LSAI.

⁶⁹¹ Section 4, paragraph 1 of the Article 2 of the LSAI.

While the requirement of accuracy of accounts is quite straightforward, it is again interesting to note that, similar to other European models, the new Law on State Audit Institution lays down the principle of *regularity* instead of *legality*, as defined in the Budget System Law. Similar to the UK and French systems, it appears that the concept of regularity is prioritized over the concept of legality, although the content of the regularity principle is exactly the same as of the principle of legality. Therefore it may perhaps be logical that the term ‘regularity’ is replaced with the term ‘legality’ in order to point out the seriousness of legal consequences that breach of this principle may entail. However, as the concept of *regularity* of financial transactions has become an international standard used in financial accountability and audit, especially when used in the context of external audit, changes in this respect will largely depend on the wider international agreement on this issue, as pointed out in the previous chapter.

The principle of *purposefulness* of financial operations entails a request that public money is spent in accordance with principles of economy, efficiency and effectiveness. These three Es concepts are further elaborated as follows:

- principle of economy means that minimum consumption of funds will be used for a specific activity, taking into account that it does not undermine the expected quality;⁶⁹²
- principle of efficiency denotes the relationship between achieved results in the production of goods or in rendering services and resources used for production or for rendering services;⁶⁹³
- principle of effectiveness denotes the extent to which the set goals are achieved, as well as the relationship between the planned and realized effects of a specific activity.⁶⁹⁴

⁶⁹² Article 2, para 1, item 5 of the LSAI.

⁶⁹³ Article 2, para 1, item 6 of the LSAI.

⁶⁹⁴ Article 2, para 1, item 7 of the LSAI.

This rather exhaustive definition of principles of legality, regularity and purposefulness of spending of public funds represents a big step forward in the development of the concept of public money stewardship in Serbia. However, the key question to be posed is whether it is realistic to expect that these principles will be attained in the short or even mid term perspective in the Serbian transitional environment. The Serbian central Government institutions are still struggling to satisfy the requirements of basic public money stewardship of accuracy of accounts, legality and regularity of financial operations and do not seem to have sufficient capacity to implement high performance standards set out by the new legislation, especially since achievement of these standards presupposes existence of clearly defined policy objectives and targets, which are still lacking. Despite these difficulties, it is essential that the concept of public money stewardship, defined through requests of both conformity with laws and regulations and attainment of economy, efficiency and effectiveness in the use of public funds, has been put on a statutory footing. It is of utmost importance that all public sector institutions become aware of this widely defined principle and start working on the attainment of the public money stewardship standards and objectives.

Building Effective Internal Accountability Mechanisms

Over the last couple of years, Serbia has made important progress with its initial development of internal financial accountability mechanisms. The newly established legal framework provides a good basis for establishing management accountability and delegation, proper segregation of duties and central government monitoring of financial regularity. Nevertheless, lots of efforts still need to be invested in order to meet basic European standards and criteria in the main internal financial accountability areas of internal control and internal audit.

Emerging System of Internal Financial control

Similar to the French and the EU system, the Serbian legal framework provides for the segregation of duties for payment order, financial control and accounting functions (in the French system - *ordonnateur, contrôleur financier and comptable*).⁶⁹⁵ The payment order function (*ordonnateur* function) is given to a head of DBB, who has the responsibility for the legal, regular, economical and effective use of a budget appropriation.⁶⁹⁶ A head of a DBB can delegate this responsibility to other personnel in the Ministry/special organization. This right of delegation, however, is not often used, due to the general unease of senior civil servants for taking responsibility for handling public money. The responsibility for the stewardship of public money is thus perceived to be a primarily political rather than administrative function. Accounting (*comptable*) role is performed by employees of both DBB and IBBs in question. The financial internal control function (*contrôleur financier* function), however, is carried out both by the DBBs and IBBs and centrally, by the Treasury in the Ministry of Finance.

In order to effectively perform their financial management duties, DBBs and IBBs have the responsibility for establishing their own *financial services*.⁶⁹⁷ *Financial services* are in charge of financial planning and execution and in particular: preparation of financial (budget) plans, asset distribution to indirect budget beneficiaries within the approved appropriations, preparation of documentation for executing financial plans, management of state property and accounting and book keeping.⁶⁹⁸

In addition to financial services, most of DBBs which are organizationally complex and all major mandatory social security organizations are required to establish separate

⁶⁹⁵ Article 51 of the Budget System Law.

⁶⁹⁶ Article 50 of the Budget System Law.

⁶⁹⁷ Articles 9 and 66 of the Budget System Law.

⁶⁹⁸ Decree on Financial Department of Direct Budget Beneficiaries, Official Gazette of the Republic of Serbia, 25/2005.

internal control units. This requirement is set out in the Rulebook⁶⁹⁹ on Internal Controllers⁷⁰⁰ issued by the Ministry of Finance in 2004. This Rulebook requires the establishment of internal control units in 18 DBBs and in the major mandatory social insurance organizations. The audit responsibilities listed in the Decree are focused on *ex-ante* and *ex-post* inspection of commitments and payments.⁷⁰¹

If in the process of *ex-ante* control an internal controller determines any inaccuracy of a financial statement or illegality of a financial operation, he/she will warn the person who carried out that financial operation of such an irregularity.⁷⁰² The reports on both *ex-ante* and *ex-post* controls are submitted to the head of a DBBs/head of a mandatory social insurance institutions twice a year. However, if findings of the report require urgent measures to be undertaken, internal controller makes a special report on ongoing control and immediately submits it to the head of an institution.⁷⁰³

In most cases legality of operations of DBBs is ensured via the double signature of a head of DBB, who authorizes the commitment or payment, and internal controller of the internal control unit, who approves them. DBB and IBB which do not have separate internal control services ensure the legality of financial operations through the double signature of the head of DBB and the head of the financial service who approves commitments and payments.

Although it may appear that emerging internal control systems are operating well, the key problem which arises is that DBB's/IBB's management do not take much interest and are

⁶⁹⁹ The Rulebooks are general acts passed by state administration organs and have the legal status of tertiary legislation.

⁷⁰⁰ The full name of the Rulebook is "Rulebook on Direct Budget Beneficiaries (DBBs) that Organize Special Internal Control Body and on Common Criteria for Internal Control Organization and Procedure of DBBs and Mandatory Social Insurance Organizations," Official Gazette of the Republic of Serbia No. 22/2004.

⁷⁰¹ Article 7 of the Rulebook, *ibid*.

⁷⁰² Article 6, paragraph 2 of the Rulebook, *ibid*.

⁷⁰³ Article 11 of the Rulebook, *Ibid*.

not responsible for the effective operation of their internal control units. The general perception is that the operation of internal control systems is a responsibility of the Ministry of Finance rather than of the DBB or IBB's management. The established internal controls are not designed, implemented or monitored by departmental managers, which have very limited responsibility for internal control matters. The Ministry of Finance, on the other hand, does not have the capacity to supervise and coordinate all internal control units throughout the administration (as is the case with the French Ministry of Finance in relation to *contrôleur financiers*), which leaves internal control units in a sort of an institutional vacuum. Furthermore, control systems that do exist are driven by legal instruments with no flexibility for individual departmental variations.

Due to still ineffective decentralised internal control systems in the DBB's and IBB's, there exists a second level of fairly centralised and detailed *ex-ante* internal control provided by the Treasury of the Ministry of Finance. The Treasury control is carried out by the two units of the Treasury: Treasury Control Coordinators and Internal Control Department. Treasury Control Coordinators perform ex-ante control of all commitments and payments requested by DBBs that are less than 10 thousand dinars (approximately EUR 115). The Treasury Internal Control Department controls all commitments and payments that are over 10 thousand dinars. It performs ex-ante control of documents provided by DBBs to check budget approval and availability.

At first sight, having the payment transactions processing and second instance *ex ante* controls under the full responsibility of Treasury departments might seem to be an effective and efficient solution from the viewpoint of expenditure control. However, as we could see in the EU chapter, centralized controls can have adverse effects and increase corruption, as the accountability lines for public money stewardship are not clearly established but divided between different actors. Furthermore, centralised *ex ante* controls may also cause delays in budget implementation and hinder efficient management.⁷⁰⁴ Whereas a centralization of cash balances is desirable, this does not

⁷⁰⁴ R. Allen, D. Tommasi (eds.), *Managing Public Expenditure: A Reference Book for Transition Countries*, SIGMA, OECD, Paris, 2001, pp. 216-217.

mean that the treasury should be involved in the day-to-day control of invoices and payment documentation, as it slows down the payment execution and places an unnecessary burden on the Treasury staff with constrained capacity.

In conclusion, although some elements of decentralised managerial accountability are emerging, the Serbian system of internal financial control is still overly centralised and does not meet the requirements of European Partnership which requires Serbia to “Develop and implement the principles of decentralized managerial accountability.” In order to address these weaknesses, the Ministry of Finance has started working on a strategy for developing public internal financial control which should provide the platform for strengthening the existing elements of decentralized managerial accountability. The proposals on how to improve the current system will be analyzed in more depth in the concluding chapter.

Combination of Budget Inspection and Internal Audit

The internal audit concept is not well known and developed in the Serbian system of financial accountability. There is, instead, a traditional concept of budget inspection, which has a narrower meaning and would correspond to early development of financial inspection in France, carried out by the General Inspectorate of Finance (*L’inspection Generale des Finances*). Whereas the budget inspectorate inspects finances of other bodies using quasi-judicial authorities, internal auditing reviews and appraises activities that are organised within an organisation. As pointed out in earlier chapters, through internal audits the Government is assured that procedures for minimising potentials for fraud, waste and abuse of public resources are put in place and operating. However, as there is no tradition of internal audit, the current budget inspectorate is the basis upon which the internal audit function is currently being built.

The Budget System Law provides for the establishment of joint Budgetary Inspection and Audit Service (BIAS), initially solely within the Ministry of Finance and later in other administrative organs as well. The problem, however, is that the Budget System Law

does not clearly distinguish between the budget inspection function and internal audit function. This deficiency was addressed in the “Decree on the Method of Operation and Authorities of Budget Inspection and Audit” which was adopted in 2004.⁷⁰⁵ The Decree reflects modern internal audit terminology in accordance with the Institute of Internal Auditor’s (IIA’s) International Standards for the Professional Practice of Internal Auditing (ISPPIA).

The BIAS has rather wide institutional jurisdiction. Thus, the BIAS has the right to carry out inspections and audits over DBBs and IBBs, organizations of compulsory social insurance, public enterprises founded by the government, enterprises in which the republic has direct or indirect control over capital or management and legal entities in which public funds comprise more than 50 % of total revenue.⁷⁰⁶

The BIAS was first established as a sector of the Ministry of Finance, as a key Ministry in charge of budgetary inspection and internal audit and a future centre of coordination for other BIAS services in other administrative organs. Due to different nature of tasks, the BIAS work is performed by two different departments of the BIAS sector: Budget Inspection Department and Internal Audit Department.⁷⁰⁷ As an inspection service, Budget Inspection Department has quasi-judicial authorities, which consist of issuing decisions that order an action to be taken in relation to any fraudulent practices or serious irregularities discovered by the auditors.⁷⁰⁸ The Internal Audit Department, on the other hand, has quite a wide remit of assessment of internal control systems and performance audits and also has the role of providing advice to management on the reliability of

⁷⁰⁵ “Decree on the Method of Operation and Authorities of Budget Inspection and Audit”, Official Gazette of the Republic of Serbia, No 10/2004.

⁷⁰⁶ Article 67 of the Budget System Law.

⁷⁰⁷ The World Bank, *Staffing Needs Assessment of the Government of the Republic of Serbia*, June 2005, pp. 75-76, unpublished report.

⁷⁰⁸ An inspection decision has a nature of an administrative act in administrative procedure and can be challenged in the second instance administrative procedure. The second instance act can further be challenged before the Court in administrative dispute procedure.

internal controls and audit implications relating to the introduction of new systems, procedures or business processes.⁷⁰⁹

However, the BIAS sector has been facing a number of problems in its operation. First, the position of the head of the BIAS sector has been vacant for two years which creates significant management problems. Furthermore, the BIAS sector is understaffed and its staff insufficiently trained and lacking appropriate guidelines. Whereas serious efforts have gone into developing methodological guidelines and training of staff mainly through the support of the European Agency for Reconstruction, available staff resources are not at all adequate.⁷¹⁰ Thus, while the Inspectorate has 15 staff (in comparison to 350 staff of the French Financial Inspectorate), the Internal Audit Department has only 11 staff (including the head of internal audit department). Such a staffing structure does not allow for carrying out wide inspection and audit responsibilities.⁷¹¹

The above discussion leads to the conclusion that although significant efforts have been invested so far in the development of an internal audit system, a medium term requirement of European Partnership to “establish functionally independent internal audit in accordance with the internationally accepted standards and EU best practice” has still not been met.

As will be discussed in more depth in the concluding chapter, the key recommendation which could be given at this point is that until Internal Audit Units in the major DBBs are fully operational, the capacities of the Budget Inspectorate and the Internal Audit Department of the Ministry of Finance should be significantly enhanced to provide assurance on financial regularity at the level of the Ministry of Finance and the Government. Strengthening of the Internal Audit Department is especially important in a

⁷⁰⁹ Article 68 of the Budget System Law.

⁷¹⁰ The World Bank, *Serbia: Fiduciary Assessment Update*, 2005, Internal Document of the WB, p. 18.

⁷¹¹ Support for the training of internal auditors is provided from a EUR 7 million project on “Public Finance” funded and implemented by the EAR.

view of its future role of a central coordination and harmonization unit for internal audit work and methodology.

Strengthening Parliamentary Accountability

Serbia has a relatively long tradition of parliamentary control of spending of public money. However, during the 1990s, there was a significant erosion of the budgetary process and of the budgetary powers of the Serbian National Assembly. Preparation of the Republic's budget followed a highly compressed timetable that did not allow for detailed analysis of budget issues and policies.⁷¹² Parliamentary discussions on the budget were almost absent and the budgetary proposals, as well as final budgetary reports were adopted by the Parliament almost without any remarks.

Budget reporting to the Parliament was also greatly limited. The 1991 law⁷¹³ required that annual consolidated Government accounts (financial statements) be submitted to the Parliament by 28th February of the following year. Discussion on the budget proposal for the next year and consolidated Government accounts for the previous year would, however, last only for a couple of days, without any significant debate on the substance of budget execution, presented in the consolidated accounts.⁷¹⁴ In this regard, there was an obvious lack of a professional body of external audit institution, which would be able to give its professional opinion on the state of Government consolidated accounts and point out strengths and weaknesses in the use of the public funds.⁷¹⁵

An important feature of the new Budget System Law is that it leaves considerably longer time for the consideration and approval of the budget by the Cabinet and the Parliament

⁷¹² Cf. G. Paovic-Jeknic, *Budžetska kontrola – jugoslovensko i italijansko pravo* [Control of the Budget – Yugoslavian and Italian Law], University of Montenegro, Podgorica, 2000.

⁷¹³ The Law on Public Revenues and Public Expenditures, Official Gazette of the Republic of Serbia, No. 76/91, 18/93, 22/93, 67/93, 45/94, 42/98.

⁷¹⁴ Cf. G. Paovic-Jeknic, *ibid.* pp. 178-182.

⁷¹⁵ *Ibid.*

(2 months).⁷¹⁶ Implementation of this new time-table should help emphasise the role of the budget as a key instrument for the realisation of Government policies and programmes. The Budget System Law further specifies more regular and frequent reporting on the expenditures, commitments, cash payments from the budget and other reports that would provide a comprehensive picture of the development of public finances throughout the year.⁷¹⁷

It should be noted that the adoption of the previous years' budgets seemed to be the subject of significant debate in the Serbian Parliament. The obligatory nature of the adoption of the budget was, however, used mainly as a political means of threatening the Government to be overthrown and in the same time the test if the Government has enough support in the Parliament. The lack of a more substantial debate on the budget proposal perhaps should not at all be surprising, bearing in mind that the members of the Parliament do not have sufficient knowledge to examine the details of the budgetary legislation and even lesser powers to keep the Government to account for the effective use of public monies within the approved legal budgetary framework. The absence of an independent external audit institution further undermines their accountability potentials.

