

# **PRKVF Project Strengthening Public Financial Management and Control**

## **Comparative Analysis of Germany, France and Italy and recommendations for the Czech Republic**

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## **Abstract**

Starting from the assessment of the status in the Czech Republic sector by pinpointing its major weaknesses, this study focuses on the comparative analysis of the public administration's internal control and audit practices of Germany, France and Italy. The list of recommendations contained at the end of the report originates from the juxtaposition of Czech weaknesses and good practices singled out in the three countries analysed.

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## 1 Introduction and aims

This study is part of “Strengthening public financial management and control” from the EEA and Norway grants 2014-2021 Programme “Good Governance, Programme Areas 16 - Good Governance, Accountable Institutions” whose final aim is to improve the integrity and accountability of public administration by strengthening the public financial management and control system in the Czech Republic and implementing preparatory activities related to the proposal for a new legal regulation of this system. Target groups of the projects are ministries and other central state organizations, municipalities, regions and their organizations and health insurance companies.

Among the different work packages of the wider project, the followings are considered for this specific study:

- Independent expert assessment of the current system set-up, including recommendations to address the identified deficiencies.
- Acquiring know-how and collecting best practices from other European countries in the field of financial management and control legislation.

The specific aim of this study is threefold:

1. To assess the status of internal control and audit, by identifying the weaknesses in the Czech Republic public sector.
2. To comparatively analyse Germany, France, and Italy public sector cases, highlighting good practices in fields where main weaknesses of the Czech system are identified.
3. To provide recommendations for improving the Czech internal control and audit in public sector.

Some general recommendations, followed then by specific recommendations by each dimension of the modified COSO framework (see below), have been singled out. First, some general principles and legal frameworks that apply across the different levels of government are in place in all countries analysed, but internal control and audit-specific norms and guidelines are usually related to each level of government, as they have different activities to be provided and they have a different degree of autonomy. Second, financial and nonfinancial performances must

be linked and it should be clear that internal control aims to help the organization fulfil its objectives effectively and efficiently (3Es). Third, skilled and trained employees represent an enabling condition for an effective internal control and audit and specific provisions (e.g. incentive, financing, etc.) might be available to develop an effective knowledge of IC/IA. Fourth, while the law represents the main mean of communication across the public administration, it cannot be considered as a change by itself as the managerial culture is the outcome of a long-lasting process. Fifth, the starting points for IC/IA renovation should be those aspects of “modal level of implementation” of IC/IA which seems to focus on the value-for-money concept and the link between financial and nonfinancial performance.

The report is structured as follow. Section 2 provides the lenses through which the country cases have been analysed and described, i.e., theoretical framework, as well as detailed information on the method of analysis, including the units of analysis and the detailed structure of analysis used for the Czech Republic case and for the three foreign countries. Section 3 presents the weaknesses of internal control and audit in Czech Republic. Sections 4, 5 and 6 showcase the main characteristics of internal control and auditing of the three country selected, France, Germany, and Italy, as well as their good practices. Section 7 provides a list of recommendations that originates from the juxtaposition of Czech weaknesses and good practices singled out in the three countries analysed.

## 2 Theoretical framework and method of analysis

### Literature overview

Internal control is a multidimensional concept within the management control literature (Modell, 2009), which refers to those measures and procedures designed and implemented by an organization to improve operational efficiency, financial reporting, compliance objectives and expectation of key stakeholders in matters of safeguarding assets and investments (COSO, 2013). Internal controls constitute a continually operating system integrated at all levels of an organization which helps detect, measure, and manage risks such as non-compliance and regulatory violations, financial and performance failures, fraud and corruption (Aziz et al., 2015).

From a public perspective internal control objectives are quite different from corporate and private ones, as public sector organizations are not only concerned with performance evaluation and improvement to guarantee efficiency, effectiveness, and value for money, but report to stakeholders also on the basis of transparency, accountability, and fairness (Aziz et al., 2015; Lartey et al., 2020). Internal controls foster decision maker's accountability (Bianchi, 2010), which is the cornerstone of public accounting and reporting as citizens demand to know how public resources were acquired and spent (Lartey et al., 2020), while failing to establish a reliable and dependable system could harm trust and consensus. One major determinant of fulfilling this requirement is employing ethical standards and practices spelt in the laws and legislative instruments guiding public organizations. The concept of internal controls for the public sector developed over time: it initially concerned merely legal compliance and administrative regularity issues, and only with New Public Management it also concerned performance issues linked to efficiency, effectiveness, and value for money, while with New Public Governance it eventually also encompassed transparency, accountability, and fairness (Pestoff, 2010; van Hengel et al., 2014; Wiesel and Modell, 2014). However, if an organization wants to introduce major changes it is es-

essential to recognize that these changes will probably not be fully accepted unless significant effort is put into changing the organization's culture and working procedures (Bogt and van Helden, 2020).

International organizations such as the OECD and the EU have encouraged many countries to revise their domestic control standards in alignment with the International Organization of Supreme Auditing Institution standards (INTOSAI, 2004). According to the OECD "internal control processes protect governments from fraud, corruption, waste, and abuse. They help governments measure value-for-money, assess risk, and ensure compliance with laws, regulations, and policies."

Due to the accounting scandals that happened in the early 1980s, the Fraudulent Financial Reporting Commission (commonly known as the Treadway Commission) established COSO (Commission of Sponsoring Organizations), a framework which is still relevant today, has been reviewed with its latest version published in 2013 (COSO, 2013), and has become the most accepted and widely used model for designing, implementing, and conducting internal control systems as well as assessing their effectiveness. It was initially thought for the private sector but has since been adopted by many governments as INTOSAI has developed its internal control standards to be implemented in public organizations based on the components of the COSO framework. INTOSAI (INTOSAI, 2004) considers COSO adequate and functional for the specificities of public sector organizations, that is: the pursuit of objectives that are not solely financial, but also socio-political in nature; the greater degree of complexity associated with performance evaluations which require judgments based on both the traditional criterion of legality and those of NPM's inspiration such as efficiency, effectiveness, and value for money; and the particular importance of the principles of transparency, accountability, and fairness when dealing with public funds.

### **The COSO (Comission of Sponsoring Organziations) framework**

The COSO framework focuses on five control components, namely control environment, risk assessment, control activities, information and communication, and monitoring, each one of which is then characterised by a set of principles (Figure 1).

*Control environment.* It is the most basic component of the COSO framework as it refers to the environment in which the internal control system operates. It includes business management and employee attitudes and behaviours toward the internal control structure, management principles, organizational structure, procedures, and personnel policies to be followed in granting powers and responsibilities. The related principles are:

1. The organization demonstrates a commitment to integrity and ethical values.
2. The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control.
3. Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.
4. The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.
5. The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.

*Risk assessment.* It can be described as events from both external and internal sources that may have a negative impact on an organization's ability to achieve its objectives. It is critical to understand how an organization detects risks, assesses their relevance, forecasts the likelihood of them occurring, and decides how and when to manage them. The related principles are:

6. The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.
7. The organization identifies risks to the achievement of its objectives across the entity and analyses risks as a basis for determining how the risks should be managed.
8. The organization considers the potential for fraud in assessing risks to the achievement of objectives.
9. The organization identifies and assesses changes that could significantly impact the system of internal control.

*Control activities.* This component refers to rules and procedures that help ensure that risks to achieving objectives are mitigated, if not

eliminated. Such initiatives are carried out at all levels of the organization, at all phases of its processes, and using appropriate technology. They might include manual or automated tasks including authorizations, approvals, verifications, reconciliations, and performance reviews. They may be proactive tools that deter noncompliance, or they may uncover violations after performing checks to validate transactions and compliance practices, or they may refer to the establishment of desired guidelines that will produce favourable outcomes and results, or, lastly, they may address major setbacks after monitoring and reviews of the internal control systems to prevent errors and mistakes from reoccurring. The related principles are:

10. The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.
11. The organization selects and develops general control activities over technology to support the achievement of objectives.
12. The organization deploys control activities through policies that establish what is expected and procedures that put policies into action.

*Information and communication.* Because it feeds into the other components of internal control, information from both internal and external sources is required for an organization to carry out its internal controls. Internal communication allows management to appreciate internal control concerns from employees and employees to receive indications about their control duties. External communication has a similar dual purpose: it enables relevant information from external stakeholders to be conveyed within an organization, as well as providing information about the organization to external stakeholders. The related principles are:

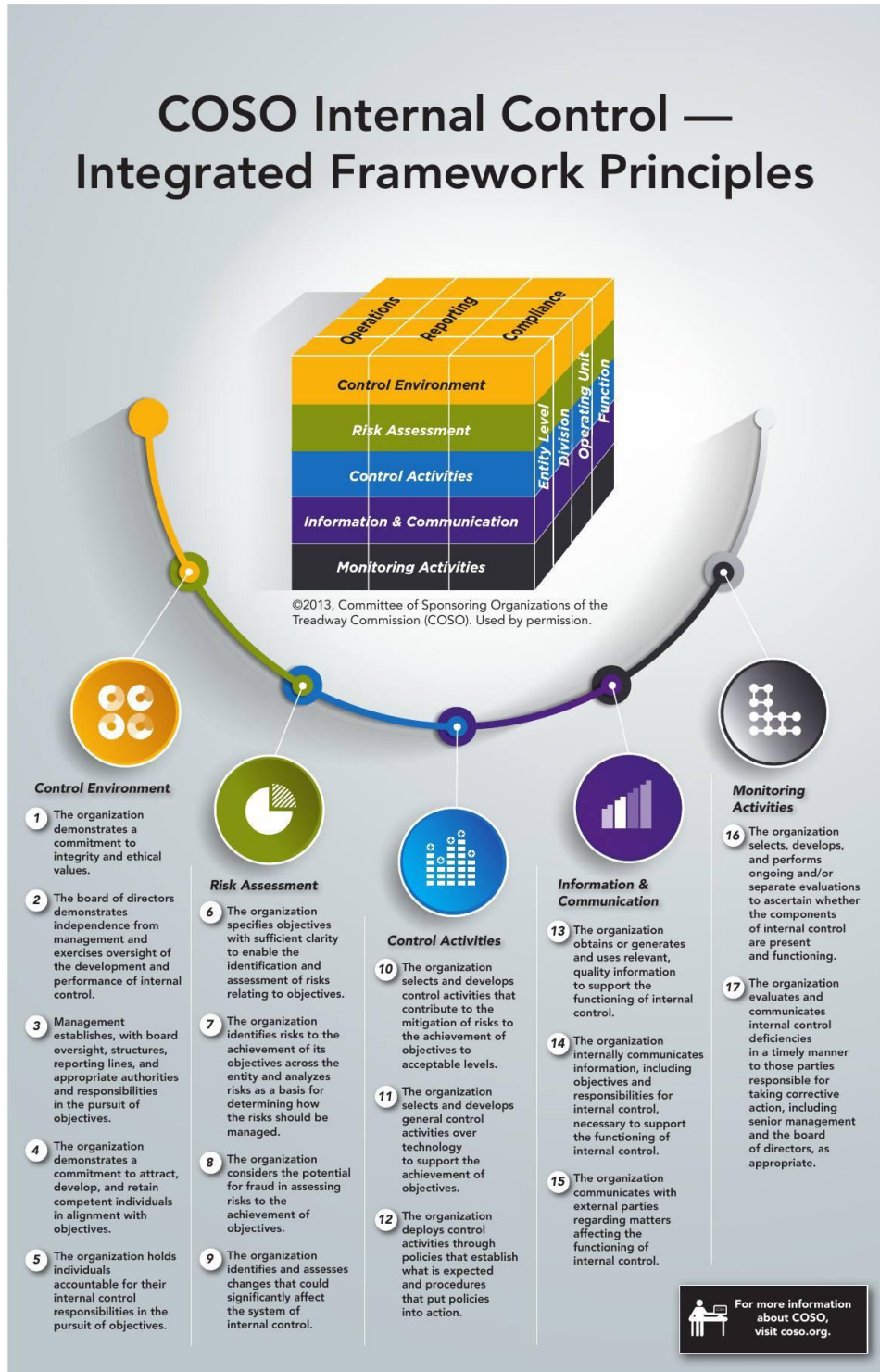
13. The organization obtains or generates and uses relevant, quality information to support the functioning of internal control.
14. The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control.
15. The organization communicates with external parties regarding matters affecting the functioning of internal control.

*Monitoring activities.* Monitoring is the stage at which the entire internal control system and its operations can be reviewed to identify potential areas for improvement and highlight possible corrective measures. Such evaluations can be ongoing or ad hoc and are used to ascertain whether the various components of an internal control system are present and functioning. Ongoing evaluations, which are embedded into business processes at all levels of the organization, should provide timely information. Separate periodic evaluations can vary in extent and frequency depending on risk assessment, the effectiveness of ongoing evaluations, and other management considerations. Effective internal audit methods can help monitor if the internal control structure is performing successfully and as expected. Internal audit reports can be submitted to top management, detailing the effectiveness, inadequacies, and weaknesses of internal control, as well as the auditor's recommendations for avoiding reported setbacks. The related principles are:

16. The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.
17. The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate.



Figure 1. The COSO Internal Control Framework (coso.org)



### **Method of analysis**

*Selection criteria for the three foreign countries.* The three foreign countries, namely France, Germany and Italy, have been selected considering that they have a good level of comparability with the Czech Republic – in particular the administrative culture<sup>1</sup>, they represent the biggest economies within the EU, they have a long lasting history of democratic institutions, and have similar public sector structure. The specific administrative traditions and institutional structures are described within each country section.

*Units of analysis.* Considering the target groups of the study (ministries and other central state organizations, municipalities, regions and their organizations and health insurance companies), the research team has first of all proceeded to find a “minimum common denominator” by structuring a list of groups of comparable public sector organizations. The following list has agreed and been used to structure each country analysis:

- *Central government*, that includes state ministries in centralized countries (Czech Republic, France and Italy) and federal ministries and agencies of federal countries (Germany)
- *Regional/State government*, that includes regions in centralized countries and states in federal ones
- *Local government*, that includes such local government as municipalities, provinces, departments, inter-municipal cooperation entities, etc.
- *Agencies*, that includes central, regional, local and other agencies in the form of separate authorities that are somehow connected with central, regional, local governments; a particular attention has been dedicated to universities and research institutions, which appeared to be the only specific “minimum common denominator” possible; for this level of government, the analysis has been simplified and provides just the most important elements.

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<sup>1</sup> According to Kuhlmann and Wollmann (2014), in these countries the principle of legality is a dominant value in administrative action, rather than performance-orientation and there is a relatively high degree of juridicisation of administrative action and the formalised direction of administrative activities.

*Modified COSO components as structure of analysis.* With the aim to reflect the Ministry of Finance policy focus on those aspects that are regulated by the current legal framework applied in the Czech Republic, the structure of analysis followed a modified COSO components pattern. In particular:

- *Control environment:* this first modified component includes the control environment component of COSO, but also includes other relevant information, such as:
  - Public spending chain: it relates to information concerning how the system of public spending management is regulated, coordinated and reviewed from the central government level (roles, responsibilities, guidelines)
  - External control chain: it is aimed to describe the review of public spending by central level or upper level governments/organizations carry on subordinate organizations
  - *Internal* control chain: here the perspective is on how the responsibility of public spending decision is shared within the organization (roles, responsibilities, internal rules).
- *Risk assessment:* this is similar to the original component, but with the following specific focuses:
  - Subject: the types of risks identified and assessed
  - Actors: roles and responsibilities of the actors included in the process of risk assessment
  - Framework: description of rules or guidelines
  - Methods: modalities of concrete risk assessment, including the possibility of networking or methodological support from external bodies
  - Impact: description of the concrete outcomes of risk detection and assessment, including the set of decisions that are made based on risk assessment
- *Control activities.* this is similar to the original component, but with the following specific focuses – that reflect the structure for risk assessment, except for the subject as the subject is always value-for-money, i.e. the 3Es concept of economy, efficiency and effectiveness:
  - Actors: who, within the organization, is entitled to make public spending decision and the roles and responsibilities top and line managers
  - Framework: description of control activities in terms of important elements that must be taken into consideration in decision making

- Methods: modalities of follow up checks or reviews before and after the operations occur, including systematic ex post reviews of public spending
- Impact: description of the consequences of negative variances (sometimes “failures”), e.g. self-learning versus sanction-based approaches

The “modified COSO components” structure has been followed for each country section; for the Czech Republic section, which focuses on weaknesses, the sub-components have not been considered.

*Basis of analysis.* In consideration of the timeframe, the bases of analysis have been differentiated for the Czech Republic and for the three foreign countries. For the Czech Republic, the weaknesses singled out in section 3 derive from a detailed survey of 31 public sector organizations across the country. For the foreign countries, information has been obtained from official documents and, in certain cases, consultations of experts or public officials.

*Description of legal framework.* The legal framework of internal control (and audit) is reported for the three foreign countries. In particular, an overview is contained in the introductory “context” section – together with information on administrative traditions and administrative structures – while the specific legal frameworks are reported for each level of government.

*Czech Republic weaknesses vis-à-vis foreign countries good practices to derive recommendations.* For the Czech Republic (section 3), weaknesses of internal control and audit have been highlighted, highlighting in brackets (COSO XX) which COSO principles they refer to. For the foreign countries analyzed (sections 4 to 6), good practices have been highlighted in special boxes, also highlighting which COSO principles they refer to. We included good practices developed within single organizations as they represent interesting cases from which important hints arise. This has allowed to derive the recommendations listed in section 7.

### **3 Weaknesses of internal control and audit in the Czech Republic**

The financial control in the Czech Republic is currently governed by Act No. 320/2001 Coll., on financial control in public authorities and on amendments to certain acts, and Decree No. 416/2004 Coll., implementing the Act on financial control. As stated by the Ministry of Finance of the Czech Republic on its website, this law is based mainly on the COSO and INTOSAI standards.

In particular, the Act on Financial Control regulates the scope and organisation of financial control, the main objectives of financial control, the organisation of financial control and control methods and procedures. It focuses on public control, financial control under international treaties and the internal control system.

The implementing decree then specifies these control methods and control procedures in more detail. It also regulates approval procedures, such as the procedures for approval under the preliminary management control before and after the commitment or entitlement is made. Further subject of modification are the operational procedures for the performance of continuous control, the evaluation procedures and review procedures for the performance of subsequent control and the audit procedures for the performance of internal audit. Finally, the Decree defines the structure and scope of the financial control reports, the procedure and deadlines for their submission.

Related laws to the Financial Control Act and the implementing decree are:

- Act No. 255/2012 Coll., on Control (Control Regulations),
- Act No. 563/1991 Coll., on Accounting,
- Act No. 418/2021 Coll., on criminal liability of legal persons and proceedings against them,
- Act No. 159/2006 Coll. on Conflict of Interest.
- The exercise of financial control is also enforced by the following laws:
- Act No. 218/2000 Coll., on Budget Rules and on Amendments to Certain Related Acts (Budget Rules), Section 39,

- Act No 250/2000 Coll., on budgetary rules for territorial budgets, in Section 15,
- Act No 131/2000 Coll., on the Capital City of Prague, in § 2 and § 3,
- Act No. 128/2000 Coll., on Municipalities (Municipal Establishment) in Section 9a,
- Act No. 129/2000 Coll., on Regions (Regional Establishment) in Section 2,
- and Act No 147/2000 Coll., on district authorities, in Section 9.

The entire legislative framework of financial control in the Czech Republic is supported by the methodological guidelines of the Central Harmonisation Unit, a department of the Ministry of Finance. Among the methodological guidelines, one can find, for example, the instruction on the management of assets in accordance with the 3Es principles (No. 15), the instruction on the audit of the internal control system in public administration bodies (No. 17), the instruction that regulates the model directive on risk management (No. 11) or the model directive on financial control for various public administration bodies such as voluntary associations of municipalities (No. 9), contributory organisations (No. 12) or municipalities (No. 10).

In the following subsections, the weaknesses found during the survey of public sector organizations analyzed in the field analysis (Analysis of the functioning of internal control systems of public administration bodies) of the Czech Republic are reported. The analysis was made by a sample of 31 selected organizations of various types and it does not cover a comprehensive analysis of all organizations in the Czech Republic, meaning that there may be exceptions from described outcomes. Organizations were selected in order to obtain representative of each type of public body in the Czech Republic. 15 types of public bodies have been defined by the Ministry of Finance and the legislative framework. The selection of subjects was also diversified by the size of the organization or by its location. They are sorted by level of government and, per each level, by the modified COSO dimensions applied in this study (see section 2). In brackets (COSO XX) are the relevant seventeen COSO principles related to the highlighted shortcomings. At the end of the section, Figure 2 provides an overview.

## 3.1 Central government

### 3.1.1 Control environment

#### 1. Large organizations manage large funds/assets which tends to result in a complex internal control system

One of the risks in the activities of central government units is their high interdependence with the State budget, which may limit their activities in times of unfavourable macroeconomic indicators. At the same time, these entities provide essential public goods and manage the State's assets, often in large volumes. Central government units also have to react promptly to emergencies in the world, such as pandemics or refugee waves, and provide other activities beyond their normal activities as directed by the government (COSO 6). Other risks are also the high number of operation commanders, budget managers and asset managers (in the case of large entities) considering large volumes of assets under management, the high demands on technical IT solutions, staff and financial resources (COSO 4).

#### 2. Limited skills IC staff due to low remuneration

Although the overall number of management and control staff is generally assessed as optimal in the interviewed entities, some report that there are occasional problems in securing specialists with specific expertise, e.g., lack of lawyers in internal audit departments in large cities, and IT specialists (especially Prague). According to the respondents, the reason for this is the low financial remuneration compared to the private sector, which they can offer to these experts with experience (financial limits of salary tariffs in the public administration). For this reason, these entities often must employ graduates without experience, whom they train for at least one year, and then it happens that the employees leave for the private sector (COSO 4).

#### 3. Formal setting of the strategy.

Identified weakness was also the formal setting of the strategy, without updating it and without linking it to the planning or to the subsequent control process (rather the case of smaller entities where the

mission is defined by the founder). On the other hand, in another entity it was noted that the strategy appeared to be too detailed and complexly formulated so that simplification was therefore being considered (COSO 6).

#### **4. No specific internal directive**

In the smallest entities, there is no separate internal directive directly on financial control, however, the requirements of the relevant law are incorporated into the internal directive on accounting or circulation of accounting documents. This describes, among other things, the roles of operation commanders, budget managers, etc., however sometimes only briefly and formally. Some provisions on financial control are also included in the description of roles in the organisation charts. This is justified by the respondents as an established practice that suits the running of the organisation and does not contradict the regulations (COSO 5, 12).

### **3.1.2 Risk assessment**

#### **1. Risk analysis done in a formal way**

Some entities do not consider practical benefits of risk management and therefore their risk assessment is practised in a rather formal way. This also results from the observation that these entities often define risks in a rather general and broad way, which makes them difficult to work with. Then risks are not used in other activities such as planning or control activities (COSO 7).

### **3.1.3 Control activities**

#### **1. Too many actors involved in decisions result in lack of clear responsibilities**

Another weakness resulting from the high number of decision-making levels, the large number of financial control bodies and the transactions approved by one person is the tendency to formalise the approval process, whereby the participants in the decision-making process are aware that a certain number of persons have checked the documentation before them and a certain number will check it after them. Paradoxically, this shortcoming has been cited more in the context of an electronic



transaction approval system tempting to quickly 'click' on a given icon without further checking the attached electronic documentation than in the case of approval of documentation collected in a single paper file (COSO 10).

## **2. No comprehensive view as several ICT systems occur**

A problem affecting more than one entity is the necessity to use several IT systems simultaneously, which are not always fully compatible. This is mainly due to the diversity of the agenda and the lack of a single system that covers all legislative requirements and the needs of organisations. Other reasons are the financial, time, technical and personnel requirements for possible migrations between several systems. This situation leads to shortcomings in terms of possible errors in data transfer between systems, temporary unavailability of some agendas, and a user-unfriendly or inconsistent environment for the entire decision-making process. This is also one of the frequently cited obstacles to the full computerisation of management processes (COSO 11).

## **3. The 3Es rules are considered complicated to apply or unnecessary given the type of activities performed**

Some organisations consider the 3Es rules to be unnecessarily complicated, or interviews show that the content is not fully understood by financial control participants, or they simplify the content to checking the price of the contract by comparing the offers of several competing suppliers, if they exist in the market. This is also the reason why some internal guidelines do not specify the 3Es verification procedure and the description essentially copies the legal standard (COSO 10).

## **4. Non clarity of different types of control (preventive, continuous and subsequent)**

There is sometimes confusion (identification) between continuous and subsequent controls, subsequent controls are more common in investment projects financed or co-financed from external sources and generally the controls are sometimes underestimated. Sometimes the participants in financial control are not fully aware that the contract does not end with the delivery of the asset (service) and its payment, but also

includes follow-up effects - evaluation of defects, claims, etc. Some respondents also contradict that it is not clear to them from the relevant regulations when exactly the preliminary, continuous, and subsequent controls start and end (COSO 10, 12).

## **5. Reluctance of introduction of ICT for IC by the organization**

The introduction of a fully computerised system for authorizing and controlling economic transactions is considered by respondents to be lengthy, costly and demanding in terms of technical solutions and staff. The provision of certified electronic signatures is also considered to be an expensive and not in all cases necessary solution (COSO 11). The introduction of the full computerisation of the approval and control process in some entities is hindered by the current use of several not fully compatible IT systems, limited financial, personnel and technical resources, as well as by the satisfactory traditional system of circulation of paper documentation, which some respondents assess as more transparent. It was repeatedly mentioned that an electronic system for approving transactions can paradoxically lead to more formality than approval of paper documentation, especially when there are multiple successive approval levels, where the current approver is aware that the transaction has been approved by someone before him and will be approved by someone after him and relies on these participants in the control process to have also reviewed the transaction (COSO 11).

### **3.1.4 Internal audit**

#### **1. Insufficiently defined activities of internal auditors**

Internal auditors report that they perform, to some extent, activities beyond the internal auditor's agenda (e.g. assisting with the implementation of new legislation), which consequently limits the capacity to carry out their own audit work. Even given the scale and volume of activity, especially of large entities and the limited capacity of auditors, their activity is carried out on a selective basis. It emerged indirectly from the interviews that some internal auditors, as well as the management of organisations (especially smaller ones), tend to confuse the role of the internal auditor with that of a regular (external) controller/auditor.

## **2. Lack of skilled internal auditors**

In large cities (especially Prague) compared to the private sector, it is sometimes difficult to get selected specialists with audit experience for a long period of time due to lower salary rates in the public administration. Recruitment is also hampered by the lengthiness of the processes resulting from the Civil Service Act.

## **3. Formality is more important than substance**

Although the internal control system, its functionality and set-up should be assessed comprehensively, in some cases internal auditors or other delegated persons focus only on examining selected sub-agencies or on assessing the more formalities of the control system. The respondents would rather like the audits to focus on the essential facts from their point of view and to be able to answer any methodological questions or to provide their opinion (interpretation) of a provision of the Financial Control Act, etc., which in their opinion is not happening.

## 3.2 Regional government

### 3.2.1 Control environment

#### 1. Inability to assign decisions to strategic objectives

It has been identified that the ability of the operation commanders to assign their decisions to the various strategic objectives of the organisations is not always evident (COSO 3, 5).

#### 2. Influence of politics

Influence of political decision-making on operation commanders (repeatedly declared 'limitation' of operation commander's decision-making power) (COSO 1).

#### 3. Too many people involved in the financial control

Other issue is large number of budget managers in organizations. This tends to be mainly because individual managers are experts in specific areas of authorisation, but the selected organisations perceived that it was appropriate to reflect on the 'appropriate' number of managers. While some of them are experts in a particular agenda, they are no longer economists or do not see it as essential to deal with 3Es at the same time, or are only formally familiar with the 3Es concept (COSO 4).

#### 4. Lack of liability for updating directives

Lack of accountability (ownership) of the relevant directive and thus problematic updating (example of a municipal district) (COSO 5, 12).

#### 5. Nonregular system of training employees

Not always a regular system of training in the field of ICS and FC (Financial Control) issues. If it exists, it is not always mandatory. The real impact is then that some persons included in the ICS are not regularly trained and may not know the current rules (COSO 4).

## **6. Insufficient knowledge of 3Es concepts**

According to IA, operation commanders have an idea of what the 3Es are, but budget managers often do not. They are usually not economists, but education is not overrated. According to respondents, length of experience rather than education determines the quality of FCs (COSO 4).

### **3.2.2 Risk assessment**

#### **1. A failure to manage risks is consequent upon too many described risks**

Too many risks described that are very difficult to manage. A frequent problem is that there is no clear link between the risk catalogue and the lowest decision-making positions (typically operations commanders). Even when risks are described and recorded, key people do not actually work with them. There is an underestimation of some risks (COSO 7, 9).

### **3.2.3 Control activities**

#### **1. No specific internal directive**

A shortcoming appears to be the setting of internal control system rules in a large number of different internal documents. The whole system of regulating the internal control system then becomes unclear and prone to violation of some rules, especially if there is no clearly declared interdependence of the individual standards with each other (COSO 12).

#### **2. No comprehensive view as several ICT systems occur**

The problem tends to be, in the perception of the respondents, the lack of connectivity of the sub-information systems. The ICS electronic systems are often not interconnected, which makes the whole process of management control difficult. Overlap between electronic and paper approvals is not ideal too. Other weakness of electronic systems is dependence on external suppliers. They are often unwilling to adapt the system to the individual needs of organisations (COSO 11).

### **3. Not performing preliminary control**

Preliminary control (in the international and MF concept) is sometimes practically not carried out, not always in all analysed organisations there is a comparison of variants of internal and external provision of services, whether in the case of existing provision and the possibility of extension, or in the case of a completely new service (COSO 10).

### **4. No prioritisation of expenditure which complicates subsequent control**

For a number of particularly routine types of expenditure, there is no clearly defined process or strategy for prioritising expenditure, nor is there a predetermined expected outcome, which makes continuous and especially subsequent control difficult. In particular, subsequent control tends to be highly formalised and respondents do not see much point or benefit to their own control or other management activities. It is still the case that many people are unable to adequately and correctly evaluate the 3Es (COSO 10).

### **5. Too many people involved in the control activities results in performing the control formally**

In some, particularly larger organisations, the analysis of approval processes identified a high frequency of commenters or signatories, but experience suggests that this is reflected in higher formality of the whole control. For example, the accounts payable pre-accounting baskets for supplier invoices contain 2 signatures of the preliminary control after the commitment: the operation commander and the chief accountant, 2 signatures according to the Accounting Act: for factual and formal correctness, and there are 2 signatures of the continuous control and 2 signatures of the subsequent control on each document. The persons concerned are not even aware of what is being done by this control and that this system can be simplified (and described as such in the Directive) (COSO 2, 4, 5, 10).

### **3.2.4 Internal audit**

#### **1. Lack of internal auditors skilled in specific areas**

One of the main shortcomings in this area is the lack of qualifications of internal auditors in some areas - especially IT, which leads to the inability to adequately audit some processes in organizations.

#### **2. Lack of skilled internal auditors**

The staffing of the internal audit can also be considered as a general weakness of internal audit in many other cases (statutory city) - it is not possible to find suitable qualified staff willing to participate in the audit.

### 3.3 Local government

#### 3.3.1 Control environment

##### 1. Insufficient staff capacity

Insufficient staff capacity, especially in small organisations (municipalities, educational legal entities), dependence of the system setup on only one person - the manager, who is usually the operation's commander and the associated risk of (in)substitutability. In addition, the system set up in this way is heavily dependent on the expertise of the person concerned and their ability to assess the adequacy of the operation (COSO 4).

##### 2. Nonregular system of training employees

There is no systematic approach to training in the area of financial control. Selected staff learn as they go, in the course of their duties (e.g. heads of department). If selected staff (e.g. operation commanders or budget managers) are trained, it is usually up to their decision (it is voluntary) and the financial capacity of the organisation (organization is not able to financially cover specific trainings) (COSO 2, 4, 5).

##### 3. Undefined responsibility for financial control.

A weakness is the lack of definition of the responsibility for internal control (e.g.: The control of the directive is carried out by the head of the body or by the control staff delegated by him - however, without further identification or definition of the selection procedure) (COSO 3, 5).

##### 4. Lack of evaluation of the ICS

Lack of a systematic approach or continuous evaluation of the setting or adequacy of the internal control system. Some organisations do not have personnel and time capacity to do this, they deal with ensuring the functioning of the office and key activities (example of a municipality) (COSO 3, 4).



### **3.3.2 Risk assessment**

#### **1. Not working with strategic documents**

There is only limited work with strategic or conceptual material. The quality of documents and the ability to work with them at operational level in normal practice varies significantly (is rather worse) (COSO 6).

#### **2. Absence of risk assessment**

In some cases, absence of systematic work with risks and lack of perception of the potential benefits of risk assessment for the organisation (COSO 6, 7, 9). Lack of risk assessment, lack of awareness of risk management, lack of understanding of the meaningfulness of risk management, lack of perception of the potential benefits of implementing risk management for the functioning of the organization (especially in the smallest organizations) (COSO 6, 7, 8).

#### **3. Risk analysis done in a formal way**

Another weakness is that some organisations describe sub-risks and have a risk map but do not know what it is for. They tend to do it formally because it is supposed to be done, rather than actually working with it (COSO 9).

### **3.3.3 Control activities**

#### **1. Paper-based financial control**

A weakness is the lack of computerisation of individual financial control processes and the resulting inflexibility and time constraints. Paper-based financial control is used, which in some cases is only converted into electronic form by scanning and is not usable for preliminary or continuous financial control. It serves more as an archive for subsequent control (COSO 11). Insufficient computerisation of individual processes, lengthy paper approval of operations. Some entities admitted that some links in the approval of operations are "irreplaceable" - i.e. waiting for the relevant staff member to return from leave. This involves a link to a

'key' staff member, which can have a significant negative impact on the relevance of the whole financial control (COSO 11).

**2. All liability lies on the operation commander as other roles are formal**

There is little flexibility in approving higher expenditure. In general, much depends on the lead authority (the operation commander) or its representative. The function of budget manager in some organisations does not fit the purpose, being linked to the position of chief accountant, but really only primarily accounting for documents and only returning them when it sees a formal irregularity. The role of the operation commander is then key (COSO 5, 10).

**3. Formal performance of continuous and subsequent control**

A weakness is the formal exercise of continuous and subsequent control. Often this is seen as an obligation rather than a meaningful activity. Organisations do not see the benefit of the subsequent control, they take it to mean that the operation has taken place, it has been approved and is therefore fine. It is not perceived that the control can be used for retrospective evaluation of the system setup and its functionality (COSO 10).

**4. Lack of perception of the importance of continuous controls and their relevance**

We encountered the view that the control is perceived only formally, e.g. as a check of the delivery note or the formalities of the invoice (COSO 5, 10).

**5. Misunderstanding of the 3Es principle, its applicability and meaningfulness**

Often 3Es was confused with market research or just comparing options in financing individual operations. Lack of linking the implementation of operations to the strategy or objectives of the organisation (COSO 10, 12).

## **6. Improper preliminary control**

For smaller contributory organisations, it is difficult in practice to set up management control of public revenue and expenditure in a way that is fully compliant with the Financial Control Act and its implementing decree. The chief accountant and budget manager is usually an external employee (accountant) and the post commitment controls are thus carried out after the purchase, at the time of posting the document. Properly, the control should take place before the purchase (COSO 4, 10).

### **3.3.4 Internal audit**

#### **1. Lack of IA assessment**

The quality assessment of internal audit is not yet carried out. A partial assessment of IA has only been carried out as part of the ISO 9001 management quality review as part of the external certification and surveillance audit.

## 3.4 Agencies: universities and research institutions

### 3.4.1 Control environment

#### 1. Insufficient knowledge of regulations for financial control

Insufficient knowledge of FC regulations among a large number of operation commanders. Qualifications in the FC area are not a standard requirement, especially for the position of operation commanders (partly also budget managers). Irregular or completely absent training processes in FC (COSO 3, 4).

#### 2. Code of Conduct only a formal document

Code of Conduct only as a formal document, the organisation does not work with it further, the problem was to 'find' it (COSO 1).

#### 3. Nonregular system of training employees

Absence of the training for the staff of the internal control system (COSO 4).

#### 4. Older generation lacks skills in IT

The process of computerisation of the ICS is strongly influenced by the generation. It is easier to computerise processes in younger age groups normally used to working with IT systems. The electronic systems of the ICS are often not interconnected, which makes the whole process of management control more difficult. Overlap between electronic and paper approvals. Dependence on external suppliers of electronic systems. They are often unwilling to adapt the system to the individual needs of organisations (COSO 4, 11).

### 3.4.2 Risk assessment

#### 1. Lack of risk assessment

Inconsistent approach to working with risks at different universities. In some public universities, there is a complete lack of a systematic

approach to risk management (at best, risk management is left to and delegated to individual staff (individual assessment)), at worst, risks are not managed at all. Absence of a risk management system, including a profound underestimation of their importance and contribution to the organisation (COSO 6).

**2. A failure to manage risks is consequent upon too many described risks**

In large universities, on the other hand, cases can be identified where so many risks are described that they are no longer manageable in reality. The risks described are usually not communicated to all staff of the ICS (in particular the principals of the operations) (COSO 6, 8, 9).

**3.4.3 Control activities**

**1. Paper-based financial control**

Computerisation is neglected from the previous period when there was no support for computerisation from the management. The organization does not even have electronic asset records (COSO 11).

**2. No comprehensive view as several ICT systems occur**

Interconnection of different parts of IT systems within the ICS lacks. Very high number of staff assigned to the ICS (especially commanders). With such a large number of staff, it is very difficult to ensure all the required knowledge and prerequisites required by the FC Act (COSO 11).

**3. Electronic financial control is more formal**

Controls are in some cases computerised - need for more signatures, which slides towards formalisation (reliance on whoever has controlled before or, conversely, is yet to control) (COSO 11).

**4. Misunderstanding of the 3Es principle, its applicability and meaningfulness**

Failure to adequately evaluate the 3Es, particularly by commanders (but often also by budget managers). Large differences in the extent of computerisation between public universities (COSO 10, 12). 3Es are not practically assessed or formalized in the organization. Some logical reasoning and "common sense" is also evident due to stalled operations (COSO 4, 10).

#### **5. Too much reliance on the information system**

The IS does not create the need to pay more attention to the design of the control plan, their systematic implementation and settlement, on the grounds that the information systems "take care of everything" (COSO 10, 11).

#### **3.4.4 Internal audit**

##### **1. Lack of internal auditors skilled in specific areas**

Lack of qualifications of internal auditors in some areas - especially IT, which leads to the inability to adequately audit some processes in organizations. For smaller universities, internal audit is implemented as a document check rather than an actual audit.

WEAKNESSES OF INTERNAL CONTROL AND AUDIT IN THE CZECH REPUBLIC

**Figure 2. Weaknesses of internal control and audit in Czech Republic  
(connection to COSO principles in brackets)**

	Central government	Regional government	Local government	Agencies (Universities)
<b>Control environment</b>	1. Lack of personnel and IT resources to develop complex internal control systems in large organizations (4, 6)	1. Inability to assign decisions to strategic objectives (3, 5)	1. Insufficient staff capacity (4)	1. Insufficient knowledge of regulations for financial control (3, 4)
	2. Limited skills IC staff due to low remuneration (4)	2. Influence of politics (1)	2. Nonregular system of training employees (2, 4, 5)	2. Code of Conduct only a formal document (1)
	3. Formal setting of strategy (6)	3. Too many people involved in the financial control (4)	3. Undefined responsibility for financial control (3, 5)	3. Nonregular system of training employees (4)
	4. No specific internal directive (5, 12)	4. Lack of liability for updating directives (5,12)	4. Lack of evaluation of the ICS (3, 4)	4. Older generation of the ICS lacks skills in IT (4, 11)
		5. Nonregular system of training employees (4)		
		6. Insufficient knowledge of 3Es concepts (4)		
<b>Risk assessment</b>	1. Risk analysis done in a formal way (7)	1. A failure to manage risks is consequent upon too many described risks (7, 9)	1. Not working with strategic documents (6)	1. Lack of risk assessment (6)
			2. Absence of risk assessment (6, 7, 8, 9)	2. A failure to manage risks is consequent upon too many described risks (6, 8, 9)
			3. Risk analysis done in a formal way (9)	
<b>Control activities</b>	1. Too many actors involved in inspections result in lack of clear re-sponsibilities (10)	1. No specific internal directive (12)	1. Paper-based financial control (11)	1. Paper-based financial control (11)

## WEAKNESSES OF INTERNAL CONTROL AND AUDIT IN THE CZECH REPUBLIC

	2. No comprehensive view as several ICT systems occur (11)	2. No comprehensive view as several ICT systems occur (11)	2. All liability lies on the operation commander as other roles are formal (5, 10)	2. No comprehensive view as several ICT systems occur (11)
	3. The 3Es rules are considered complicated to apply or unnecessary given the type of activities performed (10)	3. Not performing preliminary control (10)	3. Formal performance of continuous and subsequent control (10)	3. Electronic financial control is more formal (11)
	4. Non clarity of different types of control (preventive, continuous and subsequent) (10, 12)	4. No prioritisation of expenditure which complicates subsequent control (10)	4. Lack of perception of the importance of continuous controls and their relevance (5, 10)	4. Misunderstanding of the 3Es principle, its applicability and meaningfulness (4, 10, 12)
	5. Reluctance of introduction of ICT for IC by the organization (11)	5. Too many people involved in the control activities results in performing the control formally (2, 4, 5, 10)	5. Misunderstanding of the 3Es principle, its applicability and meaningfulness (10, 12)	5. Too much reliance on the information system (10, 11)
			6. Improper preliminary control (4, 10)	
<b>Internal audit</b>	1. Insufficiently defined activities of internal audit	1. Lack of internal auditors skilled in specific areas	1. Lack of IA assessment	1. Lack of internal auditors skilled in specific areas
	2. Lack of skilled internal auditors	2. Lack of skilled internal auditors		
	3. Formality is more important than substance			



## 4 France

### 4.1 Context

#### 4.1.1 Administrative traditions and structures

France is a unitary state considered until the 1980s and the laws of decentralisation as one of the most centralised administrative systems in Europe (Kuhlmann & Wollmann, 2019). Today, despite the laws of decentralisation and the emergence of the principle of free administration of local government, France remains a highly centralised state. Indeed, the central state and local governments intervene directly in many areas of the economy and society. At the level of the central State, the ministries steer the various public policies and can rely on their networks of deconcentrated services to implement their actions in the territories. The local governments manage the public policies for which they are responsible in their territory. Since the 1980s, local governments have had more and more powers, but regalian powers are still exercised by the State. Moreover, with the recent tax reforms, they have lost a significant part of their financial autonomy (reform of company taxation, abolition of the *taxe d'habitation*). They therefore remain fairly dependent on the State for their revenues.

