Financial Management and Control and Internal Audit System in the Public Sector in BiH

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The introduction and implementation of finansijsko upravljanje i kontrola (FUK, financial management and control [FMC]) in Federation of Bosnia and Herzegovina (FBiH) aims to incorporate a modern public internal financial control (PIFC) system into traditional public resources management models. This area is one of the reform areas in which Bosnia and Herzegovina (BiH) is obliged to harmonize the legislative framework and practice with the good practices and regulations recommended by the European Commission. The establishment and development of the PIFC are also an obligation of Bosnia and Herzegovina established by the Stabilization and Association Agreement between the European Community and the member states, of the one part, and Bosnia and Herzegovina, of the other part. The public internal financial control (PIFC) system focuses on enhancing transparency, financial discipline, and dedicated use of public resources, that is, transparent, economical, efficient, and effective management of public resources, and control of the use of those resources. The topic of this paper is “financial management and control in the public sector” where the aim is to show, through the conducted theoretical research, the level of achievement of the establishment of this system in public sector institutions in BiH. The European Union wants to direct all potential member countries towards development of internal controls in the use of their own resources, but also to create a control environment that would ensure the dedicated use of EU funds. In Bosnia and Herzegovina, there is no single legal framework in terms of a single law governing public internal financial controls. The contents of the applicable legal provisions at all three levels (BiH, FBiH, and Republic of Srpska [RS]) are largely congruent thanks to the Coordination Committee of Central Harmonization Units (CHJs) in Bosnia and Herzegovina, through which the harmonization of regulations and practices in the development of public internal financial controls is ensured.

Keywords: public sector, finance, financial management, control, internal audit

Introduction

Financial management and control (FMC) in the public sector is a comprehensive system of internal
management of public finances in the form of control of revenues, expenditures, and other monetary transactions, rational asset management, and successful project management, which is preceded by a business process approach with continuous management of risks that may appear in business operations.

Financial management and control has two main lines of reporting to competent authorities, which is an additional form of enforcement control.

Reporting is done on an annual basis by the submission of the Annual Report on the Financial Management and Control System (GIFUK). Financial management and control guarantees transparency and legality of public administration operations.

The very process of establishing financial management and control begins with the appointment of the persons responsible for the implementation of the system.

The budget user is obliged to appoint a manager for financial management and control. Budget users may appoint, as needed, the financial management and control coordinator, the financial management and control working group, as well as the person responsible for creating the risk register, but these appointments are not mandatory but are left to the choice of the budget users and are made due to the specific nature of the organization (large organization and lots of administrative departments).

The most important reporting mechanism on the functioning of the financial management and control system and the transparency of public administration is the submission of the annual report (GIFUK).

The head of budget users is responsible for establishing the financial management and control system.

The introduction of a system of internal financial controls in public sector organizations has the effect of reducing irregularities in public sector operations.

The need to introduce a system of internal financial controls in the public sector of Bosnia and Herzegovina has been imposed by the European Commission. In this way, the European Commission wants to help countries that wish to join the European Union to incorporate higher standards of control into their governance processes.

This paper gives an overview of financial management and internal control and internal audit systems known as public internal financial control (PIFC), that is, the importance of financial management and control systems, basic features, and public sector establishment at all three levels of government. The public internal financial control (PIFC) system focuses on enhancing transparency, financial discipline, and dedicated use of public resources, that is, transparent, economical, efficient, and effective management of public resources, and controlling the use of those resources.

It consists of three basic elements:
1. Financial management and control;
2. Internal audit;
3. Central Harmonization Unit (CHJ).

The main objective of financial management and control is to ensure:
1. Successful achievement of all goals and tasks of the institution;
2. Strategy for implementation of public internal financial control in the Institutions of Bosnia and Herzegovina and the Council of Ministers of BiH;
3. Security, reliability, timeliness, and completeness of information, especially financial information;
4. Compliance with the laws, regulations, policies, plans, and procedures;
5. Property protection;
6. Economical, efficient, and effective use of resources.

In order to achieve the goals of the internal control system, they need to be related to the information circulating within the organization, and to control the timely preparation of up-to-date, reliable, and relevant information presented through various reports, both to internal and external users.

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Figure 1. Activity flow in the FUK system.

Unlike operational and information goals, compliance goals are that the internal control system must ensure that the overall business of the organization must comply with the relevant legal regulations, rule books, decisions, and other applicable acts within the organization.

The system of internal control in the organization should be set up, so that, through the principle of self-control, all employees, at all levels, from executors to executives, are monitored, which is the only correct and right way to achieve efficiency and effectiveness of business.

