

**Aleksandra Rabrenović**

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



Institute of Comparative Law



FINANCIAL ACCOUNTABILITY AS A CONDITION  
FOR EU MEMBERSHIP

*Publisher*

Institut za uporedno pravo (Institute of Comparative Law)

*For the publisher*

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*Printed in*

300 copies

ISBN 978-86-80059-62-4

*Layout and print*

Dosije studio, Beograd

*Objavljivanje ove knjige pomoglo je Ministarstvo za nauku i tehnološki razvoj Republike Srbije.*

*Publishing of this book was supported by the Ministry of Science and Technological Development.*

Aleksandra Rabrenović, PhD

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Belgrade, 2009



# CONTENTS

PREDGOVOR .....	11
FOREWORD .....	15
ACKNOWLEDGEMENTS .....	19
INTRODUCTION .....	21
Objective of the study.....	21
Methodology .....	26
Structure of the study .....	27
Chapter I	
FINANCIAL ACCOUNTABILITY – CONCEPT AND SECURING MECHANISMS.....	30
Concept of accountability .....	30
The distinction between accountability and other similar concepts.....	33
Dimensions of accountability.....	35
The concept of financial accountability.....	40
Origins of financial accountability .....	45
Nature of the financial accountability relationship .....	47
Specification of the concept of financial accountability and its securing mechanisms.....	49
Variety of financial accountability mechanisms.....	51
Conclusion .....	55
Chapter II	
FINANCIAL ACCOUNTABILITY IN THE UNITED KINGDOM .....	57
A highly complex accountee – the British central government.....	57
Concept of “stewardship” of public money in UK.....	60

Mechanisms of financial accountability . . . . .	65
Internal financial accountability mechanisms . . . . .	67
External financial accountability mechanisms . . . . .	72
Parliamentary accountability . . . . .	72
Committee of Public Accounts (PAC) . . . . .	76
The Comptroller and Auditor General and the National Audit Office . .	80
Status and structure . . . . .	80
Functions of the C&AG . . . . .	81
Financial audit . . . . .	82
Value for money audit . . . . .	86
The Government accounting system . . . . .	91
Summary and conclusion . . . . .	93
 Chapter III	
FINANCIAL ACCOUNTABILITY IN FRANCE . . . . .	94
Another highly complex accountee – the French central government . . . . .	94
Constitutional background . . . . .	94
Variety of public bodies . . . . .	97
Systemic reforms of the financial accountability framework through LOLF . . . . .	99
Stewardship of public money – from compliance to performance? . . . . .	101
Internal financial accountability mechanisms . . . . .	103
Financial control posts and General Inspectorate of Finance . . . . .	103
Gradual reform of the internal control framework . . . . .	106
Enhancement of parliamentary accountability . . . . .	108
Historical background . . . . .	108
Enhancing Parliamentary scrutiny through UK recipe – creation of MEC . . . . .	109
Substantive reforms of parliamentary accountability through LOLF . . . . .	111
La Cour des Comptes (The Cour) – a traditional guardian of the ‘public purse’ . . . . .	113
Historical background . . . . .	113

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The structure and staffing of the Cour.....	114
Institutional jurisdiction of the Cour.....	117
Functional jurisdiction of the Cour.....	118
The Cour as a judge.....	119
The Cour as an auditor of financial management.....	120
The rules of the decision-making process.....	122
Follow up on the audit process.....	123
The emerging role of the Cour– an assistant to the Parliament?.....	125
Conclusion.....	128

#### Chapter IV

FINANCIAL ACCOUNTABILITY IN THE EU.....	130
Unique supranational financial accountability accountor – EU institutions.....	130
Background of reform of EU financial accountability framework.....	132
Concept of stewardship of public money.....	133
Reform of internal financial accountability mechanisms.....	137
Towards an integrated internal control framework.....	141
External financial accountability mechanisms in the EU.....	142
Parliamentary accountability – granting the discharge to the Commission.....	143
The Budgetary Control Committee – the EU PAC/MEC?.....	145
The European Court of Auditors (ECA).....	147
Historical background.....	147
Organisation and structure of the ECA.....	148
Mandate of the ECA.....	149
Relationship between the ECA and other EU institutions and member states.....	152
Nature of the EU and financial accountabilityat the EU level.....	154
Theoretical basis for EU integration.....	154
Theoretical model of EU financial system and financial accountability.....	158
Financial accountability as a condition for the EU accession.....	160
The EU key challenge – process of enlargement.....	160
Setting up the EU membership criteria.....	161

Financial accountability– a valid EU membership criterion?.....	163
Defining the European standards of financial accountability. ....	164
Public Internal Financial Control .....	166
External Audit.....	167
EU Pre-accession funding and future structural action and protection of the EU financial interests .....	168
Summary and conclusion.....	169
 Chapter V	
FINANCIAL ACCOUNTABILITY IN SERBIA.....	171
The Serbian state – a short historical overview .....	171
The Serbian Government – overcoming the flaws of a democratic transition failure.....	173
Serbia’s winding path to the EU .....	175
European Partnership and SAA priorities in the area of financial accountability .....	176
Ongoing reforms of the Serbian central government .....	178
Firming up the concept of stewardship of public money.....	181
Building effective internal accountability mechanisms.....	183
Emerging system of internal financial control .....	183
Budget inspection and internal audit .....	185
Strengthening parliamentary accountability.....	187
The role of parliamentary committees.....	189
Developing external financial accountability mechanisms.....	189
External audit in Serbia– an overview of a forgotten tradition .....	190
Contours of a new external audit legal framework .....	193
Organisation and management of the SAI .....	194
Functional and institutional jurisdiction.....	195
Audit reports and procedures .....	196
Accounting and reporting .....	199
Conclusion .....	190
 CONCLUDING CHAPTER VI .....	
European perspective as one of the incentives for creating effective financial accountability framework.....	201

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UK and French systems of financial accountability as possible models for financial accountability reform in Serbia . . . . .	203
Historical explanation of differences between presented financial accountability models . . . . .	205
Gradual harmonisation of systems – emerging European model of financial accountability? . . . . .	207
The way forward for Serbia . . . . .	209
Proposals for strengthening internal financial accountability mechanisms . . . . .	211
Internal financial control – towards the UK accounting officer model? . . . . .	212
Gradual introduction of internal audit . . . . .	215
Possible ways to enhance the role of the Parliament and its committees . . . . .	217
Creating an effective supreme audit institution . . . . .	220
Conclusion . . . . .	223
 Annex 1 HISTORY OF THE DEVELOPMENT OF FINANCIAL ACCOUNTABILITY ARRANGEMENTS IN THE UK . . . . .	  225
BIBLIOGRAPHY . . . . .	234



## PREDGOVOR

Studija „Kontrola budžeta kao uslov za ulazak u Evropsku uniju“ dolazi pred čitaoca u pravo vreme. Finansijska kriza koju upravo savlađujemo jarko je osvetlila ovo područje. Ocena velikog dela američke javnosti, koju citiraju Holzer i Callahanova, da je „državna uprava SAD generalizovani promašaj i opasnost“ – još uvek važi i u mnogim drugim zemljama. To mišljenje se formira pre svega zbog neprikladnog, često i ekstravagantnog upravljanja javnim rashodima. Efikasna kontrola budžeta ne samo da bitno smanjuje troškove države već direktno utiče i na stvarnu reformu uprave.

Autorka je sa lakoćom i iznenađujuće elegantnim stilom obavila značajan istraživački poduhvat. Pažljivi čitalac uočava sličnosti i razlike sistema kontrole budžeta Velike Britanije, Francuske i Srbije i lakše shvata suštinu eklektičkog sistema Evropske unije. Očigledan cilj autorke: upoznavanje naše stručne i naučne javnosti sa sistemima finansijske odgovornosti u drugim zemljama i u Evropskoj uniji na pregledan način – ispunjen je. Ne manje značajno, predlažu se i normativna i organizaciona rešenja koja bi trebalo da utiču na finansijsku disciplinu u Srbiji.

Studijom je temeljno istraženo područje od osobitog značaja. Zrelost koju autor pokazuje u definisanju instituta kao što je „accountability“, zatim u dubokom pronicanju u specifičnosti anglosaksonskog sistema omogućava uporedno istraživanje složene prirode odgovornosti i u našem pravu i u našem socijalnom ambijentu. Ovo je osobito od značaja jer pravna tekovina EU (*acquis communautaire*) postaje neposredno aktuelna i u našoj zemlji koja se postepeno približava članstvu u Evropskoj uniji. Funkcionisanje višeznačnog sistema finansijske odgovornosti predstavlja jedno od merila zrelosti za članstvo i dokaz da smo jedno od pitanja u izgradnji države i društva u jednoj važnoj oblasti uspešno rešili. Stoga se tema izdvaja inače neuobičajenom pravovremenosti.

Deo monografije o istorijskom razvoju kontrole budžeta u Srbiji pokazuje da smo u ranijim periodima posvećivali relativno više pažnje ovim pitanjima, u skladu sa mogućnostima vremena. Predstavljanje našeg istorijskog iskustva doprinosi ukupnom fundusu znanja u svetu i širi mogućnosti međunarodne saradnje. Ukazivanje na praktične korake koje bi trebalo da preduzmu državni organi kod nas olakšava posao odgovornih, s tim što, dakako, valja imati u vidu važnost političke volje koja je, pritisnuta personalnim interesima, često nejaka u takvim situacijama.

Ne treba zanemariti ni pomoć koju ovom studijom dobijamo u borbi protiv korupcije koja je u svim tranzicijskim zemljama postala osnovni problem. Kod nas je ta borba obeležena izuzetno snažnom retorikom i malo приметnim rezultatima.

Radi preglednosti ukazujemo na sadržaj.

Prvi deo knjige analizira pojam finansijske odgovornosti/kontrole budžeta koji se definiše kao odnos između građana i države u kome građani pozivaju na odgovornost državne organe koji troše javna sredstva. Suština finansijske odgovornosti shvata se kao obaveza države da osigura da je novac poreskih obveznika potrošen ne samo na zakonit vec i na efikasan „domaćinski“ način. U svetu su se razvili različiti mehanizmi kontrole budžeta čiji je cilj da osiguraju funkcionisanje finansijske odgovornosti. To su prvenstveno mehanizmi koje obezbeđuju demokratsku kontrolu korišćenja budžetskih sredstava putem parlamentarne kontrole; zatim mehanizmi interne kontrole unutar organa i mnogi oblici spoljne kontrole od kojih je najznačajnija kontrola specijalizovane nezavisne revizorske institucije, koja je kod nas, na žalost, jos uvek organizacijski i funkcionalno sputana.

Drugi deo studije predstavlja stanje u Velikoj Britaniji koje, sticajem prilika, autorka izuzetno dobro poznaje. Posebno su zanimljivi delovi o metodima interne kontrole Ministarstva finansija te zemlje, prestižnog Odbora za javne račune i Nacionalne revizorske institucije. Posebna pažnja posvećena je i uvođenju novog računovodstvenog sistema koji bi trebalo da poboljša finansijsko upravljanje i efikasnost u korišćenju budžetskih sredstava.

U trećem delu analizira se reforma mehanizama finansijske odgovornosti i kontrole budžeta Francuske kao predstavnika kontinentalne pravne tradicije. Posebna pažnja posvećena je prethodnoj budžetskoj kontroli od strane finansijskih kontrolora (*controleurs financiers*) i računovodja (*comptables*) kao i prestižnom Finansijskom inspektoratu (*L'inspection Generale des Finances*). Veoma detaljno se analizira i uloga impresivnog francuskog Računskog suda i sve veća uloga parlamenta u postupku naknadne kontrole budžeta. U fokusu istraživanja su rešenja Organskog finansijskog zakona (*La Loi Organique Relative aux Lois de Finances –LOLF*) iz 2002. godine, kojim se bitno poboljšava pravna regulativa kontrole budžeta, sa posebnim akcentom na rezultatima rada, budžetskoj transparentnosti i jačanju menadžerske odgovornosti.

Četvrti deo studije posvećen je sistemu finansijske odgovornosti u Evropskoj uniji. Najpre se analiziraju klasični mehanizmi finansijske odgovornosti, interne upravne i spoljne institucionalne i parlamentarne kontrole. Posebna pažnja posvećuje se zatim određivanju pojma finansijske odgovornosti na nadnacionalnom nivou Evropske unije, kao kompleksnom sistemu kontrolnih mehanizama koji se uspostavljaju između Evropske unije, zemalja članica i građana. Najzad, analiziraju se zahtevi Evropske unije potencijalnim državama članicama u oblasti finansijske odgovornosti i kontrole.

Sistem finansijske odgovornosti Srbije predstavljen je u petom odeljku, koji analizira brojne probleme sa kojima se Srbija susreće u uspostavljanju valjanog sistema odgovornosti za trošenje budžetskih sredstava. Ovaj odeljak takođe sadrži pregled istorijskog razvoja mehanizama kontrole budžeta u Srbiji u XIX i XX veku, čime čitalac stiče uvid u pravnu tradiciju u ovoj oblasti. Tek objavljivanjem ove studije postajemo svesni značaja ovog toka razvoja za napredak novovekovne Srbije.

Zaključni deo analizira razlike u razvoju anglo-saksonskog i kontinentalnog modela kontrole budžeta i uspešno postavlja teorijske osnove za izgradnju jedinstvenog evropskog modela finansijske odgovornosti. U zaključnom delu date su jasne preporuke za izmene pravnog okvira i institucionalne strukture da bi Srbija mogla da zadovolji standarde Evropske unije u oblasti kontrole budžeta. Imajući u vidu činjenicu da pravna rešenja, principi i institucije ne mogu jednostavno biti preneti iz jednog sistema u drugi, sa posebnom pažnjom se formulišu preporuke kako se evropski principi i standardi u oblasti kontrole budžeta mogu na najbolji način primeniti u srpskom tranzicionom okruženju.

U poplavi informacijama koje stvaraju sve potpunije zagađenje za čitaoca koji ne raspolaže dovoljnim znanjima da obezbedi njihovu neophodnu selekciju, ova knjiga predstavlja dobrodošao odmor. Već posle prvih stranica stvara se poverenje čitaoca. Ovo stoga što se radi o briljantnom i savesnom istraživaču koji nastavlja sistematsko istraživanje u oblasti koja je kod nas zapostavljena preko šest decenija. Upporedna analiza sistema kontrole budžeta izvedena je sa izvanrednom preciznošću ali i akribijom i izuzetnom obaveštenošću. Tačnost u ocenjivanju, bogatstvo konsultovane literature, sposobnost selekcije značajnih teorijskih stavova i izbor odgovarajuće prakse svedoči o razvoju značajnog mladog autora i dela koje popunjava prazninu u našoj stručnoj literaturi i budi interes za temu koja je od sve većeg značaja, nezavisno od finansijske krize koja je obišla svet delimično i zbog zanemarivanja kontrole budžeta.

Doprinos dr Aleksandre Rabrenović pojavljuje se pred nama u neobično važnom trenutku. Sporazum o stabilizaciji i pridruživanju predviđa mnoge složene obaveze za veliki broj stručnjaka, organizacija i institucija pri čijem delovanju je potrebno sinergijsko dejstvo. Ova studija čini upravo to: obrazlaže i predlaže rešenja koja se samo zajedničkim naporima ljudi nauke i prakse mogu ostvariti. To je čini uspešnom i dobrodošlom.

Prof. dr Dragoljub Kavran



## FOREWORD

The study *Financial Accountability as a Condition for EU Membership* appears before readers at the right time. The global economic crisis which we are currently attempting to overcome has shed strong light on this field. Assessment of a significant part of the American public, cited by Holzer and Callahan, that „the US public administration is a generalised failure and danger“ – is still valid in many other countries. This opinion is formed primarily because of inappropriate and often extravagant management of public expenditure. Effective budget control not only substantially reduces state expenses but also has a direct impact on genuine, public administration reform.

The author has made an important research endeavour with ease and surprisingly elegant style. A careful reader notices similarities and differences between the financial accountability systems of the United Kingdom, France and Serbia, and understands the essence of the European Union's eclectic system. The obvious objective of the author has been accomplished: to introduce our professional and scientific audience with systems of financial accountability in other countries and in the European Union in a clear manner. Not less important are the proposed normative and organisational recommendations which should have an impact on the financial discipline in Serbia.

This study thoroughly analyses an area of particular importance. Maturity which the author shows in defining the concept of „accountability“ and her deep understanding of specificities of the Anglo-Saxon system facilitates comparative research of the complex nature of accountability in our law and social ambience. This is of special importance because *acquis communautaire* are becoming directly relevant in our country which is gradually moving closer to EU membership. The operation of a multi-faced system of financial accountability constitutes one of the criteria for membership and is proof that we have resolved one of the important questions in the building of our state and society. Therefore, the topic distinguishes itself by its topicality.

The part of the study about historical development of financial accountability in Serbia demonstrates that we have devoted much more attention to these issues earlier on, in line with the possibilities of those times. Presentation of our historical experience constitutes a contribution to the overall scope of the world's knowledge and widens possibilities for international cooperation. A pointing out of practical steps which our state bodies should undertake in this field makes the job of our authorities easier, although one should bear in mind the importance of political will, which, being pressed by personal interests, is often rather weak in such circumstances.

This study provides important assistance in the fight against corruption which has become the key issue in all transitional countries. In our country, this fight has been marked by very intense rhetoric but much less noticeable results.

For the sake of clarity we point to the content of the study.

The first part of the book analyses the concept of financial accountability, which is defined as the relationship between the citizens and Government, where the citizens hold the Government to account for stewardship of public money. The essence of financial accountability is understood as an obligation of the Government to assure citizens that money is spent in the best possible and most effective way. In modern states, various financial accountability mechanisms have been developed in order to secure financial accountability relationships. These are primarily mechanisms which secure democratic accountability in use of public funds, discerned through budgetary control of Parliaments; in turn, there are mechanisms of internal financial control within the administrative structures of Government, and mechanisms of external financial control, provided by a specialized, independent audit institution that is in our country, unfortunately, still organizationally and functionally constrained.

The second chapter is devoted to an analysis of the UK system of financial accountability, which, for practical reasons, the author knows quite well. Diverse mechanisms of financial accountability are analysed, with special emphasis on the internal Treasury mechanisms, Public Accounts Committee and National Audit Office, in holding the executive to account for spending of public money. Special attention is also paid to the introduction of a new accounting system which is expected to enhance financial management and increase effectiveness in the use of public funds.