According to several researchers (Peters, 2008; Kuhlmann & Wollmann, 2019), France has a Napoleonic administrative and legislative system. It is characterised by three basic pillars of administrative tradition and structure:

- A centralising and unitary state that acts in many areas of society and governs much of the country's affairs. It is based on a universalist vision that leads the state to have a very strong and direct relationship with all citizens.
- A legalistic conception of public action that places respect for the law and public law above all other considerations. Thus, even if he or she is also a manager who must manage public affairs in the most efficient way possible, the civil servant sees respect for the law as the starting point for his or her action.
- A strong interconnection between senior officials and elected officials. Senior civil servants are sensitive and reactive to political will

(pressure). Moreover, many people go back and forth between senior civil servant positions and political positions.

Although the reforms inspired by the NPM have been less important in France than in other countries, they have nevertheless modified the functioning of French administrations. From the 1970s onwards, several reforms (or attempted reforms) attempted to develop a more managerial dimension in the French administration (RCB, LOLF, RGPP, etc.). These major reforms have led the French administration to a hybrid model half-way between a bureaucratic operation based on law and procedure and a managerial operation.

#### **4.1.2 Internal control: overview and legal framework**

The legal framework has two main pillars:

- Constitution, and the
- Decree on public budgeting and accounting management (PBAM).

*Constitutional basis for internal control and audit.* Articles 13, 14 and 15 of the Declaration of the Rights of Man and of the Citizen require that public authorities give a true and fair account of their management. In addition, since 2008, the Constitution also requires public organisations to ensure the accuracy of their accounts: "*The accounts of public administrations are regular and accurate. They give a true and fair view of the results of their management, their assets and their financial situation*" (second paragraph of Article 47-2 of the Constitution). These legal texts, placed at the top of the hierarchy of norms, serve as a fundamental justification for the implementation of internal financial control.

But these provisions remain very general. They do not impose any concrete measures or actions to ensure the quality, reliability and fairness of public administrations' accounts. Moreover, they do not address the issue of non-financial internal control at all.

*Decree No. 2012-1246 of 7 November 2012 on public budgetary and accounting management (PBAM).* The PBAM decree was adopted in 2012 following the LOLF, a major constitutional reform of State finances. The objective of the decree was to adapt public finance management to the new managerial context introduced by the LOLF (autonomy and accountability of managers, new organisation of public finances, reforms of the

principle of separation of authorising officers and accountants). But this decree also introduced into the law the general accounting of public organisations, alongside budgetary accounting. The PBAM decree applies to all French public organisations (State, local authorities, State and local authority operators, etc.).

The PBAM decree lays down clear obligations in terms of internal financial control: "In each body, a budgetary internal control system and an accounting internal control system shall be set up. (Chapter IV - Section 1 - Article 215). This same article specifies that: "The purpose of budgetary internal control is to control the risks relating to the pursuit of the objectives of quality of budgetary accounting and sustainability of programming and its implementation". This article also states that: "The purpose of internal control of accounting is to control the risks relating to the pursuit of the objectives of quality of the accounts, from the moment a transaction is generated to its settlement in the accounts".

The PBAM decree also lays down clear obligations in terms of internal audit: "The purpose of the budgetary and accounting internal audit, carried out independently and objectively, is to give each body reasonable assurance on the degree of control of the budgetary and accounting operations it conducts, as well as an assessment of the quality of budgetary and accounting internal control." (Chapter IV - Section 1 - Article 216)

It is important to note that the provisions of the PBAM decree on internal control and audit do not apply to local governments.

## 4.2 Central government

### 4.2.1 General overview

In France, the central government is involved in many sectors of the economy and society. It is responsible for approximately 38,8% of total public spending (including spending by various central government agencies). The ministries manage the public policies for which they are responsible. They rely on their central and deconcentrated administrations to implement public actions and services throughout the whole country.

At present, the central State has 17 ministries. The deconcentrated services are placed under the authority of regional or departmental prefects. There are 96 departmental prefectures (divided into sub-prefectures) and 13 regional prefectures (departmental prefecture where the capital of the region is located). Since the RGPP<sup>2</sup>, the division of the deconcentrated services no longer reflects the ministerial division because certain deconcentrated services have been grouped together within large regional or departmental directorates.

Since the LOLF<sup>3</sup>, the State budget follows a clear division that represents the administrative architecture of the central State. The State Budget is divided into Missions placed under the responsibility of the Ministers. These missions are divided into Programs placed under the responsibility of a Program manager. These programs are divided into Operational Program Budgets, which may be placed under the responsibility of central services (within the Ministry) or deconcentrated services (in the territories). These Operational Program Budgets are divided into Actions. For each Mission-Program-Action, the budgetary resources allocated for the year are defined, as well as the objectives and performance indicators to be achieved. The steering of services is therefore largely done through a management dialogue in which the heads of Programs or Operational Program Budgets report on the management of their budget and their results.

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<sup>2</sup> General Revision of Public Policies, an administrative modernization reform launched in 2007.

<sup>3</sup> Organic law n° 2001-692 of August 1, 2001 relating to finance laws.

But beyond this, the actions of the ministries are still strongly governed by the norms and most of the time they involve the production of legal texts (decrees, orders, circulars). The regulatory and normative aspects are still at the heart of the ministries' actions.

#### **4.2.2 Specific legal framework**

In France, following the major reform of public finance (LOLF), several norms have imposed the implementation of internal audit and control procedures within ministries. Two are particularly important:

- Decree no. 2011-775 of June 28, 2011 on internal audit in the administration
- Decree on public budgeting and accounting management (PBAM).

*The decree n°2011-775 of June 28, 2011* is the official starting point for internal control procedures in the French central administration. It requires that an internal control system be deployed in each Ministry. The decree defines internal control as "the set of formalized and permanent mechanisms decided by each minister, implemented by managers at all levels, under the coordination of the secretary general of the ministerial department, which aim to control the risks related to the achievement of the objectives of each ministry" (article 1). It also requires each Ministry to establish structures responsible for planning, carrying out and monitoring internal audits to ensure the reliability of the internal control systems established in each Ministry. The decree specifies that "internal auditing is an independent and objective activity that provides each minister with an assurance on the degree of control of his or her operations and provides advice on how to improve them. The internal audit ensures that the internal control systems are effective" (article 1). An interministerial committee has also been created to harmonize the audit and internal control practices of the various ministries (Interministerial Committee for Internal Audit Harmonization). A circular dated June 30, 2011 from the Prime Minister specifies the terms of application of this decree. These two texts clearly mark the starting point for the implementation of internal control and audit systems within government departments.

Thus, since this decree, each ministry has:

- A *Ministerial Internal Audit Committee* (Comité Ministériel D'Audit Interne), MIAC: this committee brings together the ministry's top managers and external actors (top managers from other ministries or from private sector companies). Its role is to plan ministerial audits and entrust their implementation to the Ministerial Mission of Internal Audit. This committee also votes on decisions relating to the implementation, updating and improvement of the ministerial internal control system (risk mapping, risk management action plan, redefinition of macro-processes, etc.)
- A *Ministerial Mission of Internal Audit* (Mission Ministérielle D'Audit Interne), MMAI: this Mission of Internal Audit is responsible for carrying out itself or having carried out the audits decided by the Ministerial Committee of Internal Audit. A circular dated June 30, 2011 from the Prime Minister (whose purpose is "the implementation of internal audit in the administration") specifies that this internal audit mission must be entrusted to the General Inspectorates (Inspection Générale) in the Ministries where they exist.

*Order of December 18, 2018 on the interministerial reference framework for financial internal control applicable to the State's budgetary and accounting internal controls.* The order of the Ministry of Finance has come to reform the State's financial internal control. This very detailed text specifies the objectives, scope, governance, and process of the State's internal financial control.

First, it explains that the objectives of the State's internal financial control are (1) budgetary sustainability and (2) accounting quality. Second, it specifies the scope of budgetary and financial internal controls, which are respectively the responsibility of the Authorizing Officer (the Minister and his delegates) and the Accountant. Third, it sets out the governance, i.e. the role of the various ministerial actors in the internal control process (see next sub-section). Finally, fourth, the decree specifies the practical details of the internal control process to be implemented within each Ministry (identification and coverage of risks, organization, etc.) (see next sub-section for details).

It is interesting to note that in an annex, *this decree refers directly to COSO*: "The interministerial reference framework for internal financial

control in the State is based on the international internal control framework COSO II (Committee of Sponsoring Organizations of the Treadway Commission)". This tends to demonstrate that the audit and internal control practices implemented within the central government and its ministries are directly inspired by private sector practices.

### **4.2.3 Control environment**

Historically, the administrative environment of the French Central Government has always been characterized by the prevalence of norms and administrative rules. Thus, the control environment was initially based on a very strict framework of the public spending chain. More recently, there has been a desire on the part of the public authorities to add a managerial dimension to this control environment in order to move towards a culture of risk management: "The environment conducive to the management of financial risks constitutes the foundation on which the financial internal control approach can be built. It requires the involvement of managers and the development of a risk control culture within the structures." (Order of December 18, 2018). This has resulted in the implementation of very clear chains and internal and external controls.

#### **Good practice FR1 – Control environment – Central government: Law and rules on internal control and audit bodies**

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All ministries are required by law to have internal control and audit bodies (MIAC, MMAI). This requires the top managers of the ministries to equip themselves with internal risk control tools that help develop their risk culture (both for financial and non-financial risks). (COSO 2, 3 & 5)

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### **Public spending chain**

The public spending chain begins with the construction of the ministry's budget in consultation with the Budget Department (Direction du Budget) of the Ministry of Finance. The State budget is divided into Missions-Programs-Actions. A ministry is responsible for managing one or more Missions. At this stage, control over the allocation of resources and the general balance of the State budget is ensured by the Budget Depart-

ment (Ministry of Finance). Then, the Budget Department works in partnership with the Head of the Ministerial Financial Function (Fonction Financière Ministérielle), which steers the ministerial budget under the responsibility of the Secretary General.

Once constructed, the State budget must be voted by the Parliament. At year n-1, the Parliament therefore votes on the budgetary appropriations allocated to the various Missions. Each Ministry manages one or more Missions and is responsible for distributing these appropriations to the various ministerial programs. Upstream, there is thus parliamentary control over the expenditures allocated to the various missions. The appropriations voted by Parliament then constitute the maximum limit of expenditure that can be committed during the budget year.

During the budgetary year, the public spending control chain is based on a fundamental principle: the *principle of separation of the authorizing officer (ordonnateur) and the accounting officer (comptable)*. The authorizing officer is the Minister (and his delegates). He decides on public expenditure, judges its appropriateness, and ensures its execution. On the other hand, he is forbidden to handle public money. The accountant (and his subordinates) is an administrative agent who is a referent for the organization but who is hierarchically attached to the Public Finance Department (Direction des Finances Publiques), Ministry of Finance. He handles public money at the request of the authorizing officer. He or she does not judge the appropriateness of the expenditure but simply verifies its regularity and availability. The same person cannot perform the functions of authorizing officer and accountant at the same time. The Budget Department (Ministry of Finance) monitors the proper execution of the budget by the ministries. The government can only commit expenditure within the limits of the appropriations voted by Parliament. If changes in appropriations at the level of the missions are necessary, an amending finance act must be passed by Parliament.

At the end of the budget year, the accounting statements are drawn up by the Ministry of Finance. A settlement law presenting the completed budget is voted by the parliament. The Ministerial Missions of Internal Audit, MMAI (generally entrusted to the General Inspectorates) and the ministerial accounting departments can carry out audits on parts of the



budget of certain Missions or Programs focused on certain themes (payment of delegates, payroll, valuation of assets, etc.).

### **External control chain**

The Court of Auditors (Cour des Comptes) plays a very strong role in the implementation of an external control of public spending by ministries and their departments. Indeed, the Court of Auditors regularly carries out audits of the actions of the ministries. It can thus audit a ministerial Mission or Program, either on site or on documents. This control concerns both the regularity of the expenditure (conformity) and its efficiency (performance of the public action). For example, on February 23, 2022, the Court of Auditors published a report on national police training. This analysis focuses both on the lack of clarity in the budgetary management of this public policy and on its effectiveness. In particular, it criticizes the lack of a clear and unified organization of police training practices throughout the country. The recommendations of the Court of Auditors concern the reorganization of the training services, the adequacy of the means to the objectives and the need to greatly improve the management and budgetary rigor of this public policy. The Court of Auditors is competent to audit any ministerial Mission or Program. The Court of Auditors is also responsible for certifying the State's accounts each year. This instruction is therefore the major actor of the external control of public expenditure.

### **Internal control chain**

The Secretary General of each ministry is responsible for the implementation of its internal control. Since June 30, 2011, each ministry must set up a Ministerial Internal Audit Committee. This Ministerial Internal Audit Committee must ensure the implementation of an internal control system and define the ministry's audit policy. It is composed mainly of professionals from outside the ministry concerned. The circular also provides that each ministry must set up a Ministerial Mission of Internal Audit to carry out audits in accordance with the policy defined by the Ministerial Internal Audit Committee. Generally, it is the General Inspectorates that perform this role.

Almost all departments have internal control systems based on risk maps. These maps make it possible to identify and assess departmental risks and to verify that actions have been taken to control these risks. However, the implementation of these internal control systems in the departments of the ministry or in the departments that are deconcentrated remains largely insufficient today. The implementation of internal control systems in the departments of the ministries is one of the major projects of the Ministry of Finance.

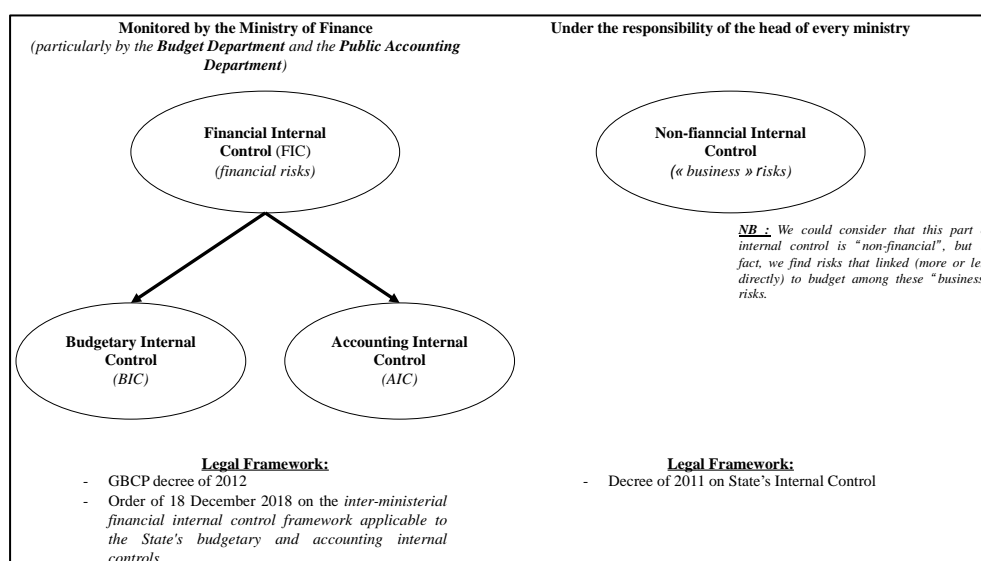
While each ministry is responsible for its own internal control systems, the Committee for the Harmonization of Internal Audit (CHIA) (Comité d'Harmonisation de l'Audit Interne de l'État) defines a general State policy on internal control and audit and works to standardize practices. The heads of the Ministerial Internal Audit Committee are members of this Committee for the Harmonization of Internal Audit.

#### **4.2.4 Risk assessment**

##### **Subject**

In France, there are two main families of risks that can be identified and assessed by ministries: financial risks (budgetary and accounting risks) and "business" risks (non-financial risks) (see Figure 3).

**Figure 3. General framework of the French State Internal Control (source : authors)**



Business risks are very broad and can affect all the departments' operational activities. The Committee for the Harmonization of Internal Audit (CHIA) nevertheless urges the departments to classify these different risks under generic headings to make the ministerial risk maps more readable. The business risks that can be identified may concern activities as varied as:

- Departmental governance
- Production, application, and compliance with standards
- Reporting, processing, and distribution of information
- Protection of the population
- Etc.

As far as financial risks are concerned, they fall into two categories: budgetary risks and accounting risks. Budgetary risks are “risks relating to the pursuit of the objectives of quality of budgetary accounting and the sustainability of programming and its execution” (Article 170 PBAM<sup>4</sup>). Accounting risks are “the risks relating to the pursuit of the objectives of quality of the accounts from the moment a transaction is generated to its accounting completion” (Article 170 PBAM).

<sup>4</sup> Decree No. 2012-1246 of November 7, 2012 on Public Budgetary and Accounting Management (PBAM), this decree represents the legal Framework of public finance management in French public administration

## Actors

There are four main actors: the Ministerial Internal Audit Committee, the Ministerial Mission of Audit Interne, the Secretary General, and the Ministerial Accounting Agency.

1. The *Ministerial Internal Audit Committee, MIAC*. Each ministry has a MIAC. The mission of the MIAC is to “define the ministry's audit policy, ensure the quality of the internal control and risk management system, ensure the quality of the ministerial audit system and follow up on the actions decided upon following these audits” (CHIA, 2020). The MIAC is therefore responsible for defining the ministry's audit policy and assessing its internal control system based on the results of audits. The MIAC is therefore responsible for controlling financial and business risks.
2. The *Ministerial Mission of Internal Audit, MMAI*. Each ministry must also create a MMAI which “defines, on the basis of a risk-based analysis, the ministerial audit program that it will submit to the Ministerial Internal Audit Committee for approval. The MMAI is therefore responsible, within the framework decided by the MIAC, for submitting an audit program to the MIAC and for conducting or commissioning the audits. In many ministries, it is the General Inspectorates that fulfils this role.
3. *Secretary General*. The Secretary General of the Ministry is responsible for setting up an internal control system within his Ministry. The head of the Ministerial Financial Function and the Ministerial Accounting Officer may assist him or her in setting up the financial internal control system. The Secretary General may also set up a steering committee to manage the Ministry's internal control policy. This risk steering committee is responsible for ensuring that the risks are mapped and that actions are decided and implemented to deal with these risks.
4. *Ministerial Accounting Agency*. The accounting officer is also a player insofar as he or she participates in identifying accounting risks. However, the PBAM decree provides that the accounting officer may conduct audits to ensure that accounting risks are properly controlled.

## Framework

The risk identification and assessment tool used by the ministries is the risk map. This tool, which has a standardized format, makes it possible to identify the risks to which the ministry is subject. In this risk map, all risks are assessed (see next section) and it is verified that control activities are in place to control the risks. In each ministry, there are often several risk maps. At the level of top management, there is often a "business" risk map and a financial risk map. In some ministries, risk maps are created in the various departments and deconcentrated services to deploy and adapt the ministry's risk assessment systems to the specificities of the services. At the level of deconcentrated departments, risk assessment systems are still rare, and the ministry's departments are currently working to ensure that more deconcentrated departments develop risk management tools, particularly regarding financial risks. All ministerial risk maps must be presented to and adopted by the MIAC. The MIAC must also ensure that the risk maps are updated annually.

Ministries are quite free to identify the "business" risks that they include in their risk maps. However, CHIA is seeking to standardize practices by distributing lists of generic risks and by regularly bringing together ministerial referents to discuss good practices. CHIA would like to see internal control practices further standardized from one ministry to another. Regarding financial risks, the risk management systems are fairly well supervised by the Ministry of Finance. The Ministry of Finance provides a list of interministerial budgetary risks (identified on the basis of the maps provided in previous years by the ministries). The various ministries must identify to which interministerial budgetary risks their own risks relate. In addition, the budgetary risks identified by the ministries must be linked to one of the 11 budgetary macro-processes identified and described by the Ministry of Finance. Ministerial budgetary risks must be transmitted to the Budget Department (Ministry of Finance) in the form of a table with 3 parts:

1. Risk description,
2. Risk rating,
3. Risk control.

### **Good practice FR2 – Risk assessment – Central government: Methodological support**

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The two types of risks that departments must identify are clearly defined by the laws and regulations: business risks and financial risks. Once they

have identified these risks, ministries must assess them according to a methodology clearly defined by the texts. The ministerial risk maps provide a support document for this internal control process. These maps are updated annually by the departmental internal control steering committees. (COSO 6, 7 & 9)

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## Methods

There are two main methods of risk assessment that reflect the two types of risks, business risk and financial risks. Regarding business risks, the assessment and prioritization of risks is the responsibility of each ministry. However, CHIA has established clear recommendations in this area, which are applied in almost all ministerial risk maps. The process of risk assessment is structured as follow:

- risk assessment begins with the rating of the criticality of the inherent risk (or gross risk); this is done through the evaluation of the impact and frequency of this risk.
- The effectiveness of the measures already implemented to secure the activities and processes is then considered to measure "risk control".
- The difference between "criticality" et "risk control" allow to determine the "residual risk"; the "residual risk" is the risk remaining after taking into account the existing and implemented risk control activities.

Thus, this risk assessment and prioritization is the result of the residual risk criticality rating.

Regarding financial risks, the Order of December 18, 2018 on the interministerial reference framework for internal control in the State stipulates that risk maps must identify and prioritize financial risks. The rating methodology is very similar to that used for "business" risks :

- evaluation of criticality of the financial risk (probability of occurrence and impact)
- evaluation of the "control risk" (effectiveness and efficiency of mesures in place)
- Determition of the residual risk (the uncontrolled portion of the financial risk)

## Impact

Risk mapping requires the top management of each ministry to identify and prioritize the financial and non-financial risks inherent in its business. This makes it possible to highlight the critical risks for which its control activities are non-existent, insufficient, or ineffective. In this case, top management must implement actions to improve its risk control. Thus, the risk maps give rise to action plans, usually multi-year, providing for the implementation of targeted control activities such as:

- Improvement or introduction of procedures
- Setting up checkpoints (automated or manual)
- Segregation of duties
- The implementation of supervisory controls
- The evolution of processes
- Etc.

CHIA explains that there are 5 ways the organization can respond to risk following the French acronym STEAM:

- Removal of risk by removing the activity
- Transfer of risk (by delegation or insurance)
- Risk avoidance by choosing a new process
- Acceptance of risk through lack of action
- Risk management through the implementation of new control activities.

In practice, risk assessment is still often considered an administrative formality rather than a real management tool. Risk maps and action plans are often drawn up to meet regulatory requirements. Moreover, the dissemination of internal control tools and practices within the various departments and deconcentrated services of the ministries remains very deficient.

The real level of implementation of the risk assessment is medium. On the one hand, all ministries have one (or more) risk maps validated by MIAC. Thus, all ministries identify and assess risks according to a standard methodology (presented above). On the other hand, the production of these maps is still largely perceived as an administrative formality. In most cases, it does not lead to a real risk management process. Moreover, in most ministerial departments or deconcentrated services,

there is no risk mapping. And no such process is in place. This situation is deplored by the CHIA.

#### **4.2.5 Control activities**

##### **Actors**

Public expenditure is governed by two main categories of actors: the authorizing officer and the accountant. The authorizing officer is an agent of authority (elected or appointed) who has the function of financial decision-maker: "authorizing officers shall prescribe the execution of revenue and expenditure" (Article 10 PBAM). This is the minister or the Prefect in the deconcentrated services. He or she decides on expenditures and revenues and orders their execution. But he or she is not allowed to handle public money. In practice, he can delegate his functions of expenditure commitment to other actors, but he retains responsibility for them.

The public accountant has a monopoly on the handling of public funds. He is personally and financially responsible for the acts and controls he/she has to carry out (Article 17 PBAM). Each ministry and deconcentrated service has a lead accountant who is responsible for the settlement of its expenditures and revenues. However, in terms of hierarchy, this lead accountant depends on the Public Finance Department (Ministry of Finance). In the event of misconduct in the performance of their duties, public accountants are judged by the financial court, i.e. the Court of Auditors.

There is a principle of separation of authorizing officers and accounting officers which states that these two functions are incompatible. The authorizing officer and the accounting officer intervene successively in the chain of expenditure so that the latter can be carried out (see in the following sub-sections).

##### **Framework**

The authorizing officer is responsible for assessing the appropriateness of the expenditure. At the ministry level, he is responsible for the



budget that details all the expenditures of the Missions-Programs-Actions for which he is responsible. For each Mission-Program-Action, there are :

- Elements relating to public spending: a list of expenditures and the planning of the execution of the expenses
- Elements relating to performance: a list of objectives to be achieved and their indicators

During the year, at the ministerial level, it may be decided to transfer appropriations between programs of the same Mission without explicit authorization from Parliament. On the other hand, the authorizing officer must execute the budget of the Ministry's missions as voted by Parliament.

At the time of budget construction, the choice of expenditures may therefore be based on the Minister's desire to favor one Mission or Program over another. This choice can also be made on the basis of objectives and performance indicators. There is no formal obligation to integrate considerations related to objectives, strategy, risks or the 3Es. On the other hand, once the budget is voted, the execution of expenditures follows a fixed plan, and this type of reflection is no longer considered. Moreover, the Budget Department (Ministry of Finance) plays a fairly strong control role over the way ministries construct and execute their budgets.

The Order issued on December 18, 2018 states that departments implement measures to control financial risks identified in the departmental financial risk map. The measures to control financial risks are first reflected in the organization of the actors. The various tasks in the financial chain must be defined and assigned in a comprehensive manner. Secondly, the implementation of control points is another element that reinforces risk control along the public spending chain. These control points can be of different kinds:

- Self-check,
- Mutual control,
- Supervisory control,
- Substantive control,
- National consistency check.

With the implementation of the Chorus financial software for all central state departments, a large part of these financial control activities are automated. Indeed, the accounting procedures of all the State's services are now managed in a single Chorus software that allows for the automation of ex-post and in-itinere controls.

### **Good practice FR3 – Control activities – Central government: Multi-year Action Plans**

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Based on the departmental risk maps, departments develop multi-year action plans to implement risk control activities. These risk control activities can be of various types (process organization, control points). Among these control activities, the development of a single, centralized accounting software package (Chorus) makes it possible to partially automate financial risk control activities. (COSO 10, 11 & 12)

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#### **Methods**

There are two main streams of internal control: “in itinere” and “ex post”. Once voted in the budget, the expenses are executed as and when they occur. This execution follows a highly standardized “in itinere” procedure that involves the authorizing officer and the accountant. Each program includes budget execution schemes. This allows for the reinforcement of financial risk control at two levels:

- Organization of the actors: clear separation of tasks between the authorizing officer and the accountant
- Implementation of mutual control points: control of the accountant on the authorizing officer.

In fact, this procedure follows 4 steps:

1. *Commitment*: the authorizing officer (or his delegate) notes an obligation against him which results in an expenditure. He must then ensure that the expenditure is correctly charged to the accounts and that the appropriations are available.
2. *Settlement*: The authorizing officer decides on the final amount of the expenditure which becomes payable.
3. *Authorization*: The authorizing officer issues a mandate to pay and the supporting documents to the accountant

4. *Payment*: The accountant carries out all the controls that are his responsibility and proceeds with the payment.

Once all expenditures have been made, there are several forms of ex post (consecutive) control. Internal control is carried out by the ministry's General Inspectorates through audits. These audits focus on a specific theme and will concentrate on a certain type of expenditure in a given Program (for example, an audit of the payment of contractual teachers in a program of the Ministry of National Education). The annual audit program is defined by the MIAC according to ministerial priorities and/or known or suspected malfunctions by top management (see above). The second form of audit is external and is carried out by the Court of Auditors. Indeed, the Court of Auditors can conduct external audits on certain Programs of a ministry. This audit may cover both financial (regularity of expenditure) and non-financial (effectiveness of expenditure) elements. For example, on January 25, 2021, the Court of Auditors published a report on the implementation of the withholding tax on income. The Court of Auditors pronounces on both the regularity of accounting operations (exceptional income not yet justified) and on the effectiveness of this approach (relevance of the implementation of the withholding tax in project mode). Another ex-post control is carried out by the Court of Auditors, which certifies the State's accounts each year. This certification is supposed to contribute to a better quality and greater reliability of public accounting information.

### **Impact**

Internal audits conducted by the Ministry's General Inspectorates may identify malfunctions and provide recommendations for their correction. In this case, the manager of the audited program is responsible for implementing these recommendations. A monitoring committee organized each year must follow up on the implementation of these recommendations. In practice, monitoring committees are rarely set up and audits are not always followed up.

External audits by the Court of Auditors can also highlight malfunctions. In the event of a serious problem, the authorizing officer or the accounting officer may be referred to the competent courts (Court of Budgetary Discipline, Financial Prosecutor's Office).

The real level of implementation of control activities is variable. As regards internal control activities, they are implemented through multi-year plans. These plans are directly derived from the ministerial risk maps. Thus, each Ministry defines action plans which it has validated by the MIAC. However, the monitoring of the effective implementation of control activities and their real impact remains relatively limited. As regards external control activities, they are still lacking in concrete effects. The Court of Auditors makes recommendations but, very often, these are not implemented by the audited services.

#### **4.2.6 Internal audit**

##### **Actors**

The MIAC sets the department's internal audit policy. It establishes an audit program based on the priorities discussed and set by the members of the MIAC. The audits to be carried out may be selected on the basis of known or suspected malfunctions or on the basis of ministerial priorities. Once the audit programme has been drawn up, it is voted on by the members of the MIAC.

The MMAI is responsible for carrying out the audits that have been decided by the MIAC. It can do these audits by its own means (civil servants dedicated to audit missions) or by a third party (audit firm). In most ministries, it is the Inspectorates General that play the role of MMAI.

##### **Frameworks and methods**

Audits focus on a risk identified in the ministerial risk map. The audit may cover a specific program or theme within a ministerial program. In practice, audit assignments often deviate from the risks that are identified in the mapping. Internal audits are carried out according to a standard procedure resulting in an audit report. This report is sent to the ministry's top management. A follow-up committee led by the auditor must ensure that the recommendations made in the report are actually implemented by the departments concerned.

##### **Impact**

Each year, the MMAIs carry out or commission several internal audits on a wide variety of subjects. These audits result in reports that are provided to the Ministry and brought to the attention of MIAC. A follow-up committee must also be organised to ensure, some time later, that the audit recommendations have been implemented.

In reality, these follow-up committees are rarely implemented and checks on the proper implementation of audit recommendations are rarely carried out. Moreover, as audit reports are not public, it is difficult to know their real impact. We do not know whether the Minister or the ministerial top management actually takes decisions on the basis of these audit reports.

## 4.3 Regional government

### 4.3.1 General Overview

The Regions (Régions) are the largest local government in France. France has 13 regions (in metropolitan France). The members of the Regional council are elected by direct universal suffrage for a period of 6 years. They elect the President of the Regional council who represents the executive power of the Region. He is surrounded by Vice-Presidents who are responsible for one or more given public policies. The President transmits his instructions to the Regional council's Administration. The administration is headed by a Director General of Services and is structured in a pyramidal manner.

The elected members of the Regional council vote on the major policy directions decided by the President and vote each year on the regional council's budget. The budget is organized by type of expenditure and can be broken down by public policy. Each department then manages the part of the budget that concerns it.

The managerial changes observed at the level of the State have been slower to penetrate at the level of local government. Thus, in some regional councils, performance management and/or public policy evaluation systems are in place. But in most cases, the organisational steering is based mainly on the budget. The law and the norm also remain very important in the functioning of the Regional councils.

In France, the Regions are responsible for the following competences:

- *Economic affairs and Transportation*: road network and facilities (regional), public transportation, support to local enterprises and entrepreneurship, ports (sea and fishing, inland waterways), tourism (regional area)
- *Education*: secondary education (buildings and non-teaching staff), vocational education and training
- *Environmental protection*: parks & green areas, nature preservation, air pollution, climate protection
- *Housing and community amenities*: housing (subsidies)

- Recreation, culture recreation and religion: cultural heritage and monuments
- *Social protection*: unemployment subsidies and benefits

### 4.3.2 Specific legal framework

There is no specific legal framework concerning internal control for Regional councils in France. Unlike State services, the Regions have no specific legal obligations in terms of internal control. The only legal reference which can be used to justify an internal control implementation is the obligation of all public officials to be accountable for their administration, as set out in articles 13, 14 and 15 of the Declaration of the Rights of Man and of the Citizen, as well as in the second paragraph of article 47-2 of the Constitution (see section 4.1.2). But these are very general laws that apply equally to all public administrations. They do not specify the methods and actions to be implemented and only deal with internal financial control, lagging behind business risks (see section 4.2.4).

In the same way, the Regions are subject to the PBAM decree, and in particular Article 57, which defines the accounting principles that ensure the quality of public accounts (see section 4.1.2).

The Law on the New Territorial Organization of the Republic (NOTRe), passed in 2015, specifically concerns local governments which include Regions in France. Among its provisions, it provides for the implementation of an experiment in the certification of local government accounts. In this context, two Regions have participated, as of 2017, in this experiment aimed at having their accounts certified by auditors (see the following section).

### 4.3.3 Control environment

#### Public spending chain

The authorizing officer is the President of the Regional council (and his delegates). The president of the Regional council judges the appropriateness of the expenditure and decides on its execution. He is therefore responsible for the vote of the budget by the elected members of the Regional council and he is also responsible for its proper execution. In

these functions, he is assisted by the administrative services of the Regional council and especially by the financial department.

The Region's Finance Department is responsible for the construction of the budget, taking into account the political orientations of the presidency and ensuring the major balances. The golden budgetary rule prohibits regions and local governments from voting for budgets with an operating deficit. The Finance Department also monitors budget execution throughout the year. It keeps the local government's budgetary accounts. Thus, at the end of the fiscal year, the Finance Department publishes the Administrative Account (completed budget) which must be voted on by the elected members of the Regional council.

The principle of separation of the authorizing officer and the accountant also applies to the Regions. This means that the President of the Regional council (and his departments) cannot handle public money. He or she decides on the expenditure, but its settlement must be carried out by the public accountant responsible for the Region. This public accountant is hierarchically attached to the Public Finance Department (Ministry of Finance). The public accountant checks the regularity of the expenditure and the availability of funds before making the payment. He or she also keeps accounts and produces the Region's financial statements at the end of the year.

### **Good practice FR4 – Control environment – Regional government: Principle of separation of authorising officers and accountants**

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The principle of separation of authorising officers and accountants which applies to local governments (Regions, Departments, Municipalities) makes it possible to strengthen the Regions' internal accounting control. Indeed, the accountant controls the accounting operations of the authorising officers before proceeding to the payment of the public expenditure. (COSO 5)

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### **External control chain**

External control of the Regions is carried out by two actors. The first actor is the Prefect, who is responsible for checking that the budget voted



by the Region respects the principle of real balance. If this is not the case, the Region is placed under the supervision of the Prefect, who refers the matter to the Regional Audit Chamber (“Chambre Régionale des Comptes”) to re-establish a balanced budget.

The second external control actor is the Regional Audit Chamber. Indeed, the Regional Audit Chamber is competent to carry out audits of the management of the Region. These controls can be carried out on site or on documents. The Regional Audit Chamber gives its opinion on the regularity and reliability of public expenditures and accounts, but also on its effectiveness (results of public action).

For several years, the certification of local government accounts by auditors has been a recurring issue in the French administration. For its advocates, the certification of local government accounts would strengthen the reliability of their accounts. Since 2016, several local governments have been selected to participate in an experiment on the certification of accounts. This experiment should be conducted in three stages:

- 2016: selection of local government participating in the experiment (a panel of 25 local governments selected, including 2 Regional councils),
- 2017-2019: support for pilot local government by the Court of Auditors in a gradual process of assessing the reliability of their financial statements,
- 2020 - 2023: completion of preparatory certificates by the auditors.

The initial results of this experiment are mixed. In fact, in 2021, of the 24 local governments that remained in the experiment, none had their accounts certified without reservation (22 could not be certified, 1 was certified with reservations and 1 was postponed for one year).

### **Internal control chain**

There is no specific regulation concerning the establishment of an internal control system within the Regional councils. The President of the Regional council may instruct the Director General of Services to set up an internal control system within the regional administration. When such a decision is taken, the Director General of Services generally relies on an Internal Audit Department that reports directly to him/her.

The Internal Audit Department is then responsible for building and leading the Regional council's internal control system. This generally involves mapping risks and implementing actions to control them. The Internal Audit Department also organizes audits to ensure the reliability and effectiveness of existing risk management systems.

In reality, few Regional councils have truly reliable and mature internal control systems. The last major study conducted on these subject dates to 2013. At that time, the IFACI/AMRAE/ANDGGC barometer showed that the level of maturity of local governments was limited, both in terms of tools and culture.

#### **4.3.4 Risk assessment**

##### **Subject**

In the Regions, two types of risks can be identified: financial risks and risks related to the management of public policies (non-financial risks). These risks are equivalent to the "business risks" assessed in the Central State administration. So the approach is broadly similar to that of the Central State with the identification of both financial and non-financial risks. Regarding financial risks, central government departments encourage local governments to set up internal accounting and financial control systems. The objective of this internal accounting and financial control is to ensure the quality of local public accounts, i.e. their regularity, accuracy and fairness. This involves identifying and prioritizing the accounting and financial risks borne by the Region. Risks can be identified thanks to audit reports, reports of the Regional Audit Chamber, conclusions drawn from self-assessments or the accountant's tools. Once these risks have been identified, they must be described and evaluated in an accounting and financial risk map. In practice, the implementation of an internal accounting and financial control system is the responsibility of the Region, and few organizations have one. However, Central State departments (in particular the General Directorate of Local Governments and the Public Finance Department) produce a wealth of documentation to encourage and guide the Regions in developing accounting and financial internal control systems.

Regarding the risks linked to the management of public policies (non-financial risks), the aim is for the Regions to identify the risks likely to harm or prevent the smooth running of public policies and services. In this context, the risks could relate to policies as varied as economic development, regional planning, vocational training, the responsibility and maintenance of secondary schools or even the management of hazardous waste. Thus, a wide variety of non-financial risks can be identified:

- Operational risk
- Legal risk
- Compliance risk
- Image risk
- Human risk
- Societal risk.

As far as non-financial risks are concerned, the State's departments are much less active than for financial risks. As a result, even fewer Regions have put in place systems for managing non-financial risks. Most managers working in the Regions have little understanding of these concepts and their implications for the management of their organizations.

### **Actors**

There are four main actors: the Director General of Services, the Regional Finance Department, the Internal Audit Department, the Central State services.

1. *The Director General of Services.* The establishment of an internal control system (financial or non-financial) depends on the willingness of the Director General of Services of the Regional council to develop one. He or she is the head of the administration and works directly with the President of the Regional council (elected) or his or her cabinet. His or her impetus is necessary to set up a truly legitimate internal control system.
2. *Regional Finance Department.* The Finance Department is the administrative department of the Regional council in charge of the organization's budgetary control and accounting. It is in direct contact with the public accountant to ensure the execution of expenditures. It is a major player in the implementation of an internal financial and accounting control system. Indeed, the Finance Department will have a major

role to play, both in identifying and assessing financial risks and in leading the internal control system.

3. The *Internal Audit Department*. In some Regional councils, Internal Audit Departments have been set up. They generally report directly to the Director General of Services to ensure a certain degree of independence. These departments are responsible for building, leading and evaluating the Regional council's internal control system.
4. The *Central State services* (the Public Finance Department and the General Directorate of Local Governments). The State is trying to encourage the Regions to set up internal control systems, in particular Internal Accounting and Financial Control. In this context, they publish and distribute a number of guides. They also lead a number of working groups. However, the principle of free administration prevents these departments from imposing the implementation of internal control procedures or systems.

### **Framework**

There is no internal control system or framework that must be put in place by the Regions. On the other hand, the guides produced by the Central State services encourage regional administrations to develop risk maps.

Risk maps represents the basic support for the risk identification and control process. It also allows the formalization of the departments' thoughts on internal control. The implementation of risk mapping is recommended both in the context of financial risk management and in the context of non-financial risk management. Thus, in a guide for regional and local governments, it is stated that: "Drawing up a map of accounting and financial risks will enable the authority to formalize all the risk analysis work carried out. It will be an important decision-making aid in managing the strengthening of accounting and financial internal control" (Ministry of Finance, 2019).

These risk maps must make it possible to identify and describe the risks, to target the processes to which they relate and to evaluate them. The risk maps also make it possible to identify actions to control risks and to designate those responsible within the organization.

In practice, these risk maps are not mandatory and many regional administrations do not have them. Similarly, when they do exist, they are not always integrated into formalized risk management processes that require, in particular, an annual update of the map.

### **Methods**

There is no mandatory risk assessment methodology for the Regions. However, the Central State services have defined a clear method for assessing accounting and financial risks. This rating method is presented in documents distributed to regional and local governments. It should make it possible to rank the accounting and financial risks identified.

In concrete terms, we start by evaluating the criticality of the risk according to two axes, its probability of occurrence, and its accounting impact. These two axes make it possible to assess the criticality of the inherent risk, i.e. before taking into account the effect of the risk control measures put in place. The next step is to assess the level of control of each risk by determining the “internal control risks”. The use of a risk management maturity scale is used to assess this internal control risk. This makes it possible to assess the residual risk, i.e. the risk remaining after taking into account the existing internal control measures.

Regarding non-financial risks, there are no methodological guides produced by central State services detailing risk assessment methods. However, the documentation provided on this topic by various working groups converges on risk rating methods that are fairly similar to the one presented above.

### **Impacts**

Internal control and risk management are generally underdeveloped in the management of regional administrations. The issue of accounting quality was generally a subject that was little investigated by local governments. It has been brought back to the forefront somewhat with the experiment of certification of regional and local government accounts by statutory auditors. The launch of this experiment has

prompted the State services (Public Finance Department and General Directorate of Local Governments) and the financial jurisdictions (Court of Auditors and Regional Audit Chamber) to assist the selected regional and local governments in setting up or improving their internal accounting and financial control systems. The issue of certification of accounts has revived the debate on the implementation of internal financial control in regional and local governments. But overall, progress at this level remains limited.

As regards internal control and the management of non-financial risks, the Regions' practices and tools are even less developed. State departments pay very little (if any) attention to the introduction of this type of system in regional and local governments.