Control is an integral part of every organization, and its implementation is the responsibility of each employee according to the authority and description of their workplace, and the basis is certainly the written acts in the form of instructions and procedures, which clearly distinguish the powers and responsibilities of both managers and employees (Tušek, 2000).

Internal control is primarily focused on achieving the following goals in an organization:

- Ensuring the reliability and integrity of the data and information generated;
• Ensuring compliance with business policies, plans, work programs, legal and other regulations, and other restrictions;
• Keeping assets;
• Economical and efficient use of all types of resources;
• The realization of the formulated plans, programs, and set goals and tasks.

The purpose of introducing FMC into the public sector is as follows:
• Business in a proper, ethical, economical, and efficient way;
• Business compliance with the laws, regulations, policies, plans, and procedures;
• Protection of property and other resources from losses caused by mismanagement of public resources, unjustified and non-transparent spending, and protection against irregularities and fraud;
• Strengthening responsibility of executives for successful achievement of set business goals;
• Timely and transparent financial reporting as well as monitoring of business results (Vukoja, 2016).

Financial Management and Control

Financial management and control (FMC), as one of the elements of PIFC, encompasses the overall system of financial and all other controls within a public sector institution, that is, all those controls that are integrated into any of the activities of the institution.

Financial management and control includes methods, organizational structure, and procedures that apply not only to the financial system but also to the strategic and operational systems of budget users.

- Public Internal Financial Control (PIFC) System
- Improving transparency, financial discipline and the dedicated use of public money.

The goal of PIFC is to ensure the compliance of legislation, the transparent, economical, efficient, and effective management of public resources and the control of their use.

The term “internal financial control in the public sector” means the complete, unified system established by governments to control, audit, and report on the use of budgetary resources

• The development and strengthening of the system is an important segment in public sector reform;
• The public sector internal financial control system consists of the following basic elements:
  • financial management and internal control (FUK);
  • functionally independent internal audits (IR);
  • central unit for the harmonization and coordination of financial management and control systems and internal audit methodology.

Financial Management and Control (FUK) = PIFC’s first pillar

1. A comprehensive system of policies, procedures, and activities established and under the responsibility of the institution’s manager.
2. It is based on risk management and provides a reasonable assurance that the goals of the institution will be achieved in a proper, economical, efficient, and effective way.
3. Internal controls are procedures implemented by executives and employees of an organization that are designed to provide reasonable assurance of achieving the organization’s goals.
4. Effective control systems are designed to provide reasonable assurance to management that resources are being used in accordance with laws, regulations, and policies, and are protected from waste, loss, and misuse.
Numerous regulations have defined the way of management and control in the institutions of BiH.

a. Financial management and control refers to all financial and non-financial aspects of an institution’s business operations;

b. It implements in all organizational units and covers all resources, including foreign funds;

c. The assumptions for establishing an efficient FUK system are a clearly defined mission and goals of the institution, the organizational structure;

d. For the success of establishing an efficient FUK, established control over the realization of the goals of the institutions is also crucial, which will enable the financing decisions (program budget) to be made based on the realization of the goals of the institution.

Second pillar of the PIFC is internal audit.

Third pillar = Central Harmonization Unit

It is an integral part and is a necessary condition for successful access and development of the public internal financial control system.

The Central Harmonization Unit is responsible for the development and application of methodology and standards for the financial management and control system, as well as for internal audit in the public sector.

It is responsible for coordinating and providing appropriate training to public sector management and officials in the area of financial management and control and internal audit in the public sector.

Financial Management and Control System in the Public Sector of Bosnia and Herzegovina

The system of financial management and control in the public sector of Bosnia and Herzegovina is established by the heads of public sector organizations in order to successfully accomplish the tasks set by the budget user.

This means that the heads of public sector institutions are directly responsible for establishing procedures for the functioning of the internal control system and internal audit departments in order to create added value, and to carry out any activity in the public sector economically, efficiently, and effectively, in accordance with legal regulations.

This system in Bosnia and Herzegovina was launched back in 2005 with the adoption of instructions for development and maintenance of the internal control system by the Ministry of Finance and Treasury (MFT) of BiH.

FBiH Official Gazette

The Central Harmonization Unit (CHJ) of the MFT BiH is the central body for coordination and harmonization of activities on the establishment and development of the system of public internal financial controls in the institutions of Bosnia and Herzegovina.

The establishment and development of the PIFC system by CHJ MFT BiH entails two areas:

- establishment and development of financial management and control;
- establishment and development of a system of functional and independent internal audit.

The basic law governing the establishment and development of financial management and control in the institutions of Bosnia and Herzegovina is the law on financing of the institutions of BiH.\(^1\)

\(^1\) Official Gazette of BiH, No. 32/13.
This law sets the principles, standards, methodological framework, and basic rules for financial management and control in BiH institutions.