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 the role of financial controllers (*controlleurs financiers*) and accountants (*comptables*), as well as the prestigious Financial inspectorate (*L'inspection Generale des Finances*). The increasing role of Parliament and the prestigious French *Cour des Comptes* in the *ex post* control of expenditure is further examined in great detail. The focus of the research is the organic financial law of 2002 (*La Loi Organique Relative aux Lois de Finances –LOLF*), which significantly improves the legal framework of financial accountability, with special emphasis on performance, budget transparency and enhancement of managerial accountability.

The fourth part of the study is devoted to an analysis of the financial accountability system of the EU. First, the author examines the interplay of various EU, financial accountability mechanisms, such as internal financial control and external institutional and parliamentary control. This is followed by an analysis of the concept of financial accountability in the EU supra-national context, as a complex system of accountability mechanisms which are established between the European Union, its member states and their citizens. Lastly, EU requirements in the area of financial accountability and control with regard to potential EU member states are thoroughly examined.

The financial accountability system in Serbia is presented in the fifth chapter, which analyses a number of current problems experienced by the Ser-

bian Government in establishing a system of financial accountability. This chapter also examines in more depth the historical development of financial accountability mechanisms in Serbia in the XIX and XX centuries, by which the reader gains insight into the Serbian legal tradition in this field. Only through the publishing of this study are we becoming aware of the importance of progress in this area for overall Serbian state development.

The final part of the study focuses on the identification of differences and similarities between the described financial accountability systems and successfully establishes a theoretical basis for development of a unique European model of financial accountability. In the final part of the study, the author provides clear recommendations for changing the Serbian legal framework and existing institutional structures, in line with EU financial accountability standards and requirements. Bearing in mind that legal rules, principles and institutions cannot simply be transplanted from one legal system to another, the ways in which modern Western standards of financial accountability could be applied within a still fragile Serbian transitional context are carefully analysed.

In the flood of information that creates significant waste for readers who do not possess sufficient technical knowledge in order to carry out necessary filtering and selection, this book constitutes a welcome relief. Already, after the first pages, reader confidence is established. This is because the author is a brilliant and conscientious researcher who continues systematic research in a field that has been neglected in Serbia for over six decades. The comparative analysis of financial accountability has been carried out not only with excellent precision but also with thoroughness and extraordinary informativeness. Accuracy in assessments, richness of literature used, selection of important theoretical views and of adequate practice, gives witness to the development of an important young author and a study that fills the gap in our professional literature and incites interest for a topic that is of ever-increasing importance, irrespective of financial crises which have spread over the world (partly owing to the neglect of issues of budget control and accountability).

The contribution of Dr Aleksandra Rabrenović appears before us in an exceptionally important moment. The Stabilisation and Association Agreement envisages numerous and complex requirements for a number of experts, organisations and institutions which need to operate in a synergic fashion. This study does just that: it explains and proposes solutions which can be implemented only through the joint efforts of people of science and practice. This makes the study successful and welcome.

Prof. dr Dragoljub Kavran



## ACKNOWLEDGEMENTS

I would like to thank everyone who has contributed to the conduct of my research. My special thanks goes to my supervisor, Professor Noreen Burrows (University of Glasgow), for her continuous support, especially throughout difficult phases of this research. Her guidance, understanding and encouragement were essential for the completion of this study. I would also like to thank Mr. Francois Roger-Cazala (Cour des Comptes) for assisting me with the preparation of the French chapter of the research and enabling my access to the staff and library of the Cour des Comptes.

I would further like to express my gratitude to my dear colleagues and friends, Tony Verheijen (The World Bank) and Željko Šević (Glasgow Caledonian University), who have provided useful comments and supported me throughout my research.

I also thank my dear professor Dragoljub Kavran for his continuous support and guidance, and the Director of the Institute of Comparative Law, dr Jovan Ćirić, for encouraging me to publish this research. The assistance of Hugh Grant and Slobodan Šućur in reviewing my use of the English language is also greatly appreciated.

Special thanks goes to my family and all my dear friends, who have provided invaluable emotional support throughout my research and have become part of my wider family.

Significant financial assistance from the University of Glasgow is gratefully acknowledged, as it enabled me to enter into the inspiring research community of the Glasgow University and experience the warmth of the Scottish people.

Finally, financial assistance from the Ministry of Science of the Republic of Serbia is very much appreciated as it enabled me to publish this research and share it with the Serbian and international audience.



# INTRODUCTION

## Objective of the study

This study 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 establishment of an effective system of control and audit powers over spending of Serbian taxpayers' money is a precondition for combating the high incidence of corruption and providing better value for money of use of public funds. This is particularly important in the time of global economic crises, which requires significant reduction of overall public expenditure. 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 should be on the top of the agenda of policy makers and constitute an important part of the overall transition reform process in the years to come.

This research 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 the countries of Western Balkans and underlined the European Union's determination to support their efforts to move closer to the European Union.<sup>1</sup> 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 process started in October 2005<sup>2</sup> and was successfully completed by signing the Stabilisation and Association Agreement (SAA) between Serbia and EU in April 2008. However, the implementation of SAA was immediately suspended, mainly due to inadequate cooperation with the International Criminal Tribunal for the former Yugoslavia (ICTY) in the Hague. Nevertheless, the Serbian Government decided to start implementing the trade part of the SAA in January 2009, in order to show its determination to the EU accession process.

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

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

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

states of weak governance and divided societies, with recent history of armed conflicts.<sup>3</sup> 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 study. 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.<sup>4</sup>

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.<sup>5</sup> 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.<sup>6</sup> We shall then examine the variety of accountability mechanisms to ensure that money is spent in accordance with parliamentary wishes.<sup>7</sup> 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.<sup>8</sup>

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

4 S. Redlynch, “Holding to Account, The Review of Audit and Accountability for Central Government”, February 2001, [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk).

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

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

7 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.

Furthermore, it is important to stress that financial accountability mechanisms are not isolated phenomena, but 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,<sup>9</sup> 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 between its different supporting mechanisms, so that weaknesses in one form of financial accountability can be compensated for by controls through other mechanisms.<sup>10</sup>

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

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

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

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.<sup>11</sup> 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 not operational nine years after the democratic changes. 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 control on any Member/Candidate State.<sup>12</sup> 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 study 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 study 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

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

12 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.

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.<sup>13</sup> Instruments of internal 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 functions<sup>14</sup> 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.

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- 13 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 President and auditing at central, regional and local level). UK National Audit Office, *State Audit in the European Union*, December 2005, available at [http://www.nao.org.uk/publications/state\\_audit/state.htm](http://www.nao.org.uk/publications/state_audit/state.htm)
- 14 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. 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.<sup>15</sup> 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.<sup>16</sup> 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.<sup>17</sup> 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.

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.<sup>18</sup> 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 *ac-*

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

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

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

18 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.

*quis communautaire*. In that sense, the comparative law methodology also serves a function of *legal unification*.<sup>19</sup>

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 dependent variable).<sup>20</sup> 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 predict<sup>21</sup> 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.

## Structure of the study

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.<sup>22</sup> Therefore, the task of our preliminary comparative inventory is

19 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.

20 J.H. Merryman, *op. cit.*, pp. 100–101.

21 D. Kokkini-Iatridou, *op. cit.*, pp. 187–188.

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

the identification of various mechanisms which have a role of securing financial accountability in different European states. In this way we have determined the *tertium comparationis*, as a precondition for any comparative research undertaking.<sup>23</sup> 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 supra-national 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.

The fifth chapter examines 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

23 D. Kokkini-Iatridou, *ibid.*, pp. 158–161.

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,<sup>24</sup> 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.<sup>25</sup> 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.

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24 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.

25 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.<sup>26</sup> The concept of accountability has gradually evolved and encompassed a number of different meanings, which often call for further clarification of its genuine sense.<sup>27</sup>

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”.<sup>28</sup> *Computare* is the compound of *com*, which means together, and *putare*, which means to count, reckon, consider, as well as to settle (an account).<sup>29</sup> 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 explore its usage through current academic literature. Only then will we be able to fully define the concept of financial accountability.

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.<sup>30</sup> Other sources interpret “accountable” as subject to giving an account – “answerable” and capable of being accounted for – “explainable”.<sup>31</sup>

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

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

28 R. Behn, *Rethinking Democratic Accountability*, (Brooking Institution Press), 2001, pp. 3–8.

29 Ibid.

30 *Oxford English Dictionary – Tenth Edition*, (Oxford University Press), 1999.

31 J.M. Shafritz, *The Dorsey Dictionary of American Government and Politics* (Dorsey Press), 1988, p. 4.

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 accountant, 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 accountant? 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 accountant 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/accountants 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”.<sup>32</sup> In a similar vein, Lord Sharman states that “Accountability is needed wherever there are hierarchical 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,<sup>33</sup> 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.<sup>34</sup> 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.<sup>35</sup> Accountability seems to be a “stronger” concept,

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

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

34 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 M. Geoffrey, *Constitutional Conventions. The Rules and Roles of Political Accountability*, 1986, (Oxford, Clarendon); R. Pyper, “The Parameters of Accountability”, in Robert Pyper

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.<sup>36</sup> 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, 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.<sup>37</sup>

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.<sup>38</sup> 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.<sup>39</sup>

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.<sup>40</sup> A number of authors are 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.<sup>41</sup> Besides its preventive function, accountability thus defined enables the performance of an accountee to be continuously scrutinized

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(eds.), *Aspects of Accountability in the British System of Government*, 1996, (Tudor Business Publishing Ltd.).

36 R. Behn, op. cit. pp. 9–10.

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

38 E.L. Normarton, *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.

41 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.

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.<sup>42</sup> In any case, it is essential that accountor 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.<sup>43</sup> 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.<sup>44</sup>

### **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*”)<sup>45</sup>, but foremost “to behave rationally and reliably and with consistency and trustworthiness in exercising internal judgment”<sup>46</sup> Therefore the concept of responsibility (sometimes called moral, professional accountability)<sup>47</sup> 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 ex-

42 D. Kavran, *Nauka o upravljanju, Oranizacija, kadrovi, rukovodjenje*, (Naucna knjiga, 1991), pp. 78–80.

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

44 Ibid.

45 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.

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

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

ternal 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, generally implies the existence of a malpractice or misconduct, which needs to be remedied. Therefore, liability assumes the duty "to restore, to compensate, to recompense for wrongdoing or poor judgment".<sup>48</sup> 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 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.<sup>49</sup> 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.<sup>50</sup> Therefore, these terms may also have a rather negative connotation, as they generally contain an inherent element of a wrongdoing and subsequent punishment.<sup>51</sup> 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, such as 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 the concept of *control* tends to be rather broad, starting from influencing and guiding to restraining and inspecting.<sup>52</sup> In the French and Serbian languages, on the other hand, the meaning of control (*controle/kontrola*) is much more restrictive and precise than in English and refers to inspection, verification, examination, checking

48 Ibid.

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

50 Ibid.

51 A. B. Cendon, op. cit., pp. 24–25.

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

against fixed standards,<sup>53</sup> which is close to the English meaning of accountability. In professional literature, control is 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.”<sup>54</sup>

Although there is some overlap between the concepts of accountability and control, as they relate to the social situation in which one actor (accountee/a controlled actor) is required to give an account for his/her behaviour to another actor (accountor/controller), we may argue that the main distinction between these concepts is that accountability denotes the complex and stable *relationship* which exists between two actors (based on delegation of duties), while control denotes a *process* which aims to ensure that things are done in the way it was required and that expected standards have been met. Therefore, control is inherently dynamic concept, while the concept of accountability comprises static, continuous and dynamic elements. It may further be argued that the concept of accountability subsumes within itself the concept of control. As will be explained in more detail later, control may very well be used as a mechanism for ensuring accountability and a basis for calling someone to account.

### 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;
4. how it is secured and measured.<sup>55</sup>

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.

53 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, p. 47. 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.

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

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

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 accountors/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.<sup>56</sup> 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.<sup>57</sup>

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.<sup>58</sup>

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.<sup>59</sup>

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.<sup>60</sup>

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

57 Ibid.

58 A. Sinclair, op. cit., pp. 219–237.

59 F. White, K. Hollingsworth, op. cit. pp. 6–7.

60 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.).<sup>61</sup> 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.<sup>62</sup>

Dwivedi and Jabbra (1989) separate out the following accountability categories: administrative/organizational, legal, political, professional and moral accountability.<sup>63</sup>

In similar vein, Sinclair (1995) distinguishes between five types of accountabilities—political, public, managerial/administrative, professional and personal.<sup>64</sup> Similar classification of accountability could also be found with Cendon

61 P. Day, R. Klein, op. cit., pp. 6–7.

62 Ibid.

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

64 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

(1999), who differentiates political, administrative, professional and democratic accountability.<sup>65</sup>

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.<sup>66</sup> 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.<sup>67</sup>

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.<sup>68</sup>

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.<sup>69</sup>

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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.

65 A. B. Cendon, *op. cit.*, pp. 24–25.

66 R. D. Behn, *op. cit.*, pp. 6–10.

67 *Ibid.*

68 R. Pyper, *op. cit.*, pp. 7–8.

69 R. D. Behn, *op. cit.*, pp. 5–6.

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 creation of such a reliable structure of accountability mechanisms would enable an accountant 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.<sup>70</sup> 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.<sup>71</sup> 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 regulation in general.<sup>72</sup> In this way, the meaning of accountability would to a great extent correspond to a narrower concept of 'control'.

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 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

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70 R. Mulgan, op.cit., pp. 555–573.

71 Ibid.

72 Ibid.

informal interaction between the superiors and officials in the process of assessment.<sup>73</sup> 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.<sup>74</sup>

These definitions of financial accountability provide the answer to one of the crucial dimensions of accountability – for what. They define the *object* of financial 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.<sup>75</sup> 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.<sup>76</sup>

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, particularly in a comparative context. The defi-

73 T. Virtanen, op. cit. p. 7.

74 Lord Sharman of Redlynch, “Holding to Account, The Review of Audit and Accountability for Central Government”, February 2001, [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk), pp. 9–25.

75 Ibid.

76 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.

nitions of public expenditure have been changing and developing over time<sup>77</sup> 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, 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.<sup>78</sup> 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.<sup>79</sup>

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.<sup>80</sup> In some countries (e.g. UK) requirement of probity, on the other hand, refers to compliance 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

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77 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.

78 L. Sharman of Redlynch, op. cit, p. 15.

79 Ibid.

80 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 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.<sup>81</sup> The state is thus defined as an “abstract identity bearing inherent responsibility for the performance of public functions”<sup>82</sup>

In contrast, in the Anglo-Saxon legal tradition the clear state conception is missing and reference is usually made to the term ‘Government’.<sup>83</sup> 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.<sup>84</sup> 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), encompass-

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

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

83 R.J. Stillman, *Preface to Public Administration*, (New York: St. Martin’s), 1991.

84 C. Knill, *ibid*.

ing 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.”<sup>85</sup> Furthermore, we shall at times 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 defence, conduct of relations which 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.<sup>86</sup> ‘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.<sup>87</sup> 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.

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.<sup>88</sup> However, while in despotic regimes the highest superior, and therefore the main principal of financial accountability is the ruler, in democratic regimes the ultimate prin-

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

86 Ibid.

87 Ibid.

88 P. Day, R. Klein, op. cit. pp. 8–9.

cipals/accountors of the financial accountability relationship are citizens.<sup>89</sup> As our financial accountability research is focused on the analysis of the democratic state, we may conclude that the ultimate accountant'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.<sup>90</sup> 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 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.<sup>91</sup>

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

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89 Ibid.

90 F. White, K. Hollingsworth, *op. cit.* pp. 7–8.

91 O.P. Dwivedi, J.G. Jabbra, *op. cit.*, pp. 5–7.

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, 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.”*<sup>92</sup>

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.<sup>93</sup> 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.<sup>94</sup> 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.<sup>95</sup> 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 elements of the state. This was the idea of the separation of powers, expressed by Montesquieu.<sup>96</sup> 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.<sup>97</sup>

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

93 E.L. Normarton, op. cit. p. 3.

94 Ibid, pp. 3–5.

95 Ibid.

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

97 D. Coombes (ed.), op. cit., pp. 13–21.

The first elements of a democratic financial accountability were developed in medieval England, in a struggle between the Parliament and monarch over finances.<sup>98</sup> 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).<sup>99</sup> 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.<sup>100</sup>

The earliest financial demand was for legislative control of taxation; the control of expenditure gradually followed, with the requirement of proper accounts.<sup>101</sup> 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.

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.”*<sup>102</sup>

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.”*<sup>103</sup>

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.<sup>104</sup>

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 impor-

98 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.

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

100 Ibid.

101 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 15<sup>th</sup> and 16<sup>th</sup> Centuries*, Ph.D. Thesis (Glasgow, 1980), 180.

102 Article I, Section 9 of the USA Constitution.

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

104 E.L. Normarton, op. cit. pp. 7–8.

tance. 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.<sup>105</sup>

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.<sup>106</sup> 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.<sup>107</sup>

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.<sup>108</sup> 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.<sup>109</sup> This amounted to a crisis of the whole system of financial control, experienced in all advanced countries.<sup>110</sup>

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 upset the arrangements for the democratic financial accountability, bringing about new challenges for keeping its proclaimed democratic nature.<sup>111</sup>

### 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,

105 Ibid, pp. 10–11.

106 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.

107 E.L. Normarton, op. cit. p 8.

108 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.

109 E. L. Normarton, *ibid*.

110 *Ibid*.

111 *Ibid*.

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.<sup>112</sup>

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.<sup>113</sup>

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”.<sup>114</sup> Putting this the

112 P. Day, R. Klein, op. cit., pp.12–13;

113 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.

114 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.

other way around, we may well argue that money emanates from the people and therefore has to be exercised in trust for the 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.<sup>115</sup> 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.

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.

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

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,<sup>116</sup> 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
3. Spending of the money voted
4. Accounting for the money spent.<sup>117</sup>

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.

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

117 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. G.Paovic-Jeknic, *Kontrola budzeta – jugoslovensko i italijansko pravo*, Podgorica, 1999. B. Jelicic, *Nauka o financijama i finansijsko pravo*, (Narodne novine, Zagreb), 1990. D. Aleksic, *Finansije i finansijsko pravo*, (Informator, Zagreb), 1982.