**Good practice FR5 – Risk assessment – Regional government: Carrying out a risk mapping that groups risks into simple categories**

At the Regional council of Brittany, the Internal Audit Department maintains a risk map defined as "a steering and decision-making tool that shows which risks are likely to compromise the implementation of the local government's project and compliance with its obligations. (Source: internal documents). Two types of risks are identified in this mapping: Major risks that may affect the strategic objectives (this involves "identifying the strategic objectives defined by elected officials and identifying the risks that could affect their achievement") Operational risks that may affect public services provided to users (this involves identifying and assessing risks that could affect the quality of services provided by the Region). (COSO 6, 7 & 9)

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### 4.3.5 Control activities

#### Actors

In the Regions, the authorizing officer (the President of the Regional council) is responsible for the vote on the budget by the Regional council elected members and for its execution. He/she judges (with his departments) the appropriateness of the expenditure and decides on its execution. He is the guarantor of the general balance of the budget. But as authorizing officer, the President of the Regional council (and his/her departments) cannot handle public money.

The Region's public accountant pays the expenditure on the orders of the authorizing officer. He is hierarchically attached to Public Finance Department (Ministry of Finance). He is therefore "independent" of the Region. He or she checks that the expenditure is regular and that the funds are available. But he does not decide on the appropriateness of the expenditure.

While the President of the Regional council, as authorizing officer, is responsible for voting and executing the budget, he/she relies heavily on the administrative services and particularly on the Finance Department. The Finance Department is a key player in the construction of the budget, the verification of the major balances and the monitoring of execution. In particular, it keeps the region's budgetary accounts in parallel with the accounts kept by the accountant.

#### Framework

In most Regions, the budget has a classic structure based on the organization's services. The budget is rarely coupled with Actions/Programs that include objectives and performance indicators. Even when the budget is structured in terms of public policy, it very rarely includes objectives and indicators that can guide budget construction. Thus, budget construction and execution follow a classic procedure in which each department is allocated a budget according to its needs and the needs of other departments.

The Regions must ensure that the budget is actually balanced. Indeed, the golden budgetary rule prohibits French regional and local governments from voting and executing unbalanced budgets. They cannot borrow to finance a deficit in the operating section. This requires regional and local governments to be vigilant about their operating expenses and to ensure that they maintain a secure cash flow. The golden budget rule (current balance) is the only legal constraint on local public spending. Beyond that, there is no legal obligation to take into account other criteria in financial decision-making, such as the definition of strategies/objectives, the 3Es or the evaluation of results. Whether or not these criteria are taken into account depends on the willingness of the regional administration's departments to integrate these dimensions into the budget process.

### **Methods**

Before the budget is voted, the President of the Regional council and his or her departments must ensure that the budget respects the golden rule. This is the only legal constraint on the budget construction of the Regions. If the budget voted by the Region does not respect the principle of real balance, the Prefect puts the Region under supervision and refers the matter to the Regional Audit Chamber to balance the budget. The financial services therefore ensure that the budget voted respects this principle of real balance. The budget must be voted on by the elected members of the Regional council before it can be implemented.

Once voted, the budget is executed by the administrative services of the Regional council under the responsibility of the President of the Regional council, who is the authorizing officer. Here, the control of the expenditure is mainly based on the principle of separation of the authorizing officer and the accountant, as for the State services. Thus, the procedure for committing a public expenditure follows four stages and allows the accountant to establish control over the authorizing officer (see section 4.2.5, Methods). In addition, the financial services of the Regional council keep the Region's budgetary accounts in parallel with the accounts kept by the accountant.

At the end of the budget year, the Region's financial services publish the Administrative Account (executed budget). The authorizing officer



(President of the Regional council) must have this Administrative Account voted by the elected members of the Regional council. Accounting operations may be audited ex-post by the Region's internal audit services. They may also be audited ex-post by the Regional Audit Chamber as part of a "management review".

### **Impact**

In the event of malfunctions identified by the Region's Internal Audit Department or by the Regional Audit Chamber, it is up to the Region's administrative departments to implement the recommendations in the reports. The correction of malfunctions therefore depends on the willingness of the administrative departments to effectively follow up on the recommendations of the internal or external auditors. In case of serious dysfunctions noted by the Regional Audit Chamber, the person responsible may be referred to the competent courts.

In fact, the issue of accounting quality at the level of the Regions remains a subject of debate. Doubts remain about the methodological rigor (and even the independence) of the audits conducted by the regions' departments and about the willingness of managers to actually implement the auditors' recommendations. As for the observations of the Regional Audit Chamber, they are made public but are not binding. And it is not uncommon for two "management reviews" carried out in the same organization two or three years apart to reveal the same dysfunctions.

#### **4.3.6 Internal audit**

##### **Actors**

Local governments have no legal obligation to choose the actors in charge of internal audit. When a Regional council decides to embark on an internal audit process, it defines an Internal Audit Department. To guarantee the independence of this department, it reports directly to the Regional council's Director General of Services. Today, the number of regions benefiting from this type of internal audit service remains limited. For example, at the Regional council of Brittany, there is an Internal Audit Department which is attached to the Director General of Services.

## **Frameworks and methods**

The internal audit departments set up by the regions are responsible for leading the entire internal control process of the Regional council. As such, they are responsible for building and updating the Region's risk map. They must also ensure that control actions are implemented to control these risks.

These departments then conduct internal audits to ensure that the risks identified in the risk map are indeed under control and that the effectiveness of risk control actions is satisfactory. If this is the case, the auditor produces an audit report that provides reasonable assurance. In this report, the auditor may also make recommendations to improve the organization's risk control. For example, at the Regional council of Brittany, the Internal Audit Department carries out audits on internal processes that are dysfunctional. The audit reports are submitted to the President.

## **Impacts**

The actual impact of the audit missions carried out within the Regional councils remains highly variable. It depends on the willingness of Regional council actors to actually implement the recommendations made by the internal auditors. Audit follow-up committees can be organized to monitor the implementation of recommendations, but here again, their organization depends on the will of the Regional council's decision-makers. At the Regional council of Brittany, the audit reports issued by the Internal Audit Department make recommendations to resolve the shortcomings identified. However, it is difficult to know whether the recommendations are actually implemented by the departments.

### **Good practice FR6 – Internal audit – Regional government: Internal audit focused on dysfunctional internal processes**

At the Regional council of Brittany, the Internal Audit Department regularly carries out internal audits within the various departments. These audits generally focus on internal processes that are dysfunctional (e.g.: signature delegation process; inventory process). The identification of

these dysfunctions can be done through internal analyses or through external audits (notably the Regional Audit Chamber). The audit report is submitted to the President and makes recommendations to improve the reliability of the audited processes. (COSO 16 & 17)

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## 4.4 Local government

### 4.4.1 General Overview

Despite its highly centralized nature, France has a very large number of local governments. In France, the local governments are grouped into three main blocks: the regional block (regional councils), the departmental block (Departmental councils) and the communal block (Municipalities and Inter-municipalities). In this section, we will only deal with the departmental and municipal blocks since the regional block was dealt with in section 4.3.

*Departments.* France has 95 Departmental councils (Départements, including the 3 overseas Departments, Département d'outre-mer). In recent years, the role of the Departments has been debated on many occasions. Their abolition has been discussed several times and was even mentioned during the first reflections on the latest territorial reform (NOTRe law). The idea is to transfer their competences to the Regions and Municipalities (or inter-municipalities). The Departmental councilors are elected by direct universal suffrage for a period of 6 years. They sit on the Departemental council and elect the President of the Departemental council. The President of the Departmental council represents the executive power of the Department. He sets the political priorities of the Department (with his vice-presidents) and relies on the Departmental administration to implement his policy. The Departmental administration is made up of territorial civil servants and structured in the form of a traditional bureaucracy (*pyramidal structure of the organisation and silo division according to the major public policies*). Finally, the Departments are still active and remain major players in the fields of social action and high schools. More generally, the competences of the Departments are as follows:

- Public order, safety and defense: firefighting, civil protection
- *Economic affairs and Transportation:* road network and facilities (departmental), special transport services (pupil transport), airports (local), public transportation (railways, road), employment policies and services, tourism (departmental area)
- *Education:* pre-primary education, secondary education (buildings and non -teaching staff)

- Housing and community amenities (subsidies)
- *Social protection*: social care for children and youth, support services for familie, elderly, disabled people, social exclusion and poverty.

*Municipalities.* France also has 34,965 municipalities (1<sup>er</sup> January 2021). Most of these municipalities are very small (25,454 communes have less than 1,000 inhabitants). The question of merging small municipalities or bringing them together in "New Municipalities" ("Communes Nouvelles") is a recurrent one, but despite this, the number of municipalities is slowly decreasing. Municipal councilors are elected by direct universal suffrage for a period of 6 years. They sit on the Municipal Council and elect the mayor. The mayor represents the municipal executive. He sets the political priorities of the city (together with his deputies) and relies on the municipal administration to implement his policy. The municipal administration is made up of territorial civil servants and is structured in the form of a traditional bureaucracy (pyramidal structure of the organization and division into silos according to the major public policies).

Municipalities located on the same territory can together found an Inter-municipal Cooperation Establishment (ICE) ("Établissement de Coopération Intercommunale") with its own tax system. The ICE can benefit from tax revenues and produces public services for the competences that the municipalities have transferred to it. France has 1,253 ICEs (1<sup>er</sup> January 2021) and only 4 municipalities are isolated. There are several types of ICE depending on the characteristics of the territory (21 Metropolises, 14 Urban Communities, 223 Agglomeration Communities and 995 Communities of Municipalities). Depending on the type of ICE, the law sets a certain number of mandatory competences to be exercised by the ICE. The mayors of the ICE member municipalities sit on the community council, which is the political body of the ICE. The members of the community council elect the President of the ICE. The President of the ICE represents the executive power of the ICE. He implements (with his vice-presidents) his community policy by relying on the administration of the ICE. The EICE's administration is made up of territorial civil servants and structured in the form of a traditional bureaucracy (pyramidal structure of the organization and division into silos according to the major public policies).

The competences of the municipalities and inter-municipalities are very numerous and spread over a wide range of areas:

- *General public services (administration)*: administrative services (marriage, birth, etc.), public and facilities (town houses, etc.), ports (sea and fishing, inland waterways)
- *Public order, safety and defence*: local police, road traffic control, traffic signs and light
- *Economic affairs and Transportation*: road network and facilities (local), parking, public transport, tourism (municipal area), housing and community amenities, drinking water, public lightening, urban heating, urban and land use planning, urban planning
- *Recreation, culture, recreation and religion*: sports and leisure, libraries, museumsm cultural activities (theatre, exhibition halls, zoos, botanical gardens, etc.)
- *Education*: primary education (buildings and non -teaching staff)
- *Environmental protection*: parks & green areas, waste management (collection, treatment, and disposal of waste), sewerage (wastewater management), street cleaning
- *Social protection*: social welfare centres, housing subsidies/benefits.

Paris is a single-status local government that exercises both the competences of the department and the municipality. The metropolis of “Grand Lyon” is also a special-status authority because it exercises both the powers of the municipality and the “Rhône Department” within its territory. Some overseas territories also have special status, but they will not be discussed in this section.

### **Specific legal framework**

The legal framework for local government (Departments, Municipalities, and Inter-municipalities) is exactly the same as that for the Regions, as in France regional and local governments belong to the same administrative level.

## 4.4.2 Control environment

### Public spending control chain

The organization of the public spending control chain in local government is identical to that of the Regions. The only difference is that the executive power is ensured by the President of the Department in the Departmental Councils, by the President of the Community Council in the inter-municipalities and by the Mayor in the municipalities.

As in the Regions, the financial directorate manages the budgetary accounts of local governments, and they are subject to the golden budgetary rule (obligation to vote a budget in real balance).

As for the Regions, the principle of separation of the authorizing officer and the accounting officer also applies to local government.

### External control chain

The external control chain for local governments is identical to that of the Regions. Local governments have also participated in the experiment on the certification of accounts by external auditors.

### Internal control chain

As for the Regions, there is no specific regulation concerning the establishment of an internal control system (see section 4.3.3). It is up to the Mayor or the President of the Department to set up an internal control system. Some Departments and municipalities have set up Internal Audit Services whose mission is to structure the internal control chain within the local government. But this type of service is very rare in local governments. In this respect, the situation is very similar to that observed in the Regional councils (see section 4.3.3).

### 4.4.3 Risk assessment

#### Subject

In local governments, two types of risks can be identified: financial risks and risks related to the management of public policies (non-financial risks). The situation is similar to that observed in the Regions (see section 4.3.4).

For example, the City of Paris is one of the most active local governments in terms of risk assessment. In 2009, a map of 28 major and cross-cutting risks was drawn up with the help of a consultancy firm, 16 of which were deemed to be priorities. These risks could be both financial ("a financial loss" [source: internal documents]) and non-financial ("a human loss; a lasting interruption in the continuity of public service; failure to achieve the strategic projects and objectives of the mandate; a loss of image; an offence involving civil or criminal liability; a challenge to the public service values of the mandate" [source: internal documents]). The risk identification and assessment methodology implemented at the time by the City of Paris was very ambitious. Nevertheless the approach did not completely succeed in stimulating a culture of risk management throughout the local government.

#### Actors

The status and structure of local authorities are exactly the same as that of the Regions. Thus, the actors involved are identical.

For example, in the City of Paris, the risk identification and assessment process was initiated in 2009 by the Director General of Services. From 2011, a network of risk managers was defined in the operational directorates to coordinate the production of these maps. However, from 2014 onwards, the tasks of controlling non-financial risks were entrusted to the Prevention and Protection Directorate (PPD). The control of financial risks was entrusted to the Finance and Procurement Directorate (FPD) in preparation for the certification of accounts.



## **Framework**

The situation for local governments is exactly the same as for the Regions. This means that there is no mandatory internal control system or framework. However, guides produced by the State encourage local governments to develop risk maps.

In practice, risk mapping is not mandatory, and many local governments do not have it. The situation is identical to that observed in the Regional councils (see section 4.3.4).

For example, in the City of Paris, most of the directorates had set up their own risk mapping. These directorates had therefore carried out work to identify, classify and assess risks in relation to the public services they were required to provide. Some of them had also enlisted the help of consultancy firms to draw up these risk maps. However, some directorates of the city of Paris still do not have a risk map (3/24).

Another example is the Department of Seine-Saint-Denis. Here, a more traditional choice has been made, since the risk mapping work is led by a clearly identified Audit, Internal Control and Risk Management Department, which reports to the Department's Director General.

## **Methods**

As for the Regions, there is no mandatory risk assessment method for local governments. Local governments that wish to do so can rely on the method developed by the State to assess accounting and financial risks.

The City of Paris has the most experience in risk assessment. A methodology for identifying, classifying and rating standard risks has been defined for all of the local government's directorates:

- "Identified risks: At this stage, a list of risks is drawn up.
- Risks defined: the critical path of the process in question is described.
- Assessed risks: the process by which these risks are selected is deliberated by the stakeholders in defining impact and frequency.

- Rated risks: to assess, the rating scale has been defined collegially and is harmonized for the structure under mapping.
- Prioritized risks: risks are ranked to build an efficient strategy and control plan" [Source: internal document].

### **Impacts**

The situation in the local governments is identical to that observed in the Regions.

The real impact of risk management approaches implemented by local governments varies greatly. They depend very much on the individual willingness of public managers to take up the tools implemented and on their appetite for risk management. For example, in the City of Paris, despite a very successful risk management approach, an internal report deplored the lack of overall consistency in the practices initiated by the various directorates, the lack of resources allocated to these missions and the need to further strengthen the directorates' risk culture. In the Seine-Saint-Denis Department, the Audit, Internal Control and Risk Management Department lacks legitimacy among the other departments of the local authority.

### **Good practice FR7 – Risk assessment – Local government: Carrying out a risk mapping thanks to internal network of risk managers**

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At the city of Paris, a risk management approach was implemented in 2009. Thus, most of the City of Paris' directorates have built risk maps according to a standardized procedure. An internal network of risk managers is used to lead this process. Thus, despite differences in practices between the various directorates, a risk culture and risk assessment tools are present in the city's various directorates.

However, even if the City of Paris is certainly the most advanced in terms of internal control and audit, the approach has not succeeded in creating a culture of risk throughout the municipality and in harmonising risk management practices. (COSO 6, 7 & 9)

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#### 4.4.4 Control activities

##### Actors

The actors involved are exactly the same as those involved in the Regions (see section 4.3.5).

The only difference is that:

- In municipalities, the authorizing officer is the Mayor
- In inter-municipalities, the authorizing officer is the President of the Community council
- In the Departments, the authorizing officer is the President of the Departmental Council.

##### Framework, methods and impact

The situation is similar to that observed in the Regions (see section 4.3.5).

#### 4.4.5 Internal audit

##### Actors

As with the Regions, local governments have no legal obligation to choose the actors in charge of internal audit (see above). They can freely choose to engage in an internal audit process by creating an internal audit department.

For example, in the City of Paris, it is the General Inspectorate of the City of Paris (GICP) (Inspection Générale de la Ville de Paris) that has taken on these internal audit missions. This has existed in the City of Paris since 1979 and was created on the model of the Ministerial General Inspectorates. It reports directly to the Mayor of Paris.

In the Seine-Saint-Denis Department, a more traditional department was created to carry out these internal audit missions: the Audit, Internal Control and Risk Management Department. It reports directly to the Director General of Services of the Department.

### **Frameworks and methods**

Where established, the internal audit services set up by local and regional authorities are similar to those set up by the Regions (see above).

For example, the city of Paris has significant staff resources enabling it to carry out a large number of internal audits each year. It also has significant investigative resources enabling it to conduct hearings of the persons concerned and documentary and on-site inspections. It is also authorized to consult files only in accordance with the regulations in force. Finally, it can consult any specialist from the City of Paris. The GICP's list of work is drawn up within the framework of an annual program decided by the Mayor and may concern audits of policies, systems and procedures and audits of subsidized organizations and associations. Ad hoc audit requests may also be made by the Mayor to the GICP. Only the Mayor is entitled to refer matters to the GICP and the GICP does not have the power to act on its own initiative. In addition, the GICP is working to bring its practices into line with international internal audit standards.

### **Impact**

As in the case of the Regions, the real impact of the audit missions carried out within local governments remains very variable and depends on the willingness of the actors to really implement the recommendations made by the internal auditors (see above).

The functioning of the GICP is quite exemplary in that the audit reports are published. Thus, although the recommendations are not binding, the publication of the results forces the operational directorates to pay close attention to the auditors' recommendations.

However, in the case of the Department of Seine-Saint-Denis, top management has questions about the use of the audit reports produced by the Audit, Internal Control and Risk Management Department.

**Good practice FR8 – Internal audit – Local government: Internal audits with important resources, reports to the mayor, its reports are public**

In the city of Paris, there is a General Inspectorate that has existed since 1979. It is this directorate that carries out the city's internal audits. The General Inspectorate of the City of Paris has very important human and investigative resources. It reports directly to the Mayor and its reports are made public. (COSO 16 & 17)

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## 4.5 Agencies

### 4.5.1 Central executive agencies

#### **General overview and legal framework**

State operators are organisations with legal personality which: (1) have a public service activity that can be linked to the implementation of a Central State policy; (2) they are mainly financed by the Central State in the form of a subsidy or an earmarked tax and the Central State exercises direct control over them through supervision. The 2020 Finance Act counted 483 operators with different legal statuses, under public or private law (public establishments, associations, economic interest groups, etc.). Each different operator is attached to a Mission and a Program of the Central State budget according to its activity. They are generally controlled by the ministry in charge of the Program to which they are attached and by the Ministry of Finance Ministerial Mission of Audit Interne. The Central State's control over its operators can be materialized by:

- Appointment of officers
- Participation in deliberative bodies
- Budgetary control
- The establishment of Contracts of Objectives and Means

#### **Internal control system and internal audit**

Most State operators are subject to the Decree of 7 December 2012 on State budgetary and accounting management (Decree on public budgetary and accounting management). As such, they must comply with the same budgetary and accounting rules as the ministries. Each operator has an authorizing officer who is responsible for the institution's budgetary management. Each operator has a public accountant who handles public funds, checks the regularity of expenditure, and handles the institution's accounts. In this respect, the control of the public expenditure chain in most operators is identical to that exercised in other public administrations (see previous sections).

From the point of view of external control, Central State operators may be audited by the Court of Auditors in the context of on-site or documentary audits. Ministries may also carry out audits within their operators. Generally, these audits are entrusted to their General Inspectorate (see previous sections). Some Central State operators have also undertaken to have their accounts certified by auditors on a mandatory basis (for public health institutions and universities) or on a voluntary basis.

Most Central State operators are subject to public accounting rules. As such, they must set up an internal financial control system (internal budgetary control and internal accounting control). The implementation of a risk management system must be one of the priority objectives of the organization. The Order of 17 December 2015 on the reference framework for budgetary and accounting internal control applies to operators in the same way as for ministries (see previous sections). In practice, the degree of implementation of internal control mechanisms in operators is much weaker than in ministries. A large proportion of operators do not have the financial risk control tools desired by the Central State (process map, budgetary and accounting risk map, action plan associated with the budgetary and accounting risk map). The Central State's departments have therefore put in place procedures to monitor the deployment of internal control within operators (questionnaire on Internal Control / ministerial reports on the risk maps sent by their respective operators). In addition, the ministerial departments offer simplified tools to assist operators in developing these internal control tools (methodological guides, self-diagnosis grids, mapping of typical risks, etc.).

As an example of control executed effectively, the Louvre Museum is a public institution which contributes to Program 175 (Heritage) of the Cultural Affairs Mission, which falls under the responsibility of the Ministry of Culture. As such, its two supervisory ministries are the Ministry of Culture and the Ministry of Finance. The Louvre is subject to the decree on public budgetary and accounting management and the decree of 17 December 2015 (like the ministries), which require it to set up an internal financial control system. The museum therefore conducted an analysis of the risks inherent in the various accounting processes and defined action plans to control these risks. The objective was to ensure that the institution has accurate, faithful and sincere financial information. In concrete terms, the Louvre embarked on a certification process in 2015.

After three years in which two accounts were certified with reservations due to the "absence of a physical inventory of intangible and tangible assets" (in 2015, 2016, 2017), the annual accounts of the Louvre were certified without reservation by the statutory auditors in 2018. Since the certification was introduced, the Louvre has carried out several projects to improve the reliability of its various accounting processes (development of a procedure for the accounting treatment of public contracts, overhaul of the VAT accounting method, introduction of a procedure for the reimbursement of tickets reserved in advance, etc.).

**Good practice FR9 – Risk assessment – Central executive agencies:  
Risk mapping as part of certification of accounts**

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Since 2015, the LOUVRE MUSEUM has embarked on a process of certification of its accounts. As part of the process, the institution has mapped its accounting processes and their associated financial risks. Action plans have been defined to control these risks. Since 2018, the Museum's accounts have been certified without reservations by the auditors. (COSO 6, 7, 9 & 16)

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## 4.5.2 Local government agencies

### General overview and legal framework

There are local public agencies that are connected to a given local government (Region, Department, Intermunicipality, Municipality). As for State operators, local public agencies have a legal personality and carry out a public service activity on behalf of a given local government (social action, water management, etc.). In return, the local authority pays a subsidy to the local public agencies and plays a supervisory role. As such, the local government is represented on the Board of Directors of the local public agencies. Local public agencies are subject to the rules of public accounting and in particular to the provisions of the Decree on public budgetary and accounting management.

Thus, the control of the public expenditure chain is identical to that described for central State operators. The authorising officer of the local public agencies will be defined in the statutes and will generally be the president or director general of the institution.

In terms of external control, local public establishments are subject to control by their supervising local government. They may also be subject to control by the Regional Court of Auditors.

### Internal control system and internal audit

In theory, the Decree on public budgetary and accounting management requires local public agencies to have internal financial control systems. However, as for the Regions and local governments, practices in the area of internal financial control are very heterogeneous and generally not very advanced. It is therefore very difficult to make a general judgement on the internal control systems put in place in the various local institutions. However, it is likely that the internal control systems in local public institutions are not very well developed, as is the case with the situation observed in local governments (see section 4.4.5).

The Paris Water Company (Société des Eaux de Paris, Paris local agencies for water management) is a local public agency that manages the water cycle on behalf of the City of Paris (a local government with a

specific status). The Paris Water Company is a good example of the deployment of internal control in local public agencies. Indeed, since 2015, as part of its Quality Safety Environment (QSE) approach, the Paris Water Company has implemented an internal control system. This has resulted in the mapping of processes, the identification of risks inherent in the various processes and the implementation of action plans designed to strengthen the control of the risks identified. This "business" internal control was accompanied by the implementation of an accounting and financial internal control system managed by the accounting agency of the Paris Water Company.

**Good practice FR10 – Risk assessment – Local government agencies:  
Risk mapping following the central government framework**

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The Paris water company has set up a system to identify and measure the risks associated with its activity. The risks identified are both business risks (non financial) and financial risks. Action plan are then put in place to control the identified risks. (COSO 6, 7 & 9)

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### **4.5.3 Universities and research institutions**

#### **General overview and legal framework**

Universities are State agencies with the status of Public Scientific, Cultural and Professional Agencies. As National Public Agencies, they are required to set up internal financial control systems. In addition, the law of 10 August 2007 on the freedoms and responsibilities of universities (LRU) made the certification of university accounts almost mandatory. Since this law was passed, the number of universities that have opted to certify their accounts has grown steadily.

#### **Internal control system and internal audit**

The certification of university accounts does not require a formalised internal control system. However, it automatically leads to the development of such practices in universities. Thus, since the introduction of certification, many universities have developed internal control systems. The departments of the Ministry of Higher Education and Research

and the Ministry of Finance have helped universities to set up or strengthen their internal control systems. Guides for process and risk mapping have been published for university presidents. Over the years, more and more universities have embarked on internal control procedures. This has led to a decrease in the number of reservations issued each year by the auditors.

As an example, the University of Aix-Marseille has thoroughly reformed its internal control system in 2021. An "internal control charter" has been drafted and voted by the members of the University's Board of Directors. This charter defines the framework and operation of internal control within the institution. It entrusts the responsibility for the internal control system to a steering committee supported by a network of internal control referents in the various components of the university. The Continuous Improvement Department, which reports to the General Director, is responsible for leading the internal control system on a daily basis. Once the general framework of internal control had been defined, risk maps were drawn up and approved by the Board of Directors:

- A mapping of major institutional risks
- Management risk mapping
- A mapping of financial risks (budgetary internal control and accounting internal control).

The level of risk control must be measured by means of self-diagnosis questionnaires. This evaluation is carried out at the level of the university's governance as well as within its various components. Depending on the results of these assessments, the Continuous Improvement Department can assist the various players in implementing the necessary control actions (process mapping, job descriptions, functional and hierarchical organisation charts, segregation of duties matrix, delegation of signature, IT authorisations, etc.). Each year, the internal control roadmap sets out the priorities of the University of Aix-Marseille in terms of internal control development and an annual report describes the progress made in this area.

**Good practice FR11 – Control environment – Universities and research institutions: Implementation of an internal control charter to help awareness**

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At Aix-Marseille University, the obligation to certify accounts has developed the organisation's risk culture. Thus, in 2021, the management of the University of Aix-Marseille voted an "internal control charter" which clearly defines the principles, tools and responsibilities in terms of internal control. (COSO 2, 3 & 5)

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**Good practice FR12 – Risk assessment – Universities and research institutions: Risk mapping supported by a special dedicated unit**

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The Aix-Marseille University has developed a fairly advanced internal control system in 2021. It has passed an internal control charter which defines a clear framework and clearly identifies the actors involved in the process. The university has also adopted three risk maps for the three main families of risks identified. Finally, the Continuous Improvement Department works closely with the various departments to help them develop their own risk management systems. (COSO 6, 7, 9, 13 & 14)

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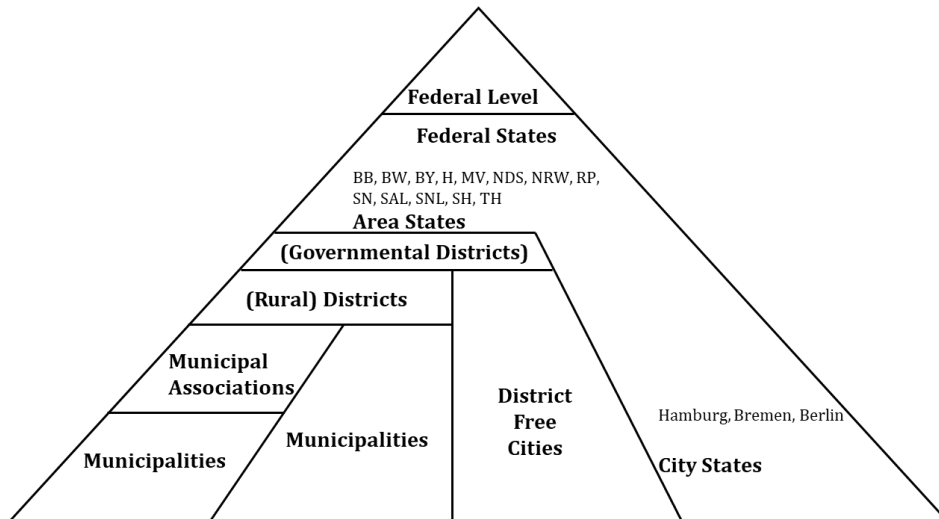
## 5 Germany

### 5.1 Context

#### 5.1.1 Administrative traditions and structures

Germany is a federal parliamentary republic and its public administration comprise three levels, the federal level, the Länder (state) level and the local level. Laws and key institutions of state are grounded upon the Basic Law (Grundgesetz). The latter also comprises fundamental financial management and control requirements (i.e. rules concerning the budget process) and also prescribes the fiscal relationship between the the federal level and the states level (Länder). The states enjoy a high level of autonomy. Moreover, through their representation in the Bundesrat they also participate in the legislative process of the federation (OECD, 2014: 12).

In the German administrative structure (see Figure 4), local governments (i.e. municipalities, cities and counties) form an important pillar, not only in functional but also in political terms. The Basic Law guarantees the right to local self-government. Local governments serve a dual purpose, comprising the fulfillment of tasks within their own responsibility (e.g., social and cultural services, water and sewer, and public transport) as well as tasks delegated to them by the state, e.g., construction supervision, local policing (see Kuhlmann et al., 2021: 6; Kuhlmann and Wollmann, 2013; Wehling and Kost, 2010).

Figure 4. Administrative structure in Germany<sup>5</sup>

According to various scholars, Germany belongs to the Continental European federal administrative tradition, which comprises the following core pillars of administrative traditions and structures (Kuhlmann, 2010, 2019; Kuhlmann and Wollmann, 2019: 142): A strong legalistic orientation of the administration and a rule-of-law culture based on the Roman legal tradition; the administrative act represents the conventional form of administrative action, and the legal correctness of administrative decisions is still the most crucial quality criterion.

- The subnational-decentral levels and the principle of subsidiarity are of major importance. As a result, the central bureaucracy is traditionally much weaker, and the administrative burden lies mainly with the subnational institutions and strong local self-government
- The administrative structure is strongly oriented toward the territorial principle and a multi-purpose model.
- Civil servants in Germany have traditionally tended to be seen as "public servants" who have a special role in society.

<sup>5</sup>[https://commons.wikimedia.org/wiki/File:Administrative\\_Gliederung\\_Deutschlands.svg](https://commons.wikimedia.org/wiki/File:Administrative_Gliederung_Deutschlands.svg) (adapted version, accessed on 25.05.2022)

However, the influence of New Public Management oriented reforms have led to new combinations of dominant legalistic administrative control with new elements of managerial administration , such as performance measurement, benchmarking, cost and activity accounting. In sum, a new mix of classic Weberian administrative principles on the one hand and NPM-related reform elements on the other has emerged (Kuhlmann and Bogumil, 2019). The latter is particularly true for the local level, as an orientation towards increasing transparency, efficiency, and effectiveness have become increasingly important in reforms since the 1990s.

### 5.1.2 Internal control: overview and legal framework

Across all government levels, and in line with a strong legalistic Rechtsstaat-tradition, aspects of (financial) internal control are laid down in laws and regulations that focus on budgeting, accounting, and auditing matters.

In this regard, the Budgetary Principle Act (Haushaltsgrundsätze-gesetz, HGrG), the Federal Budget Code (Bundeshaushaltsgesetz, BHG), and the Federal Court of Auditors Act (Bundesrechnungshofgesetz, BRHG) can also be considered as fundamental pieces in forming the anchors for financial management and internal control related aspects across all levels. Furthermore, these laws form the anchor for deriving more specific binding rules and regulations and developing (non-mandatory) recommendations or guidelines. In Germany, recommendations from different bodies (e.g., Audit Office, Ministry of the Interior) form important cornerstones for developing and implementing managerial forms of internal control. In contrast, compliance-oriented forms of internal control are laid down in numerous laws and regulations.

Mainly due to the federal structure, the adoption of internal control systems at all three levels of government, although showing mandatory and harmonized elements, are characterized by a high degree of disparity – particularly regarding more comprehensive approaches to internal control. Consequently, "*the current status quo of internal control in Germany can be described as manifold and diverse*" (Marqués-Berger and Heiling, 2015: 93).<sup>6</sup>

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<sup>6</sup> The same is true for the status of governmental accounting (see Marqués-Berger and Heiling (2015: 93).

## 5.2 Central government

### 5.2.1 General overview

Compared to other government levels, Germany's federal administration is significantly small (around ten per cent of all public employees) (Kuhlmann et al., 2021: 5). This particular feature of the country's administrative system, where the state level together with the local level carry the main responsibility for implementing programmes and laws (see section 5.1.1). A strong hierarchical organisational structure characterizes the German federal ministerial administration, and it is strongly shaped by constitutional and codified rules, which guide the structures, competencies and interactions between the different actors (see Fleischer, 2021: 61–80. for a detailed description of the federal level).

Currently (2022), the federal administration comprises 16 ministries and a large number of federal authorities (high-level, medium-level, and lower-level authorities) that are directly subordinate to the respective supreme authority (i.e. ministry). Moreover, the over 120 federal agencies employ the great majority of the federal workforce and differ widely in their mandates and tasks (see also Fleischer, 2021: 70). Agencies are structurally independent public-law organizations outside the ministerial administration and have their own decision-making powers but are subject to the control and supervision of a ministry (or ministries) (Bach et al., 2010: 13). Agencies mainly take the form of institutes (*Anstalten*,  $n = 37$ ), corporations (*Körperschaften*,  $n = 60$ ), or foundations (*Stiftungen*,  $n = 56$ ) under public law. In this regard, it is also important to mention that the federal agencies often enjoy considerable autonomy vis-à-vis their supervising ministry. While more generally the capacities to "...prepare and monitor laws are well developed..." (Kuhlmann et al., p. 5) at the federal level, a focus on compliance oriented control towards agencies prevail, as there are no specific procedures for binding them to particular objectives (in the sense of performance agreements) (see also Fleischer 2021, p 70). The indicator-based performance agreement between the federal employment agency and the respective



ministry forms an exception in this regard (see Proeller and Siegel, 2021: 400).

### 5.2.2 Specific legal framework

At the federal level, the primary legal sources for the management of public funds are the *Basic Law (Grundgesetz, GG)*, the *Budgetary Principles Act (Haushaltsgrundsätze-gesetz, HGrG)*, the *Federal Budget Code (Bundeshaushaltsordnung, BHG)* and several further budgeting and accounting regulations.

The internal organization of the authorities is governed by internal rules of procedures, supplementary administrative regulations and service directives. The joint rules of procedure of the federal ministries (*Gemeinsame Geschäftsordnung der Bundesministerien, GGO*) lay down cross-ministerial standards, i.e., principles for the organization of the federal ministries, cooperation between the federal ministries and with the constitutional bodies, participation in lawmaking and external business relations (Section 1 (2) of the GGO). It applies to the federal ministries (Section 1 (1) GGO), but it also impacts their operational fields (i.e., agencies). In addition, authority-specific regulations are laid down in internal rules of procedure and file plans. Finally, service directives determine further details (Brühl, 2022: 32).

In sum, several regulations, guidelines, and recommendations have contributed to a diverse picture regarding the configuration of internal control across ministries and their federal agencies. While mandatory regulatory requirements cover a variety of aspects of (financial) internal control (e.g., separation of functions, dual principle, processing of written material, value for money assessments), there are no precise and uniform legal requirements concerning the introduction and use of a comprehensive internal control or risk management systems that covers risk assessment, control activities, and internal auditing aspects, in an integrated way.

Therefore, it is largely up to the federal authorities themselves whether and how they implement risk management approaches that go beyond legal requirements. This is also reflected in a 2017 report of the

German Federal Audit Office (Bundesrechnungshof, FAO) that revealed that there is no uniform understanding of risk (management) across ministries and, in many cases, the authorities do not take a comprehensive approach to risk management.

For this reason, the FAO advocated a uniform risk management standard for federal authorities, intending to promote and facilitate the conscious use of the instrument (Präsident des Bundesrechnungshofes, 2017). The report proposes a risk management approach for the federal administration based on the *2013 version of the "Three Lines of Defense Model"*<sup>7</sup>. The latter is a popular model for guidance on structuring risk management responsibilities in organisations and focuses on three lines of defense: operational management, risk and compliance oversight, and internal audit, respectively. According to this model, there are three internal "lines of defense" for defending an organization against risks that have a potentially negative impact on the achievement of its objectives.

1. The departments themselves occupy the first of these lines with their process-integrated control measures, such as the multiple-eye principle, process documentation, or supervision by the immediate superior. In addition, this line of defence includes controls in the form of approval reservations or co-signatures above certain financial thresholds. It ensures the quality of certain transactions by the traditional cross-divisional departments (e.g., the budget officer, contract management, legal department, or central procurement office).
2. The second line of defense only includes functions and activities that support the organization's risk management.
3. The third line of defense is independent of processes and solely reserved for internal auditing.

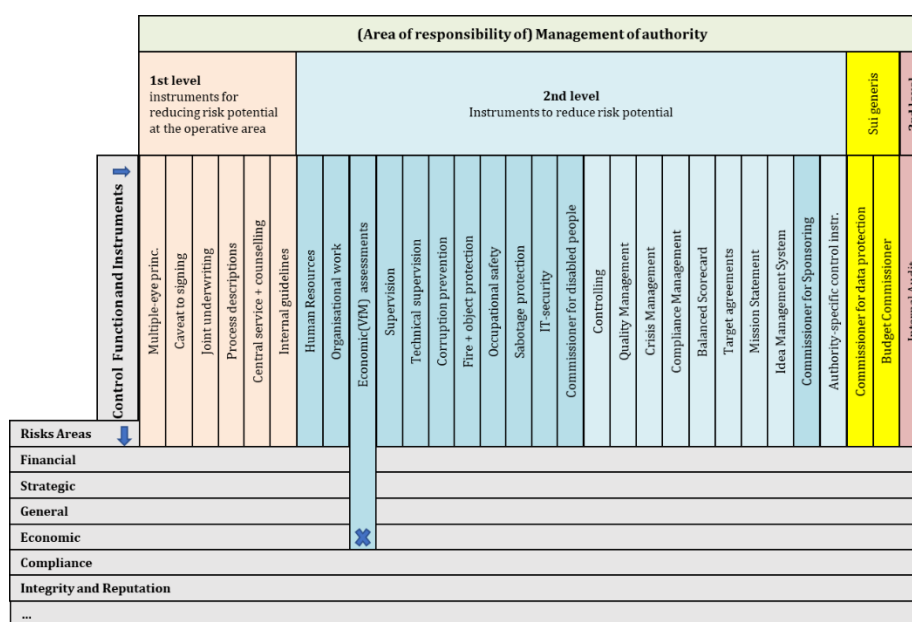
The FAO has adapted the model (see figure 5 below) to include specific features of the German federal administration to make it more comprehensible and manageable for the latter. Some of the instruments and functions covered are mandatory (e.g., the four-eyes principle value-for-money assessments or the comprehensive role and responsibility of

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<sup>7</sup> The three lines of defense model has been substantially revised and updated in 2021. An important feature of the new three lines model is a renewed focus on risk management as an enabler for achieving objectives and creating value, not just a mechanism for defending the organization and protecting value. (Institute of Internal Auditors, 2013, 2021)

budget officers), while other instruments are at the authorities' discretion (e.g., quality management, controlling or internal audit).

**Figure 5. FAO Risk Management Framework, Germany<sup>8</sup>**



The main part of the proposed model comprises a systematic approach to how authorities can identify their risks and assign them to their control and management instruments and functions. Based on this framework, authorities can assess the current situation, define a target situation and determine the need for action. While the proposed model is in line with an international approach to risk management, a number of authorities have already started to implement their own risk management approaches and, in particular, risk assessments several years ago. Therefore, their approaches and experiences are the focus of section 5.2.4.

Apart from the FAO model, additional, comprehensive regulations, recommendations, directives and manuals provide guidance for implementing specific features of internal control, e.g. value for money assessment or internal auditing. While the former is a mandatory part of each ministry's internal control activities, the decision on whether and how to

<sup>8</sup> Präsident des Bundesrechnungshofes, 2017: 8

implement internal auditing is up to the ministries themselves. Nevertheless, both are important parts of a comprehensive internal control approach and will be discussed in more detail in sections 5.2.5 and 5.2.6.

### 5.2.3 Control environment

#### Public spending chain

The federal budget is a one-year, line-item modified cash-based<sup>9</sup> budget that primarily presents financial information. Additionally, the Ministry of Finance (Finanzministerium, MoF) prepares a non-binding mid-term financial plan. More recently, the MoF introduced a –result-oriented reform that requires the ministries to describe their goals and priorities in the respective sections of the budget documents. According to the GG, HGrG, and the BHG, several principles must be followed in preparing and executing the budget (i.e., universality, specificity, fungibility, annuality, timeliness, financial sufficiency and necessity, packaging prohibition, efficiency and economy, budget balance, accuracy and reliability, and democratic authorisation and accountability).<sup>10</sup> The principle of economy and efficiency (Article 114 (2) sentence 1 GG, Section 6 HGrG, and Section 7 BHO) require the administration to exercise frugal budget management (Section 7 (1) BHO) and to observe the minimum principle (i.e., achieve a certain goal with as few resources as possible) as well as the maximum principle (i.e., achieve the greatest possible benefit with given resources). Moreover, Section 7 (2) of the Federal Budget Code (BHO) requires a (prior) economic assessment for all financial measures, which must also cover the distribution of risks. Furthermore, the consideration of the economic principle has been reinforced more recently by introducing additional spending reviews, which require a joint assessment of policy fields in terms of appropriateness, effectiveness, and efficiency.