The law introduces an obligation for the heads of institutions to submit, in addition to the annual budget execution reports, a statement of responsibility for achieving the institution’s goals.

With this statement, the head of the public sector institution confirms that they have ensured:
- earmarked, purposeful, and lawful use of resources appropriations for the achievement of set objectives;
- economical, efficient, and effective functioning of the financial management and control system for making internal regulations on financial management and control in all units within the institution.

In addition to the aforementioned law, a number of by-laws were adopted that regulate this area, and those are:
- internal control standards in BiH institutions;
- manual for financial management and control in the institutions of BiH;
- guidelines for implementing the risk management process in BiH institutions;
- rulebook on Annual Reporting in the System of Financial Management and Control in the Institutions of BiH;
- decision to publish the form and content of the annual report on the system of financial management and control in the institutions of BiH.

Financial Management and Control System in the Public Sector of the Federation of Bosnia and Herzegovina

The regulations of the law apply to users of public resources of the first and second levels of the budget of the Federation of Bosnia and Herzegovina, cantons, cities, municipalities, and extra-budgetary funds, and to those legal entities in which the FBiH or the canton has a majority ownership interest. Also, this law applies to those public sector organizations and bodies that are funded by EU funds and programs.

Financial control and management focuses on all business transactions in public sector organizations, with particular emphasis on revenues and receipts, expenditures and outlays of resources, public procurement
According to this law, users of public resources, i.e., budget users are obliged to prepare an annual report on the functioning of the FUK system, and submit this report to the federal or cantonal ministry of finance, depending on what level of government the organization belongs to.

The head of the public resources users is responsible for establishing, developing, and implementing appropriate, efficient, effective, and economical FUK in the organization concerned.

They are responsible that the goals of the users of public resources are achieved by managing those resources in a lawful, economical, efficient, and effective way.

Also, the head of the public resources users is responsible for making internal regulations on the FUK and for implementing the FUK system in all organizational units within the organization, in relation to all programs and processes that are executed, respecting the principles of legality, financial management, and transparency in accordance with internal control standards. The following users of public resources are obliged to produce the annual report on the functioning of the FUK system:

- users of the first-level public resources and extra-budgetary funds to the federal level, who submit the report to the Federal Ministry of Finance (FMF);
- users of the first-level public resources and extra-budgetary funds to the cantonal level, who submit the report to the competent cantonal ministry of finance;
- local self-government units with city status that submit the report to the competent Cantonal Ministry of Finance;
- legal entities in which the federation or the canton have a majority ownership share and submit the report to the competent line ministry.

The Cantonal Ministry of Finance consolidates reports for the canton and submits to the CHJ FMF a consolidated report on the functioning of the FUK system for the canton.

Based on the submitted report, the CHJ FMF prepares an annual consolidated report on the functioning of the FUK system in organizations and submits it to the Federal Minister of Finance, who then submits it to the government of the Federation of Bosnia and Herzegovina for review and approval. The form, deadlines, and content of the annual consolidated report are regulated by a by-law.

**Federal Ministry of Finance**

The Financial Control and Management Act prescribes action to be taken against irregularities and fraud. The head of the public resources users is responsible for managing the risks of irregularities and frauds and carrying out actions to prevent and eliminate irregularities and frauds in their organization.

Each user of public resources is obliged to implement the financial management and control system and to appoint a financial management and control coordinator, whose data are submitted to the Central Harmonization Unit. In the register of the FBiH CHJ, concluded on 04/30/2018, there are a total of 146 coordinators proposed by obligors for establishing FUK.

The task of the financial management and control coordinator is reflected in the following:

- list and description of business processes;
- creation of a map of business processes (process and procedure codes);

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2 Law on financial management and control in the public sector in FBiH, Official Gazette of FBiH, No. 38/16.

3 Law on financial management and control in the public sector in FBiH, Official Gazette of FBiH, No. 38/16.
identifying business goals;
- risk identification, risk assessment, and risk management;
- monitoring the achievement of planned activities;
- compilation of the annual FUK report and submission to the CHJ.

The implementation of financial management and control and internal audit was greatly influenced by the adoption of the new budget law in the Federation of Bosnia and Herzegovina, which was adopted in December 2013.

However, in addition to all the aforementioned activities carried out by the CHJ of the Federation of BiH and the adopted legal and institutional solutions, there are nevertheless problems and difficulties in the practical implementation of the internal financial control system in the public sector management process. The shortcomings and omissions in the management of budgetary resources are highlighted here, as evidenced year by year by the reports submitted by the Audit Office of the FBiH institutions, which constantly point out the inadequate functioning of the internal control, management and internal audit systems, and the worryingly high percentage of reported negative audit opinions.