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.<sup>118</sup>

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.<sup>119</sup> 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.<sup>120</sup> 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. 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

118 L. Normanton, op. cit. pp. 6–7.

119 F. White, K. Hollingsworth, op. cit. p. 3.

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

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.<sup>121</sup> 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.<sup>122</sup>

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.<sup>123</sup> 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.<sup>124</sup> It has further been argued that many procedures established for the purposes of parliamentary control over public funds remain under heavy influence of the Government.<sup>125</sup> Bearing in mind the importance of parliamentary 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.<sup>126</sup> 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.<sup>127</sup>

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.<sup>128</sup> Although the

121 F. White, K. Hollingsworth, op. cit. p. 4.

122 Lord Sharman of Redlynch, op. cit. pp. 9–25.

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

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

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

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

127 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.

128 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.

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.<sup>129</sup>

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 approaches to service delivery.<sup>130</sup> Audit procedures have also been criticized for their opacity and lack of transparency.<sup>131</sup> 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,<sup>132</sup> 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.<sup>133</sup> 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 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

129 Lima Declaration of Guidelines on Auditing Precepts, available on the INTOSAI web site, [www.intosai.org](http://www.intosai.org).

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

131 M. Power, *The Audit Explosion*, (Demos, 1994), pp. 48–49.

132 E.L. Normanton, op. cit. p. 83.

133 Lord Sharman of Redlynch, op. cit. 9–25.

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.<sup>134</sup> 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.<sup>135</sup>

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, etc.<sup>136</sup>

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.<sup>137</sup> 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.<sup>138</sup> This means while the cash accounting measures only flow of cash resources, accrual accounting includes all the revenues and expenses (including depreciation)<sup>139</sup>, assets (financial and physical, current and capital), liabilities and other economic flows.<sup>140</sup> It may therefore be argued that accruals accounting presents a truer picture of the financial costs of an organization. Furthermore, accrual accounting

134 R. Allen, D. Tommasi (eds.), *op. cit.* pp. 260–261.

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

136 *Ibid.*

137 F. White, K. Hollingsworth, *op. cit.* pp. 15–25.

138 R. Allen, D. Tommasi, *op. cit.*, p. 437.

139 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.

140 R. Allen, D. Tommasi, *op. cit.* pp. 291–292.

basis are believed to encourage good stewardship of public money.<sup>141</sup> 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.<sup>142</sup> 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 add value and improve an organization’s operations.”<sup>143</sup> 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.<sup>144</sup> 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.<sup>145</sup> 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 whether economy, efficiency and effectiveness in the use of resources has been attained. Growing attention has furthermore been paid to the establishment of systems

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

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

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

144 *Ibid*; 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.

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

of performance measurement<sup>146</sup> 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,<sup>147</sup> 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.<sup>148</sup>

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.

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

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

148 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,<sup>149</sup> we shall identify the key financial accountability mechanisms in the UK focusing on their role in the overall British system of financial accountability.

### A highly complex accountee – the British central government

The British Government<sup>150</sup> 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

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

150 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.

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.<sup>151</sup>

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.<sup>152</sup> 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.<sup>153</sup> 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.<sup>154</sup> 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.<sup>155</sup> Since 1997 the struc-

151 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, who is no longer a judge nor exercises any judicial function. In this way the UK highest court is detached from the Upper House of Parliament. The Act also envisages the creation of a UK Supreme Court and an independent Judicial Appointments Commission to allow greater level of independence of the judiciary from the executive. Such an ambitious reform agenda has prompted intense academic and professional discussion and its outcomes are yet to be seen in the years to come. 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 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.

152 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. D. Woodhouse: “The Reconstruction of Constitutional Accountability”, *Public Law*, Spring, 2002. pp. 73–90.

153 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.

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

155 M. Flinders, M. Smith (eds.), *Quangos, Accountability and Reform* (Palgrave, MacMillan), 1999; D. Farnham, S. Horton, “Managing Public and Private Organisations”, in S. Hor-

ture of 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.<sup>156</sup> 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.<sup>157</sup> 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.<sup>158</sup> 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.<sup>159</sup>

Although there is a number of provisional classifications of British public sector organisations,<sup>160</sup> the officially accepted one is of the Office of National Statistics which is done with the reference to ESA95.<sup>161</sup> 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.<sup>162</sup>

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

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- ton and D. Farnham (eds.), *Public Management in Britain*, (MacMillan Press Ltd.), 1999. pp.26–29. However, it should also be noted 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.
- 156 N. Burrows, *Devolution*, (Sweet and Maxwell), 2000; J. Greenwood et al., *New Public Administration in Britain*, (Routledge, 2002), p. 19.
- 157 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.
- 158 Ibid.
- 159 Cabinet Office Guidance for Departments, *Classification of Public Bodies*, August 2005. [http://www.civilservice.gov.uk/other/agencies/publications/pdf/classification\\_guidance\\_aug05.pdf](http://www.civilservice.gov.uk/other/agencies/publications/pdf/classification_guidance_aug05.pdf)
- 160 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](http://www.hm-treasury.gov.uk); Times Books, 1995, *Times Guide to the British State*, London: Times Books.
- 161 European System of Accounts 1995, <http://forum.europa.eu.int/irc/dsis/nfaccount/infor/data/esa95en.htm>
- 162 Cabinet Office Guidance for Departments, *Classification of Public Bodies*, *ibid*.

- 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.<sup>163</sup>

Relying on this definition of the British public sector, we shall restrict our focus 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. 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,<sup>164</sup> regularity is seen as a “requirement for all items of expenditure and receipts to be dealt

163 Ibid.

164 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

with in accordance with legislation authorising them, including any applicable delegated authority and the rules of the Government Accounting.<sup>165</sup> 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.<sup>166</sup> 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 permanent legislation are not respected.<sup>167</sup> 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.<sup>168</sup> 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

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

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

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

167 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.

168 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](http://www.cicap.gov.uk/case_law/documents/Procedure/r_v_secretary_of_state_ex_parte_fbu.pdf)

Government Resources and Accounts Act 2000.<sup>169</sup> 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”.<sup>170</sup> 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.)<sup>171</sup> Questions of propriety, as previously mentioned, could be raised when the terms 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.<sup>172</sup> 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.<sup>173</sup> 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

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

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

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

172 T. Daintith, op. cit, pp. 552–557.

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

'rule of law' issues. Or as some would argue: "It is a language of the auditor's certificate, not of the judge's opinion".<sup>174</sup> 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.<sup>175</sup>
3. effectiveness – the relationship between the intended and actual results of public spending – spending wisely.<sup>176</sup> Studies which focus on effectiveness look at the difference between the intended and actual results of public spending and the quality of service delivered.<sup>177</sup> Effectiveness indicates whether results have been achieved, irrespective of the resources used to achieve those results.

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?

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

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

176 NAO annual report 1999 – Helping the Nation to Spend Wisely. [www.nao.gov.uk](http://www.nao.gov.uk)

177 NAO annual report 2000. [www.nao.gov.uk](http://www.nao.gov.uk).

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*,<sup>178</sup> 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.<sup>179</sup> This has opened a number of controversies when different elements of public money stewardship are at issue.

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.<sup>180</sup> 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.<sup>181</sup>

178 [1995] 1 WLR 886, [1995], 1 All ER 611.

179 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. I. Hare, "Judicial Review and the Pergau Dam", *The Cambridge Law Journal*, Volume 54, part 2, 1995, pp. 227–230. 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.

180 I. Harden, F. White, K. Hollingsworth, op. cit., pp. 661–679.

181 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.<sup>182</sup>

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 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 di-

rectly to both the Treasury and the Parliament.<sup>183</sup> 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.<sup>184</sup>

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. There have been only a few cases of direct challenge of public expenditure decisions<sup>185</sup> and a few which only indirectly affect public spending.<sup>186</sup> 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.<sup>187</sup> Major issues of public finance appearing before the courts have been only those of taxation<sup>188</sup> while the public spending have stayed aside of the court’s agenda. This is primarily a corollary of constitutional understanding of authorisation of expenditure.<sup>189</sup> 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.<sup>190</sup>

Finally, it should be noted that the UK financial accountability legal framework has experienced notable changes through the adoption of the Government Resources and Accounts Act 2000,<sup>191</sup> which the Treasury considers as the “biggest reform and modernisation programme in the management of the country’s public finances since the Gladstone era”.<sup>192</sup> The importance of this Act is that it has put on a legislative basis the governments’ proposals for introduction of

183 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.

184 I. Harden, F. White, K. Hollingsworth, *op. cit.*, pp. 670–671.

185 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. J. McEldowney, *Public Law*, (Sweet and Maxwell), 3<sup>rd</sup> ed., 2003, pp. 371.

186 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.

187 M. Elliott, “The Control of Public Expenditure”, in J. Jowell, D. Oliver (eds.), *The Changing Constitution*, (Oxford University Press, 2000), pp. 201–203.

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

189 I. Harden, F. White, K. Hollingsworth, *op. cit.*, pp. 670–671.

190 *Ibid.*

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

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

resource accounting and resource budgeting into central Government.<sup>193</sup> 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 provides.<sup>194</sup> 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 other way around, Parliament became the Treasury's ally in a system of financial control, in which Executive largely polices itself.<sup>195</sup>

The Treasury regulates the work of departments primarily through its own rules and regulations,<sup>196</sup> 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.<sup>197</sup>

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

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193 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. J. Perrin, "From Cash to Accruals in 25 Years", *Public Money & Management*, April-June 1998, pp. 7–10.

194 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.

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

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

197 The latest Government Accounting amendments were made in 2005 (No. 4/05). <http://www.government-accounting.gov.uk/current/frames.htm>

allow monies to be released from the Consolidated Fund and the National Loans Fund.<sup>198</sup> The Treasury then has the role to distribute the requested money to Departments.<sup>199</sup> 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.<sup>200</sup> The system of *ex ante* control is further secured through the earlier mentioned regularity/legality requirement that no expenditure or commitments can be incurred without the approval of the Treasury.<sup>201</sup> However, in practice the Treasury delegates to departments authority to enter into commitments and to spend within defined limits<sup>202</sup>, as it would be impossible for it to control every detail of expenditure.<sup>203</sup> 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.<sup>204</sup> 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.<sup>205</sup> 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.<sup>206</sup> Given that there are around 550 expenditure lines

198 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. F. White, K. Hollingsworth, op. cit. p.57; NAO, *General Report of the Comptroller and Auditor General 2004–2005*, www.nao.gov.uk

199 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.

200 T. Daintith, A. Page, op. cit. pp. 117–118.

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

202 Paragraphs 2.4.3, 2.4.5 to 2.4.11, Amendment No. 6, *Government Accounting*.

203 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. T. Daintith, A. Page, op. cit. pp. 177–183

204 Ibid.

205 T. Daintith, A. Page, op. cit. pp. 159–164.

206 Treasury and Civil Service Committee Fourth Report, *Simplified Estimates and Resource Accounting*, HC 212, 1994–1995.

in comparison to earlier existing 2000 sub-heads, it is obvious that the control of the Treasury towards departments has been technically and substantially reduced.<sup>207</sup> 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.<sup>208</sup> 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.<sup>209</sup>

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.<sup>210</sup> 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.<sup>211</sup> It is also possible that in some departments other senior managers responsible for particular activities to be appointed as additional Accounting officers.<sup>212</sup> 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.<sup>213</sup>

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

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

208 T. Daintith, A. Page, op. cit. pp. 178–179.

209 Ibid.

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

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

212 Ibid, 6.3.

213 F. White, I. Harden, K. Donnelly, op. cit., pp. 526–534.

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.<sup>214</sup> 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.<sup>215</sup>

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 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.<sup>216</sup> In this way, the constitutional responsibilities of the key actor of managerial financial accountability, the accounting officer, have 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?<sup>217</sup> 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.<sup>218</sup> 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".<sup>219</sup> Such a personal nature of accountability, or better to say, responsibility for public money stewardship on

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

215 F. White, I. Harden, K. Donnelly, *op. cit.* pp. 528–529.

216 *Government Accounting* 6.1.5, December 1994.

217 D. Woodhouse, *op. cit.*, pp. 73–90.

218 L. Sharman of Redlynch, *The Review of Audit and Accountability for Central Government*, February 2001, [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk), p. 20.

219 *Ibid.*

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.<sup>220</sup> 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 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.<sup>221</sup> 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*.<sup>222</sup> 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 organisation and reviewing the adequacy of the underlying activities to manage those risks.<sup>223</sup> 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.<sup>224</sup> 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 Accounting Officers, advising and reporting on audit and internal control issues.<sup>225</sup> 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 account-

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220 Ibid.

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

222 [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)

223 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

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

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

ability, 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).<sup>226</sup> 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.<sup>227</sup> 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.<sup>228</sup>

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 though the Budget document, expenditure side is presented in a separate document, as will be explained in more detail later.<sup>229</sup> 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.

UK Parliament authorises most public money to be spent through the supply process.<sup>230</sup> 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

226 A.V. Dicey, *Introduction to the Study of the Law of the Constitution* (19<sup>th</sup> edn, Macmillan, 1960), p. 447.

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

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

229 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.

230 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. *Government Accounting*, op. cit. Sections 1.1.7., 3.2.8.

whole of Parliament through the annual Consolidated Fund (Appropriation) Act (usually called Appropriation Act).<sup>231</sup>

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.<sup>232</sup>

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.<sup>233</sup> 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.<sup>234</sup> The House of Commons has also for many years tried to achieve some control over public spending through its Estimates Committees.<sup>235</sup> 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.<sup>236</sup> 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"<sup>237</sup> unfortunately still appears to be true.

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.<sup>238</sup> The general influence of Ministers where the government has a

231 T. Daintith, A. Page, op. cit. pp. 156–157.

232 J. McEldowney, "The Control of Public Expenditure", in J. Jowell, D. Oliver, *The Changing Constitution*, (Oxford University Press, 2000), pp. 197–198.

233 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.

234 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.

235 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.

236 T. Daintith, A. Page, op. cit. pp. 156–157.

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

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

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.<sup>239</sup> 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.<sup>240</sup> 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.<sup>241</sup>

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.<sup>242</sup> 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 (re-

239 J. McEldowney, "The Control of Public Expenditure", op. cit. pp. 200–201.

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

241 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 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.

242 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.

source) accounting and supporting its powers of scrutiny by the work of parliamentary committees.<sup>243</sup>

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 times, Blair governments towards Parliament.<sup>244</sup> 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.<sup>245</sup>

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

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243 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. J. McEldowney, "The Control of Public Expenditure", op. cit. pp. 226–228.

244 J. Greenwood et al., op. cit., pp. 182–183.

245 Ibid.

members with a constituency interest in its reports.<sup>246</sup> Some authors are of the opinion that this does not undermine the importance of parliamentary based scrutiny of public money spending. An annual debate 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.<sup>247</sup>

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.<sup>248</sup> 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.<sup>249</sup>

The majority of PAC's hearings and reports are based on value for money (*vfm*) examinations.<sup>250</sup> 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.<sup>251</sup> 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

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

247 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.

248 L. Sharman of Redlynch, op. cit. pp.39–41.

249 Ibid.

250 V. Flegmann, op. cit., pp. 166–172.

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

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.<sup>252</sup> 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.

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 before it, except ministers.<sup>253</sup> 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.<sup>254</sup> However, although the Committee can invoke personal responsibility of the accounting officer, it has lost a formal power to impose sanctions on him/her. 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.<sup>255</sup> 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. Moreover, appearance before the Committee requires

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252 F. White, K. Hollingsworth, *op. cit.*, p. 49.

253 F. White, K. Hollingsworth, *op. cit.*, pp. 122–125.

254 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.

255 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.

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.<sup>256</sup> 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.<sup>257</sup> 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.<sup>258</sup> 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.<sup>259</sup> 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.

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.<sup>260</sup> 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.<sup>261</sup> 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 MPs.<sup>262</sup> Its reports are therefore at times assessed as "eccentric,

256 F. White, K. Hollingsworth, *op. cit.*, p. 50.

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

258 F. White, K. Hollingsworth, *op. cit.* pp. 132–132.

259 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. V.Flegmann, *op. cit.*, p. 169.

260 B. Landers, "Encounters with the Public Accounts Committee: a Personal Memoir", *Public Administration*, 2000, pp. 195–213.

261 F. White, K. Hollingsworth, *op. cit.*, p. 132.

262 B. Landers, *ibid.*

over-enthusiastic and possibly subversive.”<sup>263</sup> 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.<sup>264</sup>

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.<sup>265</sup> Delays in reporting could also not be taken as 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.<sup>266</sup> 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.<sup>267</sup> 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).<sup>268</sup> It is expected that production of such kind of comprehensive high-

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

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

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

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

267 F. White, K. Hollingsworth, op. cit. pp. 131–137.

268 L. Sharman of Redlynch, op. cit. pp. 39–41.

level reports will bring about an 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.<sup>269</sup>

## 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,<sup>270</sup> the 1921 Exchequer and Audit Departments Act<sup>271</sup> (which repealed and amended most of the provisions of the 1866 Act) and the National Audit Act of 1983<sup>272</sup> (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 £450 billion 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.<sup>273</sup>

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 is 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

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

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

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

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

273 NAO, Annual Report 2008, p. 51, available at: [www.nao.gov.uk](http://www.nao.gov.uk)

is 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.<sup>274</sup>

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.

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 850 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.<sup>275</sup> 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.<sup>276</sup>

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.<sup>277</sup> 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.<sup>278</sup> 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

274 Sections 2 and 4 of the NAO 1983 Act.

275 NAO Annual Report 2005, pp. 34–35.

276 F. White, K. Hollingsworth, *op. cit.* p. 48.

277 *Ibid.*

278 *Government Accounting.*

other supreme audit institutions in Europe.<sup>279</sup> However, it 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.<sup>280</sup> 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.<sup>281</sup> 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.<sup>282</sup>

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*.<sup>283</sup> However, financial audit and value for money audit are generally perceived as distinct disciplines, 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*

279 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.

280 F. White, K. Hollingsworth, *op. cit.* pp. 47–48.

281 *Ibid.* pp. 58–59.