Following Article 65 of the Basic Law, each federal (line) minister is responsible for managing its ministry (“Ressortprinzip”) and thus also

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<sup>9</sup> While accounting reforms towards accrual accounting were implemented at the state and local level, the central government maintains a (modified) cash-based accounting model (Papenfuß et al., 2017).

<sup>10</sup> These principles largely apply to all government levels.

the budget. In principle, line ministries are responsible for controlling and delivering their budget commitments during the budget year (OECD, 2015, p. 16). The intervention power of the MoF, in particular during budget execution, is limited to specific cases (OECD 2014, p 26). Each authority that manages revenues or expenditures has to designate a budget officer (§ 9 **Feder** BHO). Not only at the federal but also on the state level, the head of the budget department or otherwise the head of the department itself, generally assumes the role of budget officer, who is responsible for internal administrative control, i.e. not only for assuring that funds are assigned to proper areas and that budget limits are respected but also with regard to the efficiency of budget execution (Wenzler, 1997: 160). Budget officers are accountable to the minister and to the administrative head of the ministry (OECD, 2014: 26). The budget officer may also delegate parts of the budget to other units within the authority or other authorities for execution. However, this does not reduce his/her overall responsibility.

In sum, strict legal and hierarchical arrangements are in place. The minister, designated department heads, and budget officers are legally responsible for regularity, propriety, economy, and efficiency in using an entity's resources.

#### **Good practice DE1 – Control environment – Central government: Clear legal and hierarchical responsibilities**

Strict legal and hierarchical arrangements are in place, whereby the minister and budget officers are responsible for regularity, propriety, economy, and efficiency in using an entity's resources. The Federal MoF only exerts influence on the budget execution in specific cases. (COSO 2 & 3)

#### **Internal control chain<sup>11</sup>**

There are numerous regulations and guidelines in place to ensure the regularity of budget execution. The execution and monitoring of ministerial budget funds is carried out on the basis of budget headings. At the beginning of the budgetary year, the MoF makes the budgetary funds

<sup>11</sup> Extracted from European Commission (2012: 105–107), European Commission (2014: 137–139) and OECD (2014)

for each heading available in its central IT system to the supreme federal authorities responsible for a specific section; i.e., the constitutional authorities (Federal President, Bundestag, Bundesrat, Federal Constitutional Court, the Federal Chancellery (Bundeskanzleramt) and the ministries.

The authorised budget officers of the supreme federal authorities distribute the funds as far as possible and necessary to subordinate authorities and other bodies within the supreme federal authority. Funds can be distributed in several steps. Each heading finally has at least one heading administrator authorized to use the commitment appropriation assigned to him/her when implementing the budget or making disbursements. There are about 9000 heading (budget) administrators<sup>12</sup> for the federal budget (OECD 2014: 26).

Under Section 70 of the Federal Budget Code, payments can be accepted or made only by the cash and payment offices. Therefore, the heading administrator must issue instructions to a federal cash office for all receipts and payments through a written or (in most cases) electronic payment order. The federal cash office checks whether the payment order has been filled in correctly and signed by authorized persons whose signatures are recorded there. Therefore, when creating a payment order, it is necessary to observe the dual principle<sup>13</sup>, i.e., two people must always be involved. Then, it books the payment in the central federal IT system. Almost all payments are processed through federal accounts held at the German Federal Bank. The Federal MoF and its authorized offices, such as the Federal Treasury Offices, have exclusive access to the accounts, unlike an administrator (distributor of funds or heading administrator) from a federal authority with budgetary funds at his disposal (European Commission 2014: 137-139).

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<sup>12</sup> 8000 according to European Commission (2014)

<sup>13</sup> The so-called four-eyes principle (also: multiple-eyes or dual principle) basically aims at not letting one person alone make a decision. It thus serves both quality assurance and risk minimization by protecting against involuntary errors and deliberate misuse (e.g., infidelity, fraud). The four-eyes principle takes up the idea of separation of functions. Typical areas of application are cash management or the prevention of corruption.

### **External control chain**

The Cash Office Supervisory Authority monitors the federal cash offices. It is an independent body belonging to the Federal Centre for Cash and Accounts. The Cash Office Supervisory Authority checks the Federal Cash Offices without prior warning (a similar logic applies at the state and local levels).

Moreover, external control in Germany is carried out by the Federal Audit Office (FAO), which is based in Bonn and consists of nine audit departments covering 49 audit areas. It employs around 720 staff. According to Article 114 (2) of the Basic Law, the FAO audits the budget and accounts as well as the efficiency and regularity of the budgetary and economic management of the federal administration. The audit areas (amongst others) include i.) all federal authorities, ii.) all special federal assets (e.g. Bundeseisenbahnvermögen, Federal Railway Assets) as well as iii.) federal enterprises (e.g. Deutsche Bahn). In addition, the FAO audits bodies outside the federal administration, especially if they i.) execute parts of the federal budget or receive reimbursement of expenses from the Federal Government, ii.) administer federal funds or assets of the Federal Government or iii.) receive grants from the Federal Government.

#### **5.2.4 Risk assessment**

While implementing the proposed risk management framework by the FAO is not mandatory, some (organizational sub-units of) ministries and agencies (see section 5.5.1) have started to implement comprehensive risk management systems several years ago. Their different approaches and experiences are the focus of this chapter. In particular, this section analyzes two federal authorities:

- Federal Office for Economic Affairs and Climate Action (Bundesamt für Wirtschaft und Ausfuhrkontrolle), BAFA<sup>14</sup>

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<sup>14</sup> The presented case summarized, translated and updated the case description from Motel and Richter (2016: 73), and is based on media reports as well as the assessment of the authority's website (May 2022).

- Federal Institute for Materials Research and Testing (Bundesanstalt für Materialforschung und -prüfung), BAM<sup>15</sup>

The Federal Office for Economic Affairs and Export Control (Bundesamt für Wirtschaft und Ausfuhrkontrolle, BAFA) is a federal authority subordinated to the Federal Ministry for Economic Affairs and Climate Action. It is entrusted with important administrative tasks of the federal government in the following sectors: Foreign Trade, Promotion of Economic Development and SME, Energy, and Auditor Oversight. The Office has six Directorates-General, which are subdivided into Directorates and Divisions. The Federal Office for Economic Affairs and Export Control presently has about 1,000 employees. In 2009, the considerations for introducing a risk management system were made more concrete, and a project team was formed. Moreover, an external consultant was called in for support on a case-by-case basis. The conceptual framework and risk guidelines were developed in 2010, resulting in a binding risk management directive. Since April 2011, risk management has been incorporated into regular operations with quarterly risk documentation and reports.

BAM is a senior scientific and Federal technical institute (i.e. a higher federal authority) directly subordinate to the Federal Ministry for Economic Affairs and Climate Action (Bundesministerium für Wirtschaft und Klimaschutz, BMWi). It tests, researches, and advises to protect people, the environment, and material goods. At the various levels, the requirements for safety in technology and chemistry are identified, communicated and implemented. With its claim that "Safety makes markets", BAM is thus itself an element of the state's risk prevention in Germany. In addition to this overarching role, an internal risk management system has been established at BAM in recent years. The starting point for establishing an organization-wide risk management was an impulse from the responsible ministry (BMWi) in 2014. After that, an initial development of a risk guideline started. In the following years, risk management

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<sup>15</sup> The presented case summarized, translated and updated the case description from the latest available version of the federal organization manual (Bundesministerium des Innern und für Heimat, 2022) as well as (Hirsch et al., 2020: 90) and is also based on media reports as well as the assessment of the authority's website (May 2022)



has become increasingly important. In the quality standard ISO 17025:2017, which is authoritative for BAM in most areas, the importance of risk management has also been clearly emphasized with the current version of 2017. Finally, in August 2018, the responsible state secretary in the BMWi emphasized in a letter to the heads of the business area authorities under the BMWi that it is "imperative [to] also make use of the tools that allow us to identify risks in advance and respond adequately."

### **Subject**

The concept of risk, which is vital for BAFA as an authority, relates to the management perspective and is in line with COSO 6 in an operational context (i.e., the organization specifies objectives with sufficient clarity to identify and assess risks relating to objectives). The aim is to systematically record and evaluate events and possible developments within and outside the authority that could negatively impact the achievement of the goals set and the future fulfillment of the authority's tasks, external presentation, and resource planning (see also risk principles in Figure 6). In the case of BAM a conceptual definition of risk is not offered.

### **Actors**

In the case of BAFA the risk managers in the departments (usually the department heads) record the risks using Excel data entry forms, considering the four risk fields and further requirements (see Framework section below). The assessment of risks is also the responsibility of the risk managers in the operating departments. Concerning the aspect of fraud, the Anti-Corruption Officer supports the risk management in identifying and assessing risks in the area of corruption. He/she is involved in the assessment of the risk of corruption and fraud in various areas of work and also has a right of taking the initiative in risk identification (COSO 8)

The risk assessment-related control activities are carried out through regular meetings and based on the reports of the risk coordinator. The Risk Coordinator is responsible for ensuring that an overall view

of BAFA's risk situation is established, regularly updated and monitored. BAFA has a top-down governance for material risks but a bottom-up structure for information flow.

### **Framework**

The risk principles, which serve as a basis for the conscious handling of risks at BAFA, are shown in Figure 6.

**Figure 6. Risk management principles at BAFA, Germany<sup>16</sup>**

**Risk Principles**

The following risk principles act as a basis for the conscious approach towards risks:

**Only known risks can be affected, which means**

- a permanent adaptation of risk identification to changing circumstances and requirements is necessary,
- risk identification has to be integrated into the day-to-day workflow,
- risk information has to be obtained regularly.
- 

**Risks are hardly avoidable but usually influenceable, which means**

- not each and every risk is avoidable,
- there is no chance without a risk, but risks have to be controlled by us,
- risk control occurs through (counter-)measures leading to a mitigation of risk (both probability of occurrence and possible impacts).
- 

**Risks have to be assessed systematically, which means**

- risks that are already identified have to be assessed, including their possibility of occurrence **and** possible impacts/account of damage,
- when assessing risks, the used assessment procedure has to be consistent to allow a unified quantitative and qualitative assessment of all risks.
- 

**Risk management – 'everyone's business', which means**

- Each employee actively prevents risks from BAFA and their partners, respectively
- Each employee informs their supervisors on existing and/or emerging risks
- Active participation of each employee is necessary
- 

**Communication – 'don't be scared of openness', which means**

- occurred dangers and identified risks are communicated immediately **and** fully,
- the objective of open communication is the identification, the avoidance and the control of risks,
- it is **not** the objective to find a culprit.
- 

**Documentation – evidence is needed, which means**

- the measures for early risk detection and repulsion are documented,
- the documentation provides transparency and accountability of measures that were adopted due to risk management reasons,
- and the recording of risks and their initiated counter-measures serves as proof inter alia towards our partners as well as the interested public.

The selection of relevant risk categories is specific to the respective organization. For BAFA, the following key risk categories (risk fields) have been identified to guide risk identification (COSO principle no. 7):

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<sup>16</sup> Motel and Richter (2016: 76).

1. *Strategic risks*: Change in the political conditions that could affect the achievement of the agency's goals or the BAFA's existence; reputational risks, i.e., a negative influence on the perception of clients, partners, ministries partners, other ministries or departments and the general public.
2. *Regulatory risks*: Regulatory requirements or changes in the legal situation, e.g., technical standards, funding programs, or foreign trade law.
3. *Operational threats*: Elemental risks, such as flood, fire, storm damage; failure of critical technical systems, e.g., IT or energy..
4. *Operational risks*: e.g., delays in the processing of applications, financial risks, corruption, process, and procedural risks

Moreover, BAFA considers the potential for fraud in assessing risks to achieving objectives.

#### **Good practice DE2 – Risk assessment – Central government: The Four Risk Fields serves as basis for risk assessment**

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BAFA identifies four risk fields which serve as the basis for risk assessment. Among them, we find strategic risks which could affect the achievement of the agency's goals or the BAFA's existence. BAFA systematically considers the potential for fraud in assessing risks to the achievement of objectives by integrating the anticorruption department in the risk management cycle. (COSO 7, 8 & 9)

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In order to to systematize the causes of risks and, if necessary, combine them into larger bundles, in the case of BAM each risk is assigned to an original risk type. This also facilitates the processing of measures and cooperation with other responsible units within the organization. A distinction is made between six types:

1. Quality,
2. Legal,
3. Security,
4. Data protection,
5. Control, or
6. Operational.

Furthermore, the risks are assigned to one of three groups of possible effects. It became clear that an assessment of risk impacts in exclusively financial dimensions, which is frequently used in a business context, is not possible for BAM (and probably also for other public institutions) or does not achieve the desired results. The impacts are assigned to three groups:

- Finance,
- Reputation, and
- Result.

By shortening the list to just three groups of impacts, it was possible to concentrate a large number of sometimes diffuse descriptions of impacts and make them more comprehensible.

### **Methods**

In the case of BAFA, the likelihood of occurrence and the potential impact of the risk is used as risk measurement criteria. Where possible, a quantitative assessment is carried out. In the case of a qualitative assessment, there are predefined classifications for the probability of occurrence (unlikely, possible, probable, very probable) and for the risk impact/amount of damage (low, medium, high). The risk recording form also explicitly asks about the impact on the reputation of the authority (yes/no), requiring how severe the impact on the reputation could be. It is also important to mention that BAFA carries out the risk assessment on a net basis - i.e., taking into account measures that have already been taken.

### **Good practice DE3 – Risk assessment – Central government: Net Basis Approach**

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The identified risks are evaluated according to their probability of occurrence and impact. Moreover, BAFA carries out the risk assessment on a net basis - i.e., considering measures that have already been taken. (COSO 6, 8 & 9)

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In the case of BAM a risk report template is used for the assessment, containing all the information required for further processing. A unique identifier (no.) and a risk designation are assigned for each risk. Furthermore, the date of creation and the creator's name ("risk provider") are recorded to enable later queries, if necessary. The risk type should provide an initial classification of the risk. In practice, this was often felt to be unclear and has therefore been abolished. The central aspect of the template is the description of the cause and effect of an identified risk. The probability of occurrence and the impact of the risk from the perspective of the risk giver are also classified, resulting in different risk categories (A-B-C). The basis for determining the category is a classic risk matrix with three dimensions, each for the probability of the risk occurring and the extent of the damage. Finally, and only if possible, proposed measures for risk management are to be presented.

In an overall (organizational) view of all risks, the risk category resulting from the risk report is reviewed again and adjusted if necessary. In some cases, it made sense to reduce the extent of damage or the probability of occurrence from the organization's perspective as a whole, resulting in a lower category. For example, from the perspective of an individual organizational unit, the consequences of a risk occurrence (e.g. temporary shutdown of part of the organizational unit) are serious (category A). For the organization as a whole this is levelled out to a medium extent of damage, if necessary, and thus leads to an adjusted risk category (category B).

The risk reports of the individual departments are updated every six months. New risks identified by individual departments or overarching or permanent issues are included in the semi-annual risk reports and made available to the departments for individual assessment or the development of proposals for action. In addition, a strategic risk assessment is carried out at the central level. Relevant short-term risks are managed as ad hoc risks via the option of immediate reporting and lead to corresponding immediate activities.

### **Good practice DE4 – Risk assessment – Central government: The Risk Report Template**

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BAM classifies and assesses the overall organizational impacts of each risk involving all organizational units and assesses changes that could significantly impact the internal control system. In this regard, a distinction is made between six risk types, three impact categories, and their seriousness. Finally, the risk reports of the individual departments are updated every six months. (COSO 7 & 9)

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#### **Impact**

Risk management is fully integrated into BAFA's organizational structure and procedures. Risk management is primarily performed on a decentralized basis by the risk officers. They must install effective countermeasures and inform other organizational units affected, the management of the authority, and the risk coordinator. Furthermore, risk-relevant factors are monitored for early detection. As planned, risk management is a recurring item on the agenda in meetings at the unit level and above, e.g., the risk management system is regularly discussed at the regular department head conferences in preparation of the risk report to the management of the authority. In sum, the risk awareness of all involved has expanded, and it is possible to speak of a pronounced risk culture at the higher hierarchical levels (from the head of unit upwards).

In the case of BAM, once the risks have been identified or updated, they are systematized by the management accounting department and backed up by appropriate measures. If necessary, for each risk based on the risk report, an operational responsibility is defined for: (i) the assessment of the risk and (ii) the implementation of risk reduction or mitigation measures. In cases where "specific officers" exist, these are also listed. Based on the proposals in the risk report, the necessary countermeasures and risk-minimizing activities are defined and assigned to those responsible for implementation and given deadlines. The status of the implementation of the individual activities is checked regularly. Finally, all activities carried out in the past (since the start of the risk report) are documented in a risk history. A resubmission date is used to monitor the implementation of the individual activities. At the same time,

a regular review of the risk assessment and the effectiveness of the respective measures is controlled.

### **Good practice DE5 – Risk assessment – Central government: Contrasting Measures**

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BAM selects and develops control activities and document risk history, contributing to the mitigation of risks to the achievement of objectives to acceptable levels. (COSO 7 & 9)

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From the point of view of the management accounting department and the organizational units involved, the risk management tool is a practicable instrument for managing risks which is comprehensible and understandable. At the same time, it combines risk reporting with the necessary risk-controlling measures.

#### **5.2.5 Control activities**

The implementation of control activities differs between ministries, some of them being in line with international proposed risk management frameworks like COSO. Several regulations and rules mandate the implementation of control activities that are mainly oriented toward ensuring the legality, compliance, and regularity of actions as well as mitigating risks related to these aspects. However, there is also an important mandatory internal control instrument, i.e., economic assessments, which have to be applied by all ministries and federal agencies and intend to cover the rationale behind a given activity and assess the intended outcome and impact of capital expenditures (i.e. performance and value-for-money assessments). Given this project's aims, we mainly focus on control activities in the context of mandatory economic/value for money assessments<sup>17</sup>.

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<sup>17</sup> The definitions are used inter-exchangeable. This section is based on Präsident des Bundesrechnungshofes (2013, 2018) and Bundesministerium der Finanzen (2011, 2017, 2021). For PPP projects as well construction project at the federal level, more specific guidelines exist.



Economic assessments (Wirtschaftlichkeitsuntersuchungen, WU) at the federal level take the form of value for money assessments and are described as crucial prerequisites for the efficient and effective use of budget funds. They comprise systematic assessments of (1) whether a planned measure is effective in achieving a political or social goal, (2) whether the resources used are in the most advantageous relationship to the results, and (3) whether the use of resources is as low as possible (3E).

The respective Federal Ministry bears the overall responsibility for the federal budget. According to section 28 of the Federal Budget Code (BHO), it has to be ensured that the Economic Principle is observed in the preparation of the annual federal budget. § 7 of the BHO puts the economic principle enshrined in the German constitution for the federal administration into concrete terms. In particular, Section 7, paragraph 2 of the BHO obliges the administration to conduct appropriate economic (value for money) assessments for all financially effective measures. Moreover, the risk distribution associated with the measures must be considered. In specific cases, providers from the private sector must be given the opportunity to demonstrate whether and to what extent they can perform public tasks or economic activities serving public purposes just as well or better.”

Economic or value for money assessments are mandatory for 'all financially effective measures'; additionally, the corresponding administrative regulation clarifies that all measures of the central governmental level affecting the federal budget must comply with the economic principle. In its version in force since September 2005, the regulation also explicitly refers to the need to consider the risk aspect in value for money assessment. These general requirements in §7 BHO are supplemented by administrative regulations and a work manual ('Introduction to Value For Money Assessments') which is published and updated (last update in 2021) by the Federal Ministry of Finance and contains specific instructions, explanations and minimum requirements. The work manual supplements although not formally binding, is considered as the proper implementation of budgetary law by the FAO - and thus in fact has a normative effect.

The assessments are therefore based on a comprehensive regulatory framework and form an important part of control activities in the management of public funds. In the following sections, several fundamental questions regarding the implementation value for money assessments are addressed.

### **Actors**

In accordance with the administrative regulations on section 7 of BHO, value for money assessment should generally be prepared by the respective organisational unit that is also responsible for the financially effective measure. However, this does not preclude central organisational units of the authorities concerned, such as special service units or competence centres, from acting in an advisory capacity in the preparation of value for money assessments or from carrying it out. The budget officers – who are in charge for all budgetary issues at each federal authority - can participate in value for money assessment at their own discretion or be informed about the respective results (see impact section). Here, the question of whether adequate economic analyses have been carried out is also of fundamental importance.

According to the information from the federal authorities evaluated by the FAO, in 2008 36 % of the economic assessments were prepared by the specialised organisational units and 28 % by central organisational units. External advisors were commissioned for 28 % of the assessments. The budget officers were involved in 69 % of all authorities' assessments; in 31 % they were not involved.

The FAO recommends that organisational units - generally speaking - should conduct the studies on their own, but also offers the possibility of involving a central organisational unit as a 'competence centre' with an advisory function.

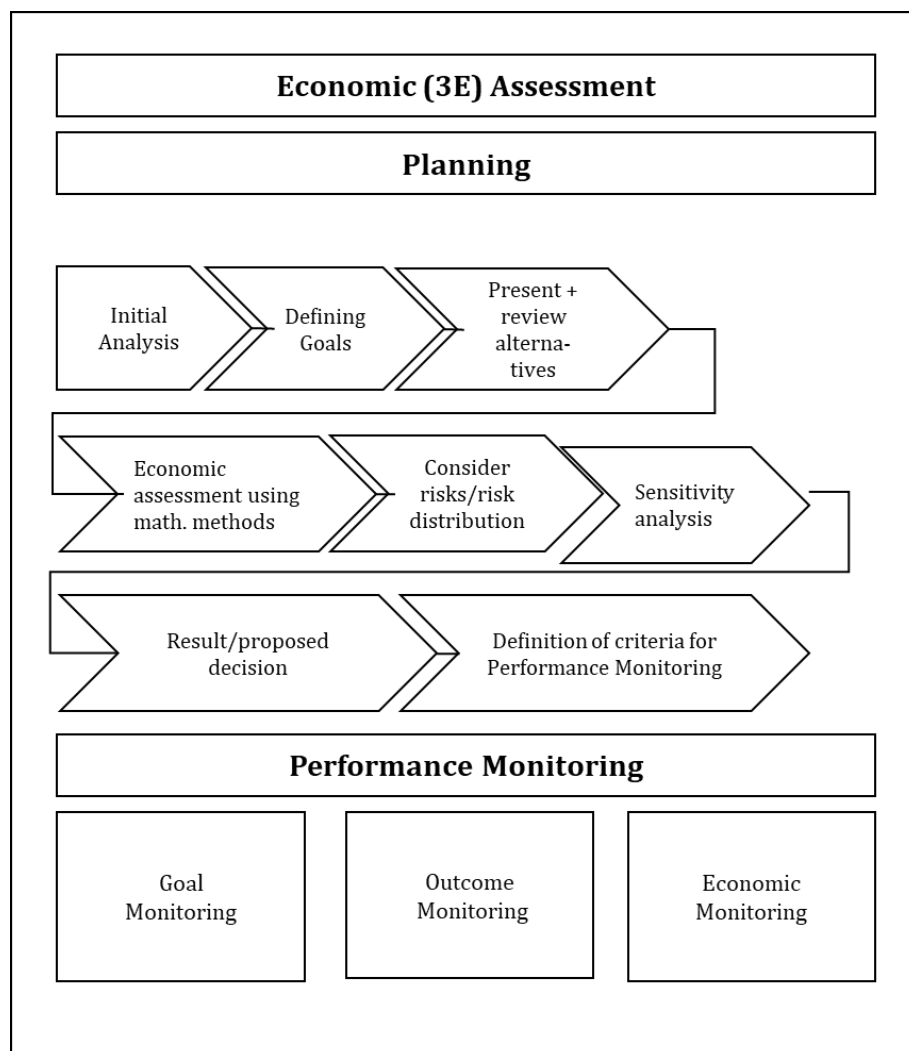
The ultimate authority to decide should be the organisational unit implementing the measure. Further on, the FAO recommends the involvement of external parties to build expertise within the organisation and therefore decrease reliance on external experts in the future. According to the experience of the FAO, the bundling of tasks in connection with research and development at central organisational units can have

positive effects. This is especially true with regard to the bundling of methodological knowledge, standardisation and objectification of standards beyond the individual case and the transparency and comprehensibility of the investigations. The FAO also sees this as a starting point for raising awareness of the necessity of economic assessments by providing advice and imparting knowledge.

### **Framework**

The underlying basis of the economic assessments should be the interest (or, the benefit) of the central government level. Even though in most cases the interest of the respective organisational forms is the centre of attention, the effects of respective measures on the federal budget also have to be considered. The perspective can have an enormous impact on the evaluation of the level of efficiency of a financial measure. A narrow perspective can lead to wrong evaluation results if several authorities are involved in carrying out the respective measure; further on, if a measure has substantial macroeconomic effects, the perspective of economic studies has to be on a macroeconomic level. Therefore, economic assessments should be conducted under the extended perspective (i.e., considering effects on the federal budget). The organizational units should determine the possible effects of the participation of other federal authorities/departments by mutual agreement. In the case of significant macroeconomic impacts, the economic feasibility study should be from a national perspective and in consultation with all parties involved.

Assessments are required when (1) planning new measures, including the modification of measures already in progress as well as (2) during implementation and (3) after the completion of measures (Figure 8 below).

Figure 7. Process of economic assessments, Germany<sup>18</sup>

A study revealed that assessments are regarded as a lower priority in the authorities, especially during (2) and after (3) the completion of measures. However, it is precisely through that undesirable developments can be counteracted and mistakes in future financially effective measures can be prevented.

<sup>18</sup> Präsident des Bundesrechnungshofes 2013: 119. See for a detailed explanation of the different steps BMF (2021)

All work steps, including assumptions, data origin, and assessment results, must be documented comprehensively. In the case of measures with only minor financial significance, this scope of documentation can be refrained from. Despite the obligation to document the whole assessment process, many authorities consider this to be an 'onerous duty' and only record the 'studies' results. However, the knowledge and decision-making process should be permanently comprehensible and must be documented thoroughly. For a comprehensible and understandable decision, the FAO recommends recording at least the work steps according to the MoF's instruction sheet, including assumptions, data origin, and the result of the economic efficiency study. Only in cases of minor financial importance (e.g. purchasing consumables in small quantities) the scope of the standard documentation may be deviated from.

#### **Good practice DE6 – Control activities – Central government: Instructions, guidelines and benchmarks to favour value-for-money**

In order to ensure uniformity and comparability of cost-effectiveness calculations in the federal administration, the MoF sets personnel cost rates, lump sums for material costs and calculation interest rates for cost calculations. Moreover, the MoF's instruction sheets serve as corner stone for the systematic documentation of the value for money assessment and may help to counteract the tendency to report only the results (and not the underlying procedure) of value for money assessments. (COSO 12)

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### **Methods**

There are a variety of methods which are used for value for money assessments. Quantitative methods of cost-effectiveness analysis are used for assessment and decision-making when the financial effects of alternative measures can be quantified. Within the quantitative methods (also: methods of capital investment calculation), a further distinction can be made between static and dynamic methods. Quantitative methods of capital investment analysis are suitable when several alternative solutions for financially effective measures are available for selection in the target conception or when one or more alternatives are to be compared with the actual state. A prerequisite for the application of quantitative

evaluation methods is the availability of monetary data of the investment effects of the alternatives to be compared that are as exact as possible. It must be possible to quantify what payments and disbursements or costs are associated with the investment, in what amount and in what year. In the opinion of the Federal Ministry of Finance and the Federal Audit Office, the primary quantitative valuation method to be used is the net present value method. Qualitative assessment methods play a role when non-monetary aspects (e.g., quality or safety) are included in the evaluation of different alternatives, i.e. when purely quantitative economic considerations do not provide clear results or when they are not reasonably feasible.

### **Impact**

The results of the assessments must be reported to the approving bodies in a timely manner. Budget officers have the option of making the consideration of a financial measure in the budget dependent on the existence of an appropriate value for money assessment. In this regard it is also considered as advisable for the budget officers to make greater use of their right to make the consideration of a measure in the preparation and implementation of the budget dependent on the submission of economic assessments.

#### **5.2.6 Internal audit**

There is no legal obligation to set up internal audits at the federal level. The existing regulations either have a recommendatory character or are limited to individual departments. With the dissolution of the so-called pre-audit offices in 1998, the recommendation was made to set up internal audits, which should practically act as a substitute for them<sup>19</sup>.

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<sup>19</sup> Until the end of 1997, numerous preliminary audit offices existed to reduce the workload of the Federal Audit Office. In terms of organization and service, these offices were located in the authorities and institutions to be audited, but were subject to the supervision of the Federal Audit Office. The Budget Law Development Act of December 22, 1997 abolished the preliminary audit offices in the immediate federal administration and replaced them with audit offices that have the same audit powers as the Federal Audit Office and are subordinate to it not only in terms of subject matter but also in terms of service and organization (Section 100 of the Federal Budget Code and Section 20a of the Federal Audit Office Act). The aim of the restructuring was, in particular, to clearly distinguish external financial control

However, as it is a non-binding recommendation, their implementation is slow and takes time. The Federal Audit Office (FAO) stated in 2005 that internal auditing did not yet have the necessary 'status' in the authorities of the Federal Administration.

In many cases, it was not understood in its function as a management instrument. The latter and authorities' faulty risk analyses led to deficiencies in the organization, progress planning, and deployment of internal audits. In response to this, the Federal Ministry of the Interior (Bundesministerium für Inneres, BMI) in agreement with the other ministries, published recommendations (2007) for implementing internal auditing in federal authorities. However, also in this case, "...the decision as to whether and to what extent an internal audit is necessary for the respective departments (...) is a matter of the individual departments".<sup>20</sup> In its resolution of May 7, 2021, the Audit Committee of the Budget Committee of the German Bundestag requested that the current recommendations on internal auditing in the federal administration should be converted into an administrative regulation. In addition, a 2019 survey shows that 83% of the highest federal authorities (19) have an internal audit unit, according to their accounts (Bundesministerium des Innern und für Heimat, 2020).

While there is still no explicit legal framework, many federal authorities implementing internal audit procedures follow the above mentioned recommendations. The main aspects of the internal audit guideline are summarized below (see also EU Commission, 2014 and BMI 2007). A more detailed description, which also includes good practices, is offered in section 5.3.6

### **Subject**

Audits can take the form of compliance audits, inventory audits, system-based audits, especially motivated or inspection audits (checking whether previous instructions and recommendations have been implemented). Depending on their focus, the audits are carried out according

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from internal financial control and to strengthen the independence of external financial control by separating it from the institution to be audited (Bundesrechnungshof, 2015; Sorgatz, 2021: 25).

<sup>20</sup> Bundesministerium des Innern (2007)

to the following criteria: legality, correctness, security, cost-efficiency, durability, usefulness/effectiveness, and impact.

### **Actors**

Each authority has only one internal audit unit. No other units are acting as central coordination or harmonization units in dealing with questions of internal control. Based on a threat or risk analysis relating to the authority and considering the cost/benefit ratio, the internal audit unit draws up a catalog of audit topics on which it bases its audit plan. It then submits this plan to the management for approval. The recommendation states that the internal audit unit does not take instructions from top management when drawing up audit reports. Instead, after completing an audit, it immediately submits the final audit report to the management of the directly superior authority.

### **Framework and Methods**

The internal audit unit takes suitable measures to ensure the quality of its work. These can include task-specific basic and further training, exchanging experiences with other internal audit units, and observing other internal audit units. The relevant ministries ensure the exchange of internal experiences, while the Federal Ministry of the Interior ensures the exchange of cross-ministerial experiences. There is no public certification procedure.

### **Impact**

The management decides how the internal audit unit's recommendations will be implemented. The auditee itself is responsible for implementation. The internal audit does not accept duties outside the scope of internal audit but falls under managerial responsibility, including implementing rules to solve conflicts of interest.



**Good practice DE7 – Internal audit – Central government: Delegation model for smaller entities**

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At the federal level in Germany, smaller authorities have been given the option of having internal auditing performed by the Federal Office of Administration (BVA), as a service by way of delegation. The BVA is an authority situated within the Federal Ministry of the Interior. This is also known as the delegation model (according to the FAO) or more commonly as "external internal auditing". Since 1998, various authorities - also outside the scope of the Federal Ministry of the Interior - have delegated their internal auditing to the BVA.

This options is particularly interesting for smaller authorities in which an internal audit would be important from a risk perspective but cannot be justified in terms of human resources (Sorgatz 2021) .

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## 5.3 Regional/State government

### 5.3.1 General overview

The federal (area) states are composed of a regional parliament (Landtag) and a regional prime minister (Ministerpraesident). Generally, the parliaments are elected for five years by proportional representation, with the regional prime minister being elected by the regional parliament. The parliament forms the cabinet of the respective state. The Laender cabinets are organized in ministries, with the structure and covered areas being comparable with the ministries at the federal level.

In Germany's federal system, the administrations of the 16 federal states (Länder) have central responsibility for federal and state law enforcement. Notwithstanding the heterogeneity in their size, administrative tradition, and culture, there is relative uniformity in their administrative structures (except for the three city-states). The latter are considered Stadtstaaten (Berlin, Bremen, Hamburg), being federal states and municipalities simultaneously (Kuhlmann et al. 2021: 6).

In most of the large federal states, the administration has a three-tier structure: At the top are the ministries. These are followed by the administrative districts (in the case of Baden-Württemberg, these are Stuttgart, Karlsruhe, Tübingen and Freiburg) as the middle authorities. In addition, the states are divided into counties (Baden-Württemberg, n= 35), city districts (Baden-Württemberg, n = 9) and municipalities (Baden-Württemberg, n = 1,101 municipalities), which form the lowest administrative level. These are also the main providers of indirect state administration. However, the constitutions of the Länder guarantee municipalities the right of self-government (5.4.1).

In addition to the ministries and the agencies directly subordinate to them, there exist also a large number of agencies at the state level which, similar to the federal level, differ widely in their mandates and tasks. Similar to the federal level, agencies are structurally independent public-law organizations that are outside the ministerial administration, have their own decision-making powers, but are subject to the control and supervision of a ministry (or ministries). Also in the case of state level, agencies mainly take the form of institutes corporations or

foundations under public law. The same is true for city states. In the case of Berlin, corporations under public law include, in particular, the Berlin Medical Association, the Berlin Chamber of Architects and the Berlin Bar Association, the Berlin Accident Insurance Fund, Charité Universitätsmedizin Berlin, Freie Universität Berlin and Humboldt-Universität zu Berlin. The legal status of an institution under public law is held, among others, by the Berliner Stadtreinigungsbetriebe (BSR), the Berliner Verkehrsbetriebe (BVG), the Berliner Wasserbetriebe (BWB) and the Verwaltungsakademie Berlin. Foundations under public law include the Berlin Opera Foundation, the Berlin Philharmonic Foundation, the Prussia Philharmonic Orchestra, the Prussian Palaces and Gardens Foundation Berlin-Brandenburg, the Foundation for and the Berlin Central and Regional Library Foundation (see Brühl 2022: 35).

### 5.3.2 Specific legal framework

At the state level, the main legal sources for the management and control of public funds are the Basic Law (Grundgesetz), the Budgetary Principles Act (Haushaltsgrundsatzgesetz), the State Level Budget Codes (Landeshaushaltsordnung) and further budgeting and accounting regulations. While resting on the same core pillars (e.g., in terms of budget principles), the federal states are largely autonomous and independent in regulating their (internal) financial management practices (Reichard and Küchler-Stahn, 2019: 102; also Article 109 Basic Law); In sum, several regulations, guidelines, and recommendations have contributed to a diverse picture regarding the configuration of internal control and internal auditing approaches across states and state agencies. Similar to the the central level, mandatory regulatory requirements cover specific aspects of internal control in many cases also following the logic of the central level (e.g., value for money assessments , see also 5.3.3.). However, there are no precise and uniform legal requirements concerning introducing and using a comprehensive risk management system covering both internal control and internal auditing aspects.

In the case of the state authorities, the concept of risk is listed in different parts of the respective state budget regulations (LHOs). However, not all federal states have included risk-related aspects in their regulations. For example, in most federal states, risks are mentioned mainly

concerning credit authorizations and, only in three cases (i.e., Brandenburg, Schleswig-Holstein and the city state Berlin), concerning value for money assessment of financially effective measures (see also Hirsch et al. 2020: 14–20 for an overview).

Similar to the federal level, it is mainly up to the state authorities themselves whether and how they implement comprehensive internal control or risk management approaches beyond legal requirements in most states. In this regard, empirical evidence is hard to find. Similar to the central level, additional, comprehensive regulations, recommendations, directives, and manuals guide implementing specific features of internal control, e.g., value for money assessment or internal auditing. The former is a mandatory part of the internal control activities of each state authority and largely follows the same logic at the federal and state levels (see 5.2.5). However, risk assessments are only mentioned in three out of sixteen cases as parts of economic/value for money assessment. As mandatory regulations on internal control largely follow the logic of the central level, this chapter focus on internal auditing.

Internal auditing approaches are also present at the state level. In most state regulations, internal auditing however is mentioned as an instrument for preventing corruption. Similarly to the federal level, most states recommend the implementation of internal auditing, which means that the decision on whether and how to implement internal auditing is up to the state authorities themselves. However, some (city-) states (i.e., Hesse, Bremen) developed more comprehensive mandatory internal auditing regulations and guidelines, which also serve as a reference point for deriving good practices in chapter 5.3.6.

### **5.3.3 Control Environment**

Similar to the federal level, the emphasis is on compliance to rules and procedures for internal and external controls.

## Public spending chain

According to Article 109 (1) of the Basic Law, the German federal and state governments are autonomous and independent of each other in their budgetary management. This constitutional budget autonomy means that the federal government and the Länder each draw up their own budgets and are responsible for executing, accounting and auditing them. Each level is thus to be enabled to perform its respective tasks on its own responsibility. In addition to Article 109 of the Basic Law, the legal bases of the budgets are the budgetary regulations of the respective state constitutions, the 16 state budgetary regulations issued in fulfillment of the HGrG<sup>21</sup> or the BHO, certain provisions of the Stability Act (StWG) and the directly applicable Part II of the HGrG. As in the case of the federal government, the Länder also have to comply with their respective budget laws, which are subject to a fixed time limit for the budget period. The HGrG ensures the uniformity of budget laws and the budget systems at the federal and Länder levels. The Länder budget regulations are largely aligned with the BHO in terms of both substance and form in the sequence of paragraphs. However, deviations are possible. For example, it is possible to prepare the budget for two years, separated by year (so-called "double budget"). While the majority of the states regularly make use of this option, the federal level does not.

The majority of the Länder applies cameralist (modified cash) accounting and traditional line item based budgeting. Only three have implemented accrual accounting (Hessen, Bremen and Hamburg). Moreover, only occasionally performance indicators and/or (strategic) objectives are included in the documents (see Reichard and Küchler-Stahn, 2021 for an overview). Against the backdrop of NPM-oriented reforms, results-oriented approaches have also found their way into the authorities of the federal states (including the police, prisons, and educational

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<sup>21</sup> The Budgetary Principles Act (Haushaltsgrundsätze-gesetz, HGrG) is a law that regulates the principles for the preparation and execution of budgets at the federal and state levels. The Federal Government and the states must base their respective budget laws - i.e. the Federal Budget Code (Bundeshaushaltsordnung, BHO) and the individual state budget codes (Landeshaushaltsordnungen, LHO) - on the principles prescribed by the Budget Principles Act.

institutions), although the corresponding implementation steps that have been taken vary in their progress.

Apart from these developments, the public spending chain is largely comparable with the federal level.

### **Good practice DE8 – Control environment – Regional government: Performance orientation**

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Some states include performance indicators in the budgeting documents (e.g. Hesse, North-Rhine Westphalia, and the city states Bremen and Hamburg). In some areas, the federal states have implemented performance agreements with authorities and agencies (e.g., universities). (COSO 2, 6 & 14)

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#### **Internal control chain**

The internal control chain follow the logic from the federal level.

#### **External control chain**

The regulations on external budget control (i.e. external auditing) at the federal and state level are largely harmonized, being a consequence of Section 42 of the Budget Principles Act, which had to be implemented by the federal and state governments until 1972.

### **5.3.4 Risk assessment**

In contrast to the federal level, comprehensive recommendations from audit offices (i.e., in the form of frameworks) regarding the assessment of risks do not exist.

#### **Subject**

At the state level, identifying and monitoring risks focuses on specific aspects, e.g., corruption, transparency, data protection, information

security and compliance. Anti-corruption regulations and guidelines are widely implemented and mainly help identify, assess, and mitigate risks in corruption-prone areas of work. These regulations often mandate the appointment of an organizational unit (for example, the internal audit unit) by the department head. This unit is responsible for carrying out the mentioned tasks.

The way in which risk aspects are addressed in practice varies widely. The assessment of financial risks is often related to the accounting approaches (i.e., cameralist vs accrual accounting). In this regard the city-state Hamburg systematically presents the risks that have a negative impact on the assets, financial position and net income of the city in the management report and carries out an assessment. Moreover, the report also includes measures for the mitigation of risks.

#### **Good practice DE9 – Risk assessment – Regional government: Accrual accounting stimulates financial risk mapping**

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Some (city)states, and here in particularly the ones which adopted accrual accounting, assess and present financial risks as well as measures for mitigating them in their budget documents. In this regard it seems, that the implementation of the financial management reform also lead to a better communication of (financial) risks to the public. (COSO 6)

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#### **Actors, Framework, Method, Impact**

Not applicable

#### **5.3.5 Control activities**

While the implementation of voluntary control activities probably differs between federal states and ministries and agencies within states, empirical evidence about their adoption or alignment with international proposed risk management frameworks like COSO is hard to find.

#### **Subject**

Similarly to the central level, several regulations and rules mandate the implementation of control activities that are oriented toward achieving the principles layed down in the constitutions (i.e. legality, compliance, regularity) and mitigate risks in this regard. Moreover, there is also an important mandatory internal control instrument, i.e., value for money assessments, which must be applied by all ministries and state agencies. In this regard, most federal states follow the recommendation and guidelines from the central level (see section 5.2.5).