Significant delays in establishing an external audit institution have had serious consequences for the Serbian financial accountability system as Government annual consolidated financial statements for 2002, 2003, 2004 and 2005 have not been audited and submitted to the Parliament. The BSL provides a deadline of June 1 in the following fiscal year to submit consolidated annual reports to the National Assembly, which has obviously not been met. The only solution to address this problem in the short term was to commission a private external audit of accounts for the previous years. This solution was accepted for 2001 accounts, which were audited by a private firm. However, no qualified external private auditor was appointed to fill the external audit gap from 2002-2005 and therefore Parliament did not have a chance to see and discuss Government

⁷¹⁶ Article 14 of Budget System Law.

⁷¹⁷ Articles 10-13 of the Budget System Law, "Official Gazette of the Republic of Serbia", No. 9/2002.

actual spending decisions for the last four years. This also means that currently there is no official record of government expenditures for these years. A tender for the external audit of the 2002, 2003, and 2004 government accounts has now been undertaken, which is a good step, but there is an urgent need to find sustainable solutions to these problems.

The role of Parliamentary Committees

The parliamentary committee system in Serbia is still underdeveloped in comparison to its western counterparts. There is a number of Parliamentary Committees which are responsible for the review of the legislative proposals. Their general authorities are prescribed by the Rules of Procedure of the National Assembly.⁷¹⁸ However, civil servants are rarely called to account before the standing Parliamentary Committees. It is only the Committees for special inquiries, which are formed on an *ad hoc* basis to examine specific cases, that have the right to summon the civil servants involved in the case. This has also been given some attention in the media, which is still insufficient for provoking a strong public debate on the discussed issues. Committee support services are still weak and their organisation is not flexible nor adaptable to work-load changes. Therefore, there is unanimous consent across all political actors that Parliamentary Committees need expert, specialised research assistance to improve their review of draft legislation and fulfil their mandates as prescribed.⁷¹⁹

The public finance oversight function of the National Assembly is primarily carried out by the Finance Committee. The Finance Committee has 15 members and is set up to review draft laws, other regulations and by-laws and other issues in the field of public finance and not to scrutinise the activities of the Government. The chairman of the

⁷¹⁸ Poslovnik Narodne Skupstine Republike Srbije [Rules of Procedure of the National Assembly of the Republic of Serbia], the final text of 28 June 2005.

http://www.parlament.sr.gov.yu/content/cir/akta/poslovnik/poslovnik_1.asp.

⁷¹⁹ Southeast Europe Parliamentary Program (SEPP), Parliamentary Centre, Join Baseline Report on the Internal and Human Resources Management in the National Assembly of the Republic of Serbia, November 2003.

Committee has been appointed and is a member of an opposition party, in line with the best European practice. However, as the current president of the Committee at the same time discharges functions of the mayor of Belgrade, he rarely attends the sessions of the committee and leaves most of the work to his deputy, who is a member of a governing coalition party. The committee itself has neither a proper structure and resources nor a clear mandate and is obviously not a specialized committee for the scrutiny of public accounts, but carries out primarily legislative function.

Nevertheless, it should be noted that a Sub-committee for “Supreme Audit Institution Establishment Law Drafting” was established in 2004 and prepared the draft Law on Supreme Audit Institution. This is an encouraging sign, as it should enhance the MPs awareness of the need to develop scrutinising role of parliamentary committees, in cooperation with the supreme audit institutions. However, as the independent external audit institution has still not been established, the Parliament still does not have a key ally to assist him perform its paramount function of being a guardian of the public purse.

Developing external financial accountability mechanisms

Today, Serbia seems to be the only European country which does not have an institution to perform independent external audit of public revenues and expenditures. Although the National Assembly adopted the Law on State Audit Institution in November 2005, the State Audit Institution (hereinafter the SAI) has not been established yet. The main reason for the delay in creating the SAI is a difficulty to reach a political consensus in the National Assembly of who should be elected as a member of the SAI’s management. This raises serious concerns for establishment and operation of this new institution in the current unstable political environment in Serbia. The absence of a key financial accountability mechanism greatly undermines exercise of a democratic accountability to the Parliament, which simple does not have appropriate means of holding the Government to account for the public spending.

It should, however, be stressed that external financial accountability mechanisms were very much present throughout the Serbian history in different shapes and forms, depending on the broader political and social developments. In order to be able to provide recommendations on how the new Serbian financial accountability system could be built and strengthened, it would be important to outline a brief history of external audit developments in Serbia and ex-Yugoslavia, which could be used as a source of inspiration for the future times. Lessons from the past should not be forgotten and should duly be taken into account when setting up a new transitional system of financial accountability.

External audit in Serbia – an overview of a forgotten tradition

Serbia has a significant tradition in the field of external audit. Similar to Britain and France, the development of external audit in Serbia, and later in first Yugoslavia, was fairly dependent on the continuous struggle between the monarch and the legislature. During the XIX and the first decades of XX century, external audit gradually evolved from the instrument of autocratic control of state revenues and expenditures to a key supporting mechanism to the democratic parliamentary control of spending of public money.⁷²⁰

It is interesting to note that the first Serbian Constitution (Sretenjski Ustav), proclaimed in the period of struggle for independence from the Turkish Empire in 1835, envisaged the creation of fairly advanced external audit institution. Article 107 of the Sretenjski Constitution proclaimed: “Prince and State Council (Drzavni Sovjet)⁷²¹ will establish the

⁷²⁰ Cf. N. Stjepanovic, *Opsta teorija o glavnoj kontroli Kraljevine Jugoslavije* [General Theory on the Supreme Control of the Kingdom of Yugoslavia], doctoral dissertation, Faculty of Law, University of Belgrade, 1937.

⁷²¹ Drzavni Sovjet was the earliest form of Serbian Parliament, which performed legislative functions until the establishment of the National Assembly by 1869 Constitution. Drzavni Sovjet consisted of the Monarch’s advisors and key political persons of that time and besides legislative, carried out other key state functions, such as the supreme court of law, with a power of declaring the law.

supreme accounting institution, which will audit all the financial accounts of the state and make sure that public money is not spent for other purposes than those approved by National Assembly". However, these provisions were never implemented in practice, due to continuous infighting between the Prince (Milos Obrenovic) and the legislature and the Prince's unwillingness to accept legal constraints to his power.

The second Serbian Constitution, the so-called Turkish Constitution (1838), provided for the creation of an audit institution (*racundzinica praviteljstvena ili glavna kontrola*) as an organisational division of the Ministry of Finance. This division performed audit of all the state accounts and its findings were presented to the State Council by the Minister of Finance. In this way, external audit became a constitutive part of the executive and hence did not contain elements of a democratic audit. This, perhaps, should not be surprising, as the Prince's powers in this period were still prevailing upon the scarce, but growing powers of the legislature.⁷²²

Only a few years later, in 1843, the legislature won its first victory in the field of control of public money. Under legislative pressure, the audit division of the Ministry of Finance was transferred to the State Council. In 1844, the first Decree regulating the organisational structure and functions of the external audit institution was passed. The Decree formally created a Supreme Control institution (*Glavna kontrola*), which obtained a status of a division of the State Council. During the following two decades, the authorities of Supreme Control were gradually expanding, so that in 1862 it obtained a quasi-judicial authority to decide on damages emanating from irregularities, errors and mismanagement of public money. However, the Constitution of 1869, reinstated Supreme Control in the structure of the executive, transformed the State Council into an advisory body of the Government,⁷²³ thus taking away the democratic elements of its operation.

⁷²² Cf. N. Stjepanovic, *ibid.*

⁷²³ Articles 56 and 63 of the 1969 Constitution.

The Supreme Control was able to regain and strengthen its democratic features two decades later, in 1888, when the new Constitution was proclaimed. The Constitution enabled the Parliament to reinforce its right to approve the budget as well as its right to control the execution of the budget. In order to help the Parliament perform these authorities, the Constitution considerably strengthened the position of the Supreme Control it devoted a special section (section XI) to the functions of the Supreme Control, which were further elaborated in the Law on its implementation (1892). According to the Constitution and the Law (1892), The Supreme Control obtained authority to exercise several important functions:

- 1) the function of *ex ante* control of the execution of the budget, which consisted of checking the legality of sought amounts and their conformity with the budget. If the Control finds the payment request legal, it would grant a *visa* (authorisation) of the issue of public money to government departments.⁷²⁴ If, however, it finds that the request is in breach of the material legislation and the budget, it would, after communication with the Government department, issue a visa with reservation and inform the Parliament about the issue.
- 2) the function of *ex - post* control of the budget execution, which entailed:
 - a) financial audit of all the state accounts;
 - b) quasi-judicial authorities in deciding on damages emanating from the accounts;
 - c) certifying and providing the opinion on the Government consolidated financial statements (government accounts),⁷²⁵ which would only after the

⁷²⁴ This function is similar to the UK Comptroller function of controlling the issue of public money from the Consolidating and National Loans fund to Government departments and other public bodies.

⁷²⁵ The Consolidated Financial Statements were drawn up by the Ministry of Finance and included details of: the revenue and expenditure of the national Government, including both a budgetary income and expenditure statement based on a modified cash basis and a cash statement showing all sources of funds cashed and all disbursements made during the year. The final report included a general declaration of conformity and details of significant breaches of budgetary rules.

certification and provision of the Supreme Control's report be submitted to the Parliament for the final discharge.

The Parliament, on the other hand, obtained the right to approve the members of Supreme Control, whose positions, according to the Constitution, were permanent and immovable. In this way the Supreme Control secured independence from the interference of the executive. Nevertheless, the Control still did retain some links with the Executive, as, interestingly, the Prime Minister was in the last instance held accountable for the performance of its tasks and duties.⁷²⁶

The formal position of the Supreme Control did not substantially change in the following decades, although its functional independence was frequently jeopardised by the Monarch, who attempted to exercise greater influence on the Supreme Control's work. After the creation of first Yugoslavia, 1921 Constitution (so-called Vidovdanski Ustav) reinforced the organisation and functions of the Supreme Control as was prescribed by the 1892 Law. However, after the introduction of the so-called dictatorship of 6th of January 1929, when King Aleksandar temporarily abolished the Parliament in order to overcome serious obstructions in the Parliament, the position of the Supreme Control was substantially changed, as all the Parliamentary competences regarding external audit were transferred to the Monarch. Only two years later, the 1931 Constitution (so-called Oktroisani Ustav) returned the competences of financial control to the Parliament and again established direct reporting relations between the Parliament and the Supreme Control, whose status and competences remained largely unaltered until the beginning of World War II.

The function of external audit was not alien to the second Yugoslavia, where a special kind of external audit institution - "Social Accounting Service" (SAS) was created in 1959. The SAS, however, was not a specialised audit organ, but combined the audit tasks with functions which, elsewhere, are entrusted to national banks and/or treasuries. The

⁷²⁶ Cf. N. Stjepanovic, op. cit. pp. 129-130.

SAS had to watch over the legality of the disbursement of state and public (social) funds through pre-audits and post-audits. The SAS also exercised quasi-judicial authorities with regard to errors, irregularities and mismanagement of public funds by officials and civil servants. If, during the examination of the public accounts, the SAS would discover accounting irregularities and/or breaches of legal regulations, it had the right to require the organ in question to correct errors and irregularities and return the funds acquired by the irregular/illegal practice.

It is interesting to note that all users of public funds as well as private firms were required to open accounts with the SAS. The SAS investigated whether enterprises fulfilled their financial obligations towards the state and, if necessary, made these payments itself from their accounts. This function was clearly outside the scope of western European's supreme audit organisations and enabled the Government to interfere and fully control the economy. The SAS also had responsibilities in the sphere of national financial recording and statistics. Perhaps the final proof of the totally different nature of the SAS was the fact that it actually charged for its services, and hence was not financed out of any fund of the state budgets.⁷²⁷

Contours of a New External Audit Legal Framework

Although Serbia still does not have an institution of independent external audit, it is encouraging that the new Law on State Audit Institution (hereinafter the LSAI) was passed in November 2005. The Law has been appraised as a very good piece of legislation by a number of international organisations and experts and definitely represents an important step forward in creating a functional system of financial accountability.

⁷²⁷ Cf. R. Szawlowski, "State Audit in Communist Countries", in B. Geist (ed.), *State Audit – Developments in Public Accountability*, (The MacMillan Press Ltd), 1981, p. 189.

The LSAI is quite detailed and comprises a number of sections which regulate the organisation, management, functions and procedures of the State Audit Institution (hereinafter SAI). As we have already discussed some of the concepts of the new law (such as the stewardship of public money) we shall pay attention to other important elements of the LSAI related to its structure, management, guarantees for independence, functional and institutional jurisdiction and audit process.

Organisation and management of the SAI

According to the new LSAI, a Council of the Institution is the supreme collegial authority of the SAI. The Council members bear a collective responsibility for the decision making process,⁷²⁸ which should enhance the quality of the SAI's decisions, especially since it is a brand new institution yet to be established. The Council has five members: a President, a Vice-President and three members. Organisation of the SAI consists of audit units, headed by the Supreme State Auditors, and assisting services. In addition, the Secretary of the SAI carries out an important managerial function, by coordinating the activities of different audit units and services.⁷²⁹

Although the SAI has a collegiate management, significant managerial powers have been provided to the President of the Institution. The President has the right to: manage the work of the institution by determining and implementing the work programme; prescribe rules for individual stages of audit activity; make decisions on supervision of implementation of the audit objectives; appoint the Supreme State Auditors and Secretary of the Institution, etc.⁷³⁰ Exercise of these authorities should enable the President of the SAI to prevent and remove any potential inefficiency in the collegiate work of the Council.

⁷²⁸ Article 13 of the LSAI.

⁷²⁹ Article 32 of the LSAI.

⁷³⁰ Article 25 of the LSAI.

Personal independence of the Council members is expected to be secured through rather strict conditions and procedures for their appointment and dismissal. Council members ought to have an appropriate university education and relevant working experience⁷³¹ and must not be employees of any Government body for two years prior to their appointment to the Council. This should ensure at least some degree of political and personal impartiality of the Council members in conducting ex post audits of Government operations. The cornerstone of Council Members' independence, nevertheless, is provided by a requirement that Council Members are to be appointed by the National Assembly for a period of 6 years, at the proposal of the competent working body of the Assembly and cannot be reappointed to their respective posts more than twice.

Although the legal framework providing for independence of the Council Members is quite well established, the problems in the implementation of these provisions have already appeared in practice, as the Council Members have still not been elected by the National Assembly. Namely, the transitional provisions of the LSAI foresee that the Council of the SAI will be established six months after the adoption of the LSAI. Council Members have still not been appointed. This is due to political sensitivity of the Council operation, which will not only have important administrative but also political influence on the governance processes. Since the Serbian Government is a minority coalition Government, it has not been easy to reach a political compromise on the appointment of the SAI's Council Members. This is just the first sign of the difficulties which this institution may encounter in practice, in spite of a fairly well designed legal framework.

⁷³¹ The Law requires the Council members to have a university degree and at least 10 years of working experience, out of which minimum 7 years on jobs related to the powers of the Institution. It is further stipulated that a minimum of 2 members of the Council must be graduated economists with the corresponding auditing or accounting profession and working experience in the domain of public finances, while a minimum of one member of the Council must be a graduated jurist with passed juridical exam and working experience in legal activities in the domain of public finances.

Being aware of the challenges which the SAI will face in its work, the draftsmen of the law have underlined a *need for securing organizational, functional and financial independence* of this institution. First, the law provides that the SAI has the right to independently determine its internal organizational structure and staffing plans (job systematisation), as well as to issue independently by-laws and other acts necessary for implementation of the present Law.⁷³² Second, *functional independence* is secured through the right to independently define the scope, time and nature of audit; to conduct audit examinations on the spot; to have access to all necessary documents and to submit audit and other reports without any restrictions.⁷³³ This is fully in line with the Commission's and LIMA declaration's standards and provides a positive answer to Commission's baseline question mentioned in the chapter IV on whether the SAI is free to decide what work it will carry out. Lastly, *financial independence* should be assured by determining the funds for work of the Institution as a separate budget item in the scope of an annual Law on Budget of Serbia.⁷³⁴ The financial plan of the SAI is determined by the Council and approved by the working body of National Assembly and only then submitted to the Ministry of Finance for inclusion in the general budget. This is also in line with the Commission's requests for an independence of the financial resources needed for the fulfilment of the SAI's mandate, as pointed out in the previous chapter.

Functional and institutional jurisdiction

As mentioned in the review of the concept of stewardship of public money in Serbia, the SAI is authorised to conduct three basic types of audit: audit of accuracy of accounts, audit of regularity of financial operations and performance/value for money auditing.⁷³⁵ Besides the 'usual' auditing powers, the SAI is also authorised to carry out other tasks that are closely linked with the audit function, such as: assessment of functioning of

⁷³² Article 12 of the LSAI.