282 NAO, General Report of the Comptroller and Auditor General 2004–05, [www.nao.gov.uk](http://www.nao.gov.uk)

283 F. White, K. Hollingsworth, *op. cit.* pp. 60–61.

*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.<sup>284</sup> Qualified opinion is always followed by a report, which provides the background and the reasons for the qualification.<sup>285</sup> 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.<sup>286</sup>

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.<sup>287</sup> 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.<sup>288</sup>

284 In 2006–2007 financial year, NAO has qualified its opinion on only four resource accounts (seven in 2005–06) – the Department for Work and Pensions, the Armed Forces Pension Scheme, the Ministry of Defence and the Teachers Pension Scheme (England and Wales). Cf: NAO, *Financial Reporting and Financial Management, General Report of the Comptroller and Auditor General 2007*, HC 417, Session 2007–2008, available at: [http://www.nao.org.uk/publications/0708/general\\_report.aspx](http://www.nao.org.uk/publications/0708/general_report.aspx), p. 7.

285 F. White, K. Hollingsworth, op. cit, pp. 73–74.

286 Ibid., pp. 63–64.

287 Ibid., pp. 58–59.

288 Ibid., p. 28.

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.<sup>289</sup> It consists of provision of advice to the audited body on accounting issues and financial controls, commenting where 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.<sup>290</sup> 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 contact between the NAO and auditee is established, without elements of democratic, parliamentary accountability.<sup>291</sup>

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. In addition, 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.

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 statu-

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

290 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.

291 F. White, K. Hollingsworth, *op. cit.* pp. 128–129.

tory 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.<sup>292</sup> 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.<sup>293</sup> Lastly, the ability of the NAO to follow public monies into private contractors' hands and local public spending bodies was also significantly constrained.<sup>294</sup>

These concerns were expressed in one of the reports of the Committee of Public Accounts,<sup>295</sup> 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 by the Committee of Public Accounts quickly.<sup>296</sup> 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.<sup>297</sup> 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 NDPBs within the C&AG remit.<sup>298</sup> As for the audit of companies, the progress on Lord Sharman's review has been somewhat slower, due to the need to change the existing legislation on companies. In 2006, Companies Act was passed, designating the Comptroller and

292 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.

293 L. Sharman of Redlynch, *ibid.*

294 F. White, K. Hollingsworth, *op. cit.* pp. 86–87.

295 PAC, *Report on Government Resources and Accounts Bill*, 9<sup>th</sup> Report 1999–2000 HC 159.

296 6<sup>th</sup> Report, Session 2000–01, HC 260.

297 *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>

298 NAO, *Financial Reporting and Financial Management, General Report of the Comptroller and Auditor General 2007*, HC 417, Session 2007–2008, available at [http://www.nao.org.uk/publications/0708/general\\_report.aspx](http://www.nao.org.uk/publications/0708/general_report.aspx), p. 18.

Auditor General as a registered auditor of companies. This has enabled him to audit companies for the first time from financial years commencing on or after 1 April 2008. The NAO has already started working with the independent supervisor appointed under the Act, the Professional Oversight Board, to enable it to undertake the audits of wholly owned government companies from the 2008–09 financial year.<sup>299</sup>

### 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.<sup>300</sup> However, the existing practice of value for money studies was formally recognised only relatively 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 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,

<sup>299</sup> Ibid. p.6.

<sup>300</sup> D. Dewar, "Value for Money Audit: The first 800 years", *Public Finance and Accountability*, 1985.

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.<sup>301</sup> A study can also originate from other sources, including members of the Parliament, departments themselves, or the public.<sup>302</sup> 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 relevant facts have been included in the report and that their presentation was fair.<sup>303</sup> Where a common ground does not exist, both views can be reflected in the report. The last phase is publication of the *vfm* report, which will generally include recommendations to the auditee.<sup>304</sup>

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

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301 NAO Annual Report, 1999.

302 F. White, K. Hollingsworth, *op. cit.*, pp. 74–76.

303 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 *vfm* report. PAC refused to arbitrate between the NAO and departments and asked for process to be reviewed and agreement on facts to be made. J. Keen, “On the Nature of Audit Judgements: The Case of Value for Money Studies”, *Public Administration* 1999, 77, 509–525.

304 F. White, K. Hollingsworth, *op. cit.* p. 77.

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.<sup>305</sup> However, most authors and NAO auditors agree that up to now relatively few genuine audits of effectiveness have been carried out.<sup>306</sup> Audit offices are criticised for concentrating too much on ensuring 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.<sup>307</sup> Furthermore, effectiveness is a particularly sensitive matter because it has the potential to question the merits of policy objectives.<sup>308</sup> 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.<sup>309</sup> 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.<sup>310</sup>

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 defend their positions by claiming that auditors are

305 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.

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

307 Ibid.

308 F. White, K. Hollingsworth, *op. cit.*, pp. 74–76.

309 H. Gordon, *ibid.*

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

interfering with issues of policy, in the cases when auditors attempt to examine only its financial implementation aspect.<sup>311</sup>

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”<sup>312</sup> or “review”,<sup>313</sup> instead of providing more detailed measures which the audited body should take in order to improve unsatisfactory segments of its work.<sup>314</sup> 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.<sup>315</sup> 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 PAC and Parliament. Although NAO’s independence towards both Parliament and PAC is constitutionally supported, NAO’s position of “Parliamentary assistant” requires it to pay attention to the needs of its main audiences, members of 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.<sup>316</sup> 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

311 H. Gordon, *op. cit.*, pp. 5–6.

312 See for example NAO vfm report: “The BBC: Collecting the Television Licence FEE”, 2001–02, available at [www.nao.gov.uk](http://www.nao.gov.uk)

313 See for example NAO vfm report, “Government on the Web II”, 2001–02., available at [www.nao.gov.uk](http://www.nao.gov.uk)

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

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

316 S. Roberts, C. Pollitt, *op. cit.*, pp. 546–547.

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 Defence's purchasing policies and number of other cases which reflected badly on the Government's management of Departmental resources.<sup>317</sup> NAO also became the first national audit institution to examine the variety and complexity of privatization sales.<sup>318</sup> 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 subject of a great number of NAO's critical reports.<sup>319</sup> NAO has also quickly responded to crises which occurred at various public service areas.<sup>320</sup> Lastly, in recent years NAO, together with PAC, has started producing high-level overview reports on thematic subjects.<sup>321</sup> 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?

317 A. Harrison, *ibid.*

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

319 See recent NAO reports on NHS: *Pay Modernisation: A new contract for NHS consultants in England*, HC 335, *Prescribing costs in primary care*, HC 454, *Improving services and support for people with dementia*, HC 604, *Helping people through mental health crisis: the role of Crisis Resolution and Home Treatment services*, HC 5, *Report on the NHS Summarised Accounts 2006–07: achieving financial balance in the NHS*, HC 129–1, (all produced in 2007–2008), *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](http://www.nao.org.uk)

320 NAO reports: *Managing financial resources to deliver better public services*, HC 240, *The budget for the London 2012 Olympic and Paralympic Games*, HC 612; *Compensating victims of violent crime*, HC 100 (all produced in 2007–2008), *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)*, available at: [www.nao.gov.uk](http://www.nao.gov.uk)

321 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.*

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 timely 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 climate within which they work, i.e. the general level of public interest in the questions they examine.<sup>322</sup>

## 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 Board<sup>323</sup> and include in the accounts contents: statement of financial performance, statement of financial position and a cash flow statement.<sup>324</sup> 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.<sup>325</sup> Sections 6 and 8 furthermore deal with authorities of the C & AG in examination of accounts. Subsection 6 (1) prescribes that in examining 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

322 A. Harrison, *ibid.*

323 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.

324 s. 5(4)a and b.

325 s. 5(7).

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.<sup>326</sup> 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.<sup>327</sup>

The Chancellor's 2007 Budget Report confirmed the Government's decision to proceed with the publication of Whole of Government Accounts (WGA) prepared on the basis of International Financial Reporting Standards. The March 2008 budget postponed the first year of published WGA until the 2009–10 year of account.<sup>328</sup>

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 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.<sup>329</sup> 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.<sup>330</sup> 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

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

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

328 NAO, *Financial Reporting and Financial Management, General Report of the Comptroller and Auditor General 2007*, HC 417, Session 2007–2008, available at [http://www.nao.org.uk/publications/0708/general\\_report.aspx](http://www.nao.org.uk/publications/0708/general_report.aspx), p. 17.

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

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

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 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 public companies and a gradual introduction of resource accounting and budgeting. 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 – LOLF<sup>331</sup> 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.<sup>332</sup> After many hundreds of years of monarchy, a variety of political 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

331 *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.

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

(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.<sup>333</sup> The Constitution, in turn, vests in the executive strong powers to regulate by decree (*décrets*).<sup>334</sup>

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.<sup>335</sup>

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.<sup>336</sup> The President appoints the Prime Minister, senior civil servants and military commanders and oversees observance of the constitution.<sup>337</sup> He promulgates laws passed by the Parliament and has the power, although seldom used, to refer laws back to the Parliament.<sup>338</sup> 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.<sup>339</sup>

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*).<sup>340</sup> The basic function of the Constitutional Council is adjudication upon the validity of presidential, parliamentary elections and referenda<sup>341</sup> and checking the constitutionality of laws approved by the Parliament.<sup>342</sup>

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

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

335 Article 24 of the French Constitution.

336 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 prevented major institutional change.

337 Article 7 of the French Constitution.

338 Article 10 of the French Constitution.

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

340 Articles 56 – 63 of the French Constitution.

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

342 L. N. Brown, J. Bell, *op. cit.*, pp. 14–15.

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.<sup>343</sup> 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).

France can furthermore be depicted as a “legal model” state (*rechtsstaat*).<sup>344</sup> 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.<sup>345</sup> 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.<sup>346</sup> 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.<sup>347</sup> 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 central to regional and local government occurred.<sup>348</sup> Furthermore, during the period of the socialist government (1981–86) extensive nationalizations were undertaken (exactly the oppo-

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

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

345 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.

346 Ibid.

347 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.

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

site 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.<sup>349</sup> There are no pre-existing criteria to determine whether a given activity is to be performed by a Government 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.<sup>350</sup>

EPs 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.<sup>351</sup> Whereas the administrative EPs are subject to public

349 The EPs were actually created by case administrative law precedents rather than enacted into statutes or issued as regulations. The concept of the EPs was defined by the *Conseil d'Etat* already in mid 19<sup>th</sup> 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). L. Digi, *Preobrazaj javnog prava* [Transformation of Public Law], (Geca Kon, Belgrade), 1929. 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.

350 S. Touchon, D. Tommasi, op. cit., pp. 43–73.

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

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.<sup>352</sup>

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.<sup>353</sup>

Questions are also being raised about the need to tighten the financial control over all EPs.<sup>354</sup> 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 bodies 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.<sup>355</sup>

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.<sup>356</sup> 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.<sup>357</sup> 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.

352 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. S. Touchon, D. Tommasi, *ibid.*

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

354 S. Touchon, D. Tommasi, *op. cit.*, p. 49.

355 The first SCN was created in 1997, *ibid.*

356 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*).

357 S. Touchon, D. Tommasi, *op. cit.* 47–49.

All this variety of public bodies coupled with the private ones receiving considerable public funds constitute a rather complex and comprehensive financial accountability 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 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 over the last three decades. 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 public expenditure management was governed for more than 40 years by a Constitutional Bylaw of 1959, the so-called French “Financial Constitution”.<sup>358</sup> 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 administrative state and structure of *Grands Corps* that appear to have stayed in control of most of the reforms, with their central roles not being seriously undermined.<sup>359</sup>

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.<sup>360</sup> The LOLF attempts to

358 Lordonnance N 59–2 du 2 janvier 1959, which ceased to be in effect from 1 January 2005.

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

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

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.<sup>361</sup> 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.<sup>362</sup> 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".<sup>363</sup> However, although the importance of this Act for the enhancement of financial accountability in 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.

The LOLF provides the basis for the introduction of programme budgeting in the French central Government, which has started to be implemented in 2006 budget. Unlike in the previous system, where each body was assigned the budget based only on different types of expenditure (operational, capital etc.), in the new system the expenditure is based both on usual presentation of different types of expenditure and, more importantly, on missions which correspond to the Government's key public policies (security, education, research, etc.).<sup>364</sup> Each Mission consists of a number of programmes, which are further divided into sub-programmes (actions) as operational means to implement the Programme.<sup>365</sup> This introduces much more transparency and flexibility in the system. Namely, in the new system appropriations may be freely re-allocated within the pro-

361 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.

362 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.

363 H.M. Treasury News Release 195/99. F. White, K. Hollingsworth, "Public finance reform: The Government Resource and Accounts Act 2000", *Public Law*, 2000, pp. 56–61.

364 F. Mordacq, "Financial Accountability of the French Public Administration", presentation presented at the conference: *A Forward-Looking Administration for a European Serbia – Public Administration Reform 2009–2012*, Belgrade, December 2008.

365 Article 7, paragraph 1 of the LOLF. *Ministere de l'Economie des Finances et de L'Industrie, Budget Reform and State Modernisation in France*, available at [www.minefi.gouv.fr](http://www.minefi.gouv.fr) or [www.lolf.minefi.gouv.fr](http://www.lolf.minefi.gouv.fr)

grammes and their breakdown according to sub-programmes is now purely indicative, which allows for much more flexibility for the organisation's management.<sup>366</sup> 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.<sup>367</sup>

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 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 (*controle de la regularité comptable*),<sup>368</sup> where the *Cour* has to be assured that figures in the accounts are properly stated;
2. regularity of financial operations (*controle de la regularité de la gestion*),<sup>369</sup> 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.<sup>370</sup>

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

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

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

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

370 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. C. Deescheemaeker, *La Cour des Comptes*, (La Documentation Française, Paris), 1998, pp. 61–62.

3. quality of management, assurance of “good use of public funds” (*bon emploi des fonds*)<sup>371</sup> and “verification of the accounts and management of public enterprises” (*la verification des comptes et de la gestion des entreprises publiques*)<sup>372</sup> 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 accounts’ 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.<sup>373</sup> However, it is also not in 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.<sup>374</sup>

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

372 Article L III - 4 of the Code des juridictions financiers.

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

374 Ibid.

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. It has been estimated that since the programme budgeting was introduced in 2006, around 8 billion Euros have been saved as a result of reform over the period of three years,<sup>375</sup> which is quite an impressive achievement. Nevertheless, the reform itself has not proved to be an easy undertaking. The first pilot ministries which have undergone this process, have experienced difficulties when attempting to reorient budgets to the performance budgeting framework.<sup>376</sup> 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.

## 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 *controleur 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*).<sup>377</sup> 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 *controleur 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.<sup>378</sup> Thus, *comptables* are personally responsible for the decisions taken and liable for the sums involved should

375 F. Mordacq, *ibid.*

376 F. Waintrop, C. Chol, *op. cit.* p. 11.

377 S. Touchon, D. Tommasi, *op. cit.* p. 59.

378 Normarton, *The Accountability and Audit of Governments*, (Manchester University Press, 1964), pp. 18–19.

a payment be made without appropriate authorisation or without legal authority in the budget.<sup>379</sup> 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*.<sup>380</sup> This 'imbalance' in accountability lines was attempted to be addressed in 1948, by creation of the Court of Budgetary and Financial Discipline (*La Cour de discipline budgétaire et financière*), which has the authority to decide on the cases of irregular action of commitments of officers or other persons involved in financial matters other than *comptables*.<sup>381</sup>

*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.<sup>382</sup> 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.

*Controleur 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. *Controleur 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.<sup>383</sup>

For an outside observer, the function of *controleur 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 *controleur 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 noted that in addition to their role of controlling the regularity of operations, *controleur 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.<sup>384</sup>

379 J. Magnet, *Les comptables publics*, (L.G.D.J, Paris), 1995, pp. 105–137.

380 Normarton, *ibid.*

381 J. Magnet, *La Cour des Comptes les institutions associees et les chambres regionales des comptes*, 4<sup>th</sup> edition (Berger-Levrault, Paris), 1996, pp. 313–329.

382 National Audit Office, *State Audit in the European Union*, 2005, pp. 89–90, available at [www.nao.gov.uk](http://www.nao.gov.uk)

383 E. Devaux, *Finances Publiques*, (Breal Editions, 2002), pp. 266–268.

384 Normarton, *op. cit.* 92–93.

The function of the *contrôleur financier* was introduced as early as in 1890 and gradually developed to modern times.<sup>385</sup> 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.<sup>386</sup> Usually, *contrôleurs financiers* are experienced civil servants, without express political affinity, at the end of their career.<sup>387</sup> 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*.<sup>388</sup> 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 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*.<sup>389</sup> 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.<sup>390</sup>

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 responsibili-

385 E. Devaux, op. cit., pp. 266–268.

386 Ibid.

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

388 J. Magnet, *Les comptes publics*, op. cit, p. 10.

389 S. Touchon, D. Tommasi, op. cit., 59–60.

390 Ibid, p. 60.

ties 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 *controlleurs 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'.<sup>391</sup> It has a staff of some 350 inspectors 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.<sup>392</sup> 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.<sup>393</sup> 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 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

391 Its staff is normally recruited from the prestigious ENA.

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

393 E. Devaux, *ibid*.

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 allows for much more flexible management, as managers in charge of individual programmes are able to freely reallocate appropriations between sub-programmes or types of expenditure. This does not only greatly strengthens the role of *ordonnateurs*, but also substantively lessens the importance of the role of *controlleurs financiers*, whose *ex-ante* controls of expenditure are becoming 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 *controlleur financier* from *ex ante* control to *ex-post* internal audit,<sup>394</sup> 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.<sup>395</sup> 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

394 NAO, op. cit., p. 90.

395 Article 31 of the LOLF.

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 are in the process of establishment results (performance) indicators and target values, which 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 Discipline<sup>396</sup> or to possibly allow the Cour 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 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).<sup>397</sup> 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.<sup>398</sup>

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

396 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.

397 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.

398 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.

with very real powers enabling it to influence the contents of the budget and thus control the Government. The debate on the 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.<sup>399</sup> 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.<sup>400</sup>

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".<sup>401</sup> 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.<sup>402</sup> 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 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).<sup>403</sup> This led a year later to the establishment

399 P. Lalumiere, *ibid.*

400 *Ibid.*

401 Lordonnance N 59-2 du 2 janvier 1959, which ceased to be in effect from 1 January 2005.

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

403 Assemblée Nationale, Groupe de travail sur l'efficacité de la dépense publique et le contrôle parlementaire, Rapport, 1998. H.B. Street, "MPs Attitudes towards Scrutiny in Britain

of a “Mission d’Evaluation et de Controle”, MEC, as a sub-committee of the Parliament’s Finance Committee, modelled on the UK PAC.<sup>404</sup>

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.<sup>405</sup> 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.<sup>406</sup> Furthermore, the MEC is co-presided by 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.<sup>407</sup>

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.<sup>408</sup> 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.<sup>409</sup> The

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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.