In order to counteract the long-standing weaknesses in value-for-money assessments continuously identified by the audit offices, various German states followed the developments and further improvements at the federal level. At the state level, there have also been numerous amendments to the state budget regulations and revisions of working instructions for value-for-money assessments. In particular, Hamburg and Schleswig-Holstein have adopted very progressive and demanding regulations. These require that target criteria be clearly stated and that their achievement be monitored throughout the investment process. The search for and development of alternatives must be actively pursued and documented. An evaluation of the options for taking action against the background of the described objectives is intended to allow the entire decision-making process to be traced (see Neumann et al. 2018 for a comprehensive assessment).

**Good practice DE10 – Control activities – Regional government: Continuous improvement of regulations and instructions for value-for-money control**

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The continuous improvement of regulations and instructions for value for money assessments across central and state level lead to an accumulation of important organizational and technical knowledge which have the potential to increase their relevance, quality and acceptance of these assessments. (COSO 12, 13 & 16)

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**Actors, Framework, Method, Impact**

Not applicable



### 5.3.6 Internal Audit

Internal auditing is mentioned in most state regulations to prevent corruption. When searching for references in the anti-corruption regulations of countries concerning internal auditing, numerous hits are found (e.g., countries, Saxony). However, more comprehensive and general regulations (i.e., Bremen) and recommendations (i.e. Hesse) only exist in isolated cases (see also Sorgatz 2021). For example, Hesse has formulated recommendations on standards for internal audits in the Hessian state administration. The latter also contains illustrations for an authority-specific internal audit service instruction and illustration structure of an audit report. In one case, i.e., for the ministry of Justice, these recommendations have been translated into binding regulations (Hesse, 2016). The detailed recommendations are presented below (summarized from Hessisches Ministerium der Finanzen, 2016: 1055–1060).

#### **Subject**

The internal audit supports the authority management in the performance of its overall responsibility. Internal audit performs independent auditing and control functions on behalf of the authority's management. In addition, it provides support in professional and administrative supervision, ensuring and optimizing the quality, efficiency, and effectiveness of administrative action and creating transparency.

The internal Audit activities extend to all organizational units and areas of responsibility of an authority to cover all administrative actions and avoid audit-free spaces. The following possible subjects may be part of the audit review: compliance with regulations within the administration, adherence to the principles of economic action, adequate safeguarding of assets, appropriateness of internal risk management, including internal control systems, proper exercise of professional and official supervision of managers.

#### **Actors**

According to the recommendation, 'establishing an internal audit office is possible at the central level (i.e., the level of the highest state authority) and at the decentralized level (in each case in the highest state

authorities and insubordinate departments of the business area). However, in the case of a decentralized solution, the responsibility of internal auditing in a supreme state authority extends to all organizational units of the department, irrespective of the responsibilities of the local internal auditing units of the subordinate area.

In line with the duties and obligations to perform them, the internal audit office has comprehensive access rights for investigation, information, and organizational access. Likewise, all employees of the organization are obligated to support and promote the IA in its tasks (this includes, among other things, providing information and making required documents available).

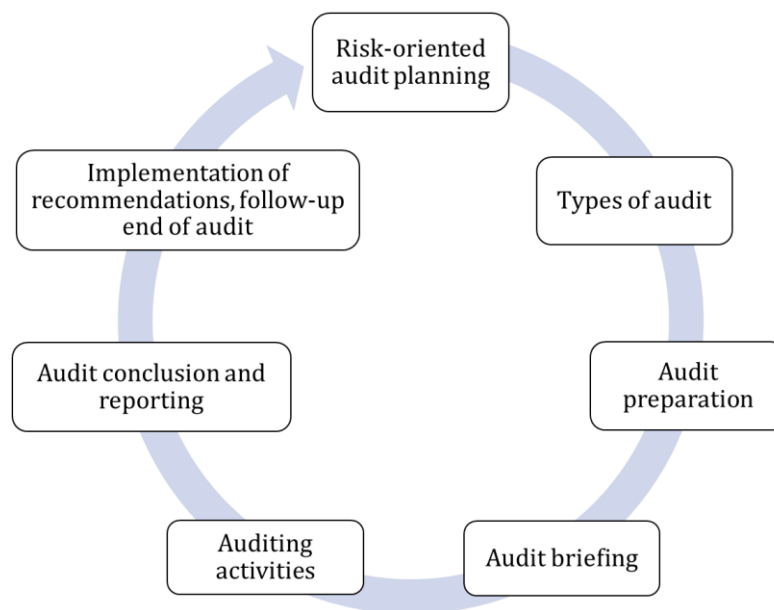
IA staff members are committed to impartiality, independence, and conscientiousness in performing their duties. In particular, the following principles are essential:

- Integrity, as a basis for the reliability of the investigations;
- Objectivity, to evaluate all relevant circumstances without being influenced by own interests or third parties;
- Confidentiality so that no disclosure of information occurs without an existing legal obligation.

### **Framework and method**

Internal auditing processes follow a seven-step framework and comprise different audit types (Hessisches Ministerium der Finanzen, 2016: 1058–1059):

Figure 8. Seven-step framework of internal audit processes, Germany<sup>22</sup>



### 1. Risk-based audit planning:

In a first step, an annual or semi-annual catalog of audit topics is drawn up based on the audit planning. The latter is derived from an audit map (audit universe) and an authority-specific risk analysis, considering the cost/benefit ratio. After the approval of the plan by the authority's management, the audit assignment is issued. Audit planning can and should be extended or updated with experience gained or changes in the general conditions.

### 2. Audit types:

There are different types of audits. They are listed below:

- "plan reviews in the sense of an objective assessment of audit evidence from an organizational unit with the aim of an independent evaluation of facts" (p.1057),
- "cross-cutting audits of multiple organizational units to independently assess issues" (p.1057),

<sup>22</sup> Based on Internal Audit Standards, Hesse (Hessisches Ministerium der Finanzen, 2016)

- "special incident investigations" (ibid.),
- "post-show examinations" (ibid.).

3. Audit Preparation:

Audit preparation includes analyzing the subject matter, familiarizing oneself with the subject matter, obtaining information, and planning the details of the audit process" (p.1057)

4. Audit Announcement:

Following the audit assignment, Internal Audit shall give the respective organizational units due notice of the audit, provided that audit purposes do not conflict with this. In an introductory meeting, the planned course of the audit is explained, and questions relating to the audit are clarified" (ibid.).

5. Audit procedures:

In the course of its audit activities, the IA collects and evaluates facts; in the process, audit actions, findings, and assessments are documented. At this stage, findings already obtained and proposals based on them can, if possible, be discussed with the audited organizational units. The following criteria, in particular, are to be taken into account during the audit:

- Risks
- Legality
- Regularity
- Security
- Economic efficiency
- Securing the future
- Expediency/effectiveness
- Impact orientation.

Moreover, the audit must always be carried out as a team effort. This may also include actors from internal auditing units from different organizations in specific areas.

### **Good practice DE11 – Internal audit – Regional government: Networking and Cooperation**

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Networking/Cooperation. More complex audits are generally carried out by the Internal Audit department of the Hessian Ministry of Finance, which has been in existence since 1970 together with other actors. Experienced auditors from the construction and tax sectors as well as legal experts, are available for this purpose. These investigations are facilitated by the "networked model" introduced with the explicit support of the Hessian Audit office. In this model, the auditing units of the Hessian State Office for Construction and Real Estate and the Hessian Central Office for Data Processing, as well as the Central Office Audit of the Regional Finance Office in Frankfurt, work together with the lead internal audit unit of the Hessian Ministry of Finance (Kleine Anfrage, Hessischer Landtag, 09.10.2018) (COSO 14 & 17).

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#### 6. Audit conclusion and reporting:

The internal audit office drafts an audit report for the audit conclusion. This report contains findings, evaluations, and recommendations for correcting and improving deficiencies and further conclusions if necessary. After a final discussion (not obligatory; it may be dispensed by mutual agreement between the IA and the organizational unit), the IA prepares a final audit report, which is generally submitted to the authority's management for approval. The audited organizational unit also receives a copy.

#### 7. Implementation of recommendations, follow-up, end of the audit

In the end, the authority's management must decide on implementing the IA's recommendations. It is the responsibility of the audited organizational unit itself to meet the deadline for this implementation; the IA monitors the implementation of the recommendations following a systematic procedure (follow-up). Once the recommendations have been implemented, the follow-up is considered completed.

## **Impact**

The internal audit supports agency management in carrying out its overall responsibilities. 'The focus of Internal Audit's activities is to detect deviations and irregularities and to provide suggestions for their elimination and future prevention. It examines administrative actions and provides information, analyses, assessments, recommendations, and advice. In this way, it contributes, among other things, to verifying and sustainably improving the risk management, culture, quality, effectiveness, and efficiency of administrative action.' (ibid.) However, in the end, the authority's management must decide on implementing the IA's recommendations.

### **Good practice DE12 – Internal audit – Regional government: Structured audit procedures that ends with implementation of recommendations**

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The internal audit's activities contributes to verifying and sustainably improving the risk management, culture, quality, effectiveness, and efficiency of administrative action. (COSO 16 & 17).

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## 5.4 Local government

### 5.4.1 General overview

Local governments in Germany form the nearest to citizen level within the three administrative layers and are subdivided into counties (Kreise), municipalities, and municipalities associations (Reichard 2003). The country has 10,796 (2022) municipalities with an average population (median) of 1,719. The number of municipalities varies highly across the 16 states, from 52 (Saarland) to 2,305 (Rhineland-Palatinate), and so does the average population per municipality – excluding the three cities with the special statute as city-states, the average population per municipality ranges from 559 (Rhineland-Palatinate) to 20,824 (Northrhine Westphalia) (see Papenfuß et al., 2017: 118). In total, only 39 cities have a population above 200,000, while the vast majority, 86 per cent of the municipalities, have less than 10,000 inhabitants (see also Kuhlmann and Bogumil (2021: 278–285) for an overview with regard to territorial reforms).

According to the constitution, municipalities are an integral part of the country's 16 states (Länder). Thus from a formal view, Germany has a two-layer administration (federal and state level), but the functions and competencies devolved to the local governments in fact, account for them to be the third administrative level (Kuhlmann and Wollmann 2013, p. 77). Moreover, the Basic Law guarantees the right to local self-government which together with the wide variety of competencies account for the high autonomy and power of German local governments in political and functional terms. Local governments consist of the local council and (in most cases) a directly elected 'strong mayor'. Besides exercising political leadership as the chair of the council, the mayor also serves as the chief executive officer and thus the administrative leader of the local government (Wollmann, 2004). In sum, local governments serve a dual purpose, comprising the fulfillment of tasks within their own responsibility (e.g., social and cultural services, water and sewer, and public transport) as well as tasks delegated to them by the state, e.g., construction supervision, local policing (see Kuhlmann et al. 2021: 6, Kuhlmann and Wollmann 2013, Wehling and Kost 2010).

### 5.4.2 Specific legal framework

At the local level, the legal sources for the management and control of public funds are manifold and diverse. The local budget regulation is subject to the legislative competence of the *Länder*. However, the principle of municipal self-government according to Art. 28 section 2 sentence 3 of the Basic Law, which also includes financial self-responsibility, must be observed.

The essential rules in this regard are codified in the municipal constitutions (*Gemeindeverfassungen*, GV) and municipal regulations (*Gemeindeordnungen*, GO) of the *Länder*, respectively. Furthermore, to regulate the details, the ministers of the interior of the federal states have issued several regulations. The Municipal Budget Regulation (*Gemeinshaushaltsverordnung*, GemHVO) is the most important reference point for the management of municipal budgets and contains, among other things, binding rules for the design and execution of budgets.

Separate regulations exist regarding more specific aspects, e.g., cash management (*Gemeindekassenverordnung*) or the management of municipal enterprises (*Eigenbetriebsverordnung*), and are also regulated in special decrees (e.g., the decree for the credit management of municipalities).

There are no specific laws, regulations, or decrees on risk management. However, the concept of risk, similar to the state level, can be found in various municipal budget regulations, especially in connection with credit authorizations and in some states regarding the valuation of assets and reporting requirements as well as with regard to the management of municipality owned corporations (see also Hirsch et al., 2020: 17–22). Moreover, the principles of proper computerized accounting systems (GoBS) explicitly require users of software solutions in financial management to set up an internal control system. Additionally, there are a number of regulations which are related to addressing service or task related risks (e.g. in the case of child welfare).

The economic principle must also be obliged at the municipal level. Local governments and associations are obliged to use their funds in a lawful, economic, and efficient way according to municipal budget regulations. A lawful use of funds requires normative and organizational



measures in the management of funds, accounting procedures, and the conduct of cash transactions, which ensure that irregularities emanating from employees with the consequence of financial losses are avoided. Regulations in connection with the design and implementation of internal control systems can be found in various ordinances and, with regard to the compulsory parts, largely correspond to the regulations at the state level.

### **5.4.3 Control environment**

#### **Public spending chain**

Each state regulates financial management related aspects for the local governments located in its territory, which is why budgeting and accounting practices differ from one state to another (see Ridder et al., 2005). In this regard, most states have started implementing accrual accounting from the mid 2000s with transition periods until 2016 latest. Three states however still allow their local governments to choose between (modified) cash accounting and accrual accounting (Bavaria, Schleswig-Holstein, Thuringia) (see Holtkamp, 2012).

While all Länder agreed on the core pillars of the reform, i.e. moving to accruals accounting and performance budgeting, they made use of their discretion in standard setting and in formulating the various Länder-specific budgeting and reporting acts. Therefore, differences across states exist with regard to e.g. valuation of assets and liabilities or to the composition of the budget and the balance sheet (Reichard and Küchler-Stahn, 2019: 106). However, some common key features also exist: (1) Product-oriented structuring of budgets, (2) Dual focus on cash- and accrual based plans, (3) Mid-term perspective, (4) Lump-sum approach, with varying levels of spending discretion, and (5) Inclusion of performance information in form of objectives and/or indicators.

Moreover, some fundamental aspects (i.e. budget principles) were already harmonized across states before the reform.<sup>23</sup>

The most important budgetary principle is to ensure the continuous fulfillment of tasks. Thus, most municipal regulations state, that the municipalities must plan and manage their budgets in a way that ensures the continuous fulfillment of their tasks. Moreover, municipalities have always been required to take all measures to avoid a deficit in order to balance the budget and also to ensure liquidity as well as the financing of investments at all times (see for instance § 75 Para. 6 GO NRW). If a municipality is unable to meet its obligation to balance the budget most of the federal states provide for the compulsory of a budget consolidation concept (Haushaltssicherungskonzept, HSK). However, the requirements are formulated in significantly different ways across the states. The above mentioned principles or objectives are also interpreted as the basis or central reference points for municipal risk management.

The majority of other (process-oriented) budgetary principles largely correspond to the regulations that apply at the federal and state level. They are also laid down in the GO. Unlike the state levels, the municipalities however are bound by principles of revenue procurement. According to these principles, the revenue required for the fulfillment of tasks is, as far as justifiable and necessary, first to be raised from special charges (fees, contributions, private-law charges) for services provided by the municipality and otherwise from taxes. In addition, the municipalities are bound to a specific order in their financing. It is stipulated, for example, that special charges such as fees and contributions have priority over general taxes. Finally, the municipality may only take out loans if other financing is not possible or would be economically inappropriate.

Even before the introduction of the reform, the requirement of prudent and economic budget management was a general and binding budgetary principle. However, the addition of the concept of efficiency to the list of general budget principles underscored the new orientation from input to output control. The principle of efficiency is also used to justify the obligations contained in the municipal budget regulations (KomHVO)

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<sup>23</sup> The following paragraphs are translated from Knirsch (2019) who mainly refers to North-Rhine Westphalia which is considered a frontrunner and “role model” with regard to the introduction of the accrual accounting reform.

to define product-oriented targets and indicators to measure the degree of target achievement (see, for example, Section 4 (2) KomHVO; Section 4 (7) Kommunalhaushalts- und -kassenverordnung - KomHKV of the State of Lower Saxony) (Knirsch 2019: 11). The following figure shows important steps along the budget cycle at the local government level which broadly apply across states.

**Figure 9. Budget cycle, Germany<sup>24</sup>**



From a control perspective, a noteworthy step in the budget cycle, which is also different from the federal and state level, is the compulsory presentation of the budget act together with all annexes to an external supervisory authority. This has to be done one month before the beginning of the financial year at the latest. The detailed budget - often referred to in practice simply as the "budget" - forms the prerequisite and basis for the actual budget act, which are adopted by the municipal council after the conclusion of the deliberations. From a formal point of view, the budget is an annex to the budget act. As a result, the budget as a whole acquires the quality of an act and, when implemented, becomes a binding

<sup>24</sup> Kirsch (2019: 40)

instruction for the administration. If the municipality wishes to make significant changes to its budget, it can only do so by means of a bylaw: the supplementary budget (Knirsch 2019: 40).

With the introduction of the reform, municipalities and municipal associations were obliged to regulate specificities and details of their control and accounting systems themselves, essentially by means of service directives, instructions and other organizational acts. This requirement also applies to regulations designed to ensure the accuracy of accounting systems and procedures and the processing of payment transactions. Municipal enterprises (i.e. *Eigenbetriebe*) may be exempted from the application of individual requirements of the municipal budget code granting them higher autonomy and flexibility. In addition, they draw up their own budget in form of an economic plan, which must be approved by the local council. Moreover, they are also often obliged to follow rules which apply for private enterprises, requiring the implementation of more comprehensive internal control systems.

### **Internal control chain**

Similar to the other government levels, the (financial) control environment at the local level is the sum total of the internal policies and rules of procedure as well as relevant external legal regulations on the basis of which local governments perform their everyday operations. In this regard, internal control systems are nothing new for municipalities and address almost all work processes of the municipal administration (e.g., ranging from security standards for accounting procedures to service related aspects). Moreover, there are strict legal and hierarchical arrangements in place, which should ensure clear responsibilities regarding the regularity, propriety and economy and efficiency in using resources. However, it is less clear if the different control activities are integrated in a systematic and comprehensive way.

The municipal cash regulation forms the core of the municipal cash law in the respective federal state. It provides the framework and minimum requirements for ensuring that cash transactions are carried out properly and securely, while at the same time leaving sufficient scope for an effective and efficient cash management system. Supplementary regulations are therefore required for the individual cash offices at local level

(service instructions, individual instructions). The Municipal Cash Ordinance (GemKVO) is a regulation issued by the Ministry of the Interior (usually in agreement with the Ministry of Finance) of the respective federal state. The dual control principle is also expressed here, i.e. that important decisions should not or must not be made by a single person or that critical activities should not or must not be carried out by a single person. The aim is to reduce the risk of errors and misuse. The budget and cash regulations contain a large number of specifications in this regard (e.g. separation of order and execution, separation of determination and order according).

### **Good practice DE13 – Control environment – Local government: Clear roles and responsibilities**

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Internal control systems are nothing new for municipalities and address almost all work processes of the municipal administration (e.g., ranging from security standards for accounting procedures to service related aspects). Moreover, there are strict legal and hierarchical arrangements in place, which should ensure clear responsibilities regarding the regularity, propriety and economy and efficiency in using resources. (COSO 3 & 5)

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The municipal budget regulations also stipulates that the responsibility for information systems is to be separated from the responsibility for financial accounting (§ 28 para. 10 no. 10 GemHVO.). This fulfills the requirement for cash security, according to which payment instruction (order) and payment processing may not be carried out by the same person. (Section 106 (5) GemO, Section 25 (5) sentence 1 GemHVO). Proper allocation of authorizations in financial accounting as well as their documentation is part of proper accounting. It is therefore necessary to review the authorizations at regular intervals and to adjust them if necessary, as well as to update the documentation. It is imperative that the authority to do this is assigned to staff outside the financial accounting department (IT system administration).

Finally, internal audit offices (Rechnungsprüfungsämter, RPA) form an important part of the internal control environment. The rights and

purposes of these offices are laid down in different general and specific regulations. Apart from the audit of the annual financial statements and the overall financial statements, the tasks comprise: (1) the ongoing audit of cash transactions at the municipality and at the municipal undertakings in preparation for the audit of the annual financial statements, (2) the cash monitoring, in particular the performance of the cash audits at the cash offices of the municipality and the municipal corporations (see section 5.4.6).

### **External control chain**

The federal structure led to the creation of decentralised audit bodies. In this regard, the municipal codes of the Länder specify the regulatory framework for budget supervision in each state and provides the supervisory authority (i.e., regional audit institution) with specific rights of intervention. According to their statutory mandate, financial supervisory authorities should ensure the sound fiscal management of municipalities, assess compliance with budgetary law and sanction fiscal rule violations (Geissler et al., 2019: 102–110). Financial supervision in the different states either exhibit a two-tier or a three-tier structure. In a three tier structure (e.g., in Rhine Westphalia) the Ministry of the Interior coordinates the operative agencies (district governments and counties) while district governments are in charge of monitoring the budgets of counties and large cities, and counties are in charge for monitoring municipal budgets (Person and Geissler, 2021: 231).

To fulfil their tasks, supervisory agencies have several preventive as well as repressive instruments at their disposal (e.g, the right to request information, approval of loans and budget plans, request of budget consolidation concepts, denial of (cash) loans and budgets or the enforcement of austerity measures). In particular, the reservations of approval regarding borrowing represent a preventive instrument for monitoring municipal loan financing. However, a comparison between the Länder shows that there are considerable differences in the design of these instruments (see Person and Geissler (2021: 229f) and Geissler et al. (2021) for a detailed overview).

#### 5.4.4 Risk assessment

Comprehensive recommendations (i.e., in the form of frameworks) regarding the assessment of risks do not exist. At the local level, identifying and monitoring risks focuses on specific aspects, e.g., related to valuation of assets, loans, corruption, transparency, data protection, and compliance.

##### **Subject**

The concept of risk, similar to the state level, can also be found in various municipal budget regulations, especially in connection with credit authorizations and in some states regarding the valuation of assets and reporting requirements (see also Hirsch et al. 2020: 17-22). In this regard the annual management report is considered an important tool, which has to be prepared in addition to the financial statements. The objective of the management report is to provide a true and fair view of the assets, liabilities, financial position and results of operations of the local authority and to present the financial performance of the local authority. In particular, the management report presents those matters that are not, or only to a limited extent, apparent from the annual financial statements and the monetary figures presented therein, such as financial opportunities and risks.

Figure 12 provides an overview of the main points, functions and addressees of the management report based on the relevant legal requirements for municipalities in North Rhine-Westphalia. The counterpart to the management report in the annual statement is the introductory report in the budget planning documents. The management report and the introductory report should be coordinated in terms of content and structure.

**Figure 10. Main aspects of the management report, Germany<sup>25</sup>**

<p><b>Contents of the management report</b> (following §48 GemHVO NRW)</p> <p><b>Obligatory Contents</b></p> <ul style="list-style-type: none"> <li>• Overview of the most important results of the annual financial statements and the course of budgetary management</li> <li>• Transactions of particular significance (also after the close of the financial year)</li> <li>• Analysis of the budgetary management and the asset, debt, income and financial situation according to the scope of municipal task fulfillment</li> <li>• Risks and opportunities of future developments (including underlying assumptions)</li> </ul>
<p><b>Recommended contents</b></p> <ul style="list-style-type: none"> <li>• Product-oriented goals and key figures</li> </ul>
<p><b>Functions of management report</b></p> <ul style="list-style-type: none"> <li>• Accountability function</li> <li>• Consolidation function</li> <li>• Complementary function</li> <li>• Communication function</li> </ul>
<p><b>Addressees of management report</b></p> <p>Current and potential administrative employees, debt providers, companies, citizens, suppliers, neighbouring municipalities, municipal supervision, financial analysts, etc.</p>

The way in which risk aspects are addressed in practice varies widely. A good practice example can be found in the annual reports of Frankfurt a.M.<sup>26</sup>. In addition to the risks for the core administration, the whole of government report as well as the investment report<sup>27</sup> also include a risk assessment for the municipal utilities. As already stated above, the city-state Hamburg systematically presents the risks that have a negative impact on the assets, financial position and net income of the city in the annual management report and carries out an assessment. Moreover, the report also includes measures for the mitigation of risks.

### **Actors, Framework and Method**

An important instrument in this area are also the annual audits of financial statements which are carried out by the (internal) audit office (Rechnungsprüfungsamt). In this regard, the Institute of Public Auditors has developed a reporting guideline in connection with audits of annual financial statements (IDR Audit Guideline 206, 2009). This guideline also requires a statement about the assessment of the economic situation and on potential risks and opportunities. The audit report on these aspects is

<sup>25</sup> Burth, (n.s.) Haushaltssteuerung Lexikon: Lagebericht

<sup>26</sup> Bergerhoff (2022)

<sup>27</sup> Stadt Frankfurt am Main (2021a, 2021b)



to be divided into two sections. The first section highlights the main statements/assessments of the mayor for the expected development of the municipality and the associated opportunities and risks. The second section contains the auditor's opinion with regard to these statements/assessment. If the auditor discovers facts that endanger the future development of the municipality, this must also be reported in the audit report.

### **Impact**

The external visibility of this procedure contribute to the re-assessment or further clarification of risks.

### **Good practice DE14 – Risk assessment – Local government: Risk assessment included in reporting guidelines for audit reports**

Reporting guideline for audit reports. The reporting guideline in connection with audits of annual financial statements requires a statement about the mayors' assessment of the economic situation and on potential risks and opportunities. If the auditor discovers facts that endanger the future development of the municipality, this must also be reported in the audit report. The report on these aspects is to be divided into two sections. The first section highlights the main statements of the mayor for the expected development of the municipality and the associated opportunities and risks. The second section contains the auditor's. (COSO 7)

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### **5.4.5 Control activities**

The requirements, i.e. regarding the establishment, structure, functions and tasks of local government internal control systems is prescribed by legal regulations. In line with the hierarchical structure of the legal system, the need to maintain appropriate internal control systems arises, in particular, from the principles in the context of budget regulations. Further provisions can be found in local directices.

### **Subject**

Similarly to the other levels, there exist a variety of important mandatory internal control instruments, mainly focusing on compliance and the proper use of public funds (e.g., definitions of role and authorization concepts, checks of four eyes principle, establishment of functional separation, service instructions). While the implementation of voluntary control activities probably differ between local governments empirical evidence about the adoption of more comprehensive internal control approaches is hard to find. (see Dortmund as exception and good example). The city of Dortmund however is one of the rare documented cases, which serve as good example in this regard (see Gemeindeprüfungsanstalt Nordrhein-Westfalen 2019; Stadt Dortmund, 2018). Dortmund already operated numerous process-integrated control systems resulting from specific legal foundations or its own internal regulations (e.g., role and authorization concepts, checks of four eyes principle, quality controls, plausibility checks, service instruction, checklist for administrative processes, training concepts for new employees, employee training).

Starting from there, the city administration has started to develop and implement more comprehensive internal control systems since mid-2014. The experience gained is continuously incorporated into the internal control system concepts. Initially, the focus was on the development of internal control system concepts for processes in the area of accounting. Using special work instructions, internal control system concepts were created in the departments for the processes of invoice processing.

### **Actors**

More than 250 municipal employees have now been trained in the methodology of process modeling and internal control system creation. At the same time, independent internal control system concepts were created in the departments for work in the accounting department as well as for specialist processes, some of which are also located outside the accounting department. The Human Resources and Organization Office supports the departments by providing sample documents, informational meetings, internal control system training, etc.

### **Good practice DE15 – Control activities – Local government: Deployment of control through policies and procedures**

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Dortmund deploys control activities through policies that establish what is expected and procedures that put policies into action by establishing procedures using competent personnel to support deployment of management's directives (i.e. trainings) and by establishing responsibility and accountability for executing procedures (i.e. department heads) and taking corrective actions in a timely manner (i.e. random and automated checks). (COSO 12)

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#### **Method and Framework**

Moreover, after a trial stage, a guideline has been published which uniformly regulates the procedure for the creation of internal control systems for the city of Dortmund. This procedure enables departments to carry out a rough ICS analysis for all the processes of a department, using the resources available, in order to then identify the particularly high-risk processes that then need to be looked at in particular and in detail.

The use of this resource-saving procedure pursues the goal of preventing damage and helping to detect errors and irregularities in operational processes, establishing protection against fraudulent acts, and ensuring compliance with all relevant legal provisions. The internal control system is intended to draw attention at an early stage, in a generally applicable manner, to risks that could have a negative impact on the achievement of defined municipal objectives.

The ICS gross analyses prepared in the departments are reviewed in cooperation between the (Internal) Audit Office and the Human Resources and Organization Office for their basic plausibility and comprehensibility as well as for the uniform application of the methodology throughout the administration.

#### **Impact**

In this regard, the internal audit office also concluded in its 2019 report that Dortmund regularly assesses financial risks and is in the process of establishing an ICS for functional risks. Control measures are developed on the basis of the findings of the annually prepared ICS management report. In addition, the city already uses process-integrated and process-independent controls, which can be used to track the observance of and compliance with defined specifications for the workflow and procedural standards as well as the proper execution of tasks. In addition, numerous checks for plausibility are already integrated into the defined processes. Process-independent checks are carried out as random checks by the respective manager.

**Good practice DE16 – Control activities – Local government: Selection of control activities that contribute to the mitigation of identified main risks**

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Dortmund selects and develops control activities that contribute to the mitigation of identified main risks. The approach taken integrates with risk assessment and consider unit specific factors as well as aim to identify critical processes. Moreover, it clearly assigns responsibility for the various roles in the processes. (COSO 9 & 10)

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#### **5.4.6 Internal Audit**

The internal auditing practices in local governments and local government associations follow regulatory requirements and directives from the state and local levels. Today, the tasks of audit offices (Rechnungsprüfungsämter)<sup>28</sup> are broad and vary across local governments, with some of them voluntarily taking a more comprehensive and systematic approach. The latter is also more in line with (international) internal auditing standards and reflects the development of traditionally being confined to merely checking accounting records and detecting financial (i.e., cash related) errors and irregularities to broader internal control

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<sup>28</sup> In 2001 a working group which comprised different audit offices in Hesse issued a working paper on new tasks of audit offices and recommended to use Revisionsamt instead of Rechnungsprüfungsamt: (Arbeitsgemeinschaft der Rechnungsprüfungsämter in Hessen, 2001).

related activities such as the review of the effectiveness and efficiency of operations or the reliability of financial reporting. In addition, internal auditing sometimes includes evaluations, risk assessments, and (ex-ante) management support functions (e.g., in the case of Stuttgart with serves as good example).

In sum, (internal) audit offices mainly perform their duties to the extent stipulated by law (mandatory duties). However, there are also local governments whose auditing practices are more extensive and in line with comprehensive internal auditing guidelines for private corporations. In the following, Stuttgart serves as a good-practice example as its internal approach is certified according to Audit Standard No. 3 of the German Institute of Internal Auditors (DIIR)<sup>29</sup> and the Quality Norm DIN EN ISO 9001:2008. The DIIR Auditing Standard No. 3: "Quality Management in the Internal Audit Activity" is based on the International Standard "1300 - Quality Assurance and Improvement Program" and provides guidance on the establishment and operation of quality management in internal auditing. The standard is supplemented by the "Guideline for Implementing a Quality Assessment (QA)". This guideline consists of a total of 82 quality criteria, which are described as a set of target criteria. The quality criteria are divided into three thematic blocks with a total of eleven areas of consideration.<sup>30</sup>

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<sup>29</sup> The working group "Internal Auditing in Public Institutions", founded within DIIR e.V., has been in existence for about 20 years, and has been joined by specialized working groups, for example, of internal auditors of security authorities or hospitals.

<sup>30</sup> Deutsches Institut für Interne Revision e.V. (2017) acc.: [https://www.diiir.de/fileadmin/fachwissen/standards/downloads/DIIR\\_Revisionsstandard\\_Nr\\_3\\_2017.pdf](https://www.diiir.de/fileadmin/fachwissen/standards/downloads/DIIR_Revisionsstandard_Nr_3_2017.pdf).

**Figure 11. Quality Criteria of internal audit, Germany<sup>31</sup>**

<b>BASICS</b>	<b>IMPLEMENTATION</b>	<b>EMPLOYEES</b>
I. Organisation, positioning in the company and fields of activity	IV. Preparation	IX. Selection
II. Budget/Resources	V. Audit	X. Development and training
III. Planning	VI. Reporting	XI. Management of the Internal Audit
	VII. Audit rework	
	VIII. Follow-up	
Summary assessment of the appropriateness and effectiveness of internal auditing during the assessment period based on 81 quality criteria in 11 scopes of consideration within 3 areas (including 6 so-called K.O. criteria)		

### Subject

Irrespective of the structural differences between the federal states, the main traditional tasks include, in particular, audits of the annual financial statements as well as carrying out (ad hoc) cash audits (see also section 5.4.3). In addition, a distinction is made between core or mandatory tasks of the RPA and additional tasks assigned to RPAs by specific internal bodies (i.e., the local council or Mayor).

The local government regulation of the respective federal state defines the mandatory tasks of the RPA. The latter includes, in particular, the (post) audit of whether:

- budgetary requirements have been met,
- revenues and expenditures are justified and documented, and the annual financial statements and assets are properly prepared,
- economic and economical procedures have been followed,
- tasks can be performed more effectively with lower personnel or non-personnel costs or other means.

Core tasks also include:

<sup>31</sup> Deutsches Institut für Interne Revision e.V. (2017) DIIR Auditing Standard No. 3: Quality Management in Internal Auditing

- the audit of the annual financial statements (BW, BB, BY, H, MV, NDS, NRW, RLP, SAL, SN, SNL, SH, TH),
- ongoing examination of cash transactions and supporting documents in preparation for the audit (BW, BB, H, MV, NDS, NRW, SAL, SN, SNL),
- cash monitoring, in particular carrying out cash audits of the local authority's cash offices and the local utilities (BW, BB, H, MV, NDS, NRW, SAL, SH, SNL).<sup>32</sup>

The local board or the Mayor may assign additional tasks to the RPA through corresponding audit regulations in the respective local governments. These additional tasks, which differ in each federal state, include:

- organizational , efficiency, and effectiveness audits(BB, BW, NDS, NRW, SN, SAL),
- the audit of stocks and assets (BB, H, MV, NDS, NRW, SH),
- the auditing of accounts, operations, and cash matters in the case of subsidiaries, in the case of granted loans, or other matters (BW, BB, H, MV, NDS, NRW, RLP, SAL, SH, SN, SNL).

Moreover, some local governments go beyond this and explicitly refer to the support function of internal auditing. In Stuttgart, explicit reference is made to the fact that added value is created through the work of internal auditing together with the audited units. Moreover, internal auditing provides recommendations for action to optimize processes, potential savings, and points out legal and financial risks.

### **Actors**

All local governments in the federal states must ensure that their budgetary and economic activities are audited (internally). However, there are differences in the obligation to establish local audit offices assigned to carry out these tasks. In the majority of Länder, specific internal audit offices (Rechnungsprüfungsämter; RPA) are responsible for carrying out these functions, which often take the form of post-audits and specific forms of internal controls. Although the offices are an internal part

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<sup>32</sup> Based on the relevant ordinances of the respective states

of the local administration, they are independent regarding the audit results. In some states, audit committees bear the primary responsibility, and audit offices support them insofar as this is necessary due to the size of the local government.

In some cases, the size of local governments (i.e., population) influences the need to establish an RPA. In Hesse, for example, all municipalities with more than 50,000 inhabitants must set up an RPA (cf. §129 HGO), while smaller local governments have the right to consider other options. If no internal local office exists, the RPA of the respective county carries out these tasks. In Mecklenburg-Western Pomerania, this limit is already set at 20,000 inhabitants (cf. Kommunalprüfungsgesetz Meck.-Vorp).

The (internal) local audit office has a unique position within the local administration. The local council appoints the head of the audit office and the auditors and, if necessary, also dismisses them. However, the internal auditors perform their duties on their own and in an independent manner. In carrying out its tasks, the local audit is only subject to the relevant laws and is not obligated to follow internal instructions.

In the case of Stuttgart, it is clearly stated on the website that the Audit Office is independent in carrying out its tasks, is not restricted by internal orders, independently determines the time, type, and scope of its audit activities, and is directly subordinate to the Mayor in terms of supervision.

#### **Good practice DE17 – Internal audit – Local government: Guarantee of independence of IA body by law**

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The independence of the internal audit office is laid down in regulations and often explicitly made visible in unit statements to outside actors. In the case of Stuttgart, it is clearly stated on the website that the Audit Office is independent in carrying out its tasks, is not restricted by internal orders, independently determines the time, type, and scope of its audit activities, and is directly subordinate to the Mayor in terms of supervision.

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### **Framework/ Method**

There are no standardized regulations concerning the audit procedure; the latter is regulated differently in the respective federal states and the respective local governments. There are also variations concerning audit deadlines and the frequency of audits. In light of NPM-oriented budgeting and accounting reforms, discussions about how the local audit's tasks and functions should change increased. The ex-post audit and ongoing controls are still considered vital tasks in this context. However, they should be complemented by future-oriented or prospective audits, which particularly support the political-administrative function.

#### **Good practice DE18 – Internal audit – Local government: Increasing IA certified by external standard setters**

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Some internal audit offices are certified according to Audit Standard No. 3 of the German Institute of Internal Auditors (DIIR) and the Quality Norm DIN EN ISO 9001:2008. The latter covers all aspects of auditing activities and helps to monitor the effectiveness of internal auditing on an ongoing basis. (COSO 16 & 17)

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In Stuttgart, the planning of the frequency and focus (i.e., administrative processes, internal control systems, or specific transactions) of audits is systematically derived from risk assessments. The Audit Office prepares a final report on its main audit findings annually. The Audit Office is certified according to Audit Standard No. 3 of the German Institute of Internal Auditors (DIIR) and the Quality Norm DIN EN ISO 9001:2008. The latter regulates the quality management of internal auditing - it covers all aspects of auditing activities and helps to monitor the effectiveness of internal auditing on an ongoing basis.

### **Impact**

The impact of the RPA's audits on the administration is likely to vary. In many cases (apart from the annual financial statement audits) the audit reports are usually not published but remain within the respec-

tive administration. The impact therefore depends on how those responsible comply with the RPA's recommendations and implement them. The actual impact is thus somewhat limited. In Stuttgart however, RPA reports are published annually on the website and provide detailed explanations of the audit results. In this way, the impact of the RPA's audit on the administration is likely to be strengthened, as public pressure can be exerted, which could favor the implementation of the RPA's recommendations.

## 5.5 Agencies

### 5.5.1 Central executive agencies

#### **General overview and legal framework**

In Germany, the federal constitution requires the administration to be organized on a decentralized basis. In addition, it must be taken into account that structurally independent authorities have always existed in the federal administration (but also in the state administrations), and that the ministerial administration has primarily legislative preparatory tasks, while operational tasks are performed in "subordinate authorities" (i.e. agencies). As already mentioned in section 5.2 there are over 120 federal agencies. Agencies are structurally independent public-law organizations that are outside the ministerial administration, have their own decision-making powers, but are subject to the control and supervision of a ministry (or ministries) (Bach, 2013; Bach et al., 2010: 13). Agencies mainly take the form of institutes (Anstalten, n = 37) corporations (Körperschaften, n = 60) or foundations (Stiftungen, n = 56) under public law. Similar to the federal level, agencies also at the state level are structurally independent public-law organizations that are outside the ministerial administration, have their own decision-making powers, but are subject to the control and supervision of a ministry (or ministries). Also in the case of state level, agencies mainly take the form of institutes, corporations or foundations under public law. The same is true for city states.

#### **Internal control system and internal audit**

Federal (and also state) agencies often enjoy considerable autonomy vis-à-vis their supervising ministry. Moreover, agencies may be exempted from the application of individual requirements of the Federal Budget Code granting them higher autonomy and flexibility. They are subject only to the legal supervision of the responsible federal (or state) ministry (with some important exceptions, e.g. the Federal Employment Agency or the Federal Financial Supervisory Authority, BaFin). Agencies also have the option of drawing up a so-called economic plan instead of a classic budget (Section 110 of the Federal Budget Code), which allows

for net budgeting. However, their budget must also be approved by the responsible ministry.

These agencies are subject to the same legal requirements as the supreme federal or state authorities. This means that the (mandatory) regulation on the control environment, risk assessment, and internal control, which are described in sections 5.2.2 (3) and 5.3.2 (3), also predominantly apply to them.

In the next section, we focus on the federal employment agency, which stands out regarding the development and implementation of a comprehensive risk management systems aligned with international models. Moreover, in regional terms, it carries out its tasks across all levels, including the central, regional and local levels.

**Risk assessment, internal control and internal auditing – the case of the federal employment agency (Bundearbeitsagentur, BA)<sup>33</sup>**

As a public corporation with self-government, the BA carries out its tasks on its own responsibility, within the framework of the law that applies to it.

On January 1, 2004, the "Third Law for Modern Services on the Labor Market" came into force that was followed by a series of structural changes within the BA. From the very beginning, the management of the Federal Agency associated the changes with the primary goal of transforming the former agency into an effective and modern agency. A board resolution in 2004 cleared the way for professional risk management within the BA. With this step, the BA, the largest federal authority with over 100,000 employees, took a pioneering position in the German public sector.

The organization of the BA comprises:

- the head office in Nuremberg,
- 10 regional directorates,

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<sup>33</sup> Translated, summarized and updated from Hirsch et al. (2020: 51–60), available audit and media reports as well as internal documents and directives.

- 156 employment agencies and approx. 591 branch offices,
- 303 job centers, which the local employment agencies have set up in cooperation with cities and counties.

Since 2004, BA has operated in risk management based on the following definition: "A risk is a danger that events or actions will prevent the Federal Employment Agency and its departments from achieving their goals or successfully implementing their strategies."

In the first phase, this resulted in a strong focus within a department at the Federal Agency's headquarters on identifying risks based on a relatively large catalog of risks (including strategic risks, planning risks, market risks, financial risks, project risks, legal risks, political risks, communication risks, corporate governance risks, performance risks from the value chain and the support functions). These risks were then assessed by managers from various organizational levels (headquarters, regional directorates, employment agencies), also with the help of external experts, with regard to the probability of occurrence and extent of damage, and presented to the Executive Board in a quarterly risk report.

However, there were also some weaknesses in the first phase. The risk reports appeared too often and were, at the same time, too detailed. They did not focus on risks that were relevant to the board or decision-making, and the reporting and assessment of risks were too opaque. As a result, the risk report did not gain the same acceptance as, for example, controlling reports. As a result of this deficiency, the relevant risks were not managed consistently.

Risk management procedures underwent significant further development in 2009. The introduction of risk management software now made it possible to systematically and transparently display risks in all business areas and define them as risk owners. This introduced a new quality to the federal agency's risk management, which the Federal Audit Office also confirmed. Moreover, the risk management process embedded in the overall structure of the Federal Employment Agency was considered exemplary by the Federal Audit Office.