⁷³³ Articles 3, 5, 6, 35, 36, 39 of the LSAI.

⁷³⁴ Article 51 of LSAI.

⁷³⁵ Section 2, 3 and 4, paragraph 1 of Article 2 of the LSAI.

systems of internal control, general advisory function to auditees, giving proposals for changing of existing legislation, adoption of auditing standards and tackling the fraud and corruption.⁷³⁶

The SAI's institutional jurisdiction is also quite wide. It is authorised to carry out audits of a wide spread network of institutions which are using public funds, such as: all DBBs and IBBs of the Republic, units of territorial autonomy and local governments; organisations of mandatory social insurance; budget funds established by a special law or secondary legislation; public utilities, companies and other legal entities founded by a DBB or IBB which participate in its capital or management; National Bank of Serbia (in the part referring to operations with the State budget and public funds); political parties; legal or physical entities which receive state donations and other irretrievable funds or guarantees; users of EU funds, donations and assistance by international organizations, foreign governments and non-governmental organizations.⁷³⁷

Since the SAI is authorised to audit all public funds, resources and operations (including EU funds and resources), regardless of whether they are reflected in the national budget and regardless of who receives or manages public funds, it may be inferred that its functional and institutional jurisdiction is quite satisfactory. However, it should be noted that such a jurisdiction will require intensive efforts on the part of the new institution and therefore it will be very difficult for SAI to manage to cover it, especially in the first years of its operation.

In order to concentrate the SAI efforts, the law prescribes so called 'compulsory audits', which need to be conducted each year. These are:

- annual budget of the Republic of Serbia;
- organizations of mandatory social insurance;
- National Bank of Serbia, in the part related to spending of public funds;

⁷³⁶ Article 5 of the LSAI.

⁷³⁷ Article 10 of the LSAI.

- a number of public utilities, companies and other legal entities founded by a DBB or IBB which participate in its capital or management;
- budget of a suitable number of local self-government units.⁷³⁸

Conducting even this limited number of mandatory audits would be a very demanding task for the SAI in the first years of operation. The Institution will need time to find appropriate staff and build its capacity, which will be a long and demanding process. Therefore, the initial expectations of the operation of this important institution should be kept fairly realistic.

Audit Reports and Procedures

Similar to its counterparts, a key SAI's weapon is issuance of audit reports and annual report on its work. The main instrument of reporting is the annual report on consolidated Government accounts and final accounts of organisations of mandatory social insurance which is to be submitted to the National Assembly every year.⁷³⁹ The SAI is also required to submit an annual Report on its work to the Assembly by the 31st of March of the current year for the preceding year.⁷⁴⁰ In the course of the year, the Institution may submit special reports on particularly important and urgent issues, whose content is defined in more detail by the Rules of Procedure of the Institution.

The procedure of audit is regulated in quite a detailed manner in the LSAI. This poses a question of whether some of the procedural details could have been left for secondary legislation, as putting them on a statutory footing takes away the flexibility necessary for fine-tuning and adjusting to the real needs.

⁷³⁸ Article 35 of the LSAI.

⁷³⁹ Article 47 of the LSAI.

⁷⁴⁰ Article 45 of the SAI Act.

The Audit procedure conducted by the SAI may be divided into three main phases:

1. Pre-Audit phase, relates to determining the annual audit plan and programme of the SAI and collection of information and documentation prior to the commencement of the process of audit. The Law grants the SAI the right of access to any information it requires to undertake its tasks.⁷⁴¹ If an auditee fails to provide requested information, it will be fined by an appropriate penalty,⁷⁴² determined by the penal provisions of the law.⁷⁴³

2. Process of Audit comprises a number of procedures and principles, such as the right to a fair hearing (*audi et alteram partem rule*) and the right to object to the findings of the report in a two-instance procedure. Each audit starts with the adoption of the conclusion on undertaking of audit, which may be a subject of objection by an auditee.⁷⁴⁴ The Council decides on such an objection and its decision is final (no right of appeal is allowed).⁷⁴⁵ When a draft audit report is completed, it is sent to an auditee for comments and objections. If an auditee submits an objection or comments, the SAI will organise a hearing to discuss these objections and acquire any additional information to be presented by an auditee at the hearing.⁷⁴⁶ After the hearing, the draft report, together with objections and comments is given to a Member of the Council or a Supreme State Auditor, who will review the report.⁷⁴⁷ After reviewing the report, a Council Member or a Supreme State Auditor will issue an audit report proposal, which will be sent to the auditee. An auditee has the right to another objection to the report, which is then sent to the Council for the final decision. The Council can decide to either take out the objected finding from the report or to leave in it in the report (as it already is or to reformulate

⁷⁴¹ Article 36 of the LSAI.

⁷⁴² 5.000-50000 dinars which corresponds to around 50-5000 pounds.

⁷⁴³ Article 57 of the LSAI.

⁷⁴⁴ Para 1, Article 38 of the LSAI.

⁷⁴⁵ Paragraphs 2 and 3 of the Article 38, of the LSAI.

⁷⁴⁶ Paragraphs 1-9 of Article 39 of the LSAI.

⁷⁴⁷ Paragraph 10 of Article 39 of the LSAI.

it).⁷⁴⁸ The final report is sent to the auditee, the National Assembly and other organs, which, in Council's view, should be informed of the audit findings. The Council's decision is final and there is no legal remedy which could challenge it.⁷⁴⁹

As we can see, the process of audit is rather complex and assumes active participation of an auditee in all stages of the process. Such a demanding procedure should make sure that a final audit report to be submitted to the National Assembly and the public includes only disclosures substantiated by credible evidence that corresponds to the actual state of affairs. It is further important to provide information to future audited subject and stakeholders awareness in general on their rights and responsibilities in their relations to the SAI.

3. Post-Audit Procedure. Provision for adequate follow-up procedures of SAI's recommendations in the post-audit process is of particular importance. An auditee is obliged to take actions in accordance with SAI's recommendations and to notify the Institution thereof not later than 90 days from the date of delivery of the audit report.⁷⁵⁰ If an institution fails to comply with the SAI's recommendations in case of a significant irregularity or non-purposefulness of operations, the SAI shall determine that there is a serious violation of a 'good practice' in the auditee's operation.⁷⁵¹

One of the key issues to be posed is whether the SAI should have any sanctioning powers in the case of non-respect of its recommendations. As we could see in chapter II, the UK NAO does not have any power of sanction of its own. Instead, its basic weapon is the PAC, which holds the executive to account for the stewardship of public money. In the French system of financial accountability, the *Cour des Comptes*, in turn, does have sanctioning powers through the process of judging of accountants. In the EU system, the ECA does not have any sanctioning powers on its own, but relies on support from the

⁷⁴⁸ Paragraphs 11-15 of Article 39 of the LSAI.

⁷⁴⁹ Paragraphs 16-17 of Article 39 of the LSAI.

⁷⁵⁰ Paragraphs 1-2 of Article 40 of the LSAI.

⁷⁵¹ Paragraphs 3-4 of Article 40 of the LSAI.

COCOBU, Commission and Courts of Auditors of Member States. The question is what kind of sanctioning powers, if any, should be given to the Serbian SAI. This question will be in more depth analysed in the concluding chapter. At this point, we shall outline the solutions presented in the new Law on SAI.

According to the Law, the SAI does have limited sanctioning powers over the auditees. Unlike the classical Westminster model or the French model of judicial authorities, the SAI has been given the power to directly issue orders to auditees for acting in the case when there is a serious violation of a ‘good practice’ in an auditee’s operation. In the case when an auditee fails to take actions in the defined time limit to remedy identified irregularity, the SAI has the right to:

- issue a call for dismissal of the responsible officer of the auditee to the authority which the Institution considers to be able to carry out or initiate the procedure for dismissal;
- inform the National Assembly;
- inform the public.⁷⁵²

If the SAI has a reasonable doubt that the auditee has committed a misdemeanour or a criminal offence, it will propose to the relevant authority to submit a request for initiation of a misdemeanour proceeding or bring charges in the criminal procedure.⁷⁵³ These sanctioning rights of the SAI are reasonably well defined, although they themselves do not provide sufficient assurance that the audit findings will be respected and followed-up by an auditee. Therefore, in order to effectively perform its role, the work of the SAI will need to be substantively supported by other financial accountability actors, such as Parliament and the Ministry of Finance, as will be discussed in more depth in the concluding chapter.

⁷⁵² Paragraphs 9-13 of the LSAI.

⁷⁵³ Article 41 of the LSAI.

Overall, the adoption of the new Law on SAI is a very important step forward in creating a supreme audit institution in Serbia. However, the question remains on whether there are sufficient underlying conditions that will enable its effective operation in practice. As we could see earlier, the EU Partnership medium term priority for Serbia is to “*Strengthen the operational capacity and functional as well as financial independence of the Supreme Audit Institution*”. This condition has obviously not been met at all, since a SAI has not been created yet. Therefore, it is important to examine what are the ways to establish the SAI as soon as possible and to secure its smooth operation in the first years of its functioning.

Accounting and Reporting

Public financial accounting system in Serbia operates on a cash basis, in accordance with the Decree on Budget Accounting adopted in 2003.⁷⁵⁴ The Decree requires that financial statements of all budget beneficiaries be prepared in compliance with the Cash Basis International Public Sector Accounting Standards (Cash IPSAS).⁷⁵⁵ The Decree, moreover, requires ledgers of all budget organizations and mandatory social security organizations be kept on the basis of double bookkeeping, chronologically, accurately and regularly updated.⁷⁵⁶ Although it may be argued that operation of the accounts on a cash basis is not in line with the modern principles of accrual accounting, it must be born in mind that the Serbian accounting system is still at a fairly early stage of development, in which even basic cash accounting principles are not properly implemented. Whereas the central accounting function of the Treasury appears to be fairly modern and well equipped the accounting systems of most budget beneficiaries are generally outdated. Once the cash accounting system starts operating properly, options for a more advanced system of resource accounting should be thought through. Nevertheless, it should be

⁷⁵⁴ The Decree on Budget Accounting, “Official Gazette of the Republic of Serbia,” No. 125/2003.

⁷⁵⁵ Article 3 of the Decree on Budget Accounting.

⁷⁵⁶ Article 4 of the Decree on Budget Accounting.

noted that although periodical budget execution reports and financial statements are cash based, some accrual information, including on commitments, is already available from the Treasury's accounting system, which is a positive step and will be important for the future development of the accounting system.⁷⁵⁷

Conclusion

Although Serbia has made progress in building a democratic financial accountability system, the overall development is unsatisfactory, primarily due to the inability to establish a supreme audit institution. The Serbian legal framework for public sector financial control is still not aligned with EU Partnership priorities and requirements for internal audit and external audit. Considerable effort, including capacity building, will be needed to meet these requirements as well as the specific provisions of the *Acquis* for controlling and managing EU pre-accession funds.

Development of procedures and administrative capacities to ensure effective protection of the EU financial interests will still require extensive efforts in order to be developed properly. Funds from the EU are managed directly by the European Agency for Reconstruction (EAR) and the European Commission has not yet indicated that it would be prepared to consider any degree of decentralization of management of aid, for instance from the CARDS⁷⁵⁸ programme. As we could see in the previous chapter, in accordance with article 164 of the EC financial regulation,⁷⁵⁹ the Commission may decide to entrust

⁷⁵⁷ The World Bank, *Serbia: Fiduciary Assessment Update*, op. cit., p. 23.

⁷⁵⁸ Community Assistance for Reconstruction, Development and Stability, provided under Council Regulation (EC) No 2666/2000: http://europa.eu.int/eur-lex/pri/en/oj/dat/2000/l_306/l_30620001207en00010006.pdf

⁷⁵⁹ Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities, OJ L 248/1, 16.9.2002.

management of certain actions to authorities of beneficiary countries only after having established that the beneficiary third country or countries are in a position, in the management of Community funds, to apply in whole or part a number of predefined criteria for financial management and control. At this stage it is however unlikely that the EAR or the European Commission will consider using a decentralized model for funds management in the short or medium term.

Therefore, still a lot of work remains to be done on establishing a satisfactory financial accountability system in Serbia. The concluding chapter shall examine the ways this could be done and provide recommendations for its future development relying on the conducted analysis of financial accountability systems of the EU Member States (UK and France) as well as the EU system.

Concluding chapter VI

In this concluding chapter we shall attempt to map the way for Serbia to establish effective financial accountability system, in the view of the European Union accession requirements. We shall first reiterate the importance of the European Union integration process as an incentive for building of a reliable system of financial accountability, as one of the conditions for the EU membership. In order make suggestions as to how the current system of financial accountability in Serbia can be reformed to be able to meet the EU requirements, we shall use comparative-historical and legal-sociological analysis of the financial accountability systems of the UK, France and the EU. We shall attempt to explain why different financial accountability systems have been applied on the British isles and the continent and how they influenced the creation of the specific EU system of financial accountability and, subsequently, spelling out of the EU financial accountability requirements towards the acceding countries. This shall provide us with a background for an in-depth analysis of the options for development of the Serbian system of financial accountability. The aim of this exercise is not to prescribe a particular model of reform to be applied, but rather to identify certain strategic choices, risks and constraints which will be faced in building a sound financial accountability system in Serbia and facilitate its integration into the complex EU financial accountability space.

European perspective as one of the incentives for creating effective financial accountability framework

The process and the prospects of Serbia's accession to the European Union serve as an important anchor for reform of financial accountability mechanisms, as a part of overall institutional reforms in Serbia. As pointed out in the previous chapter, the Copenhagen Council of December 2002 and Thessaloniki European Council of June 2003 confirmed the European perspective of state union of Serbia and Montenegro and underlined the European Union's determination to support its efforts to move closer to the European

Union.⁷⁶⁰ The successful completion of negotiations with some of Serbia's closest neighbours who joined the Union in May 2004 greatly contributed to making Serbia's own perspective for joining the EU real and visible and reinforce the message that hard work and at times painful reforms will pay off.

The accession of Serbia to the EU will ultimately depend on two factors – Serbia's progress in meeting the conditions for membership and the continuity of the EU determination to accept Serbia as an EU member. In this sense, at the current stage of development, the key issue for Serbia in its path to the EU is establishment of full cooperation with the Hague tribunal, the lack of which has brought about suspension of negotiations for the Stabilisation and Association Agreement in April 2006. All the other issues, including the financial accountability, seem to be only of secondary importance. On the other hand, the actual accession of Serbia and other countries of the Western Balkans in the EU, will, naturally, depend on the current Member States wish to embrace the countries of Western Balkans in the union of European nations. It is still to be seen how the recently enlarged EU system will continue to develop (especially in relation to adoption of the EU Constitution)⁷⁶¹ and what will be economic and social consequences of the latest enlargement. Nevertheless, it should be noted that up to now the EU institutions themselves have very much supported the accession of the Western Balkans countries, one of the reasons certainly being the wish to prevent possibility of breaking out of another military conflict in the Balkans in the aftermath of the war in ex-Yugoslavia. Therefore, the sometimes forgotten role of the concept of European integration, as a tool for prevention of national conflicts through economic integration, is expected to fulfil its role in the turbulent Balkan countries region.

⁷⁶⁰The Thessaloniki European Council explicitly states that the Western Balkan countries are to become members of the EU "once they meet the established criteria". Cf. Presidency Conclusions of the Thessaloniki European Council, 19 and 20 June 2003, www.europa.eu.int

⁷⁶¹ Some commentators argue that the rejection of the EU Constitution at referenda in France and the Netherlands is the corollary of their citizens disapproval of the accession of the countries of Central and Eastern Europe in the EU.

Once political conditions are met it is expected that the issue of financial accountability will come to the forefront of the accession agenda. This is primarily due to a decentralised nature of the EU budget implementation, which makes the overall EU financial accountability framework very much dependent on the soundness of financial accountability mechanisms of the Member States and Acceding Countries. In the EU chapter we have pointed out the problems which the EU Commission is facing with the shared management of EU funds, as the ECA has not been able to provide statement of assurance for legal and regular use of the overall EU funds in 11 consecutive years.