404 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*, Report, No. 1781, July 1999.

405 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.

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

407 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.

408 Ibid.

409 For example Assemblée Nationale, *Rapport d’Information par la Commission des Finances, de l’Economie Generale et du Plan en conclusions des travaux de la Mission d’évaluation et*

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.<sup>410</sup>

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 co-operation 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.<sup>411</sup>

### 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 paying 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 now also has the right to supervise the movements of appropriations, such as credit transfers, carry-overs to the next budget year, advances or cancellations or particular expenditure items.<sup>412</sup>

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*de controle (MEC) sur la gouvernance des Universites 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>

410 D. Hochedes, „La mission d'évaluation et de contrôle (MEC) Une volonté de retour aux sources du Parlement : la défense du citoyen – contribuable“, *Revue française de finances publiques*, No. 68/1999.

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.

412 Ministère de l'Economie des Finances et de L'Industrie, *Budget Reform and State Modernisation in France*, available at [www.minefi.gouv.fr](http://www.minefi.gouv.fr)

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.<sup>413</sup> 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 now have greater investigative and hearing powers. They 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.<sup>414</sup> In this way, the current position of the MEC in making its own investigations and hearings has been significantly reinforced.

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.<sup>415</sup> 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),<sup>416</sup> which provided room for detailed analysis of particular missions and definitely revived the Parliament's 'power of the purse' in France. Similar practice continued over the last couple of years. For example, proposal for the *loi de finances* for 2009, was subject to 898 amendments<sup>417</sup> and was discussed

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 1<sup>st</sup> 2001 on budget acts*, available at <http://www.minefi.gouv.fr/lof>.

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](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](http://www.assemblee-nationale.fr/12/dossiers/loi_finances_2006-calend2.asp)

417 [http://recherche.assemblee-nationale.fr/amendements/resultats2.asp?NUM\\_INIT=1127&LEGISLATURE=13](http://recherche.assemblee-nationale.fr/amendements/resultats2.asp?NUM_INIT=1127&LEGISLATURE=13).

over the period of more than one month (October–November 2008), in 33 sessions of the lower house of Parliament and around 15 sessions in the Senate.<sup>418</sup>

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, 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.<sup>419</sup> 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.<sup>420</sup> 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

418 [http://www.assemblee-nationale.fr/13/dossiers/loi\\_finances\\_2009.asp](http://www.assemblee-nationale.fr/13/dossiers/loi_finances_2009.asp) .

419 C. Deescheemaeker, *La Cour des Comptes*, (La Documentation Francaise, Paris), 1998, pp. 8–10.

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

of the rights man and the citizen,<sup>421</sup> two clear opposing tendencies appeared: one, which favoured the examination of the accounts by the National Assembly itself and another, which proposed the establishment of a body independent both from the legislative and executive power.<sup>422</sup> The latter option undoubtedly prevailed.

It was not until the beginning of the 19<sup>th</sup> 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”.<sup>423</sup>

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 *gréffier en chef*”.<sup>424</sup> 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 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.

421 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 states that “Society has the right to require of every public agent an account of his administration”.

422 C. Deescheemaeker, *ibid*.

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

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

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 Nationale 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 maîtres* 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.<sup>425</sup>

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.<sup>426</sup> 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 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.<sup>427</sup> 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.<sup>428</sup>

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.<sup>429</sup> 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*

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

426 Ibid.

427 It is interesting to note that the former French President Chirac had started his career in the Cour.

428 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.

429 Website of the Cour des Comptes: <http://www.ccomptes.fr>

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.<sup>430</sup>

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.<sup>431</sup> Presidents of Chambers further allocate tasks to 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.<sup>432</sup> 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 *Conseil Constitutionnel*, which proclaimed the disputed provision unconstitutional, in violation of the Article

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430 Ibid.

431 Since 12 September 1997, the workload 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; 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.

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

47 of the Constitution.<sup>433</sup> 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.<sup>434</sup>

Institutional jurisdiction of the Cour can be mandatory or optional.<sup>435</sup> Mandatory examinations are those where the Cour is the only body authorized by primary legislation<sup>436</sup> 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 bodies (*Autorité Administrative Indépendante* –AAI); since 1950, social security bodies; and, since 1976, public corporations and nationalised industries.<sup>437</sup>

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

433 Le Conseil Constitutionnel decision No 2001-448 DC du 25 Juillet 2001.

434 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. J. Bertucci, "Le droit de contrôle des juridictions financières", *Revue Française de Finances Publiques*, No. 75 2001, pp. 95-101.

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

436 Primarily by the Code on Financial Jurisdiction (Code des juridictions financières) 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.

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

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).<sup>438</sup>

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 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,<sup>439</sup> 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).<sup>440</sup>

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

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

439 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*). 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.

440 J. Magnet, *La Cour des Comptes les institutions associees et les chambres regionales des comptes*, op. cit., pp. 73–74.

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.<sup>441</sup>

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.<sup>442</sup>

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 definition of its jurisdiction, as there have been many misunderstandings concerning this issue.<sup>443</sup>

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, as 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

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441 C. Descheemaeker, op. cit., pp. 61–62.

442 Ibid.

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

settle their arrears.<sup>444</sup> 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*.<sup>445</sup> 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 stated that:

*"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."*<sup>446</sup>

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*.<sup>447</sup> All judgments emanating from auditing the accounts are also communicated to the Minister, in order to avoid repetition of errors.

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*.<sup>448</sup>

### 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 quali-

444 J. Magnet, *La Cour des Comptes les institutions associees et les chambers regionales des comptes*, op. cit., pp. 147–148.

445 Ibid.

446 Cour des Comptes, 10 August 1880, commune de Frasne (Doubs), p. 8.

447 J. Magnet, *La Cour des Comptes les institutions associees et les chambers regionales des comptes*, op. cit., 191–194.

448 J. Magnet, "La regularisation de la gestion de fait", *Revue Francaise de Finances Publiques*, No. 66, 1999; C. Descheemaeker, *La Cour des comptes*, op. cit. 119–133; On the need to reform the 'gestion de fait' procedure, see: R. Hertzog, "La necessaire reforme de la procedure de gestion de fait", *Revue Francaise de Finances Publiques*, No. 66, 1999.

fied 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 Cour may not, in any case whatever, claim any jurisdiction over *ordonnateurs*".<sup>449</sup> 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.<sup>450</sup>

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.<sup>451</sup> 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 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.<sup>452</sup>

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.<sup>453</sup> 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.

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449 C. Descheemaeker, op. cit. 119–133.

450 Ibid.

451 J. Magnét, *La Cour des Comptes les institutions associées et les chambres régionales des comptes*, op. cit., 313–329.

452 NAO report, op. cit, p. 94.

453 Ibid.

### 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.<sup>454</sup> 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.<sup>455</sup> 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 vote first, while the president of the chamber votes last. In the case of a balance of votes, a president's vote is decisive.<sup>456</sup>

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.<sup>457</sup> 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.<sup>458</sup>

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

454 Article 22 of the Decree 11 February 1985.

455 Website of the Cour, <http://www.ccomptes.fr>

456 J. Magnet, op. cit. p. 110.

457 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. website of the Cour des comptes, <http://www.ccomptes.fr>

458 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).

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 extraordinary remedies which can be used to challenge the judgments of the Cour: revision and cassation.<sup>459</sup>

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.<sup>460</sup>

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.<sup>461</sup>

### 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). 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.<sup>462</sup> More serious, especially recurrent financial management irregularities, are in charge of the *Premier Président* of the Cour (Article L 135–1).<sup>463</sup> Following the gen-

459 J. Magnet, *La Cour des Comptes les institutions associees et les chambers regionales des comptes*, op. cit. pp. 273–280.

460 Ibid.

461 Ibid.

462 J. Magnet, *La Cour des Comptes les institutions associees et les chambers regionales des comptes*, op. cit. p. 137.

463 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

eral 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.<sup>464</sup>

It is interesting to note that most of the Cour's audit work is not published nor distributed to the broader audience.<sup>465</sup> 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.

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.<sup>466</sup> 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 (*rapports publics particuliers*).<sup>467</sup> 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.<sup>468</sup> The reports are addressed to the Ministers concerned, to the head of the audited body, or to the appropriate legal authori-

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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. website of the Cour, <http://www.ccomptes.fr>

464 Thus, Article 135–5 of the Code provides the possibility for the Cour to communicate its findings to Finance Commission of the Parliament.

465 C. Pollitt et al, op. cit. p. 181.

466 Ibid.

467 The Cour has been authorized by the Council of Ministers decision of 1991 to conduct specific public reports. C. Pollitt at al, op. cit., p. 154.

468 The Cour's reports could be found on the Cour's website, <http://www.ccomptes.fr>

ties. 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 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.<sup>469</sup> 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.<sup>470</sup>

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 more closely analysed 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 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.

469 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. C. Pollitte, op. cit. p. 181.

470 C. Pollitt, H. Summa, "Reflective Watchdogs? How Supreme Audit Institutions Account for themselves", *Public Administration*, Vol. 75, summer 1997, pp. 313–336.

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);<sup>471</sup>
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.<sup>472</sup>

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'.<sup>473</sup> It is further argued that although the Cour should certainly have 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 of the Financial Committee's own words: "The democracy requests the controllers also to be sometimes controlled".<sup>474</sup>

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

471 Article 58, paragraph 1 of the LOLF.

472 Article 58, paragraph 2 of the LOLF.

473 Assemblée 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 éevaluation et de controle," Report No. 2298, of May 2005., available at <http://assemblee-nationale.fr>, p. 61.

474 Ibid.

annual reports: the preliminary report on developments in the national economy and public finance trends,<sup>475</sup> (which is to assist the Government to prepare for the Parliamentary discussion on the *loi de finances* for the next year)<sup>476</sup>; 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.<sup>477</sup> 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.<sup>478</sup> Up to now, the Cour has finalized annual reports for 2006<sup>479</sup> and 2007<sup>480</sup> (reports for 2008 have not been finalized yet).

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 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 is requested to provide statement of assurance (*déclaration d'assurance-DAS*) on reliability of the EU accounts and its underlying transactions. This is one of examples 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 accrual accounting in the French Government. Introduction of accrual 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 already had 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 two years to be

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475 Article 58 paragraph 4 of the LOLF.

476 Article 48 of the LOLF.

477 Article 58, paragraph 6 of the LOLF.

478 Article 58, paragraph 5 of the LOLF.

479 Cour des Comptes: *Certification des Comptes de l'Etat, Exercice, 2006*, available at: <http://www.ccomptes.fr>

480 Cour des Comptes: *Certification des Comptes de l'Etat, Exercice, 2007*, available at: <http://www.ccomptes.fr>

fully successfully implemented.<sup>481</sup> 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 sight. Namely, concept of certification implies a sort of technical examination of the accounts, rather than deciding on a personal responsibility of accounts, which is the basis of French financial accountability system.<sup>482</sup> Certification is a process in which a certifier has to be assured that there are no significant errors in the quality of accounts, which comprises the assessment of risks and internal audit and control processes in the organization.<sup>483</sup> Therefore, certification is a much broader concept than traditional Cour's judgment of accuracy of accounts and their legality and regularity and is expected to provide a much comprehensive view of the state of accounts both to Parliament and the general public and in this way enhance democratic means of control of public expenditure in France. 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

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481 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>

482 P. J-R. Alventosa, "La nouveau role de la Cour des comptes," *ENA mensuel*, June 2002, No. 322, pp. 9-11.

483 Ministere de l'Economie des Finances et de L'Industrie, *La reforme des comptes de l'Etat*, December 2006, available at [www.minefi.gouv.fr](http://www.minefi.gouv.fr) .

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 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 accountant 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.<sup>484</sup>

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.<sup>485</sup>

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 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.<sup>486</sup>

The key executive organ of the Community is the European Commission. 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.<sup>487</sup> Assisted by around 24000 multinational civil servants, the Commission lies at the heart of the EU supranational system.<sup>488</sup>

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.<sup>489</sup> Each Directorate General is headed by a Director General, who is responsible to the relevant Commis-

484 D. Dinan, *Ever Closer Union, An Introduction to European Integration*, Macmillan, 1999, pp. 205–229.

485 [www.europa.eu.int](http://www.europa.eu.int)

486 Ibid.

487 T.C. Hartley, *The Foundations of European Community Law*, Clarendon Press Oxford, 1999, pp. 12–17.

488 D. Dinan, *ibid.*

489 N. Nugent, “At the Heart of the Union”, in N. Nugent, *At the Heart of the Union*, (London: Macmillan) 1997, pp. 1–26.

sioner. 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.<sup>490</sup>

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.<sup>491</sup> 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.<sup>492</sup> 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 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 over the last decade. There has been a quite high incidence of financial irregularities,

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490 Ibid.

491 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.

492 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.

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.<sup>493</sup> 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.<sup>494</sup>

The reports of the Committee of Independent Experts and the subsequent Commission White paper on reforming the Commission (2000)<sup>495</sup> 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 Council Financial Regulation, adopted in 1977.<sup>496</sup> 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 Communities<sup>497</sup> (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 transac-

493 A. Tomkins, "Responsibility and Resignation in the European Commission", (1999), 62 MLR 744.

494 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.

495 Commission's White Paper: "Reforming the Commission", COM (2000)200, Brussels, 5.4.2000.

496 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).

497 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.

tion 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.”<sup>498</sup> The concepts of reliability, legality and regularity of 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;<sup>499</sup>
- Legality and regularity require that all transactions must conform to applicable laws and regulations, and that they are covered by sufficient budgetary appropriations.<sup>500</sup>

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.<sup>501</sup> 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 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

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498 Article 248 (ex Article 188c) EC.

499 Brochure of the ECA, *Improving the financial management of the European Union*, 2004, [www.eca.eu.int](http://www.eca.eu.int).

500 Ibid.

501 ECA’s annual Report concerning the financial year 2004.

legal order in so far as it has an effect on expenditure.<sup>502</sup> Thus, in practice, any legal provision affecting revenue or expenditure provides a point of reference for examination of legality and regularity.<sup>503</sup>

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.

The 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”.<sup>504</sup> The principle of efficiency is defined in a usual way, as “the best relationship between resources employed and results achieved.” Effectiveness is 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.<sup>505</sup> 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.<sup>506</sup>

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 finan-

502 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.

503 Ibid.

504 Article 27, paragraph 2 of the Financial Regulation No 1605/2002 .

505 Article 27, paragraph 3.

506 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.

cial 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.<sup>507</sup> The question which therefore may be posed is why ‘value for money’ principles 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.<sup>508</sup> 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.<sup>509</sup> 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.<sup>510</sup>

Furthermore, it may be argued that the lack of sufficient budget restraint in the EU undermines the achievement of sound financial management.<sup>511</sup> 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. Furthermore, the difficulties experienced in 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 ex-

507 ECA, Annual Activity Report for 2008; Annual Report concerning the financial year 2007 and Annual Report concerning the financial year 2006; 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](http://www.eca.eu.int).

508 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.

509 R. Levy, *Implementing European Union Public Policy*, (Edward Elgar), 2000, pp. 69–96.

510 The Commission has thus tended to resist the ECAs 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). I. Harden, F. White, K. Donnelly, *ibid*.

511 *Ibid*.

penditure as a whole” is still valid.<sup>512</sup> This implies an overall tendency towards ‘spending culture’ rather than setting of priorities and achieving sound financial management.<sup>513</sup>

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.<sup>514</sup> 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 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,<sup>515</sup> we shall use the French terms to denote their functions.<sup>516</sup> 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* was in charge of authorizing expenditure, i.e. entering into financial commitments and issuing payment orders. The *contrôleur financier* monitored the commitment and authorization of all expenditure and gave visa for the operation requested by the *ordonnateur*.

512 D. Coombes, *The Power of the Purse in the European Communities*, (London, Chatham House: PEP), 1972, p. 69.

513 I. Harden, F. White, K. Donnelly, op. cit. pp.615–616.

514 C. Pollitt et al, *Performance or Compliance? Performance Audit and Public Management in Five Countries*, (Oxford University Press), 2002.

515 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”.

516 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.

And finally, the *comptable* was 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*, *controleur financier* and *comptable* had to be different individuals.<sup>517</sup>

The *controleur financier* was envisaged to be the key person in charge of securing financial accountability within the EU institutions. Each institution had to appoint a *controleur financier*, a completely independent person, to be responsible for *ex ante* checking of all commitments and expenditure incurred by granting *visas* for each operation.<sup>518</sup> Although an institution who appointed its *controleur financier* also had the right to dismiss him/her, the *controleur 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).<sup>519</sup> It should be noted that the *controleur 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).<sup>520</sup>

Despite this seemingly well designed system, the internal EU financial accountability mechanism based on the traditional French model proved to be ineffective in practice.<sup>521</sup> 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 responsible for financial management.<sup>522</sup> 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.<sup>523</sup>

517 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).

518 Article 39 of the Financial Regulation.

519 Articles 42–43 of the Financial Regulation.

520 I. Harden, F. White, K. Donnelly, op. cit. pp. 606–607.

521 Committee of Independent Experts, *ibid.*

522 *Ibid.*

523 OECD Policy Brief, *Public Sector Modernisation: Modernising Accountability and Control*, 2005., [www.oecd.org/publications/pol\\_brief](http://www.oecd.org/publications/pol_brief).

The 2002 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.<sup>524</sup> This has been confirmed by quite strict and lengthy provisions on the *ordonnateur's* liability for misconduct in the discharge of his/her duties.<sup>525</sup> 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.<sup>526</sup>

Each institution performs the duties of *ordonnateur*<sup>527</sup> 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 possibility for sub-delegation.<sup>528</sup> 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.<sup>529</sup> 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.<sup>530</sup> *Odonnateur'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.<sup>531</sup>

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).<sup>532</sup> Furthermore, any

524 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/lcp68dwin-ter2004p107.htm>.