In parallel with the focus of the reform, the entire risk management process was again scrutinized and simplified in 2012, and the identified

business policy risks were subjected to more stringent specifications, plausibility checks, and monitoring. In detail, this meant that the number of risk categories was reduced, and they were defined more sharply. Since 2012, risk management has been oriented to the COSO principles, which were defined in consultation between the Chairman of the Board of Directors and the internal auditing department. These principles also serve as a basis for Internal Audit to review whether the BA's risk management can meet its objectives through a qualitatively adequate internal control system and whether there are opportunities to improve risk management performance.

**Good practice DE19 – Risk assessment – Central executive agencies:  
Own practicable model is successful**

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With the risk management process, in a half-yearly rhythm and with a manageable number of risks, a practicable mode has been established for the organization to counter significant business policy risks for the organization that require appropriate management attention. (COSO 6, 7 & 9)

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Risk management is now anchored throughout the Federal Employment Agency in a continuous, transparent process repeated twice a year. The comprehensive recording and aggregation of all potential risks starts with a monitoring process under the responsibility of risk management, continues with a dialog with the respective risk managers of the business units and their self-assessment, and ends with the integration of all ten regional directorates via a specific risk management software. In this way, the identification of risks was extended to the entire regional network. The regional directorates are responsible for determining employment agencies' risks and job centers' risks in their federal states. Every six months, the BA's risk management department brings together the risk managers of the regional directorates and promotes the exchange of best practices in this regard.

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**Good practice DE20 – Risk assessment – Central executive agencies:  
Vertical integration via technical solution**

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The identification of risks was extended to the entire regional network with the integration of all ten regional directorates via a risk management software. (COSO 7)

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In order to decide in controversial cases who has to take which measures and which risks are still so critical that they have to be reported to the Board of Directors, a further committee has been created: The risk board consists of the managing directors of the head office, supplemented by three alternating chairmen of the management of regional directorates. The Risk Board is chaired by the Managing Director Controlling and Finance. The Risk Management unit submits a consolidated management report to this committee. This report forms the basis for decisions on the final risk assessment in the risk matrix, the definition of management measures and the risk officer. The risk board makes a recommendation as to which risks are finally included in the report to the management board. However, the final decision on the selection of risks to be reported to the Board of Directors rests solely with the responsible risk management department. In addition, Risk Management also prepares a progress report on the risks still outstanding from previous periods. This shows whether the proposed risk management measures have been implemented and, above all, whether they have taken effect. The actual control cycle of the risk management process ideally follows the following course: Risk analysis and assessment, action planning and risk management, risk controlling and the final risk report, taking into account the defined top risks. In 2019, a further weakness (integration of operational risk management) was addressed and a binding framework for the implementation of an operational risk management system was introduced by means of a directive.

### **Good practice DE21 – Risk assessment – Central executive agencies: Continuous Improvement**

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Continuous improvement along all dimensions, including control environment, risk assessment, control activities and internal auditing based on COSO principles. (COSO 9)

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## **5.5.2 Local government agencies**

### **General overview and legal framework**

Local governments have various institutional options for organizing the provision of municipal services to citizens. In addition to the provision of services by the municipal core administration, i.e. by a unit of the respective municipality, services can be provided by an structurally independent institution that continues to be owned by the municipality and is organised as a corporation under public law (Regiebetriebe<sup>34</sup> and Eigenbetriebe).<sup>35</sup> Public enterprises or corporations under public law have been providing a range of public services (e.g., public transport, street cleaning, water supply, regional management, city marketing) for a long time.

### **Internal control system and internal audit**

Eigenbetriebe (own utilities) are considered to be a special form of cooperation under public law; the relevant legal bases are the municipal or district regulations of the federal states as well as more specific regulations (Eigenbetriebsgesetze oder -veordnungen). They do not have their own legal personality, but they do have organizational and economic autonomy within the municipality to which they are assigned. The

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<sup>34</sup> Apart from higher levels of financial and operational flexibility, the internal control systems of Regiebetriebe have to comply with the rules set up for the core administration. Moreover, they are also subject to the internal auditing procedures of the respective local government. In sum, they have to follow the mandatory requirements for the core administration.

<sup>35</sup> There are several other options, which are, however, not in the focus of this report.



operating statutes determine the degree of this independence. Eigenbetriebe are excluded from the budget of the local authority (municipal budget) and form their own special municipal funds. The fund is managed and accounted for separately. Pursuant to Section 53 (2) of the HGrG, the special assets are formally regarded as investments in municipal companies under private law. The financial year and accounting (commercial double-entry bookkeeping) are regulated in the operating statute. Section 91 (2) of the German Stock Corporation Act (Aktiengesetz, AktG) is to be applied analogously to municipal companies, so that a risk management system would now have to be in place for municipal enterprises (Eigenbetriebe) and companies under private law (e.g. AG or GmbH). In some federal states, the Eigenbetriebsverordnung (e.g. EigVO NRW) stipulate that municipalities are obliged to ensure the permanent technical and economic functioning of the Eigenbetriebe. To this end, among other things, a monitoring system must be set up to enable timely identification of any developments that could jeopardize the existence of the entity. In this regard, early risk detection includes in particular risk identification, risk assessment, risk management measures including risk communication, risk monitoring/risk updating, and documentation. While risk management is mandatory the design of the system depends on the specific local conditions.

### **5.5.3 Universities and research institutions**

#### **General overview and legal framework**

In this report, we focus on universities which are situated at the state level and mainly organized as corporation under public law, and in some cases also as foundations (see 5.5.1).

#### **Internal control system and internal audit**

While universities have to follow similar (state) regulations like directly subordinate authorities, universities that are organized as foundations face more comprehensive requirements regarding their risk management systems. Moreover, depending on the accounting approach taken (by the state), universities are required to include an assessment

of risks in their annual financial statements (Söder-Mahlmann and Möller, 2018). In addition, in some states, establishing internal auditing units is required by state directives. In Hesse, for instance, the Higher Education Finance Directive (2014) requires all universities to establish internal auditing units which have to follow the state directive and are oriented towards the standards of the DIIR (see also section 5.4.6). In other states, it is up to the university boards to establish specific directives for the internal audit units.

### **Risk management at University Göttingen<sup>36</sup>**

The Foundation University of Göttingen has introduced a commercial accounting system and prepares its accounts in accordance with Section 57 (2) of the Lower Saxony Higher Education Act (NHG) of the German Commercial Code (HGB) for large corporations and the corresponding application of the auditing principles of Section 53 (1) Nos. 1 and 2 of the Budgetary Principles Act (HGrG). As a foundation university, the University of Göttingen enjoys a high degree of autonomy compared to conventionally run universities, especially with regard to appointments, personnel, real estate and financial matters.

Since the introduction of risk management in 2006, the concept has been continuously adapted and developed to meet the current requirements of the university for effective risk management<sup>37</sup>.

### **Control environment, risk assessment and internal control**

In the understanding of the University, the subject of risk management are events and developments caused internally or externally, which can basically be expected by the University and whose causes and effects can be influenced, but which are nevertheless dependent on chance, and which are associated with a direct loss for the University as an organization or an indirect threat to the achievement of its goals. Risks directly or indirectly jeopardize the net assets, financial position, and results of operations of the University or pose a threat to its reputation.

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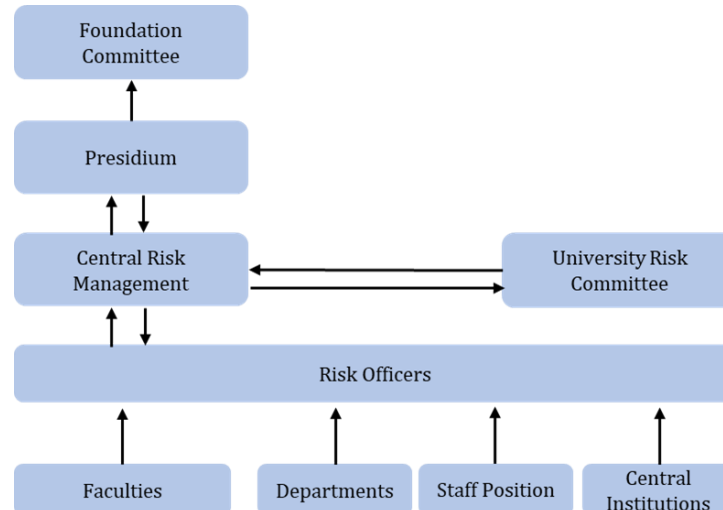
<sup>36</sup> Summarized and translated from Georg-August-Universität Göttingen (2020)

<sup>37</sup> Risk management concept (Georg-August-Universität Göttingen, 2020)

To implement the risk management system, a combination of centralized and decentralized organisational structure was chosen, which was derived directly from the organisational structure of the foundation university. This ensures that academic and administrative risks are recorded and evaluated in all areas and across all faculties throughout the university. The top-down and bottom-up approaches are combined so that the causation principle applies to operational risks, while the university management defines strategic risks. This ensures that the respective expert knowledge is a fundamental component at all levels.

At the university, the areas relevant to risks are integrated into risk management via the risk officers. At the university level, the technical coordination is carried out by the university risk committee. The final decision is made by the Presidential Board. The Central Risk Management is responsible for organization, communication, and the safeguarding and provision of process flows.

**Figure 12. Risk Management Structure (University Göttingen)<sup>38</sup>**



Risk management is integrated into administrative and academic processes as a continuous process. Responsible for the implementation of risk management are the heads of the decentral and central units. The units are responsible for ensuring that instructions are followed, risks

<sup>38</sup> Risk management concept (Georg-August-Universität Göttingen, 2020: 6)

are identified, assessed and documented, countermeasures are put in place and checked for effectiveness, and central risk management unit is informed immediately of any significant changes.

**Good practice DE22 – Risk assessment – Universities: Risk assessment integrated into administrative and academic processes as a continuous process**

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Risk management is integrated into administrative and academic processes as a continuous process. Responsible for the implementation of risk management are the heads of the decentral and central units. The units are responsible for ensuring that instructions are followed, risks are identified, assessed and documented, countermeasures are put in place and checked for effectiveness, and the central risk management unit is informed immediately of any significant changes. (COSO 8, 9 & 12)

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Risks are to be recorded and evaluated on a quarterly basis. The nature and complexity of the process may require a shorter monitoring cycle in individual cases. The responsible risk officers independently set up the information processes required for this within their own area in coordination with Central Risk Management. To facilitate the integration of the monitoring process and to ensure structured documentation, a university-wide data processing application (DP application) is provided. A traffic light system is integrated in the DP application for the quantifiable risks. The risk classes are defined as critical (red), significant (yellow) and risks to be monitored (green). Risks are assessed on the basis of a gross and net variant. Gross means that the risk is considered without taking into account the countermeasures taken to reduce (avoid or pass on) the risk. The highest possible expected monetary loss is shown here (maximum loss or worst-case scenario). The countermeasures are taken into account in the net assessment. Finally, the expected damage value is given, which is the product of net risk (extent of damage) and net probability of occurrence (Risikomanagementkonzept 2020, p. 10).

**Internal Auditing**

In the case of Goettingen the monitoring and assessment of the risk management systems is part of the risk management concept and the responsibility of the university's internal auditing unit (p. 15).

**Good practice DE23 – Internal audit – Universities: Periodic monitoring of risk management system by internal audit unit and external auditors**

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The risk management system of the University Goettingen is audited periodically by the internal auditing unit and the executive board is informed of the results. In addition, the system is checked for functionality by the (external) auditor as part of the annual audits. The Presidential Board and the Foundation University Committee are informed of the results. The internal audit unit is positioned outside the risk management process. It can be deduced from this positioning that the unit is suitable for supporting the university risk management, in this case the structure and design of the risk management process, and in particular its sustainability, both strategically and operationally. (COSO 16 & 17)

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## 6 Italy

### 6.1 Context

Italy is a parliamentary democracy. According to its Constitution, the legislative power is vested in its Parliament, while the executive power rests with the Government and the judicial power with the Constitutional Court and the justice system.

Italy is a unitary country, which recognises and promotes local autonomies and implements administrative decentralisation guaranteeing local self-government. Beneath the central government, the local level consists of regions (regioni), provinces (province), metropolitan cities (città metropolitane), municipalities (comuni), and unions of municipalities (unioni di comuni), which enjoy constitutionally ensured revenue and expenditure autonomy. In general, regions frame competences and distribute funds, functions and responsibilities to lower levels of local government, while municipalities (and provinces, etc.) define their programmes and deliver local services in accordance with the respective region.

#### 6.1.1 Administrative traditions and structures

According to various scholars (Kuhlmann & Wollmann 2019; Ongaro, 2010), Italy belongs to the Napoleonic administrative tradition which characterises many European countries and which stands on three basic pillars of administrative traditions and structures:

- an organic conception of the state as unitary and centralized with limited role for societal actors in public policymaking; citizens are primarily conceived of as subjects with rights and duties, rather than as public service users and customers;
- a central role for the bureaucracy with large ministerial cabinets, a distinctive role for a career civil service, and an interchange from administrative to political positions with highly politicized processes and a politicization of the bureaucracy often accompanied by clientelism and party patronage;

- the predominance of the rule of law and legalism, so that norms and regulations retain a crucial role in accountability and in guaranteeing the uniformity of treatment of citizens as a basic value.

However, different pressures have influenced this tradition since the end of the XX century (Kuhlmann & Wollmann 2019; Ongaro 2010). Significant devolution processes have modified the unitary organization of the state, while the privatization of many public services has resulted in the establishment of independent administrative authorities for regulating the privatized sectors and the diffusion of independent public bodies. These developments have distributed public powers among numerous institutions and contributed to breaking the monolithic structure of the state, and thus have help attenuate the previously dominant, strongly organic conception of the state (Ongaro 2010).

Moreover, the influence of New Public Management (NPM) and political change have challenged the predominance of the bureaucracy, civil service, and the law over new management practices as accountability has become a topic of growing importance in public management reforms in Italy since the end of the XX century (Caperchione & Pezzani 2000).

### **6.1.2 Internal control: overview and legal framework**

As mentioned before, a central feature of the Napoleonic tradition is the role of the law as an instrument for intervening in society rather than just as a means of conflict resolution between different societal actors (Ongaro 2010). In Italy, even after recent reforms the rule of law has retained a crucial role in accountability as the principal elements of control are through legal instruments implemented by special administrative courts (such as the State Council, the Court of Auditors and various control committees). Ex-ante controls aimed at ensuring the rule of law and strict administrative legitimacy tend to prevail, often making effective administration complex (Ongaro 2010).

Over the last few decades, internal controls in the Italian public administration have been influenced on several occasions by regulatory in-

terventions that have significantly contributed to guide the organizational choices as well as the governance and the control models that have been adopted.

The Legislator formalized not only the types of controls, but often indicated also the structures that public organizations had to set up to carry out these controls.

Moreover, the impact of policies from the private sector has determined a partial “change of course” in the definition of these controls: the Legislator has progressively moved from regulating traditional ex-ante controls on the legitimacy of administrative actions to introducing ex-post monitoring activities, more oriented towards the accountability of public administration's activities and the performance of public services in the light of the NPM concepts of efficiency, effectiveness, and economy. This has also implied a shift from legitimacy controls typical of Napoleonic bureaucracies to a guidance function (Peta 2016).

Over time these numerous regulatory interventions have resulted in a complex and uneven picture, in terms of a plurality of actors with not always clear and differentiated functions, a multiplicity of controls to be carried out, and a large quantity of documents to be produced (Peta 2016). This complexity results in internal control systems that are highly sectorial, as well as in the proliferation of verification activities that are not always coordinated and consistent with each other in terms of methodologies and tools adopted, information flows between different organizational structures, etc., with consequent inefficiencies in operations and little effectiveness in reporting to top management and supervisory bodies. The rules governing internal controls often involve obligations which, if addressed in a formal way, can burden organizations, sometimes hindering their work and even compromising the sharpness and efficiency of the same control system (Proietti 2020).

Furthermore, if, on the one hand, there are numerous subjects appointed to carry out control activities, on the other hand there is no single control room or steering committee that can supervise, direct and coordinate these initiatives and act as an interlocutor with the political management of an organization.



Other issues concern the lack of structures and processes bestowed with risk management, as well as the lack of an internal audit function or unit which have contributed to the relatively low sharpness of internal controls, which have often been reduced to the fulfilment of formal and documentary obligations, losing sight of the objective of monitoring management effectiveness and efficiency (Peta 2016). Instituting an internal audit function is considered a key tool for protecting the public interest since, by providing independent and objective assurance and consultancy on the efficient use of resources, it can support public organizations in ensuring integrity and accountability, increasing trust among citizens and stakeholders.

In line with EU recommendations, some organizations of the public sector have introduced internal audit functions, operating in compliance with international frameworks and reflecting the path already undertaken in the private sector. Such organizations include: the State General Accounting Department (*Dipartimento della Ragioneria Generale dello Stato*) at the Ministry of Economy and Finance, the National Social Security Institute (INPS), Revenue Agency (*Agenzia delle Entrate*), the Lombardy Region, and the Municipality of Milan. In other cases, independent supervisory bodies have been established with features partly borrowed from international internal auditing standards only for specific areas such as corruption, transparency, etc.

In many ways, in reaction to the failure to develop an effective internal control system, steps have been taken to accentuate the formal profiles of control activities, which are increasingly oriented towards compliance with documentary obligations imposed by the law, rather than the actual assessment of effectiveness, efficiency and economy of management activities. Overall, the causes of this are attributable to both shortcomings in the regulatory framework and to a poor integration of internal controls in the public management process, because of a traditionally low level of confidence in the usefulness and collective benefits of an efficient control system by the Italian political and administrative top management (Peta 2016).

At national level, some regulations have contributed in a preponderant way to the configuration of the internal control system in public administration. The list below includes the main regulatory measures that

have governed and organized control activities in the Italian public sector.

*Legislative Decree 286/1999 and subsequent amendments.* It re-designs the internal control practices in 4 activities:

- Control of administrative and accounting regularity, carried out normally by the accounting or financial service of a public organization and aimed at ensuring the legitimacy, regularity and correctness of public activities;
- Strategic control, aimed at evaluating the congruence between the strategic objectives defined by a public organization in the planning phase and the results actually achieved.
- Management control, aimed at monitoring the general progress of activities of a public organization with respect to the efficiency and effectiveness of its use of resources;
- Top management evaluation, aimed at an assessment of the activities carried out by the officials with managerial responsibility within a public organization;

A fifth assessment dimension can be added to these forms of control which relates to the assessment of the quality of public services through the definition of standards and measurement criteria, the adoption of service charters, and user protection conditions.

The provisions of Legislative Decree no. 286/1999 are mandatory for ministries, central administration agencies and public bodies, but only applicable by regions as part of their organizational and legislative autonomy, while they can be waived by other public administrations due to their special regime.

*Legislative Decree 81/2008 and subsequent amendments.* Introduction of the Prevention and Protection Service Manager (*Responsabile Servizio Prevenzione e Protezione* - RSPP), the person in charge, among other things, of identifying, assessing and monitoring internal risks within the organization with reference to health and safety at work in both private and public sector.

*Legislative Decree 150/2009 and subsequent amendments.* Internal controls have been divided into two pillars: i) compliance checks (control of administrative-accounting regularity), and ii) the “performance management cycle”, which includes strategic control, management control, and top management evaluation according to Legislative Decree 286/1999. Hence, the latter pillar concerns the evaluation of a public organization's performance in terms of both achieving its set objectives as well as managing available resources efficiently and cost-effectively. Moreover, it foresees that an Independent Supervisory Body (Organismo Indipendente di Valutazione - OIV) is instituted to assess organizational and individual performance which is integral part of management control and top management evaluation.

*Legislative Decree 123/2011 and subsequent amendments.* This provision differentiates between administrative compliance (adherence to rules and regulations) and accounting compliance (adherence to financial and budgetary constraints and correct recording of expenses).

*Law 190/2012 and Legislative Decree 33/2013 and their subsequent amendments.* It introduces the Head of Corruption Prevention and Transparency (Responsabile della Prevenzione della Corruzione e della Trasparenza - RPCT), an official with responsibility for the formalization and monitoring of the activities for both corruption prevention and ensuring transparency in public organizations.

*Law 124/2015 and Legislative Decree 74/2017 and their subsequent amendments.* It introduces the compliance with performance evaluation for bonuses, salary improvements, assignment of responsibilities and managerial positions.

Therefore, Italian internal controls for public entities are conceived along two separate pillars following Legislative Decree 150/2009:

- *compliance checks*, that is the control of administrative and accounting regularity, and
- *the performance management cycle*, which includes management controls, individual and organisational evaluation, and strategic control.

This conceptualisation of internal controls has led to the development of separate paths for the two types of control with separate actors. For the first pillar the key actors are *managers* who can authorise spending, a *controller who approves the administrative and regularity compliance*, and the *financial auditor* (revisore dei conti) for that entity. The controller is generally the head of the financial office at the specific level of government.

For the second pillar three key actors of internal control for Italian public sector organizations are the Independent Supervisory Body (Organismo Indipendente di Valutazione - OIV), the Prevention and Protection Service Manager (Responsabile Servizio Prevenzione e Protezione - RSPP), and the Head of Corruption Prevention and Transparency (Responsabile della Prevenzione della Corruzione e della Trasparenza - RPCT).

The *Independent Supervisory Body OIV* is appointed within each administration by the political organ for a three-year term, not extendable and renewable only once, following a selective procedure involving candidates registered on a national list. According to the ministerial decree by the Department of Public Office from 6<sup>th</sup> August 2020, to be registered people need to:

- be a citizen of the European Union;
- have completed a master degree (laurea vecchio ordinamento, magistrale o specialistica) in any subject;
- have specific professional experiences for at least five years in performance management within public or private organizations or more specifically at least in: measurement and evaluation of organizational and individual performance, or strategic and operational planning, or management control, or financial and budget planning, or risk management; and
- have participated regularly in pertinent trainings organized or recognized by the Department for Public Office over the past three years.

According to the ministerial decree by the Department of Public Office from 6<sup>th</sup> August 2020, the Independent Supervisory Body OIV can be monocratic with only one member for smaller administrations with up

to 250 employees, if the OIV has at least eight year experience in performance management and three year experience as an OIV, or for larger administrations with over 250 employees, if the OIV has at least twelve year experience in performance management and three year experience as an OIV in large administrations. In all other cases, a committee of three people must be nominated. In general, the Independent Supervisory Body OIV is responsible for internal controls pursuant to Legislative Decree 150/2009 and in particular for a multitude of tasks, such as:

- monitoring the overall operation of the evaluation system, the transparency and integrity of the internal controls and drawing up an annual report on its status;
- promptly reporting any critical issues to the relevant governance and administration bodies, as well as to the Court of Auditors (Corte dei Conti), the Inspectorate for the civil service and, if necessary, the National Anti-Corruption Authority ANAC (Autorità Nazionale Anti-Corruzione);
- ensuring that measuring and evaluation processes are correct in order to uphold the principle of rewarding merit and professionalism;
- applying correctly the guidelines, the methods and the instruments provided by the National Anti-Corruption Authority ANAC;
- promoting and certifying transparency and integrity;
- checking the results and good practices promoting equal opportunities.

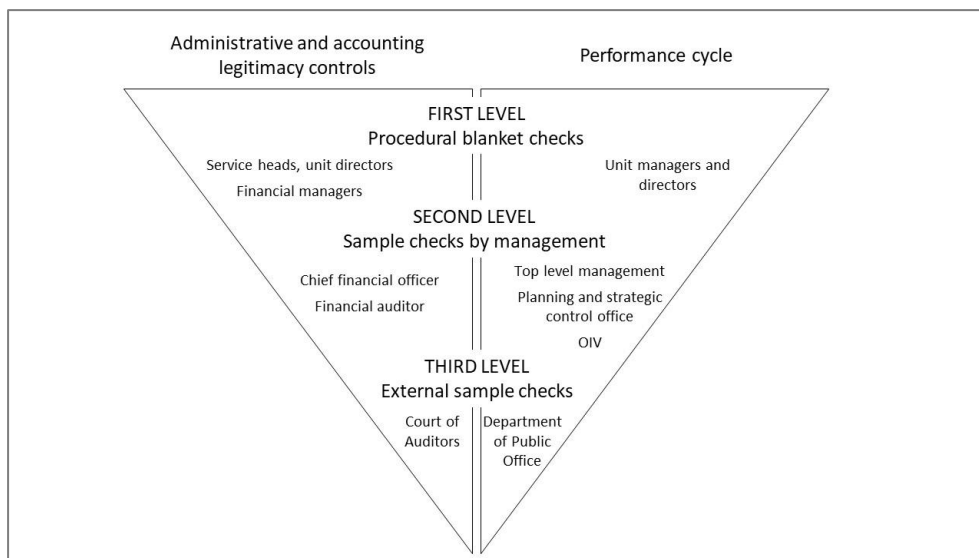
The *National Anti-Corruption Authority ANAC* has published two deliberations, namely n.4/2012 and n.23/2013, with specific guidelines, criteria, and templates to support the Independent Supervisory Bodies OIV in assessing internal control systems, verifying compliance with transparency and integrity regulations, and analysing and reporting organizational and individual performance. These tools aim at guaranteeing a minimum quality and homogeneity across evaluations.

A *Prevention and Protection Service Manager* (Responsabile Servizio Prevenzione e Protezione - RSPP) is appointed within each administration among the employees who have received the necessary training to be in charge of identifying, assessing and monitoring internal risks within the organization with reference to health and safety at work.

Similarly, following the prescription of Law 190/2012 and Legislative Decree 33/2013, the Head of Corruption Prevention and Transparency (Responsabile della Prevenzione della Corruzione e della Trasparenza - RPCT) is a manager within each administration who is entrusted with the responsibility for the formalization and monitoring of the activities for both corruption prevention and ensuring transparency. For the RPCT to be able to carry out such assignment with full autonomy and effectiveness, it may be necessary to rearrange functions and powers within the organization. Anyway, such function is generally not assigned to the Independent Supervisory Body OIV to avoid conflicts of interest between controlled and controller. The RPCT reports cases of possible violation of the provisions of the aforementioned decree to the OIV, the political organ who appointed him/her, and also to the National Anti-Corruption Authority ANAC. According to the National Anti-Corruption Plan updated in 2019, each administration needs to define a three-year plan to prevent corruption in which a process to manage the risk of corruption is outlined, corruption risks are mapped, a risk evaluation is carried out, and solutions and consequences are outlined. ANAC outlined 12 corruption related crimes in public administrations, from different form of illicit money appropriations to violations of public duties.

Figure 13 presents a general representation of the internal control system in Italian public administrations.

**Figure 13. Internal control systems in Italy**



## 6.2 Central government

### 6.2.1 General overview

The Italian parliament has a bicameral system with a Chamber of Deputies and a Senate, whose members are elected by direct universal suffrage every five years. Senators are elected on a regional basis and are assigned to each region proportionally according to its population. The Chief of State is the President of the Republic, elected for a seven-year term by an electoral college comprising the two chambers of Parliament and representatives from regional governments. The Chief of the Government is the Prime Minister (Presidente del Consiglio dei Ministri), appointed by the President and confirmed by Parliament.

Currently (spring 2022), there are 14 ministries plus 8 ministries without portfolio, that is ministers without an autonomous ministry who are located at the Presidency of the Council of Ministers and carry out only the functions that are delegated to them by the Prime Minister.

At local level, the central state is represented by 103 prefectures. Their principal functions are policing, public safety, and civil security.

### 6.2.2 Specific legal framework

At central level each Ministry enacts a yearly and a three-year Performance Plan and a Performance Measurement and Evaluation System according to Legislative Decree 150/2009. The former integrates the performance cycle with the budget cycle and with strategic planning, and proposes the indicators to be used to assess performance at ministerial level; the latter describes the "rules of the game" that a Minister has defined for the purpose of implementing the performance cycle within his/her ministry in line with the guidelines issued by the Department of Public Office (Dipartimento della Funzione Pubblica) specifically for performance management (Guidelines no.1/2017 on the Performance Plan, Guidelines no.2/2017 on the Performance Measurement and Evaluation System, and Guidelines n.5/2019 on Measuring and Evaluating Individual Performance).



From a planning point of view, Guidelines no.1/2017 outline how the “performance cycle” is to be integrated with the budget cycle and with strategic planning. In particular, each Ministry has then to enact a three-year Performance Plan together with a plan for the specific year and the “General directive for administrative and management activities” by January 31<sup>st</sup> each year, after Parliament’s approval of the yearly budget. Following the end of the year, each Ministry has to present the Performance Report together with an evaluation of such report and a report on how the system functions by the end of June of the subsequent year, when also the State’s financial report for the previous year is due. In principle, the failure of an administration to adopt the Performance Plan or to produce a Performance Report entails the non-provision of salary benefits for those officials identified as responsible of the failure. Furthermore, administrations that do not submit their Plan can neither proceed with new hires nor confer consultancy assignments. Yet, these measures have hardly been applied.

All documents, the Performance Plan, the Performance Measurement and Evaluation System and the Performance Report, must be approved by the Independent Supervisory Body OIV at each ministry, who is appointed by the relative Minister for a three-year term in a monocratic form, except for the Ministry of Economics and Finance where a committee of three people is chosen.

Ministries fulfil their transparency obligations regarding performance by publishing all related documents (Performance Measurement and Evaluation System, yearly and three-year Performance Plans and Performance Reports) in the section "Transparent administration" (Amministrazione trasparente) of their institutional site (Legislative decree 27 October 2009 and Legislative decree 33/2013).

Following Legislative Decree 150/2009, the performance management cycle, and hence the Performance Plan and the Performance Measurement and Evaluation System, focus not only on assessing performance in terms of management control (efficient and effective use of resources) and strategic control (achievement of strategic objectives) by the Independent Supervisory Body OIV, but also on assessing organizational and individual performance. The former rests on three units of

analysis: the ministry as a whole, its activities, and its processes and projects. Activities are defined in Guidelines no.2/2017 as homogeneous sets of tasks, carried out within the same organizational unit with a clear output that can be a document, a norm, a plan, but also a service. A process is a sequence of activities to produce an output repeatedly over time, while a project is a sequence of activities for the production of a specific output in a specific timeframe. For each activity, and hence process and project, the Performance Measurement and Evaluation System must assess resources, timings, outputs, and outcomes. According to Guidelines no.1/2017 and no.2/2017, the evaluation of organizational performance should consider resource status, efficiency, effectiveness, and impact. Guidelines no. 2/2017 suggest the Independent Supervisory Body OIV should define how citizens and final service users can support measuring organizational performance, for example reporting their level of satisfaction with the services delivered by a Ministry. Yet, most Ministries do not deliver services directly to citizens and this often remains a vague prescription on paper.

Individual performance evaluation rests instead on the evaluation of the contribution of each public officer to the achievement of the overall performance of the organization. According to Legislative Decree 286/1999, Legislative Decree 150/2009, Guidelines n.2/2017, and Guidelines n.5/2019, it should take into consideration outputs and behaviours and is carried out by an officer's supervisor or boss.

The Department of Public Office drew up a code of conduct for managers within central administrations (Codice di comportamento e di tutela della dignità e dell'etica dei dirigenti e dei dipendenti della Presidenza del Consiglio dei Ministri), which was adopted in 2013 (Decree of the President of the Republic n.62 from 16.04.2013 as modified by the Decree of the President of the Council of Ministers, 16.09.2014) and sets out a series of principles of ethical conduct for public-sector employees (diligence, fairness, impartiality, etc.). Its infringement may involve civil, administrative, criminal, or accounting responsibility, yet the level at which managers are held accountable is highly discretionary.

An annual appraisal is conducted, as prescribed by Article 5 of Legislative Decree 286 of 1999, which is based on the elements collected ac-

According to the Performance Plan and the predicaments of the Independent Supervisory body OIV for each ministry. For example, some ministries include in individual performance evaluations, especially for top managers, peer reviews and the evaluation by three external stakeholders. The evaluation is conducted on a hierarchical basis: the individual manager of the single office is evaluated by the head of the general managerial office concerned; the general manager is evaluated by the head of his/her department; the director or head of a department is evaluated by the minister.

If the appraisal is negative for three subsequent years, managerial powers may be removed or terminated early. In the most serious cases, the manager may also be dismissed under the terms of the national employment contract.

These rules were emphasised by Legislative Decree 150/2009, which has been particularly important because it was a cornerstone of change for Italian public administration traditions. It simplified the structure introduced by Legislative Decree 286/1999 by reducing controls to two pillars and bringing all three new performance controls under one umbrella to focus attention on the issue of performance management, which was fairly new to Italian public administration. In particular, in the public eye, but also at ministerial level, Legislative Decree 150/2009 has been promoted (even in its name) as a tool for the optimization of public officials' productivity and the efficiency and transparency of public administration.

The desire to heighten the visibility of the reform led to the engagement with citizens beyond simple communications. Since the earliest days of the reform, the media were widely used to express the view that the reform of public services was a significant issue for everyone. In addition to formal documents, the government opened a specific website for the reform, in which it was possible to see and download "the kit for the reform". This was an animated video which emphasized transparency, performance evaluation, merit, quality, digitization, and participation. The reform was also promoted through more innovative channels: a blog, Facebook, a YouTube channel and Twitter, in an attempt to engage with younger people. The campaign showed the determination of the reform

leaders to get their message across to the wider public (Arnaboldi et al., 2016).

One of the main issues is that, even though the Guidelines issued by the Department of Public Office talk also about the use of outcome measures to assess performance using indicators for resource status, efficiency, effectiveness and outcome, performance evaluation is often carried out taking into consideration process and output indicators, rather than outcome indicators (Angei & Tucci, Observatory of the Italian Public Accounts, 2020) in what is more a Napoleonic than a managerial approach.

### **Good practice IT1 – The legal framework – Central government: A pragmatic and simple legal framework promotes a new culture**

A best practice is to simplify concepts, enact them by law and focus public attention on them to change administrative traditions and culture as with Legislative Decree 150/2009. (COSO 1, 12 & 15)

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#### **6.2.3 Control environment**

The control environment is stringent only as far as compliance for the control of administrative and accounting regularity. In terms of performance there is little tradition of effective controls in the pursuit of objectives in so far as indicators are not outcome related but rather associated to inputs, processes, and outputs.

##### **Public spending chain**

At central government level, every year the public spending chain begins with the construction of the state budget which sees each ministry involved in consultation with the Prime Minister's Office and the Ministry of Economy and Finance. Following the approval of the yearly state budget, each ministry takes control over its allocation of resources.

Within ministries public spending decisions can be taken by senior managers provided they obtain a conformity visa by the Central Accounts Offices (*Uffici Centrali del Bilancio*), which exercise a first ex-ante

accounting control. The Central Accounts Offices are part of the overall System of Accounting Offices (*Sistema delle Ragionerie*), which controls public spending internally but is also under the supervision of the State General Accounting Department (*Dipartimento della Ragioneria Generale dello Stato*) at the Ministry of Economy and Finance, which guarantees local embedment with central coordination.

### **External control chain**

Public spending is monitored externally by the State General Accounting Department, but also by the Court of Auditors. The former is one of the four departments of the Italian Ministry of the Economy and Finance. It is a central body that supports and verifies policies, processes, and budget implementation for the Parliament and the Government. Its main institutional objective is to ensure the correct programming and strict management of public resources at central government level, so that one of its main duties is the supervision and control of public financial management with a uniform interpretation and application of accounting rules.

Moreover, the State General Accounting Department controls public institutions through inspection activities and has had an increasing role in monitoring and analysing expenditure trends, with regard to compliance with the limits set by the EU through the Growth and Stability Pact. Its control and supervision functions are conducted through an integrated system of public finance controls that operate over the entire country and that at ministerial level is composed of the Central Accounts Offices which are the essential link between the State General Accounting Department and the central administrations.

The Court of Auditors is responsible for an external control both *ex-ante*, monitoring the legality of government and ministerial acts, and *ex-post* to verify the state budget's management. Differently from the State General Accounting Department which carries out blanket checks, the Court carries out sample checks by setting annual audit programmes and criteria, which though make no clear reference to international audit standards even if the Court participates in the activities of the International Organization of Supreme Audit Institutions (INTOSAI) and the Eu-

ropean Organization of Supreme Audit Institutions (EUROSAI). In addition, it has the task of verifying the effectiveness of the internal control system in each ministry. The Court reports to Parliament at least once a year on the results of its control activities.

Financial inspections are conducted by the Ministry of the Economy and Finance, which is obliged to report irregularities to the Court of Auditors. In general, inspections relate to past administrations, in particular to the administration of the previous five years, a term beyond which compensation for financial losses can no longer be filed.

### **Internal control chain**

The public spending internal control chain foresees that after an expense is decided by a service head (Responsabile del Servizio) or by the manager in charge of a procedure (Responsabile Unico del Procedimento), such action is first approved by the people in charge of their organizational unit, who are responsible for adopting administrative acts, technical measures, and financial commitments in line with ministerial budgets, norms, and regulations, and then by the Central Accounts Offices for that Ministry. The Central Accounts Offices provide support and supervision at ministerial level to ensure the correct management of finances and application of budget lines.

As far as non-financial controls are concerned, at central government level the performance cycle is monitored internally by the Independent Supervisory Body OIV at each ministry and externally by the Department of Public Office.

As far as managerial performance is concerned, personnel evaluation relates both to the code of conduct and to the results achieved by managers in their administrative activity and in managing their unit. There are two possible negative outcomes: failure to reach objectives and failure to comply with policy directives.

At the Ministry of Justice in 2019-2021, following the prescriptions of Legislative Decree 150/2009 and the Guidelines for Measuring and Evaluating Individual Performance enacted in 2019 by the Department of Public Office, the Independent Supervisory Body OIV suggested to link

in the Performance Plan the evaluation of directors and top managers with the achievement or, at least, the working towards the objectives set by the Ministry and, in particular, the department or the office they were responsible for. This has been a way of establishing those outcome indicators which have failed to be clearly promoted by the Department of Public Office even in the 2017 Guidelines.

In terms of information and communication, lots of data are collected and shared within and outside ministries; information systems at ministerial level are quite adequate and developed; data is used for compliance with a “red flag” system which highlights 1) the number and types of observations made, and 2) the number of regularity visas refused and the related reasons. While such information is used for administrative and accounting regularity, it is often not acted upon for performance related issues. Many Independent Supervisory Body OIV would appreciate a “red flag” system to be implemented for performance too.

Moreover, it is important both that the Performance Plan is enacted by the end of January, so that it can be put in practice for the year, and that the Performance Report is completed as soon as possible and surely by the deadline of the end of June of the subsequent year so that corrective measures can be enacted promptly. However, the Department for Public Office revealed that only 2 out of 14 of the Ministries (Ministry of Foreign Affairs and International Cooperation, Ministry of Labour and Social Policies) adopted their Performance Plan by 31<sup>st</sup> January in 2020, while another 7 (Ministry of Health, Ministry of the Environment and Land and Sea Protection, Ministry of Agricultural, Food, Forest and Tourism Policies, Ministry of Economy and Finance, Ministry of the Interior, Ministry of Education, Ministry of Economic Development) enacted it late pleading their delay on the Covid-19 pandemic. Only 5 out of 14 Ministries (Ministry of Foreign Affairs and International Cooperation, Ministry of Labour and Social Policies, Ministry of Economic Development, Ministry of Justice, Ministry of Infrastructures and Transport) published their 2020 Performance Report by June 2021 (Department of Public Office, 2021).

### **Good practice IT2 – Control environment – Central government: Coordination**

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A best practice is that internal controls are coordinated by a single body, namely the State General Accounting Department at the Ministry of Economy and Finance, with feeds into individual ministries through the Central Accounts Offices, at least as far as administrative and accounting regularity is concerned, so that the legitimacy, validity, and appropriateness of administrative action is centrally and homogeneously guaranteed and yet relevant to each specific entity. (COSO 3)

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### **Good practice IT3 – Control environment – Central government: Managerial evaluation**

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A best practice is that legislation and guidelines link managerial evaluation to the objectives of the organization or unit. (COSO 5)

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## **6.2.4 Risk assessment**

### **Subject**

At this level of government only risks related to corruption, transparency, money laundering, and health and safety at work are monitored.

### **Actors**

Each Minister nominates a Prevention and Protection Service Manager (Responsabile Servizio Prevenzione e Protezione - RSPP), among the officials who have received the necessary training to be in charge, among other things, to identify, assess and monitor internal risks within the organization with reference to health and safety at work.

Following the prescription of Law 190/2012 and Legislative Decree 33/2013, the Head of Corruption Prevention and Transparency (Responsabile della Prevenzione della Corruzione e della Trasparenza -



RPCT) has a more prominent role. The RPCT is a manager within the ministry who is entrusted by the Minister with the responsibility for the formalization and monitoring of the activities for both corruption prevention and ensuring transparency.

#### **Good practice IT4 – Risk assessment – Central government: Timing of plans and reports**

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A best practice is enacting in time the Performance Plan to be relevant for a Ministry's activities and the Performance Report to allow corrective actions to be taken promptly (COSO 17).

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#### **Framework**

There is no overall set of rules or guidelines regarding risk management and no specific practice or norm about risk identification or risk assessment. Only anticorruption is regulated, yet Law 190/2012 and Legislative Decree 33/2013 provide only general guidance for the formalization and monitoring activities related to corruption and fraud prevention.

The 2013 and 2015 National Anticorruption Plans identify 8 areas which have to be closely monitored as more sensitive to corruption and fraud practices:

1. acquisition and progression of personnel;
2. awarding of works, services and supplies;
3. legal-related measures without direct and immediate economic effect for the recipient (e.g.: authorizations, concessions);
4. legal-related measures with direct and immediate economic effect for the recipient (e.g.: grants, contributions, subsidies);
5. income, expense, and asset management;
6. controls, verifications, inspections and sanctions;
7. appointments and designations;
8. legal affairs and litigation.

## **Method**

The RSPP function is mainly about fulfilling formal practices, agreeing about basic standards with employee representative, and complying with norms and regulations about health and safety at work.

The RPCT reports cases of possible violation of the provisions of the aforementioned legislation to the independent Supervisory Body OIV, the Minister, and also to the National Anti-Corruption Authority ANAC. According to the National Anticorruption Plan updated in 2019, the RPCT for each ministry needs to define a three-year plan to prevent corruption which needs to be approved and adopted by each Minister.