It is, however, interesting to note that a strong emphasis on financial accountability in the process of EU accession has started to yield positive results, as the specific area of management of the EU pre-accession funds has been assessed by the ECA as satisfactory in its last two reports for 2003 and 2004.⁷⁶² Namely, the ECA has given a positive assessment on legality and regularity of the management of the EU funds only for very few areas of the EU budget implementation, one of them being the expenditure incurred on pre-accession strategy area, whereas in the areas of shared management with the Member States (large part of CAP, structural measures and internal policies) the ECA could not get sufficient assurance as regards the legality and regularity of payments.⁷⁶³ This means the acceding countries have in general attained reliable systems of accountability, in some cases better than the Member States themselves. This conclusion, however, should be taken with some reservation, as not all acceding countries manage EU funds through their own financial accountability systems, i.e. on a decentralised basis. For most of the Western Balkans countries, it is the EU Commission itself through its agencies, such as the European Agency for Reconstruction, which handles the management of the EU funds. However, it is expected that this system will in the mid term be replaced with a fairly decentralised management of the EU accession funds, which will require lots of efforts on the part of the countries to improve their systems.

⁷⁶² European Court of Auditors, Annual report concerning the financial year 2004; European Court of Auditors, Annual Report concerning the financial year 2003, www.eca.eu.int

⁷⁶³ Ibid.

Serbia, however, is still far away from meeting the conditions set out in the Chapter 32 (before 2005, chapter 28) of the *acquis* and the management of EU resources is still under the Commission's European Agency for Reconstruction. A sound financial accountability framework has been underlined as one of the priorities for Serbia in the European Partnership, as a main instrument of a Stabilisation and Association process, as a framework for the EU accession. As pointed out in the previous chapter, the Commission has identified the development of a Public Internal Financial Control Strategy as a short-term priority that should be attained in the course of 2006. The medium term priorities, on the other hand, relate to: development and implementation of the principles of decentralised managerial accountability and functionally independent internal audit in accordance with the internationally accepted standards and EU best practice; strengthening the operational capacity and functional as well as financial independence of the Supreme Audit Institution and development of procedures and administrative capacities to ensure effective protection of the EU financial interest.⁷⁶⁴ The progress in implementing the priorities is regularly monitored by the Commission, notably in its Annual Reports and through other structures set up under the Stabilisation and Association Process.

In order to provide possible solutions for creating an efficient and effective system of financial accountability in line with both EU requirements and the local institutional environment and culture in Serbia, we shall draw on analysis from the previous chapters and make a comparison of financial accountability systems of the UK, France and the EU. As has been pointed out several times throughout this thesis, every financial accountability system operates in a specific socio-political environment with a distinct legal tradition and therefore it is of utmost importance to take into account the

⁷⁶⁴ Council Decision of 30 January 2006 on the principles, priorities and conditions contained in the European Partnership with Serbia and Montenegro including Kosovo as defined by the UN Security Council Resolution 1244 of 10 June 1999 and repealing Decision 2004/520/EC, (2006/56/EC), OJ L 35/32, 7.2.2006.

implications which specific social contexts have for financial accountability. Drawing the conclusions on different financial accountability models and making suggestions for Serbia will therefore necessitate careful analysis of respective historical, social, political and legal environments that have affected the creation of fairly different financial accountability models throughout the European continent.

UK and French systems of financial accountability as possible models for financial accountability reform in Serbia

Broadly speaking, Britain and France are representatives of two main approaches to financial accountability, which are at times addressed as north/south divide.⁷⁶⁵ It is argued that in “Southern” States, financial accountability systems are based on detailed legal requirements and personal liability of officials. Key financial accountability mechanisms in these states are ex ante payments control and judicial control of accounts, i.e. judging the legality/regularity of financial operations.⁷⁶⁶ The ‘northern’ States, on the other hand, devolve ex ante internal control to agency management and do not exercise judicial functions over accounts. The focus here is ensuring that the use of resources achieves the set priorities and objectives and value for money.⁷⁶⁷ Although the concept of north/south divide represents an oversimplification of a variety of financial accountability models across Europe, a comparison between the UK and French systems, as basic representatives of two different models of financial accountability, definitely deserves closer attention.

As we could see in chapter II, the accountability of the executive to parliament lies at the heart of the British system of financial accountability. For more than a century, the

⁷⁶⁵ Harden, F. White, K. Donnelly, “The Court of Auditors and Financial Control and Accountability in the European Community,” *European Public Law*, Volume 1, Issue 4, 1995, pp. 628-630.

⁷⁶⁶ Ibid.

⁷⁶⁷ OECD Policy Brief, *Public Sector Modernisation: Modernising Accountability and Control*, OECD, 2005, www.oecd.org/publications/pol_brief, p. 2.

British Parliament, assisted with its prestigious Public Accounts Committee supported by Comptroller and Auditor General, has been holding the executive to account for the stewardship of public money. The PAC is one of the oldest and most prestigious committees of the Parliament and its role in securing accountability is essential. The Executive, on the other hand, exercises control of handling the public money itself through internal, managerial accountability mechanisms. Internal accountability is based on a decentralised system in which the Treasury delegates to departments the authority to spend within defined limits. The basic link between external and internal accountability mechanisms is provided in the role of an accounting officer, who is a key manager of the department, simultaneously accountable to his/her Minister, Treasury and the Parliament.⁷⁶⁸ The role of the accounting officer is governed by tertiary legislation produced by the Treasury and easily changed whenever there is a need. The whole system of financial accountability is based on trust and consensus of all the involved institutions and actors, which equally share the interest of securing public funds and where additional, external means of control, such as courts, are not needed.⁷⁶⁹ Efficiency and effectiveness in the use of the public funds are the key issues to be addressed through the operation of both internal and external financial accountability mechanisms.

By contrast, the traditional French (Roman) system of financial accountability does not rest so much on the accountability relationship established between executive and Parliament, but much more on the strong internal accountability relationships between the Ministry of Finance and other line ministries and agencies and an external accountability mechanism established directly between the executive and the special Court of Accounts - *Cour des Comptes* (the Cour). In this system, payments are approved in advance by a controller outside the ministry, in the French case, the Ministry of Finance. As we could see in chapter III, the Cour makes a legal judgment on accounts, i.e. accountants, who are

⁷⁶⁸ It should be pointed out that accounting officers were once personally liable for misuse of public funds. The last recorded instance of accounting officials personal liability appeared to have happened in 1920, when an accounting officer was called to repay the amount of misused public money.

⁷⁶⁹ I. Harden, F. White, K. Hollingsworth, "Value for Money and Administrative Law", *Public Law*, 1986, pp. 670-671.

personally liable for the use of the public money. The Cour stands as an institution of high reputation and influence in its own right, firmly established by the Constitution as one of the three Grands Corps of the state. Unlike the British NAO, the Cour is not very close to the Parliament and only in recent years there have been attempts to establish a more active, direct relationship between the Cour and the legislature. The Cour constitutes an accepted part of the French administrative elite and shares a common set of attitudes and beliefs with the executive, especially since many senior Cour staff have previously worked in the Ministry of Finance and other Ministries. The French system is further characterised by detailed legal regulation of behaviour of all the actors of financial accountability.

It may be argued that distinctions between the two presented traditional models stem from differences in their political and legal systems and different understanding of the concept of the state, as mentioned in the Chapter I. Their financial accountability systems are placed within fairly different constitutional settings, which stem from their distinct historical developments. These differences will be shortly analysed to provide a background for examining the options for improving the Serbian system of financial accountability within its own constitutional and institutional setting.

Historical explanation of differences between presented financial accountability models

The central role of the UK Parliament in the operation of financial accountability, is related to historical roots of limitation of absolutist power on the British isles in the end of XVII century (see Annex 1). This prevented a creation of a centralised and hierarchical state administration with special authorities and separation of activities pursued in a public interest separated from the 'private interest'.⁷⁷⁰ Whereas mainland Europe was undergoing a process of state apparatus straightening, British isles were operating mainly

⁷⁷⁰ P. Dimitrijevic, R. Markovic, *Upravno pravo [Administrative Law]*, Official Gazette SFRJ, 1986., pp. 145-146.

within local communities which carried out activities of local interest.⁷⁷¹ In its long fight against absolutism, the English parliament has in comparison to its mainland counterparts relatively early obtained position of the organ of the supreme power with the right to enact laws and control taxation and expenditure.⁷⁷² The Monarch's administration was subject to the common law principles and ordinary courts, instead a special body of administrative law and special administrative courts.⁷⁷³ Therefore comes the famous Dicey's statement that Britain does not have administrative law, and doesn't wish to have it.⁷⁷⁴

UK historical development has influenced the British understanding of perception of the governance processes and financial accountability. Thus, UK is usually perceived as a main representative of a 'public interest' approach, which characterises 'Westminster system' countries, such as Australia and New Zealand.⁷⁷⁵ In these systems, the concept of the 'state' is not developed as in the mainland of Europe, as Pollitt and Bouckaert nicely explain:

*'Government' rather than ('the state') is regarded as something of a necessary evil whose powers are to be no more than are absolutely necessary and whose ministers and officials must constantly be held to public account by elected Parliaments and through other means.*⁷⁷⁶

⁷⁷¹ Ibid.

⁷⁷² Cf. P. Einzig, *The Control of the Purse – Progress and Decline of Parliament's Financial Control*, (London, Secker & Warburg, 1959). p. 17.

⁷⁷³ T. Fleiner, "The Common Law and Continental Law: Two Legal Systems", Institute of Federalism, Fribourg, 2005.

<http://www.federalism.ch/files/documents/tipsheet.pdf#search=%22difference%20between%20English%20administrative%20and%20continental%20law%22> .

⁷⁷⁴ C. Harlow, R. Rawlings, *Law and Administration*, (Butterworths), 1997, p. v.

⁷⁷⁵ Christopher Pollitt and Geert Bouckaert, *Public Management Reform – A Comparative Analysis*, Oxford University Press 1999, p. 53.

⁷⁷⁶ Ibid.

Parliamentary scrutiny by calling the Government to account for its actions is a key means of controlling the executive, instead of designing the detailed rules and regulations to which the executive would need to adhere. Administration generally has extensive discretion in decision-making process with little supervision through the courts. Instead, Parliament and its committees are seen as a more democratic force to oversee the work of the administration and confirm their consent to the Government policy. Although there is a growing number of soft-law regulations within the UK Government, there is still no special body of law which administrators apply in their routine work or when dealing with citizens.

The absence of a strong framework of administrative law makes the Westminster models much more flexible and adaptable to changes. Thus, with the (re) emergence of governance values of efficiency and effectiveness through New Public Management doctrine over the last two-three decades,⁷⁷⁷ the main objective of financial accountability has easily been shifted from ensuring compliance to ensuring the maximum productivity through maximum efficiency of expenditure.⁷⁷⁸ This, however, does not imply that there is no more interest in respecting established procedure and correctness. It is more to say that measuring performance has easily taken priority over checking compliance.

The historical development of the French state has resulted in the creation of a fairly different constitutional setting and environment of a financial accountability system. Unlike UK, France continued to develop strong state apparatus throughout the XIX century, introducing a strict separation of powers between the parliament, executive and judiciary. In order to realise its vision of the state, as a key instrument for changing the society, Napoleon built a viable governmental machine, governed by a special body of public law, relatively independent from the parliament and ordinary judiciary.

⁷⁷⁷ C. Hood, "A public management for all seasons?" *Public Administration*, 69:1, Spring 1991, pp. 3-19.

⁷⁷⁸ C. Pollitt et al, *Performance or Compliance? Performance Audit and Public Management in Five Countries*, (Oxford University Press), 1999, p. 54.

Establishment of special courts, such as the *Conseil d'Etat* and revival of the Cour contributed to the development of a rather detailed public law framework, which needed to be observed by a Weber style bureaucracy model, so called *rechstaat* model. The role of specialised courts in ensuring legality and accountability of the executive is here of utmost importance and civil servants experience greater pressure in fulfilling their tasks more strictly according to legal norms since they are more closely checked by judges and judicial institutions.⁷⁷⁹

Against such a background, ensuring the legality of expenditure seems to be the key objective of financial accountability in France.⁷⁸⁰ This, however, does not mean that the issues of efficiency and effectiveness of the use of public money is not an important concern in France, but just that the system itself is operating in a way which primarily addresses issues of compliance rather than financial management of the use of public funds. The role of Parliament is not of essential importance in ensuring financial accountability, as the key Parliament's function is a legislative, instead of a scrutinising one.⁷⁸¹ Furthermore, the financial irresponsibility of deputies under the parliamentary system of the Fourth Republic was the justification for putting the Executive firmly in charge of budget processes under the constitution of the Fifth Republic without giving the Parliament sufficient powers in the financial accountability framework.

The logic of the French legal system have strongly influenced legal thinking within the liberal Europe, as well as in the countries of Central and Eastern Europe, Serbia included. As was pointed out in the previous chapter, Serbia has embraced strong *rechstaat* tradition, with clear body of administrative law and special administrative Court – State Council (modeled on the French *Conseil d'Etat*). The *ex ante* control of payments was

⁷⁷⁹ C. van den Berg, T. Toonen, "National Bureaucracies and Internationalisation: the Weberian model in a New mould?," paper presented at the Blackburn conference of the Civil Service Systems Research Project, October 2005.

⁷⁸⁰ C. Pollitt at al, *ibid*.

⁷⁸¹ H.B. Street, "MPs attitudes towards scrutiny in Britain and France", draft prepared for the ECPR workshop on the renewal of Parliaments, March 2002, Turin.

exercised by the external auditor - Supreme Control, which granted *ex ante* approval for all payments and exercised quasi judicial authorities in deciding on damages emanating from accounts mismanagement. Nevertheless, the work of the Supreme Control was very early linked to the Parliament, which strengthened the Parliament's position against the Monarch. However, after the II World War, no democratic audit was performed, due to the introduction of the system of unity of powers. The work of Accounting and Payment Service focused exclusively on control of legality of financial operations of both public and private sector and therefore strong legalistic approach to issues of financial management has been kept to modern times.

Gradual harmonisation of systems - emerging European model of financial accountability?

Despite the outlined historical differences, there is increasing evidence of the gradual approximation of financial accountability systems of European countries. Public management reforms, based on the ideas of new public management, that started off more easily in the Westminster model countries, have recently spread, albeit to a more limited degree, to the mainland of Europe.⁷⁸² The main priority within control and monitoring systems is therefore being gradually shifted from the values of economy and regularity towards the values of efficiency and effectiveness and from detailed *ex ante* controls to increased *ex-post* accountability for performance.

In this respect, the French example is quite indicative. As we could see in Chapter III, with the adoption of the Constitutional bylaw on budget acts in 2001 (so-called LOLF),⁷⁸³ centralised *ex-ante* internal controls performed by *controlleurs financiers* are gradually changing towards the *a posteriori* control framework, placing instead a high degree of

⁷⁸² F.F. Ridley, "New Public Management in Europe: Comparative perspectives", *Public Policy and Administration* Volume 11, No. 1 Spring 1996., pp. 16-29.

⁷⁸³ *Loi organique relative aux lois de finances, LOLF* - Constitutional bylaw No. 2001-692 of 1 August 2001 on budget acts (1), French Official Journal No. 177 of 2 August 2001, p. 12480.

autonomy on organisation's management (*ordonnateurs*).⁷⁸⁴ Furthermore, the UK model of close parliamentary scrutiny for the use of public monies exercised through the work of Parliamentary Committee was also introduced in France, through a creation of the MEC (*Mission d'évaluation et de contrôle*) in 1999. Thus, it may be argued that a strong influence of new public management ideas which spread first in the Westminster countries have prompted France to introduce more radical approach to performance management in the use of the public funds.

The EU model of financial accountability represents an interesting mixture of the British and French systems and another good example of gradual approximation of the two systems. The internal control mechanisms were initially modelled on the French strict differentiation between *ordonnateur*, *contrôleur financier* and *comptables*. However, as we have shown in Chapter IV, this system proved ineffective in the EU context and eventually brought about a series of mismanagement of public money in the EU resulting in the resignation of the Santer Commission. Right after the French reforms undertaken through LOLF in 2001, the Commission also reformed its internal control framework through new Financial Regulation adopted in 2002,⁷⁸⁵ shifting the loci of accountability from *contrôleurs* to *ordonnateurs* and thus moving towards the UK decentralised model of internal control. The UK model of external financial accountability was an inspiration for creating the Court of Auditors (ECA), which has been linked to the European Parliament through the Parliamentary Committee of COCOBU. This relationship, however, has not been as effective as of the British NAO-PAC, which has to some degree undermined the effectiveness of the work of ECA. The absence of the strong Ministry of Finance in the EU institutional setting is another reason for general underachievement of the overall financial accountability framework.⁷⁸⁶ However, the most fundamental problem of divided accountability for implementation of the Community budget and lack

⁷⁸⁴ NAO study, *State Audit in the European Union*, 2005, www.nao.gov.uk/publications/state_audit/state.htm, p. 89.

⁷⁸⁵ Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities, OJ L 248/1, 16.9.2002.