Financial Management and Control System in the Public Sector of the Republic of Srpska

In Republic of Srpska (RS), the law on the system of internal financial controls in the public sector of Republic of Srpska was also entered into force on 10/28/2016, and was published in the Official Gazette of the RS No. 91/16.

The following public sector organizations are considered to be the public sector of the Republic of Srpska: users of Republic of Srpska resources, local self-government units and users of budget funds of local self-government units, extra-budgetary funds, agencies and other institutions, public enterprises, institutions and organizations in which Republic of Srpska is majority owner.

The system of internal financial controls in the public sector of the Republic of Srpska includes the organizational structure, methods, and procedures of internal controls, established by the entity’s responsible person, with the aim of successfully managing and accomplishing the tasks of the entity in a public, lawful, economical, efficient, and effective way.

The system of public financial controls in the public sector consists of:
1. Financial management and control;
2. Internal audit;
3. Central Harmonization Unit for financial management and control, and internal audit at the Ministry of Finance.

The entity manager is responsible for establishing a financial management and control system in each entity’s organizational unit, monitoring and evaluating the adequacy of functioning and timely updating to achieve the entity’s goals. They are also obliged that the CHJ submit semi-annual, annual reports on the implementation of the planned activities on the establishment and development of the financial management and control systems, by the end of July of the current year at the latest, or by the end of January.

The list of business processes is an overview of the business processes that take place in an organizational unit, that is, an overview of the procedures that determine the way in which a particular business process is conducted, as well as the supporting documentation used in their implementation.
An overview of the identified business processes

This law regulates internal audit in the public sector of Republic of Srpska, the role and tasks of internal audit, the establishment and independence of internal audit, standards, rights, and responsibilities of managers, the audit committee and the Central Harmonization Unit.

With the entry into force of this law, the law on internal audit in the public sector of Republic of Srpska (Official Gazette of the Republic of Srpska, No. 17/08) has ceased to apply, unlike the Federation of Bosnia and Herzegovina, where these areas are governed by individual laws.

Conclusion

As a candidate for EU accession, Bosnia and Herzegovina has been subject to a series of reforms that it needs to implement, one of them being the introduction of an internal control system in the public sector.

Namely, the European Commission recommended Bosnia and Herzegovina, in order to help candidates for EU membership, to strengthen the control over the spending of public resources, that is, unintended, embezzlement and the similar, to introduce a system of internal financial control in the public sector. This system works through three elements and those are: financial management and internal control, internal audits, and the Central Harmonization Unit.

Establishment of financial management and control in the public sector at all three levels of government in Bosnia and Herzegovina has been moving to a deadlock in the last two years, and significant changes have been seen regarding the adoption of laws and regulations related to this area.

Concerning the establishment and functionality of financial management and control in the public sector, it can be concluded that the process is very slow and spontaneous, and the fact is that we do not yet have consolidated annual financial management and control reports for 2017 published, from which we could see the degree of establishment and functionality of FUK.

Given that the establishment of financial management and control in the public sectors at all levels of government is quite spontaneous and slow, a number of appropriate measures should be taken to speed up the process and achieve business quality, such as:

1. Raise awareness among public sector executives of the importance of financial management as an integral part of the public sector management process. Executives need to understand what the role of financial management and control is, and that they are solely responsible for its establishment and functionality.

2. Work to develop the coordination role of current sectors or public sector finance services in such a way that they take on the role of coordinator of financial management and control development.

3. Work on improving the accounting system within the organization, in a way to timely provide all the necessary information concerning the business, i.e., information on income, expenses, assets, liabilities, results of operations, and the similar. Such a system provides a good basis for planning and executing budgets/budgets, controlling costs, finding ways to make some savings, dedicated use of public resources, all for the purpose of a more economical, efficient, and effective business.

Attention should be paid to business risks in a way to approach to the risk management with better quality by constantly identifying potential risks. The identified risk must be constantly monitored, kept under control and timely reported.

Continuous education of financial management and control coordinators appointed by public sector executives is also important.
Financial management and control as a systematic approach to management

Figure 3. Designing a process book/folder.

However, given that this obligation has been imposed by the European Commission, as well as the obligation to establish a functional internal audit in the public sector, it can be expected in the future to improve the public sector business, to raise public sector managers’ awareness of the importance, significance and need of financial management, controls and internal audits in the public sector.

As soon as public sector managers recognize the importance of this system, when it is not in their minds that it is merely a formal obligation to fulfil their statutory obligations, only then this system will be able to develop properly and act adequately on public sector managers in a more economical way, manage public resources more efficiently, effectively, and provide better public services.

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