Moreover, as part of the fight against fraud, the General Inspectorate for Financial Dealings with the European Union (Ispettorato generale per i rapporti finanziari con l'Unione Europea - IGRUE), one of the ten general departments of the State General Accounting Office, helps draw up, implement and certify the budget related EU funds and conduct an overall monitoring of the corresponding financial flows, and administers any controls delegated by the European Union.

## **Impact**

Risks are dealt with at a compliance-with-regulations level rather than at an operational and practical level. Hence, risk management is not an important component of internal controls.

### **6.2.5 Control activities**

Several internal control activities are undertaken to ensure the proper spending of public funds and the achievements of the objectives set by central administrations. While such controls do not always guarantee that value-for-money is attained, they are important to achieve it.

## **Actors**

As mentioned before, the control of administrative and accounting regularity at central government level is carried out by the Central Accounts Offices under the umbrella of the System of Accounting Offices,

which is under the supervision of the State General Accounting Department, while the performance cycle is monitored at each ministry by the Independent Supervisory Body OIV.

### **Framework**

Controls activities are organised along the two pillars of administrative and accounting regularity, and the performance management cycle with different actors and processes involved.

### **Methods**

At ministerial level, the Central Accounts Offices provide help and oversight to ensure proper financial management and budget line application. Their main functions are:

- keeping bookkeeping records of the management of central administrations;
- checking the regularity of expenditure documents issued by them;
- assessing the expenses for institutional functions, services, programmes, and projects, in order to draw up first the budget and then the financial statements for their ministry.

In particular, Central Accounts Offices receive all expense related information by cost centres within a ministry, evaluate the related charges, supervise compliance with the rules governing the protection of state assets, and ascertain financial backing and proper budget management.

By the end of February of every year the Central Accounts Offices send to the responsible Minister a summary report of the main irregularities found in the exercise of preventive and subsequent checks relating to the previous year, with a list of cases in which the regularity visa has not been granted. Hence, the information provided relates to 1) the number and types of observations made, and 2) the number of regularity visas refused and the related reasons.

Each ministry is then to act to avoid such instances are repeated. If punishable offences are revealed, they are reported to the administrative or penal courts according to the offence allegedly caused.

Within the financial compliance described above, IT systems help control activities by collecting data regarding accounting information to feed different accounting systems, and data on human resources, process description and analysis to feed the system of performance indicators.

The effectiveness of the performance measurement and evaluation system requires an ever-greater integration between operational and strategic planning, financial planning and cost accounting. Starting from traditional cash accounting, the IT accounting system for ministries and other central agencies SICOGE (*Sistema di Contabilità Gestionale*, management accounting system) has automated the financial management of state administrations and over time it has developed new functions to deal with accrual and cost accounting. It was introduced in 2002 for central government organizations and is integrated through IT flows with the information system of the State General Accounting Department (*Sistema Informatico della Ragioneria Generale dello Stato*, SIRGS). SICOGE has automated the management of all the phases of preparation and management of the budget and issuing of expenditure deeds (commitments, orders to pay, accreditation orders, decrees for the allocation of funds, etc.) to be submitted for confirmation and verification of legitimacy by the Central Accounts Office at each ministry. In a nutshell, the system can support the creation of yearly statements, feed cost accounting reports by cost centre or activities/services, and provide data for management control. As SICOGE is the accounting tool used by all Ministries and it also communicates with the other systems of the State General Accounting Department, accounting operations have been standardized, administrative processes rationalized and the use of innovative technologies widespread with the gradual dematerialization of spending actions, bringing economic savings and speed in payments.

Digitalization does not concern only financial, but also performance controls. However, differently from administrative and regularity checks, regarding the performance cycle most Ministries have developed their own tools and platforms, starting from simple Microsoft Excel sheets, which are not necessarily sophisticated and do not necessarily talk with each other and with other IT systems.

In an effort to improve value for money by linking financial and strategic control, and hence expenditure and performance targets, since

2009 the Ministry of Economy and Finance has developed an application that allows the Central Accounts Office of each Ministry to upload the explanatory note (nota integrativa) with their strategic targets together with their budgets. This allows financial objectives to be reconciled with performance objectives. Normally with the State budget due by the end of the year, the Ministry of Economy and Finance starts uploading planned financial targets the previous September, so that each Ministry can upload the corresponding indicators for strategic objectives in October/November. Once the budget is approved, in December and January the State General Accounting Department checks all indicators entered in the application for the explanatory notes and sends a report to the Central Accounts Office and the Independent Supervisory Body OIV of each Ministry with comments so that indicators can be modified before the Performance Plan of a Ministry is approved by the end of January.

### **Impact**

The several internal control activities carried out at ministerial level help ensure proper spending of public funds and attainment of ministerial objectives. Over time technology has helped Ministries with their internal controls, both recording activities punctually and optimising the indicators used, reducing their number and making them more strategic and outcome related than operational, that is input, process or output related. For example, the Ministry for Economic Development had 130 indicators in 2017, which have been reduced to just over 20 since 2018.

Moreover, the 2021 Report on the functioning of the evaluation, transparency, and integrity of internal controls” by the OIV of the Ministry for Economic Development reveals that the Ministry ran the entire performance monitoring and reporting process for 2020 and started planning the 2021 performance activities using the tools designed by the Ministry of Economy and Finance and shared with all central administrations. Such applications and platforms helped bring together information on financial resources and on the performance cycle, so that for example the OIV of the Ministry for Economic Development could claim that 99,4% of the Ministry’s budget for 2020 was associated to the performance objectives established for 2020.

After publishing the Guidelines for the Performance Plan in 2017, the Department for Public Office organised workshops to help six ministries develop their Performance Plans, namely the Ministry of Economy and Finance, the Ministry of Cultural Heritage, Activities and Tourism, the Ministry of Education, University and Research, the Ministry of Infrastructure and Transport, the Ministry of Labour and Social Policies, and the Ministry for Economic Development. This helped most of these ministries improve the timeliness and content of their plans and offered top managers within the ministries tools to improve their performance management.

#### **Good practice IT5 – Control activities – Central government: Workshops**

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A best practice is to deploy control activities not only through policies and procedures, but also through workshops. (COSO 12)

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#### **Good practice IT6 – Control activities – Central government: IT Systems to pursue value-for-money**

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A best practice is that unified IT systems not only help control activities by collecting data across ministries regarding both accounting and performance information to feed descriptions and analyses, but help also pursue value for money by integrating expenditure and performance targets. (COSO 11)

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### **6.2.6 Internal audit**

There is no mention for ministries, and central government in general, of an audit system intended as an independent, objective assurance and consulting activity designed to add value and improve their operations with a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

## **Actors**

Pursuant to Presidential Decree 105/2016, the Department of Public Office together with the Independent Supervisory Body OIV of each central administration is in charge of assessing its internal controls.

## **Frameworks and methods**

The Department of Public Office and the Independent Supervisory Body OIV of each Ministry have simply the task of monitoring the degree of implementation of performance controls by the Ministries and other central administration agencies and bodies by analysing their performance plans and reports. Results of such assessment are then shared with the relevant Minister, as well as included in a periodic report on the performance management cycle of central administrations, which is presented to Parliament.

More specific internal audit functions have been introduced at the State General Accounting Department at the Ministry of Economy and Finance as far as the General Inspectorate for Financial Dealings with the European Union (Ispettorato generale per i rapporti finanziari con l'Unione Europea - IGRUE) is concerned. However, this is not relevant, as audits concerning the effective functioning of the management and control system of the programmes financed by EU funds are beyond the scope of this research.

## **Impact**

The activities described above do not amount, however, to an internal audit function as foreseen at European and international level, since they simply foresee the revision of plans and reports and look only at one of the two pillars of internal controls, that is the performance management cycle.

## 6.3 Regional government

### 6.3.1 General overview

Regional governments feature a Regional council (Consiglio regionale) and a Regional President (Presidente). Both are elected for a five-year term by direct universal suffrage. The regional President chairs the Regional Executive Committee (Giunta regionale) which is the executive body of a Region. Regionalisation is asymmetric: among the 20 regions, 15 have ordinary status (regioni a statuto ordinario) and five have special status (regioni a statuto speciale). These five regions (namely Aosta Valley, Friuli-Venezia Giulia, Sardinia, Sicily, and Trentino-Alto Adige/Südtirol) are granted special status including legislative and financial autonomy in specific areas given their cultural and socio-geographical specificities. The Trentino-Alto Adige/Südtirol region is further divided into two special-status provinces, Bolzano and Trento, with the same legislative powers as regions.

At the very centre of regional responsibilities stands health care, managed through local health authorities and hospitals. It is a jointly provided function, with the central government defining standard levels and guaranteeing most financing and Regions providing and regulating services (Ambrosanio et al., 2016: 217). Further tasks relate to environmental protection, transport, universities and higher education, social services and housing, culture, and agriculture.

From an operational point of view, Italian Regions are organized in Central Directorates (*Direzioni centrali*) each responsible for one or more of the above tasks. The activities carried out by the Directorates in their relative sphere of intervention include:

- authorizations, accreditations and concessions;
- disbursement of contributions and financial benefits;
- acquisition and career progression of personnel;
- awarding of works, services, and supplies.

However, Italy's regional organisation is marked by long-standing regional disparities both in their formal organization and in their financial resources. For example, the level of GDP per capita in the province of



Bolzano at over 50,000 euros was twice the level the Regions of Molise, Campania, Puglia, Calabria, and Sicily in 2021 ([www.istat.it](http://www.istat.it)).

### **6.3.2 Specific legal framework**

Following Legislative Decree 150/2009 internal controls are divided into the usual two pillars of financial and performance controls.

At regional level the control of administrative and accounting regularity is carried out, first of all, by the Organizational Units which have to ensure the availability of finances and the correctness of the procedures linked to the tasks they carry out, and, in a second instance, by the Finance Directorate which verifies whether resources are employed in accordance with the plans and programmes formulated by the Regional council and translated into the operating budget.

In 2006 the so-called, SIOPE (information system for public entities' operations), inspired by the government accounting system ESA95, the European System of National and Regional Accounts now replaced by ESA2010, was introduced in all regions and local governments, as a sort of common chart of accounts mainly aimed at monitoring financial flows.

In 2012, Law Decree n. 174 reinforced control over the regions, with the aim of improving the coordination of public finance. The control is carried out by the Court of Auditors both ex-ante on the budget and ex-post on financial statements, including the documents related to all the entities involved in the Regional Health Service and the entities controlled by the Regions. In addition, the regional Executive Committee is required to prepare a report every six months to prove how they have obtained sufficient financial resources to cover the amount of expenditure incurred.

As far as the performance management cycle is concerned, internal controls are carried out by an Independent Supervisory Body OIV who is appointed by the Regional Executive Committee and is supported by various regional control offices.

At regional level the law requires special attention to be paid to controlled and related entities, so much that there is an additional type of

control, the so-called “comparable control” (*controllo analogo*), which is exercised by a Region on such entities as if they were its own structures, since they carry out most, if not all, of their activities for the controlling region. This function is of particular importance in the organization of the internal control system of a region, as the various Directorates, according to their respective powers, have the task of actively supervising and coordinating control processes on regional companies and instrumental bodies. Regional authorities exercise administrative and budgetary controls as well as strategic and managerial oversight over all organizations of the regional system to verify compliance with regional guidelines and programs defined with the approval of the regional budget. The areas of the “comparable control” function also include the control over service agreements and contracts to verify that contractual conditions are respected. Such verification is carried out by the Regional Directorates at the time of contribution disbursement or fee settlement relating to the services entrusted to regional companies, after checking their performance reports. Moreover, each Region carries out a specific “comparable control” on the Regional Health Service which is the key function regions are responsible for.

### **6.3.3 Control environment**

At this public administration level, the emphasis is also on compliance to rules and procedures both for internal and external controls, even though there are examples of a more collaborative guidance approach fostering a more efficient and effective administration to pursue value for money which will be described in the following sections.

#### **Public spending chain**

Every year each regional government draws up an annual and a three-year financial budget on the basis of the strategic lines and policies outlined in the Document of Regional Economy and Finance (*Documento di Economia e Finanza Regionale*, DEFR). Within 20 days from the approval of the financial budget by the Regional council, which should happen by December 31<sup>st</sup> of the previous year, the Regional Executive Committee approves the Executive Management Plan (*Piano Esecutivo di Gestione*, PEG), which sets out in greater detail the objectives and actions outlined in the financial budget. Based on it, regional offices are assigned

objectives for the new year as well as the financial, human, and technical resources necessary to achieve them.

Once the Executive Management Plan is approved, the power to adopt measures that involve spending commitments rests with regional directors (Direttori regionali), the heads of individual services (Responsabile del Servizio) or by those in charge of a procedure (Responsabile Unico del Procedimento), if such power has been granted to them.

### **External control chain**

In accordance with autonomy principles, external controls have been limited to the correct use of financial resources. This kind of control is delivered by the regional sections of the Court of Auditors and the National Anti-corruption Agency ANAC. The President of each Region is required to transmit every twelve months to the regional section of the Court of Auditors a report to demonstrate they are aware of the circumstances of internal controls in their Region. The results of such control are communicated to the Regional council, so that they can implement any necessary action.

As mentioned above, such controls are pursued not only on regional structures, but also on controlled and related entities. An important example of this relates to the administrative procedures for the certification of the financial statements of the Regional Health Services, including all health agencies, hospitals, and other health related service providers which were introduced by the Ministerial Decree of the Ministry of Health from 1/3/2013. Such procedure involves all internal and external control actors in compliance with procedures and controls provided by higher-level bodies, such as for example, ANAC or the Court of Auditors.

### **Internal control chain**

The responsibility for public spending decision is carried first and foremost by the heads of individual services or by those in charge of a procedure, and by the people in charge of each Organizational Unit. They are responsible for adopting administrative acts, technical measures, and financial commitments in line with the regional budget, norms, and

regulations. Such line checks are incorporated as much as possible in operational and IT procedures.

In the last decade most Regions have renounced to carrying out preventive administrative controls, entrusting such compliance responsibility precisely to service heads, regional and unit directors who are responsible for an act or for spending public funds. This is because:

1. Those who carry out a procedure or commit public resources are best placed to intervene before it is enacted if they sense an issue;
2. Procedures are becoming ever more complex and those who carry them out are also the people who know best all related issues, assumptions, and specifications;
3. Timings for issuing payments were fixed to a maximum of 30 days; since 2011 the issue of late payments by public entities had become so pressing, that Legislative Decree 192/2012 fixed the maximum term to 30 days from 2013 in implementation of EU Directive 2011/7; it was not feasible to carry out proper administrative checks anymore and most Italian Regions preferred to leave administrative responsibility with those in charge of a procedure, while maintaining accounting preventive checks by the Finance Directorate which must be carried out within 15 days, leaving enough time for modifications and corrective measures; in many cases, however, in a collaborative fashion, the Finance Directorate also points out if it detects any administrative non compliance or critical legislative issue;
4. The number of acts doubled after 2011 as a consequence of the accounting reform enacted with Legislative Decree 118/2011, which, among other things, imposed a thorough control of any subject benefiting from public funds resulting in individual control acts to be carried out for each third party.

Shifting initial controls to them has entailed a strengthening of the administrative responsibility of directors and managers across all directorates and units, who must preventively ensure the legitimacy of the acts they carry out.

As far as accounting regularity checks are concerned, the Finance Directorate carries out both blanket ex-ante and sample ex-post checks as it is also the office responsible for the preparation of the budget and of reporting documents. However, some regional Accountant General or Chief Financial Directors suggest that it would be helpful to have a hub and spoke system as at central government level with an accountant or accounting unit in each Directorate which is centrally coordinated by the Finance Directorate, but appreciate local specificities and sensibilities. This would help the smooth implementation of accounting reforms and innovations across the entire regional government as directors and managers across all directorates have the power to commit public funds, enact payments, and register them, but they are not necessarily aware of recent changes in accounting procedures as, for example, when shifting from cash to more accrual-like accounting with Legislative Decree 118/2011 or when a new accounting software is introduced as it happened in 2021 in the Friuli Venezia Giulia Region.

In most regions the Finance Directorate also carries ex-post administrative regularity checks on a sample of acts. However, in the Veneto Region, subsequent administrative controls have been dismissed as well as preventive administrative controls, so that the full administrative legitimacy resides with service heads, regional and unit directors. Their acts are then subject only to internal ex-ante and ex-post accounting controls by the Finance Directorate and to subsequent external sample controls by the Court of Auditors for both accounting and administrative compliance.

In the Emilia Romagna Region ex-post administrative sample controls are carried out by the Cabinet of the President of the Region, which emphasises the importance given to such random checks. In the Friuli Venezia Giulia Region the responsibility for ex-post administrative controls has been moved from the Finance Directorate to the Programming, Strategic planning, Management Control and Statistics Service within the Directorate for General Affairs since 2020. The same unit also supports the Independent Supervisory Body OIV appointed by the Regional Executive Committee, who is responsible for monitoring the performance cycle and for verifying the effectiveness of the internal control system and

the compliance by the regional management with legislation, strategies, and the stability pact as well as their ability to maintain financial health.

**Good practice IT7 – Control environment – Regional government: Board of directors’ involvement**

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A best practice is to ensure that board directors (e.g. the President of a Region) are aware of the circumstances of internal controls in their organization, for example by requiring they submit regular reports to external control authorities. (COSO 2)

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**Good practice IT8 – Control environment – Regional government: Accountability**

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A best practice is to make managers responsible for their actions by eliminating time consuming and redundant checks, as managers themselves should be aware of the legitimacy issues relating to a procedure. (COSO 5)

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### **6.3.4 Risk assessment**

As for other levels of government, this component is not really developed even at regional level, apart from anti-corruption and anti-money laundering procedures which are carried out by the Head of Corruption Prevention and Transparency (RPCT), who is a regional manager entrusted with the responsibility for the formalization and monitoring of such activities.

#### **Subjects**

Risk assessment concerns mainly anti-corruption and anti-money laundering procedures, but some Regions, as for example Friuli Venezia Giulia, are considering interpreting anticorruption not in a restrictive sense, but rather as risk of “maladministration” or “bad management”, mapping all possible risks relating to administrative procedures and public spending. But these are still early days for these developments.

## **Actors**

Risk management assessment are carried out by the Head of Corruption Prevention and Transparency (RPCT) nominated by the regional Executive Committee.

## **Framework**

There are no specific rules or guidelines for risk management, but only for anticorruption with Law 190/2012, Legislative Decree 33/2013 and the National Anticorruption Plans.

## **Methods**

According to the 2019 National Anticorruption Plan, regional RPCTs need to define a three-year plan to prevent corruption which needs to be approved and adopted by the regional Executive Committee.

The RPCT compiles an annual report which includes any non-compliances or violations with respect to anticorruption and transparency legislation, which when necessary are immediately reported to the Regional President, the Regional Executive Committee, the Regional council, the National Anticorruption Authority ANAC, and if necessary the judiciary system.

## **Impact**

Risks management consists mainly of compliance with regulations rather than offering a genuine consideration for risk which could inform planning as well as be included in reporting regional activities.

### **6.3.5 Control activities**

Control activities at regional level even more than at central government level concern mainly compliance rather than value-for-money issues.

## **Actors**

Even though different regions have different set ups as already explained, generally the control of accounting and administrative regularity is carried out first by the Finance Directorate, but also ex-post by the financial auditors who are nominated by regional Executive Committees to verify the compliance of regional statements with administrative and accounting regulations and the value for money of regional activities carried out in the previous financial year.

The performance cycle is usually controlled by a specific Management Control Office or the Planning and Control Office within the Directorate for General Affairs, which assists and supports the Independent Supervisory Body OIV. However, such controls are generally not as developed as at central government level, with some exceptions, so much that the regional sections of the Court of Auditors lament the absence of an overall managerial orientation towards value for money also because of the lack of databases which would allow a statistical analysis to appreciate the effective impact of each public initiative.

## **Framework**

Internal controls at regional level are ideally organized according to three lines of control, that is:

- First level checks or procedural checks for each act and process carried out by process owners themselves;
- Second-level controls or overall management control carried out by bodies other than the first-line ones as regards both financial and performance controls;
- Third-level control or internal audit.

## **Methods**

Within the framework highlighted above, specific control activities may differ across regions, but in general the first level or procedural controls include continuous and timely on-going controls, which must always be ensured for each act and process in accordance with guidelines and regulations. Hence, the following belong to this first level of control:



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- ex-ante responsibility of administrative regularity on any act which rests with the heads of individual services, with those in charge of a procedure, or with the directors in charge of each Organizational Unit;
  - preventive checks on draft laws and regulations, which are also carried out by the heads of individual services, by those in charge of a procedure, or by the directors in charge of each Organizational Unit if necessary in consultation with the Central Directorate for Legal Affairs;
  - accounting controls carried out by the Finance Directorate which checks that the expense has been properly ascribed in the budget, that the budget line is sufficiently covered, that the creditor has been correctly identified, that the reason for the expense is legitimate, and that the sum to be paid is correct.

The second level or overall management controls generally refer to all the controls carried out, periodically but also in extraordinary cases, by structures or bodies other than those who have carried out the activity subject to control. They include:

- strategic control;
- management control;
- control of organizational performance and of individual personnel performance;
- control of ex-post administrative regularity, that is once an act has been approved;
- controls deriving from the system of corruption prevention, the measures to combat money laundering and the financing of terrorism;
- control over public and private entities under regional control or owned by the region;
- controls relating to European funds, in accordance with the relevant legislation;
- inspection control in extraordinary cases.

For most of these controls, only the aims are clarified according to Legislative Decrees 286/1999 and 150/2009, but no specific tool as been developed or prescribed nation-wide for all regions, so that such controls are organized and run differently across such entities.

The third level control or internal audit function concerns verifying the correct functioning of the internal control system and is limited in most cases to an annual report by the Independent Supervisory Body OIV.

### **Impact**

The impact of internal controls varies across regions. However, in general the regional sections of the Court of Auditors lament that while compliance issues, such as the controls of administrative and accounting regularity, transparency requirements and the regulation of the prevention and repression of corruption and illegality are well developed, the control of the performance cycle, that is strategic control, management control, and staff performance evaluation, is generally not as developed as, for example, at central level.

Indeed, in general the attempt of identifying "good practices", and therefore regional administrations with an efficient and effective spending capacity, is undoubtedly disappointing, as most regional administrations lack systematic observation tools that allow to evaluate the results achieved since, on the one hand, there is no cost accounting which would identify the cost of specific services and activities, and on the other hand, there is little management control and investigation on the quality of processes and products, let alone their outcome.

However, some good practices exist. Five regions (Emilia Romagna, Friuli Venezia Giulia, Liguria, Toscana, and Basilicata) are taking part in a workshop about "Public value creation" run by the Department of Public Office which aims at discussing and developing outcome indicators.

Moreover, as mentioned before, within the Friuli Venezia Giulia Region all controls except accounting regularity, but including legislative compliance are placed within the Programming, Strategic Planning, Management Control and Statistics Service within the Directorate for General Affairs. This was part of the synergy strategy outlined by Regional Law 1/2015 which has allowed to develop a greater connection between programming and monitoring and also to pull together different resources with management, legal, statistical, and IT competences, which in turn

has nourished a cross-fertilization of competences and controls at regional level. For example, the Programming, Strategic Planning, Management Control and Statistics Service developed from the Statistics Office of the Region and, in the absence of detailed legislation on how to carry out strategic and management controls, it maintains such imprint in the way it runs its controls. It carries out six service satisfaction surveys a year for its strategic control, i.e. to assess whether and in how far objectives have been met not only using output but also outcome indicators. The results of the administrative legitimacy checks are used in the performance evaluation of regional units and their personnel. Moreover, the richness of the statistical information collected on all regional activities and functions through intelligent IT systems informs management control and allows to reach an appreciation of expenses which is extremely useful and comes close to the results offered by a cost accounting system, as observed by the regional section of the Court of Auditors in its report on the management of regional public financing published in January 2022. Such management control results are summarised in an annual report on “Management control over the costs and activities of the structures of the Presidency and of the Central Directorates of the Region” prepared by the Programming, Strategic Planning, Management Control and Statistics Service. The purpose of the report is to offer top management useful information for allocating resources, assessing personnel, adopting the appropriate corrective actions, and defining the objectives of future programming cycles.

In the Emilia Romagna Region most controls rests with the Financial Planning and Control Service which brings together financial as well as management competences. The Regional Executive Committee revised all internal controls in 2017 with deliberation 486. Management control is anchored around a rather detailed cost accounting system which allows to calculate the cost of each function, structure or service in order to compare efficiency levels across regional units to improve decision making and suggest ways to optimise resources. Strategic control is organised around the political aims set by the regional administration which are operationalised in the Document of Regional Economy and Finance (DEFR) with objectives and activity, output, and outcome indicators. Every year the Financial Planning and Control Service prepares a report on the achievement of yearly targets, as well as an overall report is prepared at the end of each regional mandate. This document too, as

in the case of Friuli Venezia Giulia, offers top management useful information on performance evaluation, corrective measures, and the refinement or definition of new objectives.

**Good practice IT9 – Control activities – Regional government: Centralization in multi-competences unit**

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A best practice is to centralise controls in a unit with multiple competences to develop control activities that put policies into action and contribute to value for money using technology. (COSO 10, 11 & 12)

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**Good practice IT10 – Control activities – Regional government: Collect and use relevant data**

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A best practice is to collect or generate and use relevant, quality information to support the functioning of the internal control system. A cost accounting system or collecting and analysing sufficient information about costs can both work. (COSO 13)

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### **6.3.6 Internal audit**

In general, internal audit is not a well-developed function within the Italian public administration, let alone among Italian Regions. Simplified internal audit functions are carried out in most regions by the Independent Supervisory Body OIV, but they are limited to a report on how internal controls function based on an analysis of their performance plans and reports. Alternatively, there are some sporadic initiatives such as the white paper (*Libro bianco*) developed by the University of Bologna for the Emilia Romagna Region at the beginning of a new legislature in 2015. In particular, the new regional leaders asked the University an interinstitutional collaboration for an independent audit of: internal structures; procedures and regulations; controlled and related entities; and the local government system. While not focusing on internal controls, the white

paper offered an opportunity for a transparent investigation of the functioning of the entire Region, which highlighted critical issues particularly with management control, cost control, and performance evaluation, which have been addressed since then.

As mentioned before, an exception to the lack of an institutionalised internal audit function is the Lombardy Region which in 2018 established a Regional Body for Control Activities (*Organismo Regionale per le Attività di Controllo*, ORAC) which is responsible for internal audit (Lombardy Regional Law 13 from 28.9.2018). The rest of this section focuses on this case.

### **Actors**

ORAC is made up of nine external experts, including its President, appointed by the Regional council, after designation by the Executive Committee, and by two regional top managers identified by the statutory law. This means that ORAC is independent from regional authorities, but at the same time its actions are coordinated with the regional structures through the common members.

### **Frameworks and methods**

ORAC performs a support function from a technical and implementation point of view in the drafting, programming and application of the guidelines relating to the control system and relates directly to the governing body, the Regional Executive Committee, as well as to the legislative body, that is the Regional council.

ORAC's overall aim is to verify the correct functioning of regional structures in terms of transparency, regularity, and effectiveness of their internal control system and corruption prevention. Its specific aims are to:

- verify the correct functioning and effective organization of regional structures and controlled entities;
- monitor the transparency and regularity of contracts and execution phases;
- evaluate the effectiveness of the regional internal control system;

- support regional activities of implementing and updating corruption prevention plans;
- coordinate the various internal control activities and works in conjunction with other control bodies (RPCT, OIV, Financial Auditors, Control Agency of the Regional Social and Health service).

ORAC can carry out audits and investigations on its own initiative or upon notification by regional structures, issue guidelines and recommendations, as well as formulate opinions on the regional internal control system. It reports every six months to the Regional Executive Committee in what is defined as a “collaborative watch” in an effort to create virtuous relationships both internally and externally of the administration to promote a control culture.

### **Impact**

Over the past four years ORAC together with other stakeholders (the Bicocca University of Milan, a local ethics foundation, and a consulting group) has created a learning and training programme for auditing the internal control system by involving internal stakeholders and including:

- mapping the elements of the regional control system;
- developing a diagnostic system to assess the level of maturity of such elements according to the COSO framework;
- implementing the diagnostic system and identifying possible areas for improvement for certain elements as well as best practices to be exploited and shared within the internal control system;
- preparing and sharing regular assessments and reports on the level of maturity of the internal control system.

Such a process has, on the one hand, thought regional authorities how to go beyond pure compliance and gain an overall view of regional systems, and, on the other, it has demonstrated the need to invest in culture, competences, and assessment tools.

### **Good practice IT11 – Internal audit – Regional government Learning and training programme developed internally**

A best practice is to develop a programme which helps promote a control culture within the organization. (COSO 14)

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**Good practice IT12 – Internal audit – Regional government: Diagnostic assessment system**

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A best practice is to provide the administration with a system which allows it to easily assess elements of the control system. (COSO 11 & 13)

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**Good practice IT13 – Internal audit – Regional government: Risk recognition**

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A best practice is to get management to recognise that an internal audit system is necessary to assess and review the internal control system in order to avoid risks. (COSO 7)

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## 6.4 Local government

### 6.4.1 General overview

As of 31 March 2022, there were 7,904 municipalities which are the local authorities closest to the citizens ([www.istat.it](http://www.istat.it)). Such fragmentation is a well-known problem in the Italian system of government (Raffer and Padovani, 2019): 70% of them have up to 5,000 inhabitants and are considered to be too small to provide services efficiently.

According to the Constitution, there are fundamental functions over which the state has exclusive legislative power and which local governments have to implement (Vandelli, 2012: 345). In general, municipal responsibilities include town planning, building and commercial permits, social housing, local (municipal) police, public transport and roads, water and waste management, education (preschool and primary school buildings), social services, local economic development, recreation and culture, etc.

Municipalities have elected councils and mayors (Vandelli, 2012: 348). Inter-municipal cooperation in the form of municipal unions (*unioni di comuni*) and mountain authorities (*comunità montane*) are common. According to the Ministry of the Interior there are currently 562 of them, involving 3,081 municipalities<sup>39</sup>. They were mainly set up to improve public service delivery and making them more efficient through economies of scale and scope. In addition, there are several other forms of inter-municipal cooperation, among which state-owned enterprises (SOEs) at the local level are prevalent.

### 6.4.2 Specific legal framework

The Italian local government's control system is defined by a set of different norms ruling the functioning of public administrations at large. As for other level of government, many of these norms were issued during the 1990s as a part of a wider renovation process aimed at improving

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<sup>39</sup> [https://dait.interno.gov.it/territorio-e-autonomie-locali/sut/elenco\\_unioni\\_comuni\\_comp.php](https://dait.interno.gov.it/territorio-e-autonomie-locali/sut/elenco_unioni_comuni_comp.php).



transparency and accountability as well as economy, effectiveness, and efficiency in the use of public resources (Reginato et al., 2016).

The provisions developed in the 1990s were incorporated in 2000 in the internal control section of the Consolidated Act on Local Governments (*Testo Unico degli Enti Locali*, TUEL), which was then amended: by new norms as for example by Legislative Decree 150/2009 regarding the performance cycle and organizational and personnel performance appraisal, by Legislative Decree 118/2011 as far as the reform of the local government accounting system was concerned, by Law 213/2012 on local government finances, by legislative decree 126/2014 on provisions concerning the budgeting and the accounting system, and by Law 12/2019 about simplifying local government procedures.

The TUEL's internal control section currently provides for six forms of control (articles from 124 to 148 and from 191 to 198):

1. monitoring administrative and accounting regularity, aimed at guaranteeing the legitimacy, regularity and fairness of the administrative action, the compliance with accounting rules, and assurance in the production of accounting information;
2. management control, aimed at ensuring that operations are executed in an effective, efficient, and economical manner;
3. strategic appraisal and control, aimed at verifying the consistency between the policies set by the political bodies and the actions undertaken in their pursuit. The assessment is made by comparing the policy objectives and the results actually obtained;
4. monitoring budgetary position also with respect to the internal Growth and Stability Treaty;
5. monitoring economy, efficiency, and effectiveness of external units such as public utilities;
6. monitoring quality of the services provided directly or by means of external organizations.

As recently as on 12<sup>th</sup> April 2022, the Italian Parliament approved Law 35 which modified TUEL once more and, among other things, simplified management control for municipalities with up to 5.000 inhabitants, that is 70% of local governments. The law does not specify how such

simplification will take place, but simply states that small local governments do not have to follow the prescriptions for management control outlined in TUEL.

Inter-municipal cooperation such as municipal unions and mountain authorities follow the same legal framework and internal control system as local governments.

### **6.4.3 Control environment**

At this level of government, the control of administrative and accounting regularity is highly regulated, while all other controls are looser and often left to the discretion of local authorities.

#### **Public spending chain**

Similarly to Regions, local governments draw up yearly an annual and a three-year financial budget on the basis of the strategic lines and policies outlined in the Single Programming Document (Documento Unico di Programmazione, DUP). Within 20 days from the approval of the financial budget by the Municipal Council, which should happen by the end of the previous year but often gets postponed, the Executive Committee approves an Executive Management Plan (Piano Esecutivo di Gestione, PEG), which outlines in greater details the objectives, responsibilities, and timings of local policies and actions. Hence, at that point the power to adopt measures that involve spending commitments passes to the city manager (Dirigente comunale) present mainly in large municipalities, the city or town clerk (Segretario comunale), and the heads of individual services or those in charge of a procedure, if spending power has been assigned to them.

#### **External control chain**

At local level external controls are quite extensive and are not limited to the correct use of financial resources.

The Court of Auditors performs a subsequent external control on local administrations which covers:

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- the compliance of administrative and financial results with the objectives set by law by the central government (budget balance, internal stability pact, debt sustainability, sound management);
  - administrative and accounting regularity;
  - the functioning of the internal control system;
  - the Mayor's report on the internal control system;
  - end-of-term reports;
  - the costs of political activity (electoral and public relation expenses);
  - a comparative assessment of costs, methods and times for carrying out activities and providing public services.

### **Internal control chain**

As for other government levels, internal financial controls are organized along two lines to guarantee administrative and accounting regularity. Before an expense is incurred, a visa of technical regularity is prepared by the head of the relevant service and approved by the town clerk, while a visa of accounting regularity, which includes a financial coverage check, is provided by the head of the municipal financial office and, if necessary, the financial auditor. Subsequently, a sample of such documentation is audited by the Town Clerk and the audit's results are sent to the heads of the relevant services, the Independent Supervisory Body OIV or the Independent Assessment Organism (*Nucleo Indipendente di Valutazione*, NIV), the Financial Auditor, and the Municipal Council.

The Financial Auditor (*Revisore contabile*) is an independent and external figure, who is required to collaborate with the administration becoming almost an internal figure and is incompatible with other control functions such as the Independent Supervisory Body OIV within the same local entity. The law requires a single financial auditor for entities with less than 15,000 inhabitants, while a board of three auditors has to be appointed in larger municipalities. Since March 2013, to improve their independence, the law requires the random appointment of professionals from regional lists of certified financial auditors, managed by the Ministry of the Interior.

Financial auditors not only audit financial statements, but also monitor preventively accounting, financial and economic regularity, asset management, tax compliance, and cash flow equilibrium. They carry out quarterly audits on cash and further controls when variations to the original budget occur. Moreover, they cooperate with city councils in improving management efficiency and effectiveness offering opinions, for example, on planning tools such as the Single Programming Document DUP, budget proposals and variations, as well as public service management, recourse to debt and innovative financing. Irregularities are reported to the Municipal Council and, wherever necessary, to judicial authorities. However, the prevailing interpretation of the regional sections of the Court of Auditors is that financial auditors should primarily check for balanced budgets, while controls of good governance and value for money should rest with the Independent Supervisory Body OIV who is involved in the performance cycle.

However, local authorities, unlike Ministries and Regions, are not obliged to have an Independent Supervisory Body OIV or to approve a dedicated Performance Plan. Municipal Councils must enact a regulation of the “integrated internal control system”, which, to simplify procedures, can:

- foresee an Independent Assessment Organism instead of the Independent Supervisory Body OIV, which essentially carries out the same functions, but whose appointment and functions are regulated locally,
- incorporate the performance plan with its objectives, measurements, and assessments in the Executive Management Plan rather than preparing a separate document.

As other government levels, local authorities must prepare an annual Performance Report by June 30<sup>th</sup> of the subsequent year it refers to.

#### **6.4.4 Risk assessment**

Apart from pro-forma anti-corruption and anti-money laundering procedures carried out by the local Head of Corruption Prevention and Transparency (RPCT), this internal control component is generally not really developed even at local level.

However, some local entities such as the Municipality of Milan have developed their own system for mapping and assessing risks. Hence, the following analysis focuses on the procedures developed specifically in Milan.

### **Subject**

The type of risks which are dealt with concern both corruption and inadequacies and issues related to municipal procedures and activities which can lead to “maladministration” in terms of for example:

- unreasonable delay;
- failure to follow policy or procedure;
- failure to provide information;
- failure to take into account relevant considerations when making a decision;
- allowing irrelevant considerations to influence a decision;
- not offering reasons for a decision;

Hence, different type of risks have been identified: operational risk, corruptive risk, and reputational risk.

### **Actors**

In Milan these activities are run within the Internal Auditing Service, which has a special Risk Assessment Unit.

### **Framework**

The Risk Assessment Unit within the Internal Auditing Service works in collaboration with the Head of Corruption Prevention and Transparency (RPCT), with other units responsible for internal controls, and all organizational units of the Municipality for the identification and assessment of the most significant risks.

Starting from the Three-Year Prevention of Corruption and Transparency Plan and from the data it collects during its monitoring, the Unit develops its own Risk Action Plan which is then implemented over the year.

## **Method**

The following activities are carried out by the Risk Assessment Unit:

- developing and continuously updating with a “step-by-step process” a census of all risks connected to processes, services, and activities carried out by the Municipality of Milan;
- monitoring organizational and process changes, in order to update the census of the Municipality’s procedures and processes;
- collaborating with the RPCT in the annual monitoring of the implementation of new operating models;
- collaborating with other other units responsible for control activities, in order to optimize the internal control system, ensuring proper information exchanges;
- assessing the organization in different risk areas, in order to prepare and update the census of risk activities and, consequently, of audit areas;
- defining the criteria and methodologies for assessing risks;
- defining risk mitigation actions;
- coordinating facilitation activities for both risk assessment and risk mitigation within municipal units;
- implementing procedures to assess and monitor risk mitigation plans;
- developing and implementing a systematic collection of data and information relating to risk management processes, also through the development of databases and information systems.

## **Impact**

The Risk Assessment Unit prepares and updates annually a Risk Action Plan, which since 2018 includes a Weighted Residual Risk Score for any process according to its operational risks with the relative mitigation actions.

Following the mapping of the various areas of administrative activity and the subsequent risk analyses, more than 300 operational models of risk prevention and management have been introduced. Published

documents do not allow, however, to gain an overview of the further impact of these risk assessment activities.

#### **6.4.5 Control activities**

At local level control activities concern mainly compliance with administrative and accounting regularity, balance budgets, and other requirements prescribed by law, rather than value-for-money and performance issues.

##### **Actors**

The entities responsible for carrying out the control of administrative and accounting regularity are the financial or accounting office or the general secretariat in larger municipalities in the first instance and the auditors in the second instance.

Similarly, other internal control activities are entrusted to two levels: top public officials within the local administration (Director of Planning, General Director, Town Clerk, etc.) and the Independent Supervisory Body OIV or the Independent Assessment Organism NIV.

##### **Framework**

At local level internal controls are organized according to the two classical pillars of:

- financial checks for administrative and accounting regularity and for adherence to the internal Growth and Stability Treaty;
- non-financial controls which include the “performance management cycle” with management control, top management evaluation, and strategic control, as well as other controls prescribed for local administrations such as service quality and monitoring municipally controlled external units.

However, interviews with top managers at more advanced local administrations praised by the Court of Auditors such as Milan (1,3 million inhabitants) or Bologna (388 thousand inhabitants), but also smaller

ones such as Pordenone (51 thousand inhabitants), reveal that they advocate the development of:

- an internal control system that relies on the same programming and reporting system, with common general objectives, which each area or unit can translate in more specific ones;
- a lean organizational structure that favours efficiency and effectiveness;
- a strong commitment from top management for innovative internal control initiatives.

### **Method**

Administrative and accounting regularity are both prescriptive and detective, with ex-ante and ex-post controls as described above. For example, in accordance with TUEL, administrative regularity controls concern expense commitments, contracts, and other administrative acts, and in particular:

- the legitimacy of an act;
- its quality and if it has been properly dealt with (made public, only available for restricted consultation, etc.);
- the procedure's level of effectiveness and efficiency;
- its compliance with the organization's overall planning;
- its compliance with the operational model foreseen by the Anticorruption plan of the municipality.

Accounting regularity entails that:

- the expense or revenue has been properly ascribed in the budget
- if it is an expense, the budget line is sufficiently covered;
- the creditor or debtor has been correctly identified;
- the reason for the expense or revenue is legitimate; and
- the sum to be paid or received is correct.

On the other hand, local governments can more freely decide how the other internal controls are carried out, even though municipalities over 5,000 inhabitants have to adhere to the prescriptions in TUEL concerning management control and some guidelines have been shared by the Department of Public Office and the Ministry of the Interior:

- management control should verify management efficiency and effectiveness through the planning cycle (DUP, financial



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budget, PEG, financial statement) to ensure the realization of planned objectives and the proper and efficient use of public resources;

- strategic control should assess the adequacy and congruence of the implementation of political plans and programmes by the Executive Committee with the objectives and guidelines approved by the Council, considering also the suitability the operationalisation of such objectives and the appropriateness of the assignment of human, financial and material resources;
- service quality assessment should be carried out on the following dimensions: accessibility, timeliness, transparency, effectiveness, compliance, reliability, and completeness;
- the assessment of top managers should be carried out by the Independent Supervisory Body OIV or the Independent Assessment Organism NIV, who verifies the fulfilment of the tasks assigned to them as required by law and the actual achievement of planned results, making the best use of available resources and using the necessary managerial tools.

### **Impact**

In 2019 the Court of Auditors published the results of the audit it carried out on local government internal control systems in 2017<sup>40</sup>. The findings revealed a heterogeneous picture of internal controls, with various structural and functional characteristics. In particular, both the preventive and the subsequent control of administrative and accounting regularity were widely adopted and followed the standards required by law. Yet, irregularities were detected in 10% of cases with remedies taken in just under half of them.