⁷⁸⁶ Harden, F. White, K. Donnelly, op. cit. pp. 631-632.

of incentives for Member States to pursue sound financial management in their administration of Community spending poses is definitely the most important problem in the EU financial accountability framework, which the Commission has started to address through the creation of a common internal control framework.

The gradual harmonisation of all these systems triggers the question if we can talk about a general European model of financial accountability, to which the acceding countries need to adhere? We would argue that although there is still no specifically elaborated European model of financial accountability, the contours of such a system are clearly emerging.

If we go back to our definition of financial accountability in Chapter I, as a relationship where citizens hold the Government to account for the stewardship of public money, we could attempt to define the main elements of the emerging European system of financial accountability. Whereas the *who* and *to whom* dimensions of accountability are clear, the remaining *for what* and *how to secure it*, can be defined as follows:

- 1) *for what* dimension of financial accountability assumes regular/legal but also economic, efficient and effective use of public money
- 2) *How to secure it* dimension finds its answers in interdependent operation of several financial accountability mechanisms, such as:
 - a) internal financial accountability mechanisms based on:
 - decentralised internal financial control, placing responsibility for the use of public money to organisation's management;
 - decentralised internal audit.
 - b) external financial accountability mechanisms based on:
 - external audit performed by independent supreme audit institution

- Strong parliamentary oversight through operation of a Parliamentary Committee for public accounts, as a key link between the external auditor, Parliament and the executive.
- c) establishing other accountability lines between internal and external mechanisms, such as for example direct cooperation between external auditor and auditee's management, internal and external auditors, etc.

The way forward for Serbia

What are the lessons for Serbia to learn from the presented comparative experience which experiences gradual harmonisation towards a single European financial accountability model?

While giving any advice to Serbia, the issue which has to be kept in mind is that legal rules, principles and institutions cannot simply be transplanted from one legal system to another.⁷⁸⁷ This is especially the case if we are talking about fairly different systems on the different stages of development. One might therefore question whether any of the Western earlier explored systems in this dissertation would be able to function properly in the still fragile democratic environment of Serbia at the moment, including the emerging European one. There are certainly a number of risks which will be faced in an attempt to introduce such a model. If we, instead, take a historical approach, we could think of going back to principles of old Serbian audit tradition, modelled on the French system. However, the question is again whether it would be feasible or desirable to re-establish such a system after more than 60 years of its absence?

⁷⁸⁷ Cf. J. Bell, "Mechanisms for Cross-fertilisation of Administrative Law in Europe", in J. Beatson, T. Tridimas *New Directions in European Public Law*, (Hart Publishing, Oxford), 1998, p. 147; S. Cassese, "Toward a European Model of Public Administration", in D. Clark ed., *Comparative and Private International Law*, (Duncker & Humblot), Berlin, 1990, pp. 361-362.

Although it is quite difficult to give answers to all complex questions of financial accountability, there are general conclusions which may be inferred from the above comparison. As Serbian legal system is based on a strong *rechtsstaat* tradition, there is no doubt that detailed legal regulation of financial accountability system would be of utmost importance for its proper functioning. In this respect, the French extensive legal regulation of the system could be a good example on how to establish a proper legal base for the system of financial accountability. However, one has to be careful not to go into overt regulation as this would have an adverse effect on the flexibility of the system. It is therefore very important to properly assess what level of detail is needed to be included in the primary legislation and what should be left for the secondary and tertiary legislation.

However, establishment of the pure French system of financial accountability is not very likely in Serbia, despite a historical institutional similarity of the French and Serbian constitutional and legal backgrounds. The absence of a democratic external auditor in Serbia for almost a century cannot be substituted so easily and it will take many years until (once established) Serbian Supreme Audit Institution will acquire the prestige of the French *Cour des Comptes*, as a key external guardian of the use of the public funds. As we have already discussed earlier, civil servants of the Ministry of Finance and of the *Cour des Comptes* represent the part of the same elite and therefore can work well together even without an important role of the French Parliament. This is not to be expected in the Serbian context. Nevertheless, some elements of the French model could undoubtedly be well applied in the Serbian context. In line with the French model and Serbian tradition of personal liability of accountants in the first Yugoslavia, establishment of some degree of personal liability of persons dealing with the public funds would be important for the proper functioning of financial accountability system. However, it would be important not to limit the accountability concept to tackling individual cases of mismanagement and irregularities, but to ensure both administrative and political accountability for stewardship of public money through effective Parliamentary scrutiny of use of the public funds.

In this respect, the British system of financial accountability, based on parliamentary accountability, could serve as a good model to look to. However, it is obvious that the pure British system would not function very well in Serbian context due to fairly weak powers of the Serbian parliament, the under-developed operation of the Parliament and its committees and lack of capacity of the Serbian civil service to adequately monitor itself. As we have seen earlier, the whole system of financial accountability in Britain is based on trust and consensus of all the involved institutions and actors, which equally share the interest of securing public funds and where additional, external, means of control are superfluous. This is in sharp contrast with the Serbian fairly underdeveloped sense of trust between different financial accountability actors, which reinforces the need for strong external means of control. Nevertheless, the important concepts of the British system could without reservation be applied in the Serbian environment and add to the creation of effective financial accountability system.

On the basis of these general concluding remarks and the European Union standards in the area of financial accountability, the remainder of this chapter shall provide more detailed recommendations for each of the mechanisms of financial accountability in Serbia in line with *acquis communautaire* requirements. As the *for what* dimension of financial accountability has been reasonably well defined in the Serbian legislation, comprising both regularity/legality and value for money in the use of resources, the key issue is to ensure the implementation of these principles through strengthening the interplay of internal and external financial accountability mechanisms.

Proposals for Strengthening Internal Financial Accountability Mechanisms

As we could see in the previous chapter, the Serbian Government administration has made important progress in developing internal financial accountability mechanisms. The

Budget System Law⁷⁸⁸ provides a legal framework for segregation of internal control actors duties and establishment of internal control and audit, which has been further regulated in more detail by secondary legislation, as pointed out in the previous chapter. Furthermore, internal control units have been created in a majority of ministries and social security funds, and a number of internal auditors have been trained under the support of the European Agency for Reconstruction.

However, significant challenges for the establishment of an effective internal accountability framework in line with the EU requirements remain. Although lots of efforts have been invested in creating a functional internal control system, principles of decentralised managerial accountability framework, required by the EU Commission, have still not been implemented, as the management of the organisation is not responsible for the establishment of a sound internal control systems. The internal audit system is also in a fairly early stage of development and will require substantive strengthening. Capacity constraints in the Serbian administration represent an important impediment for the future development of effective internal financial accountability mechanisms.

Internal financial control – towards the UK accounting officer model?

As we could see earlier, the decentralised managerial internal accountability framework has recently become a standard to which the EU Commission aspires and requires the acceding countries to adhere to as well. Learning from its own negative experience with overly centralised internal financial control, the Commission is now insisting on the decentralisation of internal control framework. In this way, it is moving away from the French system of ex-ante internal control performed by the Ministry of Finance towards a British and consequently EU model of devolved responsibility for the use of the public funds given to management of individual institutions.

⁷⁸⁸ Budget System Law, “Official Gazette of the RS,” No. 9/02, 87/02, 66/05.

The first question which, however, arises is whether the decentralisation of internal control framework is appropriate for unstable transitional governance processes. The devolved internal control systems leave considerable leeway to individual organisations to manage their own funds and are therefore more prone to financial irregularities and mismanagement. It may be argued that in the first phase of building up of a reliable financial accountability system more emphasis should be placed on establishing a sound control and compliance *ex-ante* mechanism instead of moving further to more advanced models of managerial accountability. Therefore, it seems that the French traditional model of internal control with the strong role of the Ministry of Finance is more appropriate for the current stage of development of the Serbian system.

However, the negative sides of *ex ante* centralised internal control approach should again be duly taken into account. In particular, possible implementation of the traditional French system in which a financial officer appointed by the Ministry of Finance is posted in line ministries can create problems in implementation and potential conflicts between the officials in line ministries and seconded officials of the Ministry of Finance. Furthermore, the division of responsibility for internal control between the line ministries and the Ministry of Finance would prevent establishment of clear internal accountability lines which may bring about problems encountered in the EU system of financial control.

The best answer to these complex issues could perhaps be found in trying to combine various principles of decentralised managerial accountability exercised by individual institutions, strong coordinating role of the Ministry of Finance by creation of an internal control and audit unit in the Ministry of Finance and keeping an appropriate degree of *ex ante* control exercised by the Treasury. Achievement of decentralised managerial accountability will require separation between political and managerial roles in carrying out financial operations and securing a degree of personal liability of staff engaged in this process. We shall devote closer attention to each of these elements.

Attainment of managerial accountability for establishing a sound internal control framework will undoubtedly require revision of the current Serbian legal framework, either the adoption of a new Public Internal Financial Control specific law or substantial amendments to the existing legal framework, the Law on Budget System and the Decree on Internal Control. This legislation should emphasise that management of a state organ will have a duty to establish an appropriate system of internal control and will become responsible for the secure and efficient operation of an internal control system.

The question which needs to be raised in this respect is to who should be a key accountee of the internal financial accountability mechanism – a Minister or a senior civil servant? The ultimate accountee for performance of all duties in the Ministry is, of course, a Minister who is politically responsible to Parliament for his/her performance of duties as well as of his/her Ministry. However, if the loci of financial accountability is placed only at the political ministerial level, the issue of financial accountability may become overly political and therefore unstable. The issues of financial management and accountability are not of changeable political nature, but are in essence established on administrative-economical principles of stewardship of public money, such as legality, economy, efficiency and effectiveness of the use of the public funds. When there is no distinction between the political and managerial roles, politicians actually take over the role of managers, often having responsibility for signing routine documents such as orders for goods and making ordinary payments. If this role is given only and primarily to politicians, then the management of an organisation will not take substantive interest in financial issues and will not sufficiently understand the risks and introduce appropriate safeguards.

Therefore, it is necessary for any organisation to separate between political and management functions and have an apolitical professional official who will be aware of these issues and be able to provide a good and reliable advice to his/her Minister. That person would play the role of an Accounting Officer – Permanent Secretary in the UK system or Director General in France or in the EU system. As pointed out in the previous

chapter, in the Serbian civil service system the equivalent role is accorded to a Secretary of the Ministry. In the case of Special Organisations, the head of the special organisation could be held accountable for financial management of the Organisation as he also has a status of a civil servant (in accordance with the new Civil Service Law). In this light, it would be very important to set out a clear role for the Secretary of the Ministry/head of Special Organisation to be responsible and accountable for the financial transactions within the state organ, the role close to the UK role of an accounting officer. Adding the responsibility of an accounting officer would only add to the importance of the place of Secretary General of the Ministry which would give him/her stronger role when dealing with his/her Minister.

The establishment of clear internal accountability lines of is not only important for effective functioning within the Ministry, but also for an efficient operation of external financial accountability mechanisms. The UK experience shows that giving an explicit statutory responsibility to the most senior civil servant for the financial affairs of their departments may allow Parliament and its Committees the ability to assign clear accountability lines for problems of financial management. The establishment of statutory responsibility of the Secretary of the Ministry to Parliament for matters of administration would add potential clarity and focus of investigations of once established Parliamentary Committee for public accounts. This would enable the senior civil servants to be held to account to a Parliamentary committee without confusing this with his/her responsibility to Ministers.

One important reservation, however, has to be made when talking about the establishment of a variant of a UK accounting officer model in Serbia. As noted in the previous chapter, the post of a Secretary General is still regarded as primarily political instead of a key senior civil service post. Although a number of Secretary Generals in the Serbian Government are not politicians, they do have a strong political affiliation and have been appointed by the Government for the period of 4 years, to follow the cycle of elections. The process of depoliticisation in Serbia has just began by the adoption of the

Civil Service Law in 2005 which requires all senior civil service posts to be subject to internal/open competition that should enhance professionalisation and reduce politicisation. However, the process of depoliticisation will take time and therefore it should not be expected that the Secretary General of the Ministry would obtain the status of the British Permanent Secretary over night. Therefore, although we strongly support the introduction of accounting officer model, we would still advise that it be introduced in the mid term period of 3-5 years to follow and support the ongoing process of depoliticisation of the senior echelons of Serbian administration. For the moment, it would be sufficient to leave the responsibility for the use of the public funds to the head of an organisation and at the same time build capacities of civil servants to obtain more important role in the financial management issues.

Another point of concern for establishment of the UK accounting officers model in Serbia, as will be discussed in more depth in the next section, is the still underdeveloped role of the Serbian Parliament and its Committees in scrutinising the work of the executive. In line with strong *rechstaat* tradition, and similar to the French case, civil servants work in Serbia is mainly supervised by specialised courts. In cases when personal liability for civil servants in carrying out of their duties is at stake, the usual way to secure legality of operation is to set out pecuniary sanctions for breach of particular provisions of the law. Such cases are to be decided in the misdemeanour procedure.⁷⁸⁹ More serious breaches of legal financial provisions are naturally subject to criminal procedure. It is important that these elements of personal liability, similar to ones existing in the French system, remain until much more stable and effective system of financial accountability is established. Once a more reliable system of trust between all financial accountability actors is in place, provisions of personal liability of civil servants could be gradually relaxed, as it is the case in the UK system.

⁷⁸⁹ Thus, at the moment, the Budget System Law prescribes a number of pecuniary sanctions for civil servants in breach of obligations to secure legality in the use of the public funds. They amount from 5000-50.000 dinars (around 500-5000 pounds). Article 74-75 of the Budget System Law, Official Gazette of RS, No. 9/02, 87/02, 66/05.

In order to strengthen internal accountability lines and reduce risks of financial irregularities of staff dealing with public funds, all Ministries and other state organs should have an obligation to develop written internal procedures in the form of rulebooks/regulations, similarly to the EU case. The further step could be a publication of a set of internal control regulations, issued to all relevant staff, which should establish the detailed processes to be followed by finance and operational staff (similar to the UK system of Government Accounting).⁷⁹⁰ These regulations must conform to general principles issued by the Ministry of Finance and be approved by the Central Harmonisation Unit of the Ministry of Finance.

Another important point for establishing a sound internal control framework is a need for stronger inter-ministerial coordination and harmonisation mechanisms for internal control (and internal audit, as will be pointed out in the next section). In the Serbian context of strong individual ministries and weak inter-ministerial coordinating mechanisms, it is of utmost importance to establish a Central Harmonisation unit to provide advice to departments and define common minimum standards for internal controls as well as advising on their application. A central harmonisation unit for PIFC should be established in the Ministry of Finance. This unit should be responsible for developing methodologies and standards for public internal financial control and internal audit. In order to strengthen the role of the central harmonisation unit, the Head should report directly to the Minister of Finance.

The involvement of the Treasury in the ex-ante financial control process is another important issue to be discussed. As pointed out in the previous chapter, at the moment there are centralised accounting controls within the treasury and all requests for payment and documents justifying them are sent to the Treasury, which controls them and plans their payment, even for very small amounts. Since early 2006, all the payments for direct

⁷⁹⁰ The World Bank, *Serbia, Fiduciary Assessment Update, 2005*, Internal document of the World Bank, p. 77.

budget users have been executed through the treasury single account, which is a positive development. However, although stronger Treasury controls are necessary to ensure accountability especially in the early phases of transition, overt Treasury controls could potentially lead to inefficiencies and increase of corruption and therefore should be gradually relaxed. The current overly centralised system should therefore in the mid to long term be replaced by so-called “passive Treasury Single Account”, where payments would be made directly by spending agencies, but through the Treasury Single Account. In such a system, the Treasury would set cash limits for the total amount of transactions, through the budget implementation plan, but would be involved in control of individual transactions, which would enhance efficiency and reduce possibilities of corruption practices.⁷⁹¹

Finally, it should be noted that the Serbian Government is currently preparing a Strategy or Policy Paper for PIFC development and for the creation of sustainable training facilities for financial controllers, managers and internal auditors. When compared to the European Commission’s four requirements for PIFC development (listed in the previous chapter), the adoption of the Government strategy for the development and modernization of its internal financial control system is of significant importance, as it represents a short term EU Partnership priority. It would be important that all earlier discussed issues of: decentralised financial management, establishment of a clear apolitical lines of accountability in the mid term, strong internal control coordination mechanisms and gradual relaxing of Treasury controls are entrenched in such a strategy, that will provide a comprehensive basis for establishing of sound internal financial control.