525 Chapter 4, Articles 64–66 of the Financial Regulation, 2002.

526 Article 67 of the Financial Regulation, 2002.

527 Article 59, paragraph 1, Financial Regulation, 2002.

528 Article 59, paragraph 2.

529 Article 60, paragraph 3.

530 Article 60, paragraph 1.

531 [http://ec.europa.eu/reform/2002/selection/chapter1\\_en.htm#1\\_3](http://ec.europa.eu/reform/2002/selection/chapter1_en.htm#1_3)

532 Article 60, paragraph, 4.

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.<sup>533</sup> 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.<sup>534</sup>

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.<sup>535</sup> 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.<sup>536</sup> They are intended to help *ordonnateurs* by providing a check on the overall systems adopted.<sup>537</sup>

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 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 Brit-

533 Article 60, paragraph 6.

534 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.

535 "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.theiaa.org/?act=iaa.internalAuditor>.

536 [http://europa.eu.int/comm/dgs/internal\\_audit/geninfo\\_en.htm](http://europa.eu.int/comm/dgs/internal_audit/geninfo_en.htm).

537 Financial Regulation, *supra* note 5, Art. 85–86.

ish 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.

### Towards an integrated internal control framework

Although the Commission management of expenditure has been enhanced as a result of the above mentioned 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.<sup>538</sup> Due to continuing excessive criticisms of the Community financial management, the Barroso Commission has made a strategic objective to strive for a positive assessment of legality and regularity of the Community financial operations.<sup>539</sup> 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,<sup>540</sup> the Commission adopted a communication on a roadmap to an integrated internal control framework on 15 June 2005.<sup>541</sup> The purpose of this document was to 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

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538 Ibid.

539 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.

Framework on 17 January 2006.<sup>542</sup> 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.<sup>543</sup> 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.

The European Parliament has been following the implementation of the Commission's Integrated Internal Control Framework. On 10th of March 2009, Parliament welcomed the overall progress made in the development of the action plan and the fact that the majority of actions have been implemented and most of the gaps identified in the action plan filled. Although it noted the efforts made by the Commission, the Parliament, however, regretted that, so far, the Commission has not been able to present complete and reliable figures on recoveries and financial corrections due to Member States' reporting problems. Parliament has thus asked the Commission to solve these problems and also encouraged it to increase transparency in its impact assessment of the action plan.

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'<sup>544</sup> in the 1970 Budget

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.

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).

Treaty.<sup>545</sup> 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.<sup>546</sup> Moreover, there 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.<sup>547</sup> 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.<sup>548</sup> 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 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 'com-

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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.

547 The vice 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.

pulsory 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.<sup>549</sup>

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.<sup>550</sup> 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.<sup>551</sup>

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 of the budget for 1984 before discharging the budget implementation for the 1982.<sup>552</sup> 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.<sup>553</sup> 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 au-

549 For more details on the budgetary procedure see: [http://europa.eu.int/comm/budget/budget/index\\_en.htm](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).

552 R. Levy, *Implementing European Union Public Policy*, op. cit., pp. 16–17.

553 I. Harden, F. White, K. Donnelly, op.cit. pp. 620–622.

thors 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.<sup>554</sup> 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. 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",<sup>555</sup> 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.<sup>556</sup> 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 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

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554 C. Kok, *op. cit.*, p. 352.

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.

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 Committee<sup>557</sup> (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 Commission<sup>558</sup> and produces its ‘own’ initiative reports, which provides it a rather broad basis for the final decision.

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.<sup>559</sup> 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.<sup>560</sup> 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.<sup>561</sup> 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 efficiency of its work.<sup>562</sup> Nevertheless, the Committee is still experiencing difficulties espe-

557 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.

559 Committee on Budgetary Control, *Handbook 2004 for New Members*, [http://www.europarl.eu.int/comparl/cont/guide/default\\_en.htm](http://www.europarl.eu.int/comparl/cont/guide/default_en.htm).

560 I. Harden, F. White, K. Donnelly *ibid.*

561 R. Levy, *Implementing European Union Public Policy*, op. cit. 25–25.

562 Committee on Budgetary Control, *Handbook 2004 for New Members*, [http://www.europarl.eu.int/comparl/cont/guide/default\\_en.htm](http://www.europarl.eu.int/comparl/cont/guide/default_en.htm).

cially 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.<sup>563</sup>

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.<sup>564</sup> The second is the admission of new Community Member States— Denmark, Ireland and UK in 1973.<sup>565</sup> 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.<sup>566</sup>

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.<sup>567</sup> 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

563 R. Levy, *Implementing European Union Public Policy*, *ibid.*

564 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.

565 N. Price, “The Court of Auditors of the European Communities”, in *Yearbook of European Law*, vol. 2, pp. 240, Oxford, 1982.

566 *Ibid.*

567 J. Inghelram, *op. cit.*, pp. 129–146.

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.<sup>568</sup>

### 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 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.<sup>569</sup> The members are required to perform their duties in complete independence and in the general interest of the EU.<sup>570</sup>

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.<sup>571</sup> 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 850 staff in the ECA, who have a broad range of professional backgrounds and experience from both the public and private sector.<sup>572</sup> The ECA employs nationals from all Member States in order to ensure a sufficient spread of linguistic and professional skills within its workforce.<sup>573</sup>

568 [http://www.eca.eu.int/eca/treaty/docs/disp\\_cdc\\_en.pdf](http://www.eca.eu.int/eca/treaty/docs/disp_cdc_en.pdf).

569 Article 247, paragraph 3, items 1, 2 of the EC Treaty.

570 Article 247, paragraph 4 of the EC Treaty.

571 Article 247, paragraph 3, item 3 of the EC Treaty. Mr. Vitor Manuel da Silva Caldeira from Portugal, was elected President in January 2008.

572 The European Court of Auditors, *Annual Activity Report for 2008*, p. 17, [www.europa.eu.int](http://www.europa.eu.int).

573 The European Court of Auditors, "Improving the Financial Management of the European Union", *op.cit.* p. 10.

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 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.<sup>574</sup> It furthermore appears that each enlargement reduces the workload of its members, questioning the necessity of their high position in the ECA's hierarchy.<sup>575</sup> The key related question, however, 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.<sup>576</sup> 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;
- 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;

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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.

- 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.<sup>577</sup>

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 important work of the Court”,<sup>578</sup> 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 in a wide range of areas – from the efficiency of the European Solidarity Fund (SR 3/2008) to EU support for the public storage operations of cereals (SR 11/2008).<sup>579</sup> All special reports could be found on the ECA's website.

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”.<sup>580</sup> This is quite a demanding exercise, as it requires the ECA to move from its traditional ‘system based approach’<sup>581</sup> to sample based detailed financial audit checks of all underlying transactions down to the level of the final beneficiary. Over 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,

577 [www.europa.eu.int](http://www.europa.eu.int)

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 The European Court of Auditors, *Annual Activity Report for 2008*, pp. 24–26, [www.europa.eu.int](http://www.europa.eu.int)

580 Article 248 EC.

581 The system-based approach assumes examination of different areas of revenue and expenditure over a four-year cycle. Kok, op. cit. note 4.

administrative expenditure and financial instruments and banking activities).<sup>582</sup> 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.<sup>583</sup> It should be noted that in its 2007 Annual Report, published in November 2008, the ECA presented for the first time a 'clean' opinion on the reliability of the EU accounts. However, as in previous years, the Court found too high levels of errors of illegality and irregularity in areas of the EU budget accounting for the majority of expenditure.<sup>584</sup>

The ECA 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.<sup>585</sup> 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.<sup>586</sup> Nevertheless, it should be noted that earlier 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.

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.<sup>587</sup> 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 the 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.

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582 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](http://www.eca.eu.int).

583 Ibid.

584 ECA, *Annual Report concerning the financial year 2007*, [www.eca.eu.int](http://www.eca.eu.int).

585 N. S. Groenendijk, *op. cit.* p. 702.

586 J. Inghelram, *op. cit.* pp. 132–133.

587 Ibid, p. 137.

### **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.<sup>588</sup> 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 relations with the ECA and acknowledged the many managerial weaknesses highlighted by the Court in its reports.<sup>589</sup> 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.<sup>590</sup>

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.<sup>591</sup>

Over the last decade, 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.<sup>592</sup>

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

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588 D. O'Keeffe, *ibid.*

589 B. Laffan, "Becoming a 'Living Institution': The Evolution of the European Court of Auditors", *op. cit.*, pp. 256–263.

590 *Ibid.*

591 *Ibid.*

592 ECA, *Annual Report concerning the financial year 2003*, *ibid.*

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)<sup>593</sup> 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.<sup>594</sup>

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.<sup>595</sup>

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.<sup>596</sup>

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.<sup>597</sup>

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.<sup>598</sup> Furthermore, the ECA

593 Amended Art. 188c of the TEU, Treaty of Amsterdam.

594 I. Inghelram, *op. cit.* p. 140.

595 *Ibid.*, p. 139.

596 [http://www.eca.eu.int/eca/treaty/docs/disp\\_cdc\\_en.pdf](http://www.eca.eu.int/eca/treaty/docs/disp_cdc_en.pdf).

597 ECA, *Annual Activity Report for 2008*, [www.europa.eu.int](http://www.europa.eu.int), pp. 41–42.

598 ECA, *Annual Report concerning the financial year 2004*, [www.eca.eu.int](http://www.eca.eu.int).

is currently developing an analysis of the impact of its work — both audits and opinions — over longer periods of time. As an example of this, the ECA uses a Commission database on its follow-up of audit recommendations as a base for assessing the impact of its audits. The assessment might lead to audit work consisting of separate in-depth audit tasks, leading to further findings and recommendations. These can be included in either a subsequent special report covering the audit area, or a report on the follow-up and impact of recommendations on financial management.<sup>599</sup>

Another important question is how the ECA's audit powers could be enforced 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.<sup>600</sup> 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.<sup>601</sup>

## 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 the 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 em-

599 ECA, *Annual Activity Report for 2008*, [www.europa.eu.int](http://www.europa.eu.int), p. 29.

600 J. Inghelram, *op. cit.*, p. 140.

601 *Ibid*, pp. 140–141.

phasise 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.<sup>602</sup>

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.<sup>603</sup> 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.

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

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602 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

603 P. Craig, G. de Burca, *op.cit.*, p.4.

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.<sup>604</sup>

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.<sup>605</sup>

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 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.<sup>606</sup>

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 unpopu-

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604 Ibid, pp. 9–15.

605 Ibid.

606 Ibid, pp. 16–23.

lar 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.'<sup>607</sup>

Stone, Sweet and Sandholtz have made an interesting attempt at combining the intergovernmentalism with new institutionalism (i.e. multilevel governance). They argue 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.<sup>608</sup>

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, departments, private and public associations and certain interest groups of both Union and member state levels.<sup>609</sup>

607 G. Marks, L. Hooghe, K. Blank, "European Integration form the 1980s: State-Centric v. Multiple-Level Governance", (1996) 34 *JCMS* pp. 341–342.

608 A. Stone Sweek and W. Sandholtz, "European Integration and Supranational Governance", 1997 4, *JEP*, p. 297.

609 P. Craig, G. de Burca, *The Evolution of EU Law*, op. cit. pp. 29–30.

### 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.<sup>610</sup> This keeps the budget allocation pendulum towards the intergovernmentalist end. On the other hand, other half of 'non-compulsory' expenditure the final word rests with the Parliament.<sup>611</sup> 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

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610 I. Harden, F. White, K. Donnelly, *op. cit.* pp. 602–603.

611 *Ibid.*

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 tax-payers. Instead, the financing of the budget relies on transfers from national treasuries.<sup>612</sup> 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 of their national allocation and with little regard to the substance of policies.<sup>613</sup> 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.<sup>614</sup>

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 institutions, but also between the EU citizens and their

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612 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.

613 Ibid.

614 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.

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.<sup>615</sup> 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.

## 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, followed by accession of Bulgaria and Romania in 2007, has marked a new momentum in the European integration process. On the side of the EU, the enlargement is conceived as a “historic opportunity”<sup>616</sup> for bringing the European continent together. It should provide greater security and stability of the continent and economic prosperity for all the European nations.<sup>617</sup>

615 B. Laffan, “Financial Control: the Court of Auditors and OLAF”, op. cit, pp. 249–251.

616 European Commission, “Agenda 2000. For a stronger and wider Union”, *Bulletin of the European Union*, Supplement 5/97, 13, 1997.

617 Regular Reports from the Commission on Progress towards Accession by each of the candidate countries, November, 2000.

Although enlargement denotes investment of sufficient financial resources into the CEECs economies,<sup>618</sup> 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 country is able to assume the obligations of membership by satisfying the economic and political conditions required”.*<sup>619</sup>

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.<sup>620</sup> At the moment, Croatia, Macedonia, Turkey and Iceland have the status of candidate countries while Serbia, 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, reiterated the determination of the EU to support the European perspective of the Western Balkan countries. The Council explicitly stated that the Western Balkan countries are to become members of the EU “once they meet the established criteria”<sup>621</sup> 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 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,

618 The Commission has estimated that the enlargement will cost the Union up to 75 billion ECU. D. Dinan, *Ever Closer Union*, (Lynne Reinner Publishers) 1999, p. 198.

619 European Commission, “PHARE 1994 Annual Report”, COM(95) 366 final, 14.

620 Enlargement Strategy Paper, Regular Reports from the Commission on Progress towards Accession by each of the candidate countries, November 8, 2000.

621 Presidency Conclusions of the Thessaloniki European Council, 19 and 20 June 2003.

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.<sup>622</sup> 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 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

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622 On the day of entering into EU, average GDP per head in the ten new member countries was only 46% of the EU15 average. Although one new member country, Slovenia, was richer than the poorest 'old' member, Greece, the poorest new country, Latvia, had 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. *The Economist*, May 1<sup>st</sup> 2004, Volume 371, Number 8373.

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.<sup>623</sup> 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 bearing 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 over 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 fulfil 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 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

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623 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](http://europa.eu.int/comm/enlargement/index_en.htm).

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.<sup>624</sup>

### **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

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624 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.

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 comprises *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.<sup>625</sup> Instead of relying on detail legal regulation in specific areas 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,<sup>626</sup> 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 fulfil effectively.<sup>627</sup> 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

625 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 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.

626 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..

627 On policy management, civil service, internal financial control, public expenditure management, external financial control and procurement

developments. Since 1999, the European Commission has produced its 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.<sup>628</sup>

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.<sup>629</sup> 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 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.<sup>630</sup>

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.<sup>631</sup>

628 Dimitrova, A. (2002), Enlargement, Institution-Building and the EU's Administrative Capacity Criteria. *West European Politics*, Vol. 25. No 4. 171–190.

629 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>

630 Ibid.

631 The World Bank draft Report, *Serbia – Fiduciary Assessment Update*, July 2005, p.31.

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.<sup>632</sup>

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 functionally independent, have an adequate audit mandate (in terms of scope and types of audit) and use internationally recognised auditing standards.<sup>633</sup>

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.<sup>634</sup>

### *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 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

632 Public Internal Financial Control Baselines, SIGMA baselines, October 1999.

633 Ibid.

634 The World Bank draft Report, *Serbia – Fiduciary Assessment Update*, ibid.

audit coverage.<sup>635</sup> The SAIs are further required to carry out full range of regularity and performance audit in compliance with INTOSAI auditing standards.<sup>636</sup>

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.<sup>637</sup>

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.

### *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.<sup>638</sup>

635 Public Sector External Audit Baselines, SIGMA baselines, October 1999.

636 INTOSAI: *Lima Declaration on Guidance on Auditing Precepts*, [http://www.intosai.org/Level1/1\\_defaue\\_new.html](http://www.intosai.org/Level1/1_defaue_new.html)

637 Public Sector External Audit Baselines, SIGMA baselines, October 1999.

638 European Commission Directorate-General Enlargement: *Enlargement of the European Union, Guide to the Negotiations, Chapter by Chapter*, December 2004,

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.<sup>639</sup> 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 enforcement bodies and judiciary to address cases where EU financial interests are at stake.<sup>640</sup>

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 conclusion

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

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639 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).

640 European Commission Directorate-General Enlargement: *Enlargement of the European Union, Guide to the Negotiations, ibid.*

resulted in weakening of 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 decade, 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 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.<sup>641</sup> The first steps towards full independence were

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641 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

laid in the mid 1830s, when Serbia obtained a limited form of autonomy from the declining Turkish Empire.<sup>642</sup> 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.<sup>643</sup> 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 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.<sup>644</sup> 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.

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Turks, who were mainly interested in collecting taxes and providing public order. Z. Sevic, “Politico-Administrative relations in Yugoslavia”, in T. Verheijen (ed.) *Who Rules? Politico-Administrative Relations in Central and Eastern Europe*, (NISPAcee, Bratislava), 2000.

642 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.

643 Nevertheless, the role of the monarch was at times substantial, going beyond his formally established authorities.

644 D. Kavran, A. Rabrenovic, D. Milovanovic, “Public Administration Education in Yugoslavia”, in T. Verheijen, J. Nemeč (eds.), *Building Higher Education Programmes in Public Administration in CEE Countries*, (NISPAcee & EPAN), 2000, pp. 303 – 321.

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 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 brought about 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.<sup>645</sup> 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

645 Kostic V. "Korupcija u Srbiji – fenomen zarobljene drzave" [Corruption in Serbia – Phenomenon of State Capture], *Monitor*, www.monitor.cg.yu, 2003.

even more difficult due to large and mounting fiscal pressures, huge external debt, weakened governance, and post-conflict challenges such as rebuilding damaged infrastructure.<sup>646</sup>

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.<sup>647</sup> 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.

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.<sup>648</sup> Furthermore, international surveys indicate that Serbia still suffers from a high level of corruption.<sup>649</sup> 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.<sup>650</sup> 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.

According to the new Serbian Constitution adopted in 2006, 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.

646 The World Bank report, *Serbia and Montenegro – Public Expenditure and Institutional Review*, Volume Two: Serbia, February 2003, pp.2–6.

647 The World Bank Report prepared for the Donor Coordination Meeting of November 18, 2003.

648 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 9<sup>th</sup> Maastricht Workshop in Law and Economics, Maastricht: University of Limburg, 1996.

649 In the Transparency International Report for 2008, Serbia scored 3.4 out of 10 (85<sup>th</sup> out of 180 countries) on the basis of corruption perception index, Transparency International, *Global Corruption Report 2008*. [www.globalcorruptionreport.org](http://www.globalcorruptionreport.org)

650 This is mainly due to the fact that many leading Serbian intellectuals of that time had obtained their education in France and Germany.