Gradual Introduction of Internal Audit

As we could see in the previous chapter, Serbia has no tradition of modern internal auditing, but a tradition of a “government control office” or “control activity”, such as the

⁷⁹¹ R. Allen, D. Tommasi (eds), *Managing Public Expenditure, A Reference Book for Transition Countries*, SIGMA, OECD, 2001. 244-245.

Serbian budgetary inspection. The budgetary inspection investigates complaints received about staff from either civil servants or the public and may also investigate allegations of irregularity or fraud and refer cases to fiscal or criminal police. The inspection possesses quasi-judicial authorities, which consist of issuing decisions that order an action to be taken in relation to any fraudulent practices or serious irregularities discovered by the inspectors.

Although this concept of “policing nature” of budgetary inspection seems to be outdated when compared to modern internal audit practices, it does represent a powerful tool for the Serbian Ministry of Finance to oversee and ensure implementation of financial rules and regulations. This concept perfectly fits within the context of Serbian *rechstaat*, being modelled on the prestigious French General Inspectorate of Finance (*L’inspection generale des finances*). Therefore, notwithstanding the need to move from the ‘policing’ and ‘controlling’ internal mechanisms, to ‘prevention and detection’ internal audit mechanisms, it is necessary to keep and strengthen the capacity of the budgetary inspection of the Ministry of Finance at least until the internal financial accountability system is effectively established.

At the same time, it is important to start changing the overall logic of the system from merely taken action upon individual cases of mismanagement, irregularities, corruption or fraud to be pro-active and make sure all parts of the prevention, detection and follow up chain functions well together and strengthened.⁷⁹² This will require substantive training and time in order to change the mindset of not only of internal auditors but also of organisations in which they operate.

Whereas the rules and practices of the budget inspection are relatively well understood in the Serbian system, due to long practice of existence of such an institution in Serbia, the

⁷⁹² Cf. PIFC Expert Group, *Internal Control Systems in Candidate Countries, Volume II*, February 2004, p. 76. <http://www.oecd.org/dataoecd/35/37/34891262.pdf>

development of an internal audit function will require much more effort and time. As we could see in the previous chapter, the Serbian Government currently has only one centralised internal audit unit in the Ministry of Finance. That unit certainly does not have the potential to provide the decentralised independent government-wide internal audit service, especially with a fairly limited number of staff it contains. It is therefore important to create a critical mass of auditors in key direct budget users. The first step in this respect is setting up clear legal requirements for establishing individual internal audit units in the direct budget users. This should be done by amending the Budget System Law and subsequent Government decree on Budget Inspection and Internal Audit. Once established, audit units of direct budget users should also carry out the audit of any indirect budget beneficiaries for which the organisation is responsible (e.g. Ministry of Education for network of schools, etc.). In cases when the direct budget users have only a fairly small number of employees (such as for example the Ministry of Religion, with only 8 employees), the internal audit unit in the Ministry of Finance could carry out internal audit activities on its behalf, due to limited capacities of such small institutions.

It is further important to establish clear accountability lines in the organisation. The internal auditor should be responsible to the Minister and, in the mid term, to the Secretary of the Ministry/other state organ, giving technical advice on the efficient management of resources without becoming involved in political questions. The internal audit activity should be free from interference in determining the scope of internal auditing, performing work and communicating results. Since the internal auditor is not completely independent of the ministry or organization in which he functions it is essential that the internal audit function achieves an appropriate status and weight in the organization.⁷⁹³

Similar to internal control systems, establishment of effective internal audit units in individual institutions will require strong coordination by the Ministry of Finance Central Harmonisation Unit. In this sense, the current internal control unit of the Ministry of

⁷⁹³ Cf. PIFC Expert Group, *Internal Control Systems in Candidate Countries, Volume II*, op. cit., pp. 77-78.

Finance should be strengthened to be able to provide standards and methodologies of work for all internal audit throughout the Government.

Finally, it needs to be stressed that the establishment of an effective internal audit system, similar to other elements of financial accountability, will not be an easy exercise and that expectations of such a service should not be too high. This is due to underdevelopment of all other elements that internal audit has to provide assurance of: accounting systems, internal controls systems, managerial responsibility for overall control framework etc. In such circumstances, the internal audit function should not aim for more advanced forms of internal audit, such as risk assessment or performance audit, but mainly focus on more basic issues of regularity/legality and fraud detection, which characterised early development of internal audit function in Western democracies.⁷⁹⁴ Only when these basic elements of accuracy and regularity/legality are put in place, should more advanced formulas of internal audit be sought.

Possible ways to enhance the role of the Parliament and its Committees

As we could see in the previous chapter, the Serbian Parliament exercises little control over public finances. Similar to the French Parliamentarians, Serbian MPs are still primarily interested in the legislative process and are not accustomed to carry out substantive supervisory and scrutiny role over the work of the executive. Most MPs are unfamiliar with their role in reviewing budgetary estimates and holding budgetary hearings and lack sufficient knowledge in the field of financial monitoring and control. The fact that the governing coalition is comprised of many political parties with often opposing views reinforces the old tendency to make decisions behind closed doors, rather than in a transparent parliamentary setting.

⁷⁹⁴ N. Hepworth, "Is the modern UK/US approach to internal audit appropriate in all circumstances and especially for countries with less developed systems and less well trained public officials?," October 2004, p.4, unpublished manuscript.

Strengthening parliamentary oversight capacity is vital for establishing a viable system of financial accountability in Serbia. This can be accomplished by increasing the role of parliamentary committees and establishing strong links with the Supreme Audit Institutions, once it is established. As the new Supreme Audit Institution, as was pointed out in the previous chapter, will not have substantive sanctioning powers, it will need to rely heavily on the assistance from the National Assembly in order to be able to discharge its duties and endorse its findings. Based on experience of many countries, political pressure exerted at the political level of Parliament is a strong lever to force the Government to comply with external audit recommendations.⁷⁹⁵ Therefore it is essential that MPs take an active role in financial accountability issues, primarily through strengthening the role of Parliamentary Committees.

Experience of other countries, primarily the UK, are very useful for providing food for thought on what is needed for a specialised Parliamentary Committee dealing with financial management to function properly. General recommendations are the following:

1. First, there is a need for establishing a special Parliamentary Committee that will deal solely with issues of financial accountability, modelled on the British PAC (and subsequently French MEC and the EU's COCOBU). This would require changes of the rules of procedure of the Serbian National Assembly. The Committee members should be extensively trained in order to obtain the knowledge necessary to provide support to the SAI and the Parliament in exercising the financial accountability relationship.
2. It is important to ensure that the composition of once established Serbian Committee for Public Accounts reflects the political composition of all parties in

⁷⁹⁵ F. Cazala, "The Supreme Audit Institution and Parliament: How Can their Relationship Support Implementation of the Audit Recommendations?", paper presented at INTOSAI 2nd International Conference on Internal Control, May 2000.

parliament.⁷⁹⁶ However, given that Serbian political system is still highly polarised on two major blocks - parties of ex regime and parties of so-called democratic block,⁷⁹⁷ potential strong disagreements between these parties could be very damaging to the newly established Committee. These partisan differences could easily reach a point where the government is unwilling to accept any criticism or to act on valid complaints, especially if they come from the opposing political block. It is therefore important to try to ensure a close working relationship among members from different parties and blocks, which will also depend on the further development of the political process in Serbia.

3. In order to reduce the political pressure from the work of the Committee it would be important to focus on accountability of civil servants for administrative and financial operations rather on sole political accountability of ministers, as explained earlier. The focus should therefore be on implementation of policy and not on its substance, without questioning the objectives themselves.⁷⁹⁸ In this sense, giving more explicit statutory responsibility to the Secretary of the Ministry for the administrative and financial affairs of their departments in a mid-term perspective may allow committees and others the ability to assign clear responsibility for problems to either Ministers or Secretary Generals. Secretary Generals would be obligated to account for their actions primarily to Parliament, rather than explaining issues to them while still primarily responsible to their Ministers and subject to their discipline. Therefore, as argued above, the

⁷⁹⁶ SIGMA papers: No. 33, *Relations between Supreme Audit Institutions and Parliamentary Committees*, CCNM/GOV/SIGMA (2002)1, OECD, pp. 28-34. available at www.eca.europa.eu/cooperation/publications/docs/sai_parl_136_en.pdf.

⁷⁹⁷ A. Rabrenovic, "Politico-administrative relations under the coalition Government in Serbia", in G. Peters, T. Verheijen, L. Vass, *Coalitions of the Unwilling? Politicians and Civil Servants in Coalition Governments*, NISPAcee, Bratislava, 2005, pp. 146-177.

⁷⁹⁸ R. Stapenhurst, V. Sahgal, W. Woodley, R. Pelizzo, "Scrutinizing Public Expenditures, Assessing the Performance of Public Accounts Committees", World Bank Policy Research Working Paper 3613, May 2005, p. 20.

establishment of greater statutory responsibility by Secretary Generals to Parliament for matters of administration would add potential clarity and focus for the Committee on Public Accounts. This would enable civil servants to be held more to account to Parliament without confusing this with responsibility to Ministers.

4. Another UK safeguard to ensure the Parliamentary Committees function in a non-political way is to appoint the chair of the Committee from an opposition party. Although this principle has generally been applied in the Serbian parliamentary committees, the interesting example of the Finance and Budget Committee shows that this principle can be circumvented in practice, simply due to the disinterest of the President of the Committee to attend its sessions. Therefore it is very important to work on raising the awareness of the members of the future Committee for Public Accounts and other MPs on issues of financial accountability and stewardship of public money.
5. The Committee for Public Accounts should have the authority to call for any person to testify in the Committees meetings and request any additional (written) information from any person relevant to the audit issue. In this way, the Committee would indeed hold government to account for its actions. It is hoped that appearance before the Committee will not taken lightly by public servants and will provide powerful and transparent follow-up of the Supreme Audit Institution investigations.
6. It would be helpful to allow media to follow the hearings, as it has already been done in the case of several ad hoc established committees. This is to encourage transparency and awareness of the general public of the matters being addressed. If hearings are public and open, they provide a powerful opportunity to hold the executive to account by testing the audit results in the testimony of executive officials and other experts. Hearings also can build public interest in important

policy issues. In addition, hearings create greater understanding of the Supreme Audit Institution function and of oversight more generally and alert interest groups, the rest of parliament and the public to the issues that might arise in the future.⁷⁹⁹

Achievement of effective parliamentary support for financial accountability issues will, however, ultimately depend on further consolidation of political and stable parliamentary life in Serbia. Namely, around 80% of the current MPs in the Serbian parliament have obtained a MP's status for the first time at the last elections of 2003 and therefore have obtained their knowledge of Parliamentary work and procedures only in the course of the last couple of years. MPs in Serbia usually perform various duties and are in rare cases devoted only to Parliamentary work and therefore the general attendance of Parliamentary sessions is low. The political party process in Serbia is still in the process of gradual consolidation of political parties and overcoming the overt fragmentation of political system which occurred in 2000, (when the coalition of 18 parties of fairly different political ideology united in order to defeat Milosevic). It is expected that the gradual consolidation of political parties will bring about more stable Parliamentary membership which will be able to devote itself primarily to issues of Parliamentary work which will be necessary for building any kind of expertise, including the financial accountability issues.

In the view of the above, we again underlie the need to inform and educate not only the members of the Parliamentary Committee for Public Accounts but also all the MPs on financial accountability issues. Special focus of such training should be laid on functioning of SAIs in other countries, their relations with Parliaments and overall

⁷⁹⁹ W. Krafchik, "What role can civil society and Parliament play in Strengthening the external auditing function?", The International Budget Project, <http://www.internationalbudget.org/auditorgeneral.htm>, p. 2.

Parliamentary role in scrutinising the operation of the executive, rather than performing the prevailing legislative role.⁸⁰⁰

Creating an effective Supreme Audit Institution

In accordance with our previous general conclusion, a solid, stable and applicable legal framework is an indispensable prerequisite for institutional strength and long-term development of external audit in Serbia. Importance of stability of the legal framework of the Supreme Audit Institutions has also been stressed by the Lima Declaration and the INTOSAI auditing standards.⁸⁰¹ In order to enable stability and coherence, the legal framework of a SAI should be defined at different levels – Constitution, laws, regulations, rules and procedures. The Constitution and laws form the institutional base while the regulations, rules and procedures have the objective of ensuring that the responsibilities of the SAI (as defined in the Constitution and laws) are exercised in the most effective way.

An important question to be posed in this respect is what level of regulation should be reserved for different hierarchy of legal norms to ensure stability, but in the same time allow sufficient flexibility for evolving nature of any institution. Some practitioners argue that the Constitutional provisions should comprise the following elements: the establishment of the SAI and its independence, its status and type (an audit office or a court of auditors, a single executive or collegiate leadership); nomination, removal and dismissal of its Head; basic auditing powers and duties; reporting responsibilities, including a clear definition of its relations with parliament and government.⁸⁰² We are,

⁸⁰⁰ SIGMA papers: No. 33, *Relations between Supreme Audit Institutions and Parliamentary Committees*, op. cit, p. 33.

⁸⁰¹ Cf. Lima Declaration of Guidelines on Auditing Precepts, available on the INTOSAI web site, www.intosai.org.

⁸⁰² Cf. Resolution of the Presidents of Supreme Audit Institutions of Central and Eastern European Countries, Cyprus, Malta and the European Court of Auditors, “*Recommendations concerning the*

however, of the opinion that such detail regulation would not be appropriate for Constitutional provisions as it would freeze any attempts of potential reform of once established SAI. We would, instead, opt for more general reference to the SAI in the Constitution, in line with the French solution, which would refer to establishment of an independent institution that is to assist the Government and Parliament to ensure legal, efficient and effective use of public financial resources. All other issues should be reserved, in our opinion, for primary and subsequently secondary and tertiary legislation.

Ensuring the independence of SAI is definitely an area to be regulated by the primary legislation. As we could see in the previous chapter, personal, organisational and financial independence is indeed governed by the Law on SAI, which requires that members of the SAI's Council be elected by the Parliament. The requirements for election of the SAI's members are also quite demanding (in terms of education, professional experience and request that have not been employees of any Government body in the last two years) which should secure professionalism and prevent possible political interferences in the work of this important institution. The democratic elements in the work of the SAI are secured by the role of the Parliament in its election, which points out the importance of the link between the SAI and the Parliament. However, we have already seen that in practice that even well defined legal provisions are subject to difficulties in their implementation and are not immune to political interferences, which has prevented the election of the SAI Council so far. Therefore, although establishment of a proper legal entrenchment of this body is important, it cannot be perceived as only and ultimate guardian of the real independence and professionalism of this institution. Lots of efforts and time will need to be invested in the work of this institution when it is established in order to achieve the prestige that their Western counterparts enjoy in their own institutional settings.

functioning of Supreme Audit Institutions in the context of European integration,”

http://www.eca.europa.eu/cooperation/publications/docs/recommendations_en.pdf, pp. 1-3.

The adoption of a collegial approach to deciding important issues, with considerable central direction and management of the institution, may be considered as appropriate for the new institution such as this one. The UK model of NAO, as headed by a single officer of the Parliament, (Comptroller and Auditor General) would place too much responsibility on one person for performing duties of new institution. The French collegiate model therefore appears to be better applicable in the Serbian context. However, it should not be expected that the French model of separate components of “chambers” which operate to a great extent independently of each other will be applicable, especially in the first years of SAI’s operation. In the beginning of the operation of the new SAI it would be important to secure unified audit approach through stronger management, which would later be possible to decentralise to specialised audit units, headed by High Supreme Auditors.

Another important issue that should be discussed is ensuring that conclusions which arise from SAI’s audit findings and the subsequent actions taken by the auditee are properly followed up. The natural response in this respect in the Serbian context is to provide the SAI with sanctioning quasi-judicial powers, similar to those exercised by the Social Accounting Service and the budgetary inspection. The logic behind this is very simple: if this institution does not have firm enforcement powers, there is a risk that it will be just a passive observer of financial irregularities with no possibilities to intervene in any way, except to refer it to other organs with sanctioning powers. As Serbian civil servants are accustomed to various forms of judicial and quasi-judicial accountability, establishing another body with quasi-judicial powers would not be perceived as a big novelty.

However, the historical development of supreme audit institutions point out gradual loosing of powers of sanction auditees and instead development of advisory and partnership role between external auditor and the executive. The British Court of Exchequer lost its sanctioning powers in the end of XIX century,⁸⁰³ while the French

⁸⁰³ J. Molinier, “Parliament’s Financial Powers: A Comparison between France and Britain”, in D. Coombes (eds.), *The Power of the Purse*, (London George Allen & Unwin Ltd), 1976. p. 172.

Cour des Comptes, although it does judge accounts, has lost its power to impose sanctions to *comptables*, leaving this authority to the *Conseil d'Etat*. Creation of an external audit institution with sanctioning quasi-judicial powers in Serbia may create adversarial relations between the executive and auditees, which would perceive the SAI as formidable sanctioning body rather than a partner in securing financial accountability. Therefore, we support the current solutions of the new Law on SAI with fairly restricted sanctioning role, which comprises merely in referring more serious mismanagement cases to other bodies (such as misdemeanour court and Criminal court) and calling officials responsible for serious irregularities to resign from their functions.

In the absence of clear sanctioning powers of the SAI, we reiterate the need for the establishment of a proper relationship between the SAI and the Parliament. Once the SAI in Serbia is established, it should give appropriate attention to parliamentary concerns in setting its audit priorities. It would be desirable that the SAI is aware of parliament and the Executive's needs and interests and should take them into account in setting priorities. However, it is important that the SAI would retain its discretion to accept or reject suggestions from parliament and to perform audits on its own initiative.⁸⁰⁴ The French *Cour des Comptes* clearly demonstrates that high degree of independence from both the executive and the Parliament is possible to be attained. However, this is not to suggest that the French fairly adversarial model between the external audit institution and the Parliament should be applied, but just that the SAI should primarily keep its focus on its own long-term issues of improvement of financial management. The danger is that if the SAI becomes too focused on responding to parliamentary interests, its work may be undermined by partisan short-term concerns in ways that would put its independence and credibility in jeopardy.

Finally we would like to address concrete issues related to the actual establishment of the SAI in Serbia in the near future. In this sense, there is an urgent need to create and

⁸⁰⁴ SIGMA paper: No. 33, *Relations between Supreme Audit Institutions and Parliamentary Committees*, op. cit. p. 30.

develop a proper strategy to set up the institution. Although the Law contains transitional provisions on gradual establishment of its functions, much more detail strategy is needed, as it is clear that the institution will not be operational over-night. It is obvious that the institution will not be able to fulfil its mandate as currently spelled out in the text in the short term, not even in the middle term. The issue here is to plan for the progressive installation of this new public body and what it implies in terms of resources, human, material and financial and how to take a prompt but step-wise start while developing the institution building aspects of the implementation of the law. It is further important to provide information to future audited subject and stake-holder's awareness in general and coordination and harmonisation with other laws or law drafting processes and very specifically the progress with the development and progress of internal financial control and audit.

Even once the SAI is established, it will need a whole range of detailed planning mechanisms, that should help it deal with its heavy workload. These include various instruments such as: mission and vision statements, corporate plans (to outline the business mid-term plans and targets of work), strategic plans for each of its major work components, operational plans, appropriate information systems and internal follow-up and results analysis.⁸⁰⁵ It will be therefore important for the new institution to share the experience of other relatively young SAIs in the region as well as with its more mature and experienced counterparts in the EU Member States.

Cooperation with EU financial accountability institutions

Cooperation between Serbian emerging financial accountability institutions and the EU institutions is still at the very early stage of development. As pointed out earlier, European Union funds in Serbia are at the moment managed centrally by the European

⁸⁰⁵ SIGMA paper: No. 34, *Achieving High Quality in the Work of Supreme Audit Institutions*, OECD/SIGMA, 2004, p. 21, available at [http://appli1.oecd.org/olis/2004doc.nsf/linkto/gov-sigma\(2004\)1](http://appli1.oecd.org/olis/2004doc.nsf/linkto/gov-sigma(2004)1).

Agency for Reconstruction and there is still no decentralised management of EU funds. Therefore, except for the technical advice provided by SIGMA/OECD on how to establish a sound financial accountability framework in Serbia, there seem to be no direct cooperation between the Serbian and the EU financial accountability actors.

However, if Serbia becomes a member of the EU, it will need to set out a clear legal framework for cooperation with the EU financial control and audit bodies. Thus, for example, the Serbian Supreme Audit Institution will need to be obliged to cooperate with the European Court of Auditors, as pointed out in Chapter IV. The Supreme Audit Institution will also be asked to nominate a liaison officer to act as a contact point with other EU national audit bodies and the European Court of Auditors. It will be also necessary to provide the European Court of Auditors explicit rights of access to ultimate beneficiaries of the EU funds, etc.⁸⁰⁶

It is further expected that more specific obligations in area of financial control will arise from the membership, such as the need to establish a separate body for managing the agricultural and structural funds, in accordance with the EU financial regulations outlined in the chapter IV. Serbia will be obliged to set up one or more paying agencies for disbursement to beneficiaries of monies from these funds and select a certifying body to audit the annual accounts of each paying agency. Such a paying agency will also be subject to audit by the European Court of Auditors.⁸⁰⁷

Whereas at this point of the accession process it is too early to get into all the details of future more specific requirements of management of EU funds, it is important to bear these issues in mind and gradually prepare the ground for their introduction when the time is right. At the moment, it would be important for Serbia to establish working

⁸⁰⁶ SIGMA papers: No. 20, *Effects of European Union Accession, Part 2: External Audit*, OCDE/GD(97) 164, OECD, Paris, 1997, available at www.oecd.org/dataoecd/20/38/36953294.

⁸⁰⁷ SIGMA papers: No. 19, *Effects of European Union Accession, Part 1: Budgeting and Financial Control*, OCDE/GD(97)163, OECD, Paris, 1997, p. 45, available at www.oecd.org/dataoecd/25/59/36975642.pdf.

relationships with the EU anti-fraud body, OLAF. Establishment of a formal contact point for cooperation and coordination with OLAF will enable sharing of experience and joint efforts in combating fraud and corruption in Serbia and facilitate meeting general EU financial accountability requirements.

Conclusion

The final conclusion of this dissertation is that Serbia is still far from meeting the financial accountability conditions for EU membership. Whereas significant progress has been made in establishing a sound internal financial accountability framework, external accountability mechanisms have not been set up yet, giving Serbia the unfortunate status of the only European country in the region without an institution of independent public external audit.

The comparison between the UK, French and the EU model of financial accountability has proven that neither of these systems would work well in the transitional Serbian environment. However, specific elements of all these systems, exemplified in the emerging European system, could be applied, but with a considerable sense of caution. It is therefore important not to have unrealistic and high expectations of newly established financial accountability system, especially in the next couple of years, until the external audit institution is properly established.

Once Supreme Audit institution is established, it will be important to link and support its work by the Serbian Parliament. Although lots of ink has been spelled out on the deteriorating role of Parliaments in holding the executive to account for stewardship of public money, recent developments of state audit in France and in the EU reiterate importance of role of the Parliament and its Committees for improving effectiveness of financial accountability systems, especially as far as the follow-up of audit recommendations is concerned. Therefore, it would be important to create a specialised Parliamentary Committee for Public Accounts in Serbia and provide it with necessary

powers to follow up on implementation of recommendations of the Supreme Audit Institution. Furthermore, it will be important to establish clear accountability lines between parliament and the executive, through gradual adoption of the UK accounting officers model in Serbia. However, this process will have to go hand in hand with depoliticisation of the Serbian administration, which in itself will be not an easy and smooth process.

Lastly, there is no doubt that a creation of a sound financial accountability system will take a significant amount of effort and time on the part of all financial accountability actors: the Government and especially the Ministry of Finance, the new Supreme Audit Institution and the Parliament and its Committees. It will be essential that roles of all these actors be enhanced simultaneously so that the balance of the financial accountability system and its mechanisms is achieved. The aim is therefore to establish a balanced partnership between all financial accountability actors, sharing a common objective of stewardship of public money. Only once a sound partnership between Serbian actors of financial accountability is established will the Serbian citizens be able to call the Serbian Government to account for the use of their money and Serbia will be ready to enter the complex and intricate network of financial accountabilities spreading throughout the veins of the EU.

Annex 1

History of the Development of Financial Accountability Arrangements in the UK

The historic development of British financial accountability arrangements is in many ways exceptional. The continuous struggle over finances between Parliament and Monarch has given strong and crucial impetus for overall constitutional development.⁸⁰⁸ Unlike other countries where power of parliaments was being built on broader social movements requesting various political rights – independent justice and administration, freedom from alien domination, freedom of speech, etc., the English parliament owes its origin and existence almost entirely to the English age-old determination not to be taxed without their consent.⁸⁰⁹ Interestingly enough, it was through the achievement of this end that British representative institutions secured political freedoms for British citizens much earlier and much more effectively than the Parliaments which had originated through fight for political freedoms.⁸¹⁰

The right of imposing taxes and controlling public expenditure has for a number of centuries been the common and most convenient test of parliament's power over the Monarch.⁸¹¹ While this power was on more or less regular basis exercised by the English Parliament, the Scottish Parliament, in the early times, has never had the exclusive right

⁸⁰⁸ S. Walkland, "Parliamentary control of public expenditure in Britain", in D. Coombes, *The Power of the Purse*, (London George Allen & Unwin Ltd.), pp. 179-198.

⁸⁰⁹ P. Einzig, *The Control of the Purse – Progress and Decline of Parliament's Financial Control*, (London, Secker & Warburg, 1959), p. 17.

⁸¹⁰ Ibid.

⁸¹¹ C. Innes, *Lectures on Scotch Legal Antiquities*, (Edinburgh, 1872), 111. Cf. I.E. O'Brien, *The Scottish Parliament in the 15th and 16th Centuries*, Ph.D. Thesis (Glasgow, 1980), p. 180.

to levy taxation.⁸¹² Its power of controlling the spending of public monies was even weaker. This should not be surprising, having in mind that the development of the Scottish central administration was considerably slower than its counterparts of that time.⁸¹³ This is usually explained by the disruptive effect which the war of independence had on the political and economic life of the country as well as the subsequent weakness of the Scottish crown following the death of Robert I to reorganise the royal administration.⁸¹⁴

Early medieval history of British financial control mechanisms is marked by two coinciding tendencies. While representative institutions were struggling to keep the Monarch accountable for its finances, at the same time Monarchs were working on strengthening financial scrutiny within the administration of their Courts.

The origins of public expenditure control in England could be traced back to XII century. During the reign of Henry I (1100-1135) the royal administration was expanded and the rule of law solidified. The key Royal institution dealing with financial matters, the medieval Exchequer, was established. The Exchequer was the most powerful and prestigious of all Royal offices.⁸¹⁵ It not only had the role of recording and controlling the Royal revenue, but also provided a forum for settling financial matters and disputes.⁸¹⁶

The Exchequer was structured into two levels – lower and higher. In the Lower Exchequer, which was also called the Receipt, the money was handed over to be counted, and was put down in writing and on tallies, so that afterwards, at the Upper Exchequer,

⁸¹² I.E.O'Brien, *ibid.*

⁸¹³ C. Madden, *The Finances of the Scottish Crown in the Later Middle Ages*, (Ph.D. thesis, Glasgow, 1975), p. 2.

⁸¹⁴ *Ibid.*

⁸¹⁵ N. Richard, *The Course of the Exchequer*, (London: Nelson), 1950, p. 33; R. Poole, *The Exchequer in the Twelfth Century*, (Oxford, Clarendon Press), 1912.

⁸¹⁶ N. Richard, *op. cit.*, p.34.

an account may be rendered of them.⁸¹⁷ Everyone holding king's money was under the legal obligation to render account for it and to answer for what was then found to be due. Enforcement of such obligation was enabled through establishment of the Court of Exchequer.

The Court of the Exchequer evolved originally as the court concerned with tax and revenue matters, deciding cases between the Crown and taxpayers. By the Fourteenth Century the Court had acquired a jurisdiction to deal with ordinary civil claims between one subject and another.⁸¹⁸ The Court has also performed a function of control of Royal expenditure, which was of judicial and non-administrative nature. Through its ancient audit, the debts of accountants were ascertained and enrolled on the record, followed by the judicial process and enforcement of payment through the agency of the sheriffs.⁸¹⁹ The Treasurer and Barons, leading officers of the Upper Exchequer or Court Side, were judges and their discharge of an accountant was full and sufficient in law. Through its practice, the Court of the Exchequer developed numerous rules and courses which gained the status of non-statute law. The rolls of the Court were considered the unchallengeable authority in law, unless it was proved they suffered from manifest error.⁸²⁰

The administrative aspect of the work of Exchequer was based on numerous hierarchical accountability relationships, starting with the scribes and the clerks at the bottom, up to the chief Exchequer Justiciar and ultimately the King. The Exchequer functioned as a bureaucratic organization with records being written and taxes collected in a fairly organised way.⁸²¹ It represented quite an advanced institution of the feudal system, which

⁸¹⁷ P. Halsall (eds.), *Internet Medieval Source Book*, (Fordham University Center for Medieval Studies), www.fordham.edu/halsall/sbook.html.

⁸¹⁸ A.J.H. Morris, WS Gillbert and Sir Arthur Sullivan's *Trial by Jury - A Legal Commentary*, www.lexscripta.com/pdf/TrialByJury.pdf

⁸¹⁹ J.E.D. Binney, *British Public Finance and Administration 1774-92*, (Oxford Clarendon Press), 1958, pp. 4-5.

⁸²⁰ Ibid.

⁸²¹ N. Richard, *ibid.*

basic concepts are preserved to modern times. It should be noted that the earliest found reference to the Auditor of the Exchequer, as a public official specifically charged with administrative auditing of government expenditure, goes back to 1314.⁸²² The Auditor of the Exchequer function was the one of the general comptroller, consisting of authorizing the issue of public money.

The period of XIII and XIV century in England was marked by the rise of the power of the Parliament, which on a number of occasions challenged the ancient Royal prerogative to unlimited public monies spending. Although the English Parliament still did not have strong enough power to actually enforce its appropriations, its right to criticize public spending represented quite an important limitation of the powers of Monarchs at that time.⁸²³

The Parliament used a number of different means to control excessive Royal spending. It required that the accounts be audited by institutions outside the Court,⁸²⁴ or that special Parliamentary committees or commissions be established to audit the accounts of the Monarch and its agents.⁸²⁵ Although Monarchs on many occasions resisted the demands of rendering the accounts before such bodies, they would in the end comply with these requests, often frightened by the Parliament's threats to withhold supply.

⁸²² Cf. *The History of the National Audit Office*, UK National Audit Office web site, www.nao.gov.uk.

⁸²³ P. Einzig, op. cit. p. 87.

⁸²⁴ For example, the Great Council audited the Royal accounts in 1216, when grants contained provisions for a special audit independently of the annual audit by the Court of the Exchequer, on the assumption that the influence of the Royal court was liable to be too strong there.

⁸²⁵ For example, in 1340, the Joint Committee of Lords and Commons for the examination and auditing of the financial transactions of Kings agents was established; in 1341 Parliament appointed another commission to examine the state accounts (to which Edward III agreed under certain conditions); in 1379, at the request of Commons, a Committee of Barons was set up to examine the accounts of estates of Edward III. Cf. P. Einzig, op. cit., pp. 87-90.

The next important step in strengthening financial accountability of the Monarchy was the establishment of the accountability relationship between Royal officers, responsible for handling of public funds, and Parliament. On a number of occasions, misuse of public monies was one of the key reasons for the initiation of impeachment procedures, with the main objection being that funds intended for financing wars were diverted into the King's household.⁸²⁶ Alleged maladministration of public funds at times provided a good excuse for calling Royal officers to account when both Monarch and Parliament wished to remove Royal officers for political and personal reasons. Nevertheless, even though the weapon of impeachment for misuse of public moneys was at times abused, the establishment of the principle of the accountability of Royal officers to Parliament was of great constitutional importance.

The English Parliament's efforts to achieve control of public finances were greatly undermined during the Tudor reign (1485-1603). Although Parliament criticized the expenditure occasionally, no attempts were made to actually obtain accounts. Thus, the King acquired the full control of the proceeds of taxation. Financial control was exercised by Committees set up by the Executive and proved to be quite efficient. However, Parliament was fully excluded from this process.⁸²⁷

It should be noted that under Queen Elizabeth I, in 1559, the Auditors of the Imprest Office was created, as a predecessor of the today's National Audit Office. The formal function of the Imprest Office was audit of Exchequer payments. The accounts audited by the Imprest Office were those of all persons to whom money was issued by imprest and upon account for the services of Crown and Public. In addition, the Imprest Office audited the accounts of an important group of revenue accountants such as those handling the duties of Customs, Stamps, Salt, Postage etc.⁸²⁸ It should be stressed that all audit

⁸²⁶ Ibid.

⁸²⁷ Ibid.