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.<sup>651</sup>

## 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 by the Serbian European Integration Office in May 2009, 61% of the population supports the idea of accession to the EU.<sup>652</sup> 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 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.<sup>653</sup> 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.<sup>654</sup> Negotiations for a Stabilisation and Association Agreement started in October 2005, symbolically marking 5 years from democratic change in Serbia.

Serbia signed Stabilisation and Association Agreement (SAA) with the European Union on April 29, 2008. The Agreement constitutes a comprehensive contracting relationship between the two parties with clearly defined bilateral obligations. However, the application of the Interim Trade Agreement and commencement of Agreement ratification are still waiting for "the green light" of EU Council of Ministers being conditioned by the full cooperation of Serbia with the International Criminal Tribunal for Former Yugoslavia (ICTY) in the Hague. In spite of this, the Serbian Government formally started implementing the trade side of the Agreement as of 30 January 2009.

651 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.

652 Opinion poll "European Orientation of Serbian citizens" conducted by the Serbian European Integration Office in May 2009, <http://www.seio.sr.gov.yu/code/navigate.asp?Id=104#815>

653 The Thessaloniki European Council explicitly states that the Western Balkan countries are to become members of the EU "once they meet the established criteria". Presidency Conclusions of the Thessaloniki European Council, 19 and 20 June 2003, [www.europa.eu.int](http://www.europa.eu.int)

654 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.

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.<sup>655</sup> On June 14 2004, The Council adopted a first European Partnership with Serbia and Montenegro including Kosovo as defined by the UN Security Resolution 1244.<sup>656</sup> The implementation of the European Partnership priorities is 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.<sup>657</sup>

In 2006 and 2008, the European Partnership was updated in order to identify renewed priorities for further work on the basis of the findings of the Commission's annual progress reports.<sup>658</sup> 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.<sup>659</sup>

### European Partnership and SAA priorities in the area of financial accountability

The priorities listed in the 2008 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

655 Regulation (EC) No 533/2004, OJ L 86, 24.3.2004.

656 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.

657 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](http://www.europa.eu.int).

658 Council Decision of 18 February 2008 on the principles, priorities and conditions contained in the European Partnership with Serbia including Kosovo as defined by United Nations Security Council Resolution 1244 of 10 June 1999 and repealing Decision 2006/56/EC, OJ L 80/46, 19.3.2008. 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; Commission Staff Working Document, *Serbia 2008 Progress Report*, 5/11/2008, SEC (2008) 2698 final.

659 Paragraph 5 of Serbia and Montenegro, including Kosovo: 2005 European Partnership, Annex to the Council Decision of 30 January 2006, *ibid*.

within three to four years. The priorities concern both adoption of legislation and its effective implementation.

Short term priorities in the area of financial accountability under the 2008 European Partnership are as follows:

- *Adopt and implement a public internal financial control policy.*
- *Develop procedures and administrative capacity to ensure effective protection of the EU's financial interests.*<sup>660</sup>

The medium term priorities identified in the European Partnership concerning the area of financial accountability are the following:

- *Under the coordination of the Ministry of Finance, develop and implement the principles of decentralised managerial accountability and functionally independent internal audit in accordance with international standards and EU best practice through coherent legislation and adequate administrative capacity.*
- *Strengthen the operational capacity as well as the financial and operational independence of the Supreme Audit Institution. Follow up and implement the recommendations of the latter.*<sup>661</sup>

Stabilisation and Association Agreement also contains provisions related to cooperation between EU and Serbia in the area of financial accountability. Thus, Article 92 of SAA stipulates that Serbia and EU will focus on priority areas related to the Community *acquis* in the fields of public internal financial control (PIFC) and external audit, through elaborating and adopting relevant regulation aiming to develop transparent, efficient and economic PIFC (including financial management and control and functionally independent internal audit) and independent external audit systems, in accordance with internationally accepted standards and methodologies and EU best practices. Cooperation shall also focus on capacity building of the Supreme Audit institution. Finally, in order to be able to fulfil the coordination and harmonisation responsibilities stemming from the determined requirements, cooperation should also focus on the establishment and strengthening of central harmonisation units for financial management and control and for Internal Audit.<sup>662</sup>

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

660 Council Decision of 18 February 2008 on the principles, priorities and conditions contained in the European Partnership with Serbia including Kosovo as defined by United Nations Security Council Resolution 1244 of 10 June 1999 and repealing Decision 2006/56/EC, OJ L 80/46, 19.3.2008.

661 Ibid.

662 Article 92, Internal control and external control cooperation, of the Stabilisation and Association Agreement.

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.<sup>663</sup> 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,<sup>664</sup> Law on State Administration,<sup>665</sup> the Civil Service Law<sup>666</sup> and Law on Public Agencies.<sup>667</sup> 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 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. Until 2006, 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

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663 The Government of the Republic of Serbia, *Public Administration Reform Strategy*, November 2004.

664 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.

665 Law on State Administration, "Official Gazette of the Republic of Serbia" No. 79/05.

666 Civil Service Law, "Official Gazette of the RS", No. 79/05.

667 Law on Public Agencies, "Official Gazette of the RS" No. 18/05.

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. Although this is an encouraging development, which should provide conditions for depoliticisation and professionalisation of the senior civil service, subsequent Government changes over the last 2–3 years did not allow for full implementation of depoliticisation provisions, which are expected to be fully implemented only by the end of 2009.

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.<sup>668</sup> Ministries may also have internal organs which perform administrative, inspection and related professional activities, if the nature or number of activities require broader independence than the sector within the Ministry.<sup>669</sup>

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.<sup>670</sup> 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 beneficiaries (DBBs) and indirect budgetary beneficiaries (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.<sup>671</sup> The judiciary is also an indirect budget user as it receives funds through the Ministry of Justice.

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668 Article 1, paragraph 2 of the Law on State Administration, "Official Gazette of the RS", No. 79/05.

669 Article 28, of the Law on State Administration, "Official Gazette of the RS", No. 79/05.

670 Public Agencies Law, "Official Gazette of the RS" No. 18/05.

671 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.<sup>672</sup> 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.<sup>673</sup> The need to reduce the scope of the public sector has been particularly pressing in the time of global economic crises, which has required the Government significantly reduce public expenditure in order to attempt to reduce the budget deficit and generate savings for structural reforms. 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.

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.<sup>674</sup> 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.

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672 World Bank report, *Serbia and Montenegro – Public Expenditure and Institutional Review*, Volume Two: Serbia, 2003, p. 2.

673 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>

674 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.

## 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.<sup>675</sup> A similar function was performed by the internal unit of the Ministry of Finance, called – budgetary inspection, which conducted an administrative control of spending of public funds.<sup>676</sup> 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.<sup>677</sup> 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.<sup>678</sup>

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 previous version of the Budget System Law,<sup>679</sup> which introduced the concepts of both financial and performance audit.

This concept has been further elaborated by the Law on State Audit Institution,<sup>680</sup> which defines three basic principles of public money stewardship:

675 Social Accounting Service Act, “Official Gazette of the SFRY”, No. 15/77.

676 G. Paovic-Jeknic, *Budžetska kontrola – jugoslovensko i italijansko pravo* [Control of the Budget – Yugoslavian and Italian Law], University of Montenegro, Podgorica, 1999.

677 Ibid.

678 D. Antičić et al., *Korupcija u Srbiji* [Corruption in Serbia], (Centar za liberalno-demokratske studije), Belgrade, 2001.

679 Budget System Law, “Official Gazette of the Republic of Serbia”, No. 9/2002, 87/02, 66/05.

680 The Law on State Audit Institution (LSAI), Official Gazette of the Republic of Serbia No 101/05.

- *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;<sup>681</sup>
- *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;<sup>682</sup>
- *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.<sup>683</sup>

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;<sup>684</sup>
- 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;<sup>685</sup>
- 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.<sup>686</sup>

This rather exhaustive definition of principles of legality, regularity and purposefulness of spending of public funds represents a big step forward in the

681 Section 2, paragraph 1 of Article 2 of the LSAI.

682 Section 3, paragraph 1 of the Article 2 of the LSAI.

683 Section 4, paragraph 1 of the Article 2 of the LSAI.

684 Article 2, para 1, item 5 of the LSAI.

685 Article 2, para 1, item 6 of the LSAI.

686 Article 2, para 1, item 7 of the LSAI.

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*).<sup>687</sup> 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.<sup>688</sup> A head of a DBB can delegate this responsibility to other personnel in the Ministry/special organization.<sup>689</sup> 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

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687 Articles 71 and 72 of the Budget System Law adopted on 16.7.2009.

688 Article 71, paragraph 2 of the Budget System Law.

689 Article 72, paragraph 3 of the Budget System Law.

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*. In addition to financial services, most of DBBs which are organizationally complex and all major mandatory social security organizations are required to establish separate *internal control units*, as prescribed by the Rulebook on Common Criteria and Standards for Establishment and Functioning of the System of Financial Management and Control in the Public Sector adopted in 2007.<sup>690</sup>

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 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.

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690 Rulebook on Common Criteria and Standards for Establishment and Functioning of the System of Financial Management and Control in the Public Sector, Official Gazette of the RS, No. 82/07.

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.<sup>691</sup> Whereas a centralization of cash balances is desirable, this does not 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 Serbian Government has recently adopted the Strategy of Development of Internal Financial Control in the Public Sector,<sup>692</sup> which provides the platform for strengthening the existing elements of decentralized managerial accountability, internal control and audit. This is a very important step in strengthening the internal financial accountability framework, especially as it also represents one of the short term priorities of the 2008 European Partnership. In line with Article 92 of Stabilisation and Association Agreement, the Strategy outlines short and medium term measures to be undertaken in three main areas of public internal financial control: financial management and control, internal audit and the establishment and strengthening of central harmonisation units for financial management and control and for Internal Audit.

At around the same time, in July 2009, the Parliament has adopted amendments of the Budget System Law, which operationalise elements of the strategy, providing a clear legal basis for further development of internal financial accountability framework. However, lots of work remains to be done on actual implementation of the new policy and legal framework. Detailed proposals on how to improve the current system will be analyzed in more depth in the concluding chapter.

### 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

691 R. Allen, D. Tommasi (eds.), *Managing Public Expenditure: A Reference Book for Transition Countries*, SIGMA, OECD, Paris, 2001, pp. 216–217.

692 Strategy of Development of Internal Financial Control in the Public Sector in the Republic of Serbia adopted on July 30, 2009.

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 adopted in 2002 and subsequently amended in 2006 provided the basis 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. 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.<sup>693</sup> 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 internal controls and audit implications relating to the introduction of new systems, procedures or business processes. The problem, however, was that the Budget System Law did not clearly distinguish between the budget inspection function and internal audit function. This deficiency was firstly addressed in the Decree on the Method of Operation and Authorities of Budget Inspection and Audit adopted in 2004 and subsequently by the Rulebook on Common Criteria for Establishment, Functioning and Methodological Guidance for Conducting Internal Audit in the Public Sector.<sup>694</sup> These regulations reflect modern internal audit terminology in accordance with the Institute of Internal Auditor's (IIA's) International Standards for the Professional Practice of Internal Auditing (ISPPA). Newly adopted Budget System Law of July 2009 also makes a clear distinction between budget inspection and audit, which is a positive development.<sup>695</sup>

One of the key problems in the operation of budget inspection and audit department is that they are under-resourced and therefore face a number of difficulties in performing their every day functions. 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

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693 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.

694 Rulebook on Common Criteria for Establishment, Functioning and Methodological Guidance for Conducting Internal Audit in the Public Sector, Official Gazette of the Republic of Serbia, No 82/2007.

695 Article 82 and Articles 84–91 of the Budget System Law.

inspection and audit responsibilities<sup>696</sup> and is inadequate to provide meaningful assurance of the adequacy of the systems of control in all of these organisations.<sup>697</sup> The staff numbers would need to increase substantially to provide a level of audit coverage and an assurance that would be acceptable to heads of organisations and to the Minister of Finance.

It should be noted that internal audit units have been established in a number of DBBs, but they still have to develop their practices in line with international standards. In a number of documents, internal audit units are still referred to as “internal control units”, which is an indication of the lack of awareness of the internal audit function in Serbia, which still needs to be improved. Although around 100 staff has received training in internal audit from the EAR-funded technical assistance project, so far these units have not been required to work in accordance with recognised standards, as specific methodological guidance has not been available.<sup>698</sup>

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 “*develop and implement the principles of ... functionally independent internal audit in accordance with international standards and EU best practice through coherent legislation and adequate administrative capacity*” has been only partially implemented. An important step of putting in place adequate legislative framework has recently been successfully completed, but the authorities are now facing a more difficult part of implementing the legislation, which will require significant additional investment in building personnel capacities.

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 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

696 Support for the training of internal auditors is provided from a EUR 7 million project on “Public Finance” funded and implemented by the EAR.

697 SIGMA, “Public Internal Financial Control (PIFC) Assessment”, May 2008. <http://www.sigmaweb.org/dataoecd/48/63/41637812.pdf>, p. 3

698 Ibid, p. 4.

Assembly. Preparation of the Republic's budget followed a highly compressed timetable that did not allow for detailed analysis of budget issues and policies.<sup>699</sup> 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 law<sup>700</sup> 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.<sup>701</sup> 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.<sup>702</sup>

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 (2 months).<sup>703</sup> Implementation of this new timetable 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.<sup>704</sup>

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.

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699 G. Paovic-Jeknic, *Budzetska kontrola – jugoslovensko i italijansko pravo* [Control of the Budget – Yugoslavian and Italian Law], University of Montenegro, Podgorica, 2000.

700 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.

701 G. Paovic-Jeknic, *ibid.* pp. 178–182.

702 *Ibid.*

703 Article 31 of Budget System Law.

704 Chapter V of the Budget System Law.

### 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.<sup>705</sup> 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.<sup>706</sup>

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 Committee has been appointed and is a member of an opposition party, in line with the best European practice. However, the committee 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 was an encouraging sign, as it enhanced 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 operational, 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 a functional institution to perform independent external audit of public revenues and expenditures. Although the National Assembly adopted the Law on State

705 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](http://www.parlament.sr.gov.yu/content/cir/akta/poslovnik/poslovnik_1.asp).

706 Southeast Europe Parliamentary Program (SEPP), Parliamentary Centre, Joint Baseline Report on the Internal and Human Resources Management in the National Assembly of the Republic of Serbia, November 2003.

Audit Institution in November 2005, the State Audit Institution (hereinafter the SAI) has not been operational. The main reasons for the delay in creating the SAI was 1) a difficulty to reach a political consensus in the National Assembly on who should be elected as a member of the SAI's management and subsequently 2) a lack of material, human and financial resources provided to SAI in order to be able to commence its work.<sup>707</sup> The SAI's management was elected eventually in autumn 2007, but up to now the SAI has not received adequate premises for its work and faced obstacles with recruitment of its staff. The Rulebook on the operation of the SAI was eventually approved by the National Assembly on January 23, 2009, by which formal conditions for commencement of the operation of the SAI have finally been met. However, a very long delay in establishment and operation of this new institution raises serious concerns for its further work. 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 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.<sup>708</sup>

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 insti-

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707 A. Rabrenovic (2008), "Uspostavljanje vrhovne revizorske institucije u Srbiji – povratak zaboravljenoj tradiciji?" [Establishment of the Supreme Audit Institution in Serbia- back to forgotten tradition?"] *Pravni život*, br. 10/2008, pp. 663–679.

708 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.

tution. Article 107 of the Sretenjski Constitution proclaimed: "Prince and State Council (Drzavni Sovjet)<sup>709</sup> will establish the 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.<sup>710</sup>

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,<sup>711</sup> thus taking away the democratic elements of its operation.

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:

709 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.

710 N. Stjepanovic, *ibid.*

711 Articles 56 and 63 of the 1969 Constitution.

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.<sup>712</sup> 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),<sup>713</sup> which would only after the 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.<sup>714</sup>

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

712 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.

713 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.

714 N. Stjepanovic, op. cit. pp. 129–130.

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 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.<sup>715</sup>

### Contours of a new external audit legal framework

Although Serbian new SAI has still not been fully operational, there exists a sound legal framework for its functioning. First it should be noted that the new 2006 Serbian Constitution for the first time in modern Serbian history provides legal basis for establishment and independence of the SAI. The Constitution in its Article 96 envisages that the State Audit Institution shall be supreme audit institution for auditing public finances in the Republic Serbia, that it is an independent institution and subject to supervision by the National Assembly to which it is accountable. It is important that the independence of the SAI is proclaimed in the Constitution and that a functional relationship between the SAI and the Parliament is underlined.

The Law on State Audit Institution (hereinafter the LSAI) passed somewhat before the adoption of the new Constitution (in November 2005) also represents an important step forward in creating a functional system of financial

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715 R. Szawlowski, “State Audit in Communist Countries”, in B. Geist (ed.), *State Audit – Developments in Public Accountability*, (The MacMillan Press Ltd), 1981, p. 189.

accountability. The Law has been appraised as a very good piece of legislation by a number of international organisations and experts and definitely. 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,<sup>716</sup> 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.<sup>717</sup>

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.<sup>718</sup> 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.

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 experience<sup>719</sup> 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

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716 Article 13 of the LSAI.

717 Article 32 of the LSAI.

718 Article 25 of the LSAI.

719 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.

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.

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.<sup>720</sup> Second, *functional independence* is secured though 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.<sup>721</sup> 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.<sup>722</sup> 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.<sup>723</sup> 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 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.<sup>724</sup>

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

720 Article 12 of the LSAI.

721 Articles 3, 5, 6, 35, 36, 39 of the LSAI.

722 Article 51 of LSAI.

723 Section 2, 3 and 4, paragraph 1 of Article 2 of the LSAI.

724 Article 5 of the LSAI.

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.<sup>725</sup>

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;
- 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.<sup>726</sup>

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.<sup>727</sup> 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.<sup>728</sup> 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

<sup>725</sup> Article 10 of the LSAI.

<sup>726</sup> Article 35 of the LSAI.

<sup>727</sup> Article 47 of the LSAI.

<sup>728</sup> Article 45 of the SAI..

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.

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.<sup>729</sup> If an auditee fails to provide requested information, it will be fined by an appropriate penalty,<sup>730</sup> determined by the penal provisions of the law.<sup>731</sup>
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.<sup>732</sup> The Council decides on such an objection and its decision is final (no right of appeal is allowed).<sup>733</sup> 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.<sup>734</sup> 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.<sup>735</sup> 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 it).<sup>736</sup> 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.<sup>737</sup>

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

729 Article 36 of the LSAI.

730 5.000–50000 dinars which corresponds to around 50–5000 pounds.