⁸²⁸ J.E.D. Binney, op. cit., pp. 195-197.

conducted in this division was administrative and not judicial.⁸²⁹ This system gradually lapsed two centuries later, when the new Office for Auditing the Public Accounts was established.

Financial accountability mechanisms in neighboring Scotland throughout the XIV, XV and XVI century were rather underdeveloped in comparison to its English counterpart. The power of the Parliament over public finances was much weaker than the English Parliament had at that time.⁸³⁰ The Scottish Parliament did not have exclusive right to impose taxes, mostly due to the fact that taxation in Scotland was exceedingly irregular, which had undoubtedly weakened the bargaining position of the estates.⁸³¹ Furthermore, it seems that Parliament itself let public finances be taken out of its control and given to other institutions such as general councils and convention of estates. It appears that at that time there was an accepted awareness of the need for the estates to give their consent to matters of public revenue and expenditure, while there is no record of parliament ever having expressed the view that it alone should be accorded this privilege.⁸³²

The turning point in the development of Scottish financial administration was the return of James I from captivity in England. His first hand experience of the highly developed English administrative system enabled him to start to reform the existing governing system into the new style bureaucratic government, which would restore the power and prestige of the Scottish crown.⁸³³ The first steps undertaken by James I were the

⁸²⁹ Ibid.

⁸³⁰ The first trails of the Scottish Parliament can be traced back to the second half of the XIII century. At first, a *parliamentum* was most probably a full and formal meeting of the King's advisors (the council), where they were able to discuss matters of particular importance. The parliament, however, carried out other functions, being in the same time the supreme court of law, with a power of declaring the law.⁸³⁰ However, the actual power of the Parliament in state affairs was scarce. Cf. W.C. Dickinson, *Scotland from the Earliest Times to 1603*, (Oxford at the Clarendon Press), 1977, p. 99-100.

⁸³¹ I.E. O'Brien, op. cit., p. 180.

⁸³² Ibid. pp. 180-184.

⁸³³ C. Madden, op. cit. p. 2.

establishments of the new offices of exchequer and comptroller, as well as the gradual formation of the body of professional civil servants.⁸³⁴

The Exchequer was at the centre of Scottish financial administration. In contrast to the system employed in Mediaeval England, the Scottish Exchequer was the sole organ of financial government, corresponding to the English Upper Exchequer. However, despite certain similarities, it may be argued that the Scottish Exchequer was quite an underdeveloped institution, using only a few methods of the English Upper Exchequer.⁸³⁵ Furthermore, until the second half of the XI century, the Scottish Exchequer was not a permanent institution. The Lords Auditors, drawn from the larger body of the Lords of the Council, were appointed only for the duration of the audit and were relieved of their duties after completion of their tasks.⁸³⁶ The actual number of auditors appointed for each year varied significantly.

The actual organization of the annual audit of the Exchequer in the XIV and XV century was also unsystematic and unprofessional.⁸³⁷ The date of the commencement of the annual audit of accounts was fixed at least six weeks in advance and accountants were entitled to receive a prior warning of proceedings of forty days. Accountants who failed to appear on the appointed day were liable for a fine, which was irregularly enforced. Many royal financial officials remained absent from the Exchequer for long periods without incurring massive fines.⁸³⁸ The main function of the traditional exchequer was the prevention of fraud.⁸³⁹

⁸³⁴ Ibid.

⁸³⁵ A. L. Murray, "The Procedure of the Scottish Exchequer in the early Sixteenth Century", *The Scottish Historical Review* No. 130, Vol. XL, (1961), pp. 95-97.

⁸³⁶ Ibid, p. 91.

⁸³⁷ C. Madden, op. cit. pp. 12-40.

⁸³⁸ Ibid.

⁸³⁹ J. Goodare, *State and Society in Early Modern Scotland*, (Oxford University Press, 1999), pp. 104-105.

During the XVI century, despite temporary setbacks, the revenue of the Scottish state was increasing and fiscal administration was becoming more sophisticated. Unlike the earlier system of income driven expenditure, where all the raised revenue was spent and almost no limitations of expenditure existed, the XVI century witnessed a tendency to realign expenditure towards desirable ends.⁸⁴⁰ The struggle for the royal signature,⁸⁴¹ fought between the royal Court on the one hand and privy council (a body of administrators collecting the revenue) and Parliament on the other hand, demonstrated the increasing opposition to unlimited financial Royal power and gradual establishment of efficient expenditure controlling mechanisms. The traditional exchequer, as *ad hoc* passive body which met annually to receive accounts, became a permanent institution in 1584. Although the main initial function of the permanent exchequer was judicial, his financial administrative aspect was gradually evolving, especially after 1590.⁸⁴² The permanent exchequer eventually became an active administrative department, with auditors freed from personal liability of treasurer and comptroller.⁸⁴³ Under the Act of Union between Scotland and England (1707), the Scottish Exchequer underwent legislative reorganization and became known as “The Court of Exchequer in Scotland”, continuing to carry out most of the functions it had traditionally performed.⁸⁴⁴

While the financial accountability mechanisms did not undergo significant changes in Scotland during the XVII century, the English financial control system experienced genuine reform, mainly due to urgent needs to resolve burning political issues. This enabled the gradual establishment of “public” financial accountability system in England, which main features are preserved to modern times.

⁸⁴⁰ Ibid.

⁸⁴¹ The royal sign was a means of granting land and other forms of patronage.

⁸⁴² Cf. A. L. Murray, “Sir John Skene and the exchequer, 1594-1612”, *Stair Society Miscellany*, (1971), p. 126.

⁸⁴³ J. Goodare, *op. cit.*, p. 121.

⁸⁴⁴ J.E.D. Binney, *op. cit.* pp.233-237.

The Revolution of 1688 is generally recognized as the landmark between the period of autocratic Monarchy and that of constitutional Monarchy in England. Applied to the area of financial accountability, the Revolution is assumed to mark the beginning of the period of full Parliamentary control over the public purse.⁸⁴⁵ The Revolution undoubtedly removed the main obstacle of efficient Parliamentary control. Its most important result was that it became necessary to summon Parliament every year, which provided the Commons with a good position in the financial control process.

However, apart from some early progress under William III, it took almost a century before even a beginning was made with real and lasting progress towards a genuine and well-established Parliamentary control of public finance.⁸⁴⁶ During the reign of William III annual accounts of public revenue and expenditure were examined by the Parliamentary Commissioners who were appointed under several successive Acts of Parliament. The first Public Accounts Committee in modern times was appointed shortly, in 1690.⁸⁴⁷ However, Parliament's strong efforts to control public expenditure by supervising public accounts were not long lasting. After a while the Commons lost their power of ensuring accountability and under the Hanoverian Kings no Public Accounts Committees were appointed until 1780, nor were accounts presented any longer systematically to Parliament, even though they continued to be systematically audited by officers of the Exchequer.⁸⁴⁸

It took considerable efforts during the last quarter of the century and during the first half of the XIX century to re-establish and apply financial accountability even to the extent to which it was actually applied during the last decade of the XVII century. The British defeat in the American war of independence brought existing criticisms of British financial control system to the fore. The Exchequer's constitutional monopoly, excessive

⁸⁴⁵ P. Einzig, *op. cit.* pp.117-131.

⁸⁴⁶ *Ibid.*

⁸⁴⁷ *Ibid.*

⁸⁴⁸ *Ibid.*

centralization of audit with still surviving judicial forms were criticized for their malfunctioning and rigidity.⁸⁴⁹ Members of the political opposition took the lead in calling for reform of financial administration. First effective movements towards reform were taken in 1780, when the statutory Commission for Examining Public Accounts was set up. It is interesting to note that the Commissioners were concerned not only with regularity of expenditure, but also with its economy and efficiency, avoidance of waste, extravagance and better management of resources.⁸⁵⁰ In this way, a basis for broader understanding of the financial accountability in Britain was established.

First few decades of the XIX century have announced substantial changes in assuring financial accountability. The Office for Auditing the Public Accounts, a successor of Auditors of the Imprest Office, underwent significant changes.⁸⁵¹ The size of the office in both structural and functional sense greatly expanded. The most important change, however, was the shift from reporting its findings from executive to the House of Commons, which occurred in 1832.

In 1834 the Office of Comptroller General of His Majesty's Exchequer was created. The head of this office was the Comptroller General of the Exchequer. Although his main function, responsibility for authorizing the issue of public money, was basically the same as one the medieval Exchequer, it was for the first time performed on behalf of Parliament and not the "Crown".⁸⁵² These changes undoubtedly marked the beginning of the modern period of financial accountability in the United Kingdom.

The most important figure of the modern period of financial accountability is William Gladstone, who was the Chancellor of the Exchequer from 1852 to 1866. Gladstone

⁸⁴⁹ J.E.D. Binney, op. cit., pp. 7-19.

⁸⁵⁰ D. Dewar, "Value for Money Audit: the first 800 years", *Public Finance and Accountancy*, 1985.

⁸⁵¹ Cf. F. White, K. Hollingsworth, *Audit, Accountability and Government*, (Clarendon Press, Oxford, 1999), p. 35.

⁸⁵² Cf. E. L. Normanton, *Accountability and Audit in Governments* (Manchester: Manchester University Press, 1966), p.20.

introduced a number of substantial reforms of the control of public expenditure. In 1854 Parliamentary control was expanded over the expenditure of the Revenue Departments. In 1861 the Public Accounts Committee was set up, becoming fully effective only after the Exchequer and Audit Departments Act was enacted five years later.⁸⁵³

In 1866 the Exchequer and Audit Departments Act created the post of Comptroller and Auditor General (C & AG), who was given two main functions: to authorise the issue of public money to government from the Bank of England and to audit the accounts of all Government departments and report to Parliament accordingly.⁸⁵⁴ C & AG was to be appointed by the Monarch, on the advice of the Prime Minister. The Act also established the Exchequer and Audit Department, as a merger of the office of Comptroller of the Exchequer and Office for Auditing Public Accounts. Its task was to assist the Comptroller and Auditor General in auditing of the accounts and providing support to the Public Accounts Committee in holding the executive to account for public money stewardship. In this way, in Gladstone words, the ‘circle of control’ was closed.⁸⁵⁵

The 1866 Act is considered to be a vast improvement to the system of audit which had existed previously in Britain.⁸⁵⁶ The Act stipulated the obligation of government departments to produce appropriation accounts for independent audit.⁸⁵⁷ It was the task of the Treasury to determine which departments shall actually prepare and render accounts to the Comptroller and Auditor General. Section 27 provided the C & AG the right to examine every appropriation account and verify whether payments were supported by vouchers (proofs of payment) and whether the money has been spent for the purposes intended by Parliament.⁸⁵⁸

⁸⁵³ Cf. F. White, K. Hollingsworth, pp. 35-36.

⁸⁵⁴ Cf. The Exchequer and Audit Departments Act 1866.

⁸⁵⁵ J. Molinier, “Parliament’s Financial Powers: A Comparison between France and Britain”, in D. Coombes D. et al, *The Power of the Purse*, (London George Allen & Unwin Ltd), 1976, p. 173.

⁸⁵⁶ Cf. F. White, K. Hollingsworth, op. cit., p. 37.

⁸⁵⁷ Section 22 of the Exchequer and Audit Departments Act 1866.

⁸⁵⁸ Cf. F. White, K. Hollingsworth, op. cit. p. 37.

In the first decades of the XX century, the system of audit established by the 1866 Act was already out of date. During several decades in the end of XIX and beginning of the XX century, public expenditure greatly increased, necessitating changes in public accounting and audit. Therefore, in 1921 The Exchequer and Audit Departments Act was enacted, repealing and amending a number of the 1866 Act's provisions.

The 1921 Exchequer and Audit Departments Act gave C&AG greater discretion in conducting of audit. Since the increase of expenditure made the checking of every account almost impossible, the Act allows the C&AG to rely on the individual department's checking system and, instead of examining all the accounts, test only particular transactions to ensure the effectiveness of the departmental check, without further evidence of payment in support of the charges to which the sums relate.⁸⁵⁹ The Act also extended the audit of C&AG to new types of accounts, which emerged in previous decades (trading accounts etc.).⁸⁶⁰ However, the 1921 Act did not address the key issue of C&AG independence towards the Executive, which still exercised strong discretionary powers over the C&AG.

Pressure for substantial reform of the public audit system grew from the 1960s, following concerns expressed by academics and Parliamentarians that the scope of public audit, which at that time covered only around half of public expenditure, needed to be substantially extended. Furthermore, it was argued that there was a need for a specific power to allow the C&AG to report to Parliament at his own discretion on the value for money achieved by government departments.⁸⁶¹ Reformers also argued that more robust arrangements should be put in place to ensure the independence of public auditors from government.⁸⁶²

⁸⁵⁹ Section 1(2) of the Exchequer and Audit Departments Act 1921.

⁸⁶⁰ Section 4 of the Exchequer and Audit Departments Act 1921.

⁸⁶¹ *The History of the National Audit Office*, UK National Audit Office web site, www.nao.gov.uk.

⁸⁶² *Ibid.*

Continuous reformist pressures resulted in the enactment of the National Audit Act 1983.⁸⁶³ Under the Act, the C&AG formally became an Officer of the House of Commons, and was given the express power to report to Parliament at his own discretion on the economy, efficiency and effectiveness with which government bodies have used public funds. The Act also established the National Audit Office (NAO) to replace the Exchequer and Audit Department in support of the C&AG.⁸⁶⁴ Staff of the National Audit Office was placed outside of the civil service, which provided conditions for fuller independence from the Executive.

As we could see in chapter II, these financial accountability arrangements, although with some important changes along the way, remain relevant to this day. Historical development of the UK parliamentary system and reforms undertaken to firm up the position of external auditor, laid the foundations of Parliament's full scrutiny of public money and established a firm platform of financial accountability, which enables additional improvements and adaptations to be made without risks of a systematic failure. Such robust financial accountability arrangements have served as an inspiration not only for other countries of the Westminster tradition, but also for European continental countries and the supranational EU system, which have already been 'infected' by UK financial accountability concepts, attempting to entrench and attain the Gladstone sparkling 'circle of control'.

⁸⁶³ Cf. F. White, K. Hollingsworth, *ibid*, pp. 41-46.

⁸⁶⁴ The National Audit Act 1983.

Annex 2

List of key persons interviewed (in alphabetical order)

Alventosa Jean-Raphael, Conseiller-maitre at the Cour des Comptes, Paris

Andrews Matthew, Lecturer at the Harvard University, former senior financial management specialist of the World Bank

Arsic Vesna, Deputy Minister of Finance of the Serbian Government

Barjaktarevic Mila, Head of Internal Audit unit of the Ministry of Finance of Montenegro

Cazala Francois-Roger, Principal Administrator in the Audit and Financial Control unit of the SIGMA Programme on secondment from the French Cour des Comptes

Cho Junghun, Senior Financial Management Specialist, the World Bank

Coombes David, former Head of the Capacity Building Fund, UNDP, Belgrade

Dautry Philippe, Conseiller des services, French National Assembly, Paris

Djordjevic Dragica, Senior Advisor in the Treasury Administration of the Serbian Ministry of Finance

Farmer Richard, Team Leader, Support to the Ministry of Finance Treasury Serbia, An EU-funded project managed by the European Agency for Reconstruction

Gavrilovic Zoran, Head of the Budget Inspection Department in the Treasury

Jezdimirovic Mila, Advisor to the President of the Commercial Bank in Belgrade, Former Assistant Minister of Finance in Budget Department

Jolovic Ljubislav, senior adviser in the Budget Department of the Ministry of Finance in Serbia

Obradovic Radojko, Vice President of the Financial and Budget Committee of the Serbian Parliament

Paovic-Jeknic Gordana, President, the Supreme Audit Institution of Montenegro

Pavlovic Veselin, Advisor in the Treasury Administration of the Serbian Ministry of Finance

Perron Christophe, Chargé de mission EUROSAT, SAT, Paris

Popovic Dejan, Professor of Finance at the Faculty of Law, Principal of the Belgrade University, former Deputy Minister of Finance in the Serbian Government

Steandback Madsen Johan, auditor of the European Court of Auditors, former senior finance sector specialist of the World Bank

Tekijaski Aleksandra, Local Project Officer, Support to Parliamentary Institutions in Serbia and Montenegro, an EU-funded project managed by the European Agency for Reconstruction

Van Heesewijk Piet Hein, Senior Public Sector Specialist, the World Bank

Vanini Gianluca, Programme Manager, the European Agency for Reconstruction
Belgrade Office

Woodward David, Assistant Auditor General, UK National Audit Office

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