731 Article 57 of the LSAI.

732 Para 1, Article 38 of the LSAI.

733 Paragraphs 2 and 3 of the Article 38, of the LSAI.

734 Paragraphs 1–9 of Article 39 of the LSAI.

735 Paragraph 10 of Article 39 of the LSAI.

736 Paragraphs 11–15 of Article 39 of the LSAI.

737 Paragraphs 16–17 of Article 39 of the LSAI.

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.<sup>738</sup> 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.<sup>739</sup>

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 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.<sup>740</sup>

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

738 Paragraphs 1–2 of Article 40 of the LSAI.

739 Paragraphs 3–4 of Article 40 of the LSAI.

740 Paragraphs 9–13 of Article 40 of the LSAI.

criminal procedure.<sup>741</sup> 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.

Overall, the adoption of the new Law on SAI and the SAI's Rulebook have been very important steps 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 fully operational yet. Therefore, it is important to examine what are the ways to make the SAI functional as soon as possible and to secure its smooth operation in the first years of its operation.

### 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.<sup>742</sup> 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).<sup>743</sup> 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.<sup>744</sup> 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 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.<sup>745</sup>

741 Article 41 of the LSAI.

742 The Decree on Budget Accounting, "Official Gazette of the Republic of Serbia," No. 125/2003.

743 Article 3 of the Decree on Budget Accounting.

744 Article 4 of the Decree on Budget Accounting.

745 The World Bank, *Serbia: Fiduciary Assessment Update*, op. cit., p. 23.

## 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. Therefore, still a lot of work remains to be done on establishing a satisfactory financial accountability system in Serbia. The concluding chapter shall 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 the countries of Western Balkans and underlined the European Union's determination to support their efforts to move closer to the European Union.<sup>746</sup> The successful completion of negotiations with some of Serbia's closest neighbours who joined the Union in May 2004 and subsequently in January 2007 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.

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746 The Thessaloniki European Council explicitly states that the Western Balkan countries are to become members of the EU "once they meet the established criteria". Presidency Conclusions of the Thessaloniki European Council, 19 and 20 June 2003, [www.europa.eu.int](http://www.europa.eu.int)

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 resulted in immediate suspension of the implementation of Stabilisation and Association Agreement signed in April 2008. 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 ratification of Lisbon Treaty) 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.

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 was not able to provide statement of assurance for legal and regular use of the overall EU funds over 12 consecutive years.

Serbia is still far away from meeting the conditions set out in the Chapter 32 of the *acquis*. A sound financial accountability framework has been underlined as one of the priorities for Serbia in both the European Partnership and Stabilisation and Association Agreements as main instruments of a Stabilisation and Association process. As pointed out in the previous chapter, the following priorities in the area of financial accountability have been determined: the 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.<sup>747</sup> The progress in implementing the priorities is regularly monitored by the Commission, notably in

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747 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

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 study, 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 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.<sup>748</sup> 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.<sup>749</sup> 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.<sup>750</sup> 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

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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.

748 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.

749 Ibid.

750 OECD Policy Brief, *Public Sector Modernisation: Modernising Accountability and Control*, OECD, 2005, [www.oecd.org/publications/pol\\_brief](http://www.oecd.org/publications/pol_brief), p. 2.

than a century, the 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.<sup>751</sup> 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.<sup>752</sup> 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 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.

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751 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.

752 I. Harden, F. White, K. Hollingsworth, “Value for Money and Administrative Law”, *Public Law*, 1986, pp. 670–671.

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'.<sup>753</sup> Whereas mainland Europe was undergoing a process of state apparatus straightening, British isles were operating mainly within local communities which carried out activities of local interest.<sup>754</sup> 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.<sup>755</sup> 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.<sup>756</sup> Therefore comes the famous Dicey's statement that Britain does not have administrative law, and doesn't wish to have it.<sup>757</sup>

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.<sup>758</sup> In these systems, the concept of the 'state' is not developed as in the mainland of Europe, as Pollitt and Bouckaert nicely explain:

753 P. Dimitrijevic, R. Markovic, *Upravno pravo [Administrative Law]*, Official Gazette SFRJ, 1986., pp. 145–146.

754 Ibid.

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

756 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> .

757 C. Harlow, R. Rawlings, *Law and Administration*, (Butterworths), 1997, p. v.

758 Christopher Pollitt and Geert Bouckaert, *Public Management Reform – A Comparative Analysis*, Oxford University Press 1999, p. 53.

'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.<sup>759</sup>

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,<sup>760</sup> the main objective of financial accountability has easily been shifted from ensuring compliance to ensuring the maximum productivity through maximum efficiency of expenditure.<sup>761</sup> 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. 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.<sup>762</sup>

759 Ibid.

760 C. Hood, "A public management for all seasons?" *Public Administration*, 69:1, Spring 1991, pp. 3-19.

761 C. Pollitt et al, *Performance or Compliance? Performance Audit and Public Management in Five Countries*, (Oxford University Press), 1999, p. 54.

762 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.

Against such a background, ensuring the legality of expenditure seems to be the key objective of financial accountability in France.<sup>763</sup> 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.<sup>764</sup> 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 (modelled on the French *Conseil d'Etat*). The *ex ante* control of payments was 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.<sup>765</sup> 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.

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763 C. Pollitt at al, *ibid*.

764 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.

765 F.F. Ridley, "New Public Management in Europe: Comparative perspectives", *Public Policy and Administration* Volume 11, No. 1 Spring 1996., pp. 16–29.

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),<sup>766</sup> centralised *ex-ante* internal controls performed by *controlleurs financiers* are gradually changing towards the *a posteriori* control framework, placing instead a high degree of autonomy on organisation's management (*ordonnateurs*).<sup>767</sup> 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*, *controlleur 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,<sup>768</sup> shifting the loci of accountability from *controlleurs* 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.<sup>769</sup> However, the most fundamental problem of divided accountability for implementation of the Community budget and lack 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.

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766 *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.

767 NAO study, *State Audit in the European Union*, 2005, [www.nao.gov.uk/publications/state\\_audit/state.htm](http://www.nao.gov.uk/publications/state_audit/state.htm), p. 89.

768 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.

769 Harden, F. White, K. Donnelly, op. cit. pp. 631-632.

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.<sup>770</sup> This is especially the case if we are talking about

770 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.

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?

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 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 Ser-

bian context due to fairly weak powers of the Serbian parliament, the underdeveloped 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 Law 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/audit 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.

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.

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. 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.<sup>771</sup> 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.

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).<sup>772</sup> 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.

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771 Thus, 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 5000–100.000 dinars (around 500–5000 euros). Article 74–75 of the Budget System Law, Official Gazette of RS, No. 9/02, 87/02, 66/05.

772 The World Bank, *Serbia, Fiduciary Assessment Update, 2005*, Internal document of the World Bank, p. 77.

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, as soon as possible. The legal basis for establishment of central harmonisation unit for PIFC are provided in recently adopted amendments of the Budget System Law, which is a first step in actual establishing the unit, which should be responsible for developing methodologies and standards for public internal financial control and internal audit.

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 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.<sup>773</sup>

### 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 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

773 R. Allen, D. Tommasi (eds), *Managing Public Expenditure, A Reference Book for Transition Countries*, SIGMA, OECD, 2001. pp. 244–245.

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.<sup>774</sup> 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.

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.<sup>775</sup>

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 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 devel-

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774 PIFC Expert Group, *Internal Control Systems in Candidate Countries, Volume II*, February 2004, p. 76. <http://www.oecd.org/dataoecd/35/37/34891262.pdf>

775 Ibid. pp. 77–78.

opment of internal audit function in Western democracies.<sup>776</sup> 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.

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.<sup>777</sup> 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

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776 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.

777 F. Cazala, "The Supreme Audit Institution and Parliament: How Can their Relationship Support Implementation of the Audit Recommendations?," paper presented at INTOSAI 2<sup>nd</sup> International Conference on Internal Control, May 2000.

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 parliament.<sup>778</sup> However, given that Serbian political system is fairly polarised, 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.<sup>779</sup> 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 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 better 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, that this principle can be circumvented in practice, simply due already seen practice of President of the Committee's disinterest to attend its sessions. Therefore it is very important to work on raising the awareness of the mem-

778 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](http://www.eca.europa.eu/cooperation/publications/docs/sai_parl_136_en.pdf).

779 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.

- bers 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.<sup>780</sup>

Achievement of effective parliamentary support for financial accountability issues will, however, ultimately depend on further consolidation of political and parliamentary life in Serbia. Namely, around 80% of the Serbian MPs have obtained a MP's status and 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 Parliamentary role in scrutinising the operation of the executive, rather than performing the prevailing legislative role.<sup>781</sup>

780 W. Krafchik, "What role can civil society and Parliament pay in Strengthening the external auditing function?"; The International Budget Project, <http://www.internationalbudget.org/auditorgeneral.htm>, p. 2.

781 SIGMA papers: No. 33, *Relations between Supreme Audit Institutions and Parliamentary Committees*, op. cit, p. 33.

### 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.<sup>782</sup> 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. As we could see in the previous chapter, Article 96 of the Serbian Constitution states that the State Audit Institution shall be supreme audit institution for auditing public finances in the Republic Serbia, that it is an independent institution and subject to supervision by the National Assembly to which it accounts for its work. Some practitioners argue that the Constitutional provisions should comprise additional elements such as status and type of SAI (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.<sup>783</sup> We are, 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. Therefore, the current basic Constitutional provisions which refer to SAI's establishment and independence (in line with the solution of the French Constitution) are satisfactory. 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

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782 Lima Declaration of Guidelines on Auditing Precepts, available on the INTOSAI web site, [www.intosai.org](http://www.intosai.org).

783 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 functioning of Supreme Audit Institutions in the context of European integration," [http://www.eca.europa.eu/cooperation/publications/docs/recommendations\\_en.pdf](http://www.eca.europa.eu/cooperation/publications/docs/recommendations_en.pdf), pp. 1–3.

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, as it was the case with significant delay in the election of the members of the SAI Council. 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.

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 losing 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,<sup>784</sup> while the French *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.<sup>785</sup> 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 develop a proper strategy to set up the institution. 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.

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784 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.

785 SIGMA paper: No. 33, *Relations between Supreme Audit Institutions and Parliamentary Committees*, op. cit. p. 30.

Even once the SAI is fully 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.<sup>786</sup> 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.

## Conclusion

The final conclusion of this study 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 spilled 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.

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786 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).

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.<sup>787</sup> 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.<sup>788</sup> 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.<sup>789</sup>

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.<sup>790</sup> 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 to levy taxation.<sup>791</sup> 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.<sup>792</sup> 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.<sup>793</sup>

Early medieval history of British financial control mechanisms is marked by two coinciding tendencies. While representative institutions were struggling

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787 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.

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

789 Ibid.

790 C. Innes, *Lectures on Scotch Legal Antiquities*, (Edinburgh, 1872), 111. I.E. O'Brien, *The Scottish Parliament in the 15<sup>th</sup> and 16<sup>th</sup> Centuries*, Ph.D. Thesis (Glasgow, 1980), p. 180.

791 I.E. O'Brien, *ibid.*

792 C. Madden, *The Finances of the Scottish Crown in the Later Middle Ages*, (Ph.D. thesis, Glasgow, 1975), p. 2.

793 Ibid.

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.<sup>794</sup> It not only had the role of recording and controlling the Royal revenue, but also provided a forum for settling financial matters and disputes.<sup>795</sup>

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, an account may be rendered of them.<sup>796</sup> 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.<sup>797</sup> 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.<sup>798</sup> 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.<sup>799</sup>

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

794 N. Richard, *The Course of the Exchequer*, (London: Nelson), 1950, p. 33; R. Poole, *The Exchequer in the Twelfth Century*, (Oxford, Clarendon Press), 1912.

795 N. Richard, op. cit., p.34.

796 P. Halsall (eds.), *Internet Medieval Source Book*, (Fordham University Center for Medieval Studies), [www.fordham.edu/halsall/sbook.html](http://www.fordham.edu/halsall/sbook.html).

797 A.J.H. Morris, WS Gillbert and Sir Arthur Sullivan's *Trial by Jury - A Legal Commentary*, [www.lexscripta.com/pdf/TrialByJury.pdf](http://www.lexscripta.com/pdf/TrialByJury.pdf)

798 J.E.D. Binney, *British Public Finance and Administration 1774–92*, (Oxford Clarendon Press), 1958, pp. 4–5.

799 Ibid.

written and taxes collected in a fairly organised way.<sup>800</sup> It represented quite an advanced institution of the feudal system, which 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.<sup>801</sup> 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.<sup>802</sup>

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,<sup>803</sup> or that special Parliamentary committees or commissions be established to audit the accounts of the Monarch and its agents.<sup>804</sup> 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.

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.<sup>805</sup> 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.

800 N. Richard, *ibid.*

801 *The History of the National Audit Office*, UK National Audit Office web site, [www.nao.gov.uk](http://www.nao.gov.uk).

802 P. Einzig, *op. cit.* p. 87.

803 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.

804 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. P. Einzig, *op. cit.*, pp. 87–90.

805 *Ibid.*

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.<sup>806</sup>

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.<sup>807</sup> It should be stressed that all audit conducted in this division was administrative and not judicial.<sup>808</sup> 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.<sup>809</sup> 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.<sup>810</sup> 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.<sup>811</sup>

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,

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806 Ibid.

807 J.E.D. Binney, *op. cit.*, pp. 195–197.

808 Ibid.

809 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. However, the actual power of the Parliament in state affairs was scarce. W.C. Dickinson, *Scotland from the Earliest Times to 1603*, (Oxford at the Clarendon Press), 1977, p. 99–100.

810 I.E. O'Brien, *op. cit.*, p. 180.

811 Ibid. pp. 180–184.

which would restore the power and prestige of the Scottish crown.<sup>812</sup> The first steps undertaken by James I were the establishments of the new offices of exchequer and comptroller, as well as the gradual formation of the body of professional civil servants.<sup>813</sup>

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.<sup>814</sup> 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.<sup>815</sup> 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.<sup>816</sup> 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.<sup>817</sup> The main function of the traditional exchequer was the prevention of fraud.<sup>818</sup>

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.<sup>819</sup> The struggle for the royal signature,<sup>820</sup> 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

812 C. Madden, op. cit. p. 2.

813 Ibid.

814 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.

815 Ibid, p. 91.

816 C. Madden, op. cit. pp. 12–40.

817 Ibid.

818 J. Goodare, *State and Society in Early Modern Scotland*, (Oxford University Press, 1999), pp. 104–105.

819 Ibid.

820 The royal sign was a means of granting land and other forms of patronage.

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.<sup>821</sup> The permanent exchequer eventually became an active administrative department, with auditors freed from personal liability of treasurer and comptroller.<sup>822</sup> 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.<sup>823</sup>

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.

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.<sup>824</sup> 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.<sup>825</sup> 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.<sup>826</sup> 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.<sup>827</sup>

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 account-

821 A. L. Murray, “Sir John Skene and the exchequer, 1594–1612”, *Stair Society Miscellany*, (1971), p. 126.

822 J. Goodare, op. cit., p. 121.

823 J.E.D. Binney, op. cit. pp.233–237.

824 P. Einzig, op. cit. pp.117–131.

825 Ibid.

826 Ibid.

827 Ibid.

ability 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 centralization of audit with still surviving judicial forms were criticized for their malfunctioning and rigidity.<sup>828</sup> 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.<sup>829</sup> 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.<sup>830</sup> 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".<sup>831</sup> 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 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.<sup>832</sup>

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

828 J.E.D. Binney, op. cit., pp. 7–19.

829 D. Dewar, "Value for Money Audit: the first 800 years", *Public Finance and Accountancy*, 1985.

830 F. White, K. Hollingsworth, *Audit, Accountability and Government*, (Clarendon Press, Oxford, 1999), p. 35.

831 E. L. Normanton, *Accountability and Audit in Governments* (Manchester: Manchester University Press, 1966), p.20.

832 F. White, K. Hollingsworth, pp. 35–36.

Parliament accordingly.<sup>833</sup> 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.<sup>834</sup>

The 1866 Act is considered to be a vast improvement to the system of audit which had existed previously in Britain.<sup>835</sup> The Act stipulated the obligation of government departments to produce appropriation accounts for independent audit.<sup>836</sup> 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.<sup>837</sup>

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.<sup>838</sup> The Act also extended the audit of C&AG to new types of accounts, which emerged in previous decades (trading accounts etc.).<sup>839</sup> 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 ex-

833 The Exchequer and Audit Departments Act 1866.

834 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.

835 F. White, K. Hollingsworth, op. cit., p. 37.

836 Section 22 of the Exchequer and Audit Departments Act 1866.

837 F. White, K. Hollingsworth, op. cit. p. 37.

838 Section 1(2) of the Exchequer and Audit Departments Act 1921.

839 Section 4 of the Exchequer and Audit Departments Act 1921.

penditure, 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.<sup>840</sup> Reformers also argued that more robust arrangements should be put in place to ensure the independence of public auditors from government.<sup>841</sup>

Continuous reformist pressures resulted in the enactment of the National Audit Act 1983.<sup>842</sup> 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.<sup>843</sup> 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'.

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840 *The History of the National Audit Office*, UK National Audit Office web site, [www.nao.gov.uk](http://www.nao.gov.uk).

841 *Ibid.*

842 F. White, K. Hollingsworth, *ibid.*, pp. 41–46.

843 *The National Audit Act 1983.*

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CIP – Каталогизација у публикацији  
Народна библиотека Србије, Београд

339.923:061.1EC(4)

336.1/.5(4-672EU)

RABRENOVIĆ, Aleksandra, 1972-

Financial Accountability as a Condition for EU  
Membership / Aleksandra. – Rabrenović. – Beograd :  
Institut za uporedno pravo = Institute of comparative law,  
2009 (Beograd : Dosije studio). – 247 str. ; 24 cm

Tiraž 300. – Str. 11–17: Predgovor ; Foreword / Dragoljub  
Kavran. – Napomene i bibliografske reference uz tekst. –  
Bibliografija: str. 234–247.

ISBN 978-86-80059-62-4

a) Европска унија – Придруживање

b) Земље Европске уније – Буџетска контрола

COBISS.SR-ID 170236172

Money

ISBN 978-86-80059-62-4