As far as the performance cycle is concerned, no particular operational modules seemed to emerge around a common scheme with shared techniques and tools, typified practices and homogeneous functional standards. The Court concluded that each entity seemed to follow its own

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<sup>40</sup> Court of Auditors, 2019, "Internal controls of local governments. Analysis of the control system of local governments in 2017".

path, combining the different types of controls in a subjective and differently graded approach.

The Court appreciated that management control is an important tool capable of informing local government activities as it influences the planning of its objectives, which the Court reports were mostly achieved in more than half of the local governments in 2017. However, the Court stated that an optimal functioning of management control would require a cost accounting system, that was not widely established. Indeed, its partial adoption meant that it was often not possible to identify costs and revenues properly, so that indicators could not meaningfully verify the achievement of objectives and the implementation of suitable corrective measures.

Moreover, according to the Court the reporting system was satisfactory in about one third of cases, yet in general it was not adequate and tuned to the needs of the recipients. If on the one hand it properly reflected local programming and allowed plans to be reviewed and corrective actions to be taken, on the other hand it did not often include outcome indicators and targets were set in such a way that they were often easily reachable, i.e. they were not challenging enough. This was also reported recently by the NIV of several municipalities including Milan<sup>41</sup>. Other Municipalities, such as Bologna and Padova, have linked their strategic objectives to the UN Sustainable Development Goals (SDGs) and therefore in their strategic control have implicitly adopted also some of the challenging outcome indicators set by the UN to achieve its 2030 agenda. The Independent Supervisory Body OIV for the Romagna Faentina Union of Municipalities in his 2021 report highlighted how choosing wisely indicators for the three-year performance plan can offer important advantages in terms of guaranteeing continuity and a hierarchical ranking and chronological order among objectives.

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<sup>41</sup> Municipality of Milan, "Report on the overall functioning of the system of evaluation, transparency and integrity of controls. Prepared by the NIV", 19<sup>th</sup> April 2022. On page 4 the NIV states "It is necessary to improve the ability to define objectives and targets that are increasingly challenging and more linked to a "result-oriented culture" and accountability towards stakeholders".

Further, the Court of Auditors highlighted the resistance of top management to appreciate critical issues. While the rules for safeguarding balances were applied, reports of critical issues were rarely sent by financial officers and auditors to other authorities, signalling the prevalence of a compliance attitude regarding budget constraints rather than a collaborative guidance approach. In this respect, the Independent Assessment Organism NIV of Milan Municipality reports a positive initial investment in promoting a managerial culture, with result orientation and the sharing of the principles for performance measurement and system evaluation, which needs to be boosted<sup>42</sup>. The Court of Auditors also revealed that only a quarter of local governments carried out quality and satisfaction analyses of their services. Moreover, even when satisfaction surveys were carried out, the Court lamented that their timeliness was questionable, so that results were not available when needed to improve quality, and corrective measures were delayed.

On the positive side, the report by the Court of Auditors reveals that the information system of publicly owned units was suitable and aimed at detecting and reporting the financial relations with the municipality, the entity's accounting, management and organization, the quality of service contracts, as well as compliance with the rules on public finance constraints. More than three quarters of local governments monitored their financial and economic relationships with such external subsidiaries, demonstrating how the introduction of this control is a suitable way to better appreciate the entirety of local balances, resources, and services.

#### **Good practice IT14 – Control activities – Local government: Outcome indicators and challenging targets**

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A best practice for strategic control is to include some outcome indicators to assess the level of achievement of policy objectives, and to set increasingly challenging targets, so that it can be verified whether objectives have been reached at an acceptable level. (COSO 10)

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<sup>42</sup> Municipality of Milan, "Report on the overall functioning of the system of evaluation, transparency and integrity of controls. Prepared by the NIV", 19<sup>th</sup> April 2022, page 6.

### **Good practice IT15 – Control activities – Local government: Managerial culture**

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A best practice is to promote a managerial culture, result orientation and the sharing of the principles of performance measurement and system evaluation. (COSO 12)

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### **Good practice IT16 – Control activities – Local government: Inclusion of subsidiaries**

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A best practice for management and quality control is to monitor also subsidiaries and locally controlled public entities as they make use of important public resources and often deliver crucial proximity services to citizens. (COSO 12)

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#### **6.4.6 Internal audit**

As for other levels of government, an internal audit function is not present among local authorities. Simplified internal audit functions are carried out by the Independent Assessment Organism NIV, but they are limited to a report on how internal controls function based on the analysis of the performance information included in the Executive Management Plans and the Performance Reports.

However, as mentioned before, an exception is the municipality of Milano which has been carrying out annual audits for almost a decade. Hence, the following paragraphs focus on this particular entity.

#### **Actors**

Such audit activities are carried out by Director of Internal Auditing, who was initially the Director of the Planning and Economic-Financial Control Area, but since 2017 has been appointed separately and directly by the Mayor (art.11, Regulation of the Organization of Offices and Services, Municipality of Milan). Initially Internal Auditing was under the

General Affairs Directorate, but since 2020 it has gained an independent position which reports directly to the Mayor and his/her Cabinet.

### **Frameworks and methods**

The audit covers the Milan Municipality's strategic, management, and service quality controls, plus of any other control deemed necessary to audit by the Mayor, the Executive Committee, the Secretary General or the Director General.

Audit activities are carried out according to an established process which follows the international standards of the Italian Internal Auditing Association based on which the Internal Audit Service has developed an 'Operational Manual for Internal Auditing'.

Each year the Internal Auditing Service develops an Audit Plan which identifies the activities to be carried out over the year based on the risk management evidence and the Risk Action Plan, the Three Year Corruption Prevention and Transparency Plan, and the yearly budget. The Audit Plan needs to be presented to the Mayor for his/her approval by the end of June each year.

The audit results for each task are summarized in a Final Report sent to the Mayor, the Secretary General, the General Manager and to the Director of the directorate or unit which has been audited. This Final Report contains, among others, the so-called Management Action Plan which reports the improvement interventions identified for each critical issue. For each action, the person and structure in charge are indicated, as well as the expected completion date. The Internal Auditing Service also ensures that the improvement actions have been activated by the relevant offices with the defined timeframes.

A Final Follow Up or Monitoring Report is then sent to the Mayor, the Secretary General, the General Manager and to the Director of the directorate or unit which has been audited.

### **Impact**

The 2020 “Report for Strategic, Management, Quality, and Other Controls” reported that all control processes for the Municipality of Milan were audited during the year, in particular for the issues highlighted in the 2019 “Internal Auditing Final Report”. Most problems were solved, but new issues emerged and would be tackled and monitored in due course.

### **Good practice IT17 – Internal audit – Local government: Independent IA unit**

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A best practice is to ensure the independence of the unit in charge of internal audit which should respond directly to top management. (COSO 16)

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## 6.5 Agencies

### 6.5.1 Central executive agencies

#### **General overview and legal framework**

There are over 50 agencies funded and under the direct scrutiny of the central government with very different nature and focus, from agencies regulating economic activity to bodies producing welfare, recreational and cultural services, from independent authorities to national parks and cultural entities such as national theatres and museums.

Most of these bodies rely on similar internal controls as the central government according to Legislative Decree 286/1999 and Legislative Decree 150/2009.

In particular the Revenue Agency (*Agenzia delle Entrate*), and the National Social Security Institute (*Istituto Nazionale della Previdenza Sociale*, INPS) stand out for the development of their internal control and, in particular, their internal auditing. The following section focuses on these two entities.

#### **Internal control system and internal audit**

The Revenue Agency was among the first public administrations in Italy to adapt to the new regulatory provisions with Legislative Decree 286/1999. Starting in 2002, it converted its traditional inspection function into that of internal audit, through a substantial change in its organizational structure. Its Central Audit and Security Department was set up in 2002, and specific internal audit structures were established in 2003 at the 21 Revenue Agency's regional and provincial units.

In terms of internal controls, the agency's directors and managers are responsible for accounting and administrative regularity controls, while an Independent Supervisory Body OIV nominated by the Minister of Economy and Finance is responsible for the performance cycle, that as for other central government bodies comprises strategic control, management control and performance management. The Central Audit and Security Department is responsible for:

- development and maintenance of auditing methodologies;
- general direction and coordination of the audit function;
- revision of the processes of the central structures;
- compliance audit at central and regional structures.

Regional Internal Audit Offices deal with:

- revising the processes of the regional structures and local revenue offices;
- compliance audit at the local revenue offices.

Since 1983 the National Social Security Institute has introduced a planning, programming and management control system based on the measurement of quality and value for money. The system allows to monitor all activities carried out in the Institute's units, use budgeting techniques, check the quality of the processes and services provided, and evaluate results in terms of efficiency and effectiveness, linking a portion of the salary of top management, but also personnel in general, to the achievement of planned objectives.

In 2005 INPS established its own internal auditing service, which contemplated also a risk assessment function.

Hence, the internal control system consists of three main components:

- strategic control, to assess the adequacy of the choices made in the implementation of plans, programs and other tools in terms of consistency between results achieved and predefined objectives;
- management control, with the aim of verifying the effectiveness, efficiency and value for money of the administrative action in order to optimize the relationship between costs and results, through timely corrections;
- internal auditing aimed at general checks of administrative regularity, analysis and quantification of risks, dysfunctions and irregularities in administrative and service processes, monitoring the internal control systems, including the corruption and fraud prevention systems, in order to verify their effectiveness and proposes corrective actions aimed at con-



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taining risks, development and maintenance of auditing methodologies aimed at continuous improvement and risk elimination, or at least mitigation.

INPS is organized in central offices based in Rome and territorial offices located throughout the country at a regional, provincial and sub-provincial level. Directors and managers are responsible for ex-ante and ex-post administrative and accounting legitimacy controls, while strategic, management, and performance controls are performed by the Independent Supervisory Body OIV who is supported by a performance management technical office within INPS and the Planning and Management Control Directorate. At central level a special directorate is also responsible for auditing and litigation activities. Regional and provincial territorial offices have units dedicated to internal control and auditing which support central units.

Because it delivers many different services, as part of its management control INPS has implemented a measurement system which uses quality and value for money quantitative indicators which are normalized to compare services in terms of resource consumption and processing times.

The Revenue Agency and INPS share some good practices in how they have organized their internal control and internal auditing functions:

- internal control and auditing units have been set up also at all regional offices so that the importance of these activities permeates also at local level;
- the approach is not so much that of carrying out ex-post inspections, but rather preventive, collaborative, and consultative controls to ensure value for money, improve risk management, and guarantee the reliability of the internal control system;
- directors and managers are responsible for inline administrative and accounting regularity controls, while the Independent Supervisory Body OIV and the offices responsible for internal control and auditing with their local units are responsible for strategic control, management control, and internal auditing.

Moreover, in both institutions control and auditing activities rely on 4 tools:

- a mapping of all processes which is regularly updated;
- an IT system which supports all control and auditing activities;
- operational manuals, not simple guidelines, which describe in detail how to carry out control and auditing functions and are shared also with local units;
- regular training on control and auditing issues.

#### **Good practice IT18 – Control environment – Central executive agencies: Hub & spoke units**

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A best practice is to concentrate internal control and auditing functions in one top level hub structure with local spokes. (COSO 3)

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#### **Good practice IT19 – Control activities – Central executive agencies: Operational prescriptions**

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A best practice for guaranteeing an effective control and auditing system is to describe in detail control activities and processes and share them at all levels. (COSO 12)

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### **6.5.2 Local government agencies**

#### **General overview and legal framework**

Local public entities used to represent a considerable player in the Italian economy. They dominated local utilities (water and sanitation, waste management, public transport, gas and electricity distribution) and infrastructural management (roads, motorways, local railways, airports, ports, intermodal logistics). They also operated in many other fields, such as exploitation of goods in the public domain and legal monopolies, engineering, territorial marketing, trade fairs, facilitation of lo-

cal development (industry, tourism, and agriculture), and in-house provision of services to local administrations. Yet, over time many have been privatised into limited companies, joint stock companies, joint ventures, consortia, foundations, which are fully or partly owned by local governments and are able to provide a plurality of services often for a wider area to maximise economies of scale. Article 23 of Law 142 in 1990 and subsequently articles 112 and 113 of TUEL (*Testo Unico degli Enti Locali*, Consolidated Act on Local Governments) in 2000 explicitly stated that local governments should provide public services directly only when it was not possible to entrust them to a separate company or institution because of their particular nature or limited size.

According to article 114 of TUEL, “local special agencies” and “local institutions” which remain under the umbrella and direct scrutiny of public authorities are instrumental bodies which mostly deal with delivering social service as they are entrusted with the management of locally owned facilities, such as old people homes, local sports centres, job centres, local theatres and museums, and so on. Local agencies are autonomous legal entities, have their own statute and governing body, which is though approved by the respective municipal council. Local institutions enjoy only an independent management, but they are not separate legal entities with respect to local governments. Hence, the organization and functioning of special agencies are set by their statute and regulations, while local institutions are governed by the statute and regulations of the local government they depend from.

However, over time, as provided by article 115 of TUEL, most agencies were transformed in limited companies or joint-stock companies, while local institutions were never popular.

### **Internal control system and internal audit**

The internal control and internal audit systems for local special agencies and local institutions follow the set up for local governments with no special remarks, since in both cases local governments confer the endowment capital, establish objectives and strategies, approve fundamental acts such as planning documents, financial budgets and reports. The main difference is that in the case of local institutions all internal controls are also performed by local governments, that is accounting and

administrative controls are carried out by their financial auditors and strategic, management and performance control are dealt with by their Independent Supervisory Body OIV or NIV, while the statute of local special agencies should provide for a specific financial auditing body as well as for autonomous forms of management control with the local government performing only ex-post external control activities.

As the specific internal control systems of local special agencies can vary, but generally tend to follow the set up of the local government they depend from, no additional good practices have emerged.

### **6.5.3 Universities and research institutions**

#### **General overview and legal framework**

Independent agencies sponsored by central government such as universities follow prescriptions for the central level of government or special provisions enacted by the central government for specific agencies or by the relevant ministries.

For example, in 2010 the Italian Parliament enacted Law 240 about “Rules on the organization of universities, academic staff and recruitment, as well as mandate to the Government to promote the quality and efficiency of the university system” which reformed the higher education system.

Law 240/2010 establishes that each university should approve an Administration, Finance and Accounting Regulation that must specify how internal administrative and accounting legitimacy controls must be carried out and gives a key role in performance controls to the Independent Assessment Organism (*Nucleo Indipendente di Valutazione*, NIV), which carries out within universities the functions of the Independent Supervisory Body OIV. Such organism is independently nominated by the University among people with similar characteristics to the Independent Supervisory Body OIV, but within a higher education setting.

Moreover, in the performance cycle, a key role is played by the National Agency for Evaluating the University and Research System (*Agenzia Nazionale di Valutazione del Sistema Universitario e della Ricerca*, ANVUR) which enacted its University Guidelines in 2015.

### **Internal control system and internal audit**

Similarly to other government agencies, the internal control system at universities consists of a set of rules, procedures and organizational structures aimed at allowing the sound management of resources, consistent with set objectives, through an adequate process of identification, measurement, management and monitoring of the main risks. However, because each university enjoys financial, administrative and management autonomy, the internal control systems may be set up differently across the 67 Italian public universities, even though they must follow the same legal framework.

In general, the Administration, Finance and Accounting Regulation of each university stipulates that complying with ex-ante administrative and accounting legitimacy rests with principals, department and unit heads, while the Board of Financial Auditors and the Independent Assessment Organism NIV carry out ex-post administrative and accounting legitimacy controls and all controls linked to the performance cycle, that is strategic control, management control, and organizational and individual performance evaluation.

There are three standard phases in the performance cycle:

1. The preparation and approval of a programming act, that is the three-year Integrated Performance Plan, with objectives and indicators;
2. The monitoring and, where necessary, update of such programmes, carried out internally by the university and verified by the Independent Assessment Organism NIV;
3. The evaluation of the results, which is the responsibility of the governing bodies of the entity and is appropriately reported (the Performance Report), which also leads to the attribution of individual bonuses following the validation of the Independent Assessment Organism NIV.

The three phases are based on the Performance Measurement and Evaluation System, which is the methodological tool that each university prepares and approves before starting the performance cycle, adapting

it to the specific needs of its organization and subsequently modifying it where deemed necessary.

According to ANVUR's 2015 guidelines, the key internal actors of the performance evaluation system are:

- the Board of Directors, which plays a role of guidance and assessment of the adequacy of the whole system and is responsible, in agreement with the General Manager, for the principles, objectives and related indicators included in the Integrated Performance Plan which are then assessed in the Performance Report;
- the General Manager, who supervises and leads control activities by declining and sharing objectives within the university offices and departments, identifying transversal dimensions, to then evaluate managers on the basis of their overall performance;
- managers, who ensure the implementation of the various controls, set the objectives for the organizational units for which they are responsible and who evaluate their members.

A second level performance controls are then performed by the Independent Assessment Organism NIV, which should be considered an internal-external organism, and ANVUR itself as the external controller for performance issues together with the Court of Auditors on financial aspects. The Court of Auditors is, as usual within Italian public administration, responsible for an external control both ex-ante, monitoring the legality of public universities' acts, and ex-post to verify their finances and budget's management.

Hence, most performance control activities rest with the Independent Assessment Organism NIV. Following article 2 of Law 240/2010, as well as article 44 of legislative Decree 33/2013, an Independent Assessment Organism NIV should:

- guarantee the overall appropriateness of the measurement and assessment procedures;
- verify the quality and consistency of the selected indicators with the three years objectives set in its Performance plan by the university;
- validate the Performance Report;

- ensure compliance with the guidelines by the National Anti-Corruption Authority ANAC;
- monitor the overall functioning of the internal control system.

In terms of good practices, among public administration entities, universities are often praised for their advanced reporting tools with managerial dashboards and IT system which allow for efficient data management and analysis, so much that many universities, such as the Università Alma Mater Studiorum Bologna, but also smaller ones such as the University of Udine, have combined their performance indicators and their financial information and have implemented a cost accounting system.

**Good practice IT20 – Control activities – Universities and research institutions: IT Systems to pursue value-for-money**

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A best practice is to develop a data management and analysis system which allows to combine financial and performance information. (COSO 11)

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## 7 Recommendations

From the analysis of the weaknesses which occur in the Czech Republic (section 3) and the status of implementation of internal control and internal audit in the three countries analysed, namely France (section 4), Germany (section 5) and Italy (section 6), several recommendations can be derived. These recommendations are obtained from the good practices that have been identified in each country section. In fact, despite the different contexts, these good practices might be considered as good starting points to provide insights to shape the new Czech legal framework on internal control and internal audit.

The section is organized as follows. The first sub-section reports some general recommendations obtained from the general overview of the three foreign countries analysed. Then, four sub-sections follow, each representing the modified COSO dimension of the framework of analysis applied in this study (see section 2), namely Control environment (CE), Risk assessment (RA), Control activities (CA), and Internal Audit (IA). In each sub-section, the weakness raised from the Czech case, sorted by governmental level, are confronted with the good practices identified in the three foreign countries. Starting from this comparison, a list of recommendations is provided for each modified COSO dimension. Despite good practices referring, in general, to a specific level of government, they contribute to the recommendations that are valid to all levels of government.

### 7.1 General recommendations

The internal control and audit analyses in the three foreign countries provide the following general recommendations.

- **GE1 – General principles for all, specific rules for each level of government**

Some general principles and legal frameworks that apply across the different levels of government are in place in all countries analysed, but internal control and audit-specific norms and guidelines are usually re-



lated to each level of government. The latter is necessary as different levels have different activities to be provided, usually more planning and coordinating activities for the higher levels of government and more service provision-related activities at lower levels. Moreover, lower levels may have different degrees of autonomy and, therefore, freedom to set their own rules.

- **GE2 – Linking financial and nonfinancial performances**

Linking financial and nonfinancial performances is vital, especially considering that internal control aims to help the organization fulfil its objectives effectively and efficiently (3Es). However, regardless of the actual level of implementation, it still represents a challenge in all the three foreign countries analysed.

- **GE3 – Skilled and trained employees**

Skilled and trained employees represent an enabling condition for an effective internal control and audit. Recognizing what 3Es concept is, what risk management is, the reason why of each specific step of the IC/IA processes with the ability to locate it within the “big picture”, is a key success factor. Despite some regulations concerning the recruitment criteria and training activities exist, specific provisions (e.g. incentive, financing, etc.) might be available to develop an effective knowledge IC/IA.

- **GE4 – Law as instrument for change, not change by itself**

The law is an instrument for change as it represents the main mean of communication across the public administration. Despite how it is structured and what type of incentives create to promote change, it cannot be considered as a change by itself. The managerial culture is the outcome of a long-lasting process that must be nurtured with patience and creating nudges instead of promoting breakthroughs and demanding immediate results.

- **GE5 – Focus on modal level of implementation of IC/IA**

The three different foreign countries analysed provide interesting insights not only in terms of good practices, but also in terms of the “modal level of implementation” of IC/IA. In fact, there are some common ideas that seem to be implemented, in particular, the value-for-money concept and the link between financial and nonfinancial performance as subject of IC/IA. In fact, the real way to improve public finance control (and any other public sector reform) is to focus on those ideas that proved to be applied in different national contexts and then adjust them for the specific national contexts and different levels of governments with different sets of rules/recommendations.

## 7.2 Recommendations on Control environment

**Figure 14. Control environment: Czech weaknesses vis-à-vis foreign countries' good practices**

Level	Weaknesses in Czech Republic	Good practices in France, Germany and Italy
<b>Central government</b>	<p>#1. Large organizations manage large funds/assets which tends to result in a complex internal control system</p> <p>#2. Limited skills IC staff due to low remuneration</p> <p>#3. Formal setting of strategy</p> <p>#4. No specific internal directive</p>	<ul style="list-style-type: none"> <li>• FR1 – Laws and rule on internal control and audit bodies: all ministries must have internal control and internal audit bodies</li> <li>• DE1 – Clear legal and hierarchical responsibilities: the ministers and budget officers are legally responsible for regularity and propriety, and economy and efficiency</li> <li>• IT1 – A pragmatic and simple legal framework promotes a new culture: it captures public attention, and this pushes to change administrative traditions and culture, especially in a law-driven system</li> <li>• IT2 – Coordination: internal controls are coordinated by a single body within the MoF with feeds into individual ministries guaranteeing legitimacy, validity, and appropriateness</li> <li>• IT3 – Managerial evaluation: it is linked to the organizational objectives that are managed within the internal control system</li> <li>• IT4 – Timing of plans and reports: enacting the performance plan and the performance report in time is key</li> </ul>
<b>Regional/State government</b>	<p>#1. Inability to assign decisions to strategic objectives</p> <p>#2. Influence of politics results in biased decisions</p> <p>#3. Too many people involved in the financial control</p> <p>#4. Lack of liability for updating directives</p> <p>#5. Nonregular system of training employees</p> <p>#6. Insufficient knowledge of 3Es concepts</p>	<ul style="list-style-type: none"> <li>• FR4 – Principle of separation of authorising officers and accountants: an authorising officer cannot be at the same time an accountant</li> <li>• DE8 – Performance orientation: performance indicators in budgeting documents, including performance agreements with agencies</li> <li>• IT1 – A pragmatic and simple legal framework promotes a new culture: it capture public attention and this pushes to change administrative traditions and culture, especially in a law-driven system</li> <li>• IT7 – Board of directors' involvement: the highest level of elected officials must be ensured</li> </ul>

## RECOMMENDATIONS

Level	Weaknesses in Czech Republic	Good practices in France, Germany and Italy
		awareness of the circumstances of internal control in its organization • IT8 – Accountability ... ???
<b>Local government</b>	#1. Insufficient staff capacity #2. Nonregular system of training employees #3. Undefined responsibility for financial control #4. Lack of evaluation of the ICS	• DE13 – Clear roles and responsibilities: long lasting knowledge of what internal control is, with clear responsibilities on regularity, propriety, and economy and efficiency in using resources • IT1 – A pragmatic and simple legal framework promotes a new culture: it capture public attention and this pushes to change administrative traditions and culture, especially in a law-driven system
<b>Agencies</b>	#1. Insufficient knowledge of regulations for financial control #2. Code of Conduct only a formal document #3. Nonregular system of training employees #4. Older generation lacks skills in IT	• IT1 – A pragmatic and simple legal framework promotes a new culture: it capture public attention and this pushes to change administrative traditions and culture, especially in a law-driven system • IT18 – Hub & spoke units: internal control and audit should be concentrated in one top level hub with local spokes (Revenue agency, Social security agency) • DE

- **CE1 – Set minimum requirements, including skills, for staffing internal control**

In France (FR1), a specific legal provision requires that all ministries have internal control and internal audit bodies. In Germany some ministries are also required. Despite this not guarantee that these bodies would work effectively, it at least guarantees that internal control and audit are staffed. The law may also specify specific background requirements for the employees involved. This recommendation tackles the lack of skilled personnel reported in several cases (central government, #1; local government, #1; agencies, #4) and the insufficient knowledge of regulations on financial control (agencies, #1).

- **CE2 – Clear definition of responsibilities within laws, regulations and recommendations**

Each actor of the spending (and performance) chain should be clearly held responsible not only for complying with formal rules but also

for effectiveness and efficiency, i.e., the value-for-money concept. Despite it has been a long-lasting concept, the German central/federal government provides recommendations (DE1, DE13). For example, in France (and also in Germany) the law provides that an authorising officer cannot be at the same time an accountant (FR4), avoiding overlapping of functions. In law-driven countries, like the Czech Republic, the law represents a powerful mean of communication that must be used with care. This recommendation tackles the difficulty to understand where the responsibility is when too many people are involved in the financial control (regional/state government, #3), the lack of liability for updating the directives (regional/state government, #4), the undefined responsibility of financial control (local government, #3), the lack of evaluation of the internal control system (local government, #4).

- **CE3 – The internal control legal framework must be pragmatic and simple**

The legal framework should be rooted in state-of-the-art managerial research and should be pragmatic and simple to be understood, also, by the general public. If it captures public attention, for example, by establishing specific and easily understandable key performance indicators valid across levels of government as it has been for the Italian case (e.g. absenteeism rates), it is likely that, in turn, politicians are more sensitive and are thus more keen to its real functioning (IT1). This may in turn favourite a performance orientation or value for money assessments like in central and state governments of Germany (DE8). This recommendation tackles the insufficient knowledge of the 3Es concepts (regional/State government, #6), in part the formal setting of strategy (central government, #3), and the formality of the code of conduct (agencies, #2) as well as providing external forces that should push towards a more general effective implementation of internal control (and audit).

- **CE4 – Fostering hub & spoke schemes to propagate internal control culture**

A hub & spoke scheme, i.e. a central coordinator (hub) of several peripheral offices within each ministry/department (spoke), not only guarantee legitimacy, validity and appropriateness as indicated by Italian good practices at the central government (IT2) and agency level

(IT18), but in general facilitates the propagation of internal control (and internal audit) culture. This feature might be of help especially in case of lack of training in peripheral organizations. This recommendation tackles the lack of personnel resources to develop complex internal control systems in large organizations (central government, #1), and the difficulty related to training programs (regional/state government, #5; local government, #2; agencies, #3) since specific training programs would be concentrated in the hubs that, in turn, would propagate knowledge to the spokes.

- **CE5 – Linkage of internal control with an effective strategic control process**

The internal control must be linked to an effective strategic control process. The good practices found in the foreign countries stress the importance of the timing of plans and reports, that should be respectively approved before the period to which they refer to begins and soon after the period ends (IT4). This guarantees that the strategic control process is effective and allows the board of directors (the highest level of elected officials) to be aware of the circumstances of the internal control in its organization (IT17). It also promotes a performance orientation culture at both strategic and operational levels (DE8), and where managers are held accountable, and therefore evaluated, on the organization's results vis à vis the planned objectives (IT3). It must be stressed that the good practices detected represent outstanding cases and not standards across organizations in the countries analysed. This recommendation tackles the inability to assign decisions to strategic objectives (regional/state governments, #1) and the influence of politics (regional/state government, #2).

### 7.3 Recommendations on Risk assessment

**Figure 15. Risk assessment: Czech weaknesses vis-à-vis foreign countries good practices**

Level	Weaknesses in Czech Republic	Good practices in France, Germany and Italy
<b>Central government</b>	#1. Risk analysis done in a formal way	<ul style="list-style-type: none"> <li>• FR2 – Methodological support: clear definition of methodology in laws and regulations</li> <li>• DE2 – The Four Risk Fields serves as basis for risk assessment: the integrated view also consider fraud and corruption, which is included in the framework (Federal Office for Economic Affairs and Export Control)</li> <li>• DE3 – Net basis approach: the risk assessment considers the measure that have been already taken (Federal Office for Economic Affairs and Export Control)</li> <li>• DE4 – Risk report template: classification and assessment of the overall organizational impact of each risk involving all organizational units (Federal Institute for Materials Research and Testing)</li> <li>• DE5 – Contrasting measures: selection and development of control activities and document risk history to mitigate risks (Federal Institute for Materials Research and Testing)</li> </ul>
<b>Regional/State government</b>	#1. A failure to manage risks is consequent upon too many described risks	<ul style="list-style-type: none"> <li>• FR3 – Multi-year action plans: risk control activities are planned with a multiannual perspective</li> <li>• FR5 – Carrying out a risk mapping that groups risks into simple categories: two categories of risks major and operational are mapped (Brittany Region)</li> <li>• DE9 – Accrual accounting stimulates financial risk mapping: State governments must include measures of mitigation of risks in their budget documents in case they apply accrual accounting</li> </ul>
<b>Local government</b>	#1. Not working with strategic documents #2. Absence of risk assessment #3. Risk analysis done in a formal way	<ul style="list-style-type: none"> <li>• FR7 – Carrying out a risk mapping thanks to internal network of risk managers: standardized procedures are spread out enabling risk culture (City of Paris)</li> <li>• DE14 – Risk assessment included in reporting guidelines for audit reports:</li> </ul>

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		these guidelines require assessment of economic situation and potential risks.
<b>Agencies</b>	#1. Lack of risk assessment #2. A failure to manage risks is consequent upon too many described risks	<ul style="list-style-type: none"> <li>• FR9 – Risk mapping as part of certification of accounts: 3 years for the certification without reservations in Louvre Museum</li> <li>• FR10 – Risk mapping following the central government framework: business risks (non financial) and financial risks have been included in an action plan by Paris water company</li> <li>• FR12 – Risk mapping supported by a special dedicated unit: this unit work closely with the different department to help developing own risk management at Université Aix-Marseille</li> <li>• DE19 – Own practicable model is successful: half-yearly rhythm of risk assessment and a manageable number of risks (Federal Employment Agency)</li> <li>• DE20 – Vertical integration via technical solution (Federal Employment Agency)</li> <li>• DE21 – Continuous improvement towards COSO principles (Federal Employment Agency)</li> <li>• DE22 – Risk assessment integrated into administrative and academic processes as a continuous process (University Göttingen)</li> </ul>

- **RA1 – A clear general framework should be provided in law/regulations or guidelines**

The French government has provided a simple but very easy-to-understand overarching framework for risk assessment for all levels of governments, where two types, financial and business risks, are singled out (FR2). French public managers have a clear understanding of what is “financial risk” and what is “business risk”: risk concepts and ideas are embedded in everyday managers’ language. This considerably clarifies what is intended for risk assessment, while organizations are free to apply specific frameworks in consideration of their specific activities. In Germany, the adopted solution refers to specific guidelines provided by the domestic institute of public auditors (DE14). The recommendations are based on “The Three Lines of Defense” model, that enhances the understanding of risk management and control by clarifying roles and duties. It does not matter what source, but a clear general framework should be provided instead of leaving organizations to decide on their own – of course, the



organizations should be left free to apply the frameworks considering their specificities. This recommendation tackles the weaknesses that emerge from the analysis of the current situation in the Czech Republic.

- **RA2 – Integration of risk assessment in other traditional risk-related processes**

An effective strategy to introduce risk assessment is to integrate the managerial risk assessment with other traditional risk-related processes. For example, in Germany the general framework of the “Four risk fields” applied at the central (federal) level includes the traditional fraud and corruption risk assessment (DE2), while the risk assessment of the University of Göttingen is incorporated within the administrative and academic process as a continuous process (DE22). As an effect, this strategy may make the managerial risk assessment more acceptable by the organization and at the same time may benefit from the already known risk assessment procedure as basis from which to start new risk analyses. This recommendation tackles the weaknesses that emerge from the analysis of the current situation in the Czech Republic.

- **RA3 – Simplified approaches to risk assessment methods should be preferred**

A generally accepted idea is that risk assessment is complex as many different types of risk emerge and their evaluation might be complicated and very subjective. In case of lack of a clear method or a far too complex method, the risk is to have a formal analysis of risks. Simplified approaches emerge from the “Net basis approach”, where the risk assessment considers the measures that have been already taken (DE3) or the own model by the Federal Employment Agency (DE19) that uses a risk assessment method where a limited number of risks are taken into consideration, but with a bi-annual frequency. In France, the Brittany Region has mapped its risks grouping them into two simple categories, major (strategic) and operational (FR5). Simplicity fosters communicability and therefore legitimacy across the organizations, contributing to its effective implementation. This recommendation tackles the weaknesses that emerge from the analysis of the current situation in the Czech Republic.

- **RA4 – Preferring a hub & spoke model for risk assessment supported by ICT**

The best examples of risk assessment implementation in France and Germany relate to cases where a network of analysts organized in a hub & spoke model exists. Notably, in the Federal Institute for Materials Research and Testing in Germany, the classification and assessment of the overall organizational impact of each risk involve all units of the organization, coordinated by a specific office (DE4). In the City of Paris there is a network of risk managers that allows the spreading of risk culture and the standardization of procedures (FR7). At Université Aix-Marseille, in France, risk mapping is supported by a dedicated unit that closely works with the different departments (FR12). Of course, any integration of risk assessment, particularly in large organizations, requires an effective technical solution (DE20). This recommendation tackles the weaknesses that emerge from the analysis of the current situation in the Czech Republic.

- **RA5 – Considers windows of opportunity (e.g. accrual accounting) to introduce risk assessment**

Some windows of opportunity may encourage risk assessment procedures. For example, accrual accounting, which requires risk analysis for asset impairment, is one possibility. In Germany, those state governments implementing accrual accounting reform are fostered to include measures of mitigation of financial risks in their budget documents (DE9). At the Louvre Museum, the certification of accounts, which lasted three years, obliged the organization to map its risks as part of the certification procedures (FR9). This recommendation tackles the weaknesses that emerge from the analysis of the current situation in the Czech Republic.

- **RA6 – Provide a multiannual perspective for risk assessment implementation**

Documenting risk history, i.e. keeping track of and therefore learning from risks along the years, is at the basis to assess and therefore mitigate risk in the Federal Institute for Materials Research and Testing (DE5). In the Federal Employment Agency, a continuous improvement strategy along the COSO principles is in place (DE21). In France, multi-

year action plans that also consider risk control are in place at the regional level (FR3). All in all, good practices often rely on a multiannual perspective for risk assessment implementation, with an underlying logic of both forward-looking and continuous improvement and learning from the past. This recommendation tackles the weaknesses that emerge from the analysis of the current situation in the Czech Republic.

## 7.4 Recommendations on Control activities

**Figure 16. Control activities: Czech weaknesses vis-à-vis foreign countries good practices**

Level	Weaknesses in Czech Republic	Good practices in France, Germany and Italy
<b>Central government</b>	#1. Too many actors involved in inspections result in lack of clear responsibilities #2. No comprehensive view as several ICT systems occur #3. The 3Es rules are considered complicated to apply or unnecessary given the type of activities performed #4. Non clarity of different types of control (preventive, continuous and subsequent) #5. Reluctance of introduction of ICT for IC by the organization	<ul style="list-style-type: none"> <li>• DE6 – Instructions, guidelines and benchmarks to favour value-for-money: in order to ensure uniformity and comparability of cost-effectiveness calculations</li> <li>• IT5 – Workshops: deployment of control activities through workshops</li> <li>• IT6 – IT Systems to pursue value-for-money: integrating financial and non-financial targets helps a value-for-money focus</li> </ul>
<b>Regional/State government</b>	#1. No specific internal directive #2. No comprehensive view as several ICT systems occur #3. Not performing preliminary control #4. No prioritisation of expenditure which complicates subsequent control #5. Too many people involved in the control activities results in performing the control formally	<ul style="list-style-type: none"> <li>• DE10 – Continuous improvement of regulations and instructions for value-for-money control: this allows accumulation of organizational and technical knowledge, increasing the level of individuals acceptance</li> <li>• IT9 – Centralization in multi-competences unit: this allows value-for-money by using technology (Emilia Romagna, Friuli Venezia Giulia)</li> <li>• IT10 – Collect and use relevant data: there is no need to have complex systems, e.g. cost accounting system, but some relevant info suffice (Emilia Romagna, Friuli Venezia Giulia)</li> </ul>
<b>Local government</b>	#1. Paper-based financial control #2. All liability lies on the operation commander as other roles are formal	<ul style="list-style-type: none"> <li>• DE15 – Deployment of control through policies and procedures: despite legal regulations, tailor-made policies and structures are</li> </ul>

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	<p>#3. Formal performance of continuous and subsequent control</p> <p>#4. Lack of perception of the importance of continuous controls and their relevance</p> <p>#5. Misunderstanding of the 3Es principle, its applicability and meaningfulness</p> <p>#6. Improper preliminary control</p>	<p>important to get control activities effective (City of Dortmund)</p> <ul style="list-style-type: none"> <li>• DE16 – Selection of control activities that contribute to the mitigation of identified main risks: critical business processes are identified according to their level of risk (City of Dortmund)</li> <li>• IT14 – Outcome indicators and challenging targets: these should be included in the management control system (selected municipalities)</li> <li>• IT15 – Managerial culture: promoting managerial culture, result orientation, and performance management (selected municipalities)</li> <li>• IT16 – Inclusion of subsidiaries: subsidiaries and local agencies should be part of the internal control system</li> </ul>
<b>Agencies</b>	<p>#1. Paper-based financial control</p> <p>#2. No comprehensive view as several ICT systems occur</p> <p>#3. Electronic financial control is more formal</p> <p>#4. Misunderstanding of the 3Es principle, its applicability and meaningfulness</p> <p>#5. Too much reliance on the information system</p>	<ul style="list-style-type: none"> <li>• FR11 – Implementation of an internal control charter to help awareness: this has been pushed by obligation to certify accounts (Université Aix-Marseille)</li> <li>• IT19 – Operational prescriptions: describe control activities and processes in detail and share them at all levels, in case of big organizations with several regional offices (Revenue agency, Social security agency)</li> <li>• IT20 – IT Systems to pursue value-for-money: integrating financial and non-financial targets helps a value-for-money focus (University of Bologna)</li> </ul>

- **CA1 – Do not provide a one-size-fits-all structure of information system and control activities, just principles and criteria**

General frameworks and guidelines should not contain strict standards related to the structure of the information system and the control activities to be processed. They must be limited to principles and criteria rooted on state-of-the-art management control theory. For example, in Italy the two regional governments investigated had quite different approaches for structuring their information systems, but they were both

successful. In one region, the cost accounting system is not in place, but value-for-money information is nevertheless available by using proxies (IT10). Of course, what is important, and therefore must be included in the general framework and in the guidelines, is the presence of certain types of performance indicators that are usually neglected, such as outcome and challenging targets (IT14). In Germany, the City of Dortmund developed tailor made control activities and focused only on those business processes considered to have a higher level of risk (DE15, DE16). This latter criterion could for example be part of the set of criteria established to run a control activity at national level. This recommendation tackles the lack of prioritisation of expenditure (regional/state government, #4), the lack of responsibility in the hands of other control activities' actors than the operation commander (local government, #4) as the principles and criteria should describe each actor's responsibilities.

- **CA2 – Fostering internal charters and guidelines to help awareness and consistency**

There are plenty of good practices that suggest the introduction of internal charters and guidelines that should be kept updated and communicated within the organization. On one hand, they help awareness of control activities and the related processes (IT19). On the other, they ensure consistency, uniformity, and comparability, for example of cost-effectiveness calculation, especially in large organizations (DE6). To increase their level of acceptance and effectiveness, charters and guidelines should be updated frequently to enact a continuous improvement of control activities (DE10). The body that represents the main actor of external control (national audit office or similar) may have a role in disseminating recommendations and good examples focused on managerial culture (IT15), as external control is usually considered to be the most important control, the one to constantly look at, and with particular care. This recommendation tackles the weakness of too many actors involved in inspections and consequent lack of clear responsibilities (central government, #1; regional/state government, #5) as the guideline should also clarify the responsibilities, the reluctance to consider the 3Es applicable (central government, #3; local government, #5; agencies, #4), the lack of clarity of the different types of control (central government, #4), the lack of specific internal directive (regional/state government, #1),

lack of perception of the importance of continuous controls and their relevance (local government, #4), improper preliminary control (local government, #6).

- **CA3 – Supporting workshops to deploy control activities**

The Italian Department for Public Office organised several workshops to help six ministries to develop their performance plans, as an important step for their control activities (IT5). Similar activities have been provided in France at both central and local levels. This is a good example of how to promote a managerial culture (see also IT15) and at the same time have a very practical impact. This recommendation tackles the formal performance of continuous and subsequent control (local government, #3) since the performance plan has been reviewed by (external) experts and therefore will be useful to carry out continuous and subsequent controls; it also tackles all the weaknesses related to those control activities which are more careful on formal than substantive aspects (agencies, #2, #3, #5).

- **CA4 – Promoting the integration of financial and nonfinancial aspects of performance**

Value-for-money considers both the financial (costs) and the nonfinancial performance (output and outcome). For this reason, the integration of these two aspects of performance shall be promoted. In large organizations, this may require ICT solutions (IT6, IT20) to bridge over the different databases within different ICT systems, despite this does necessarily mean to implement complex and expensive business intelligence systems (see CA1). These ICT integration solutions may also promote (and being fostered by) the centralization of the coordination of control activities in a multi-competence unit, as appeared to be in Emilia Romagna and Friuli Venezia Giulia regions of Italy (IT9). This recommendation tackles the lack of comprehensive view as several ICT systems occur (central government and regional government, #2; agencies, #2).

## 7.5 Recommendations on Internal audit

**Figure 17. Internal audit: Czech weaknesses vis-à-vis foreign countries good practices**

Level	Weaknesses in Czech Republic	Good practices in France, Germany and Italy
<b>Central government</b>	<p>#1. Insufficiently defined activities of internal audit</p> <p>#2. Lack of skilled internal auditors</p> <p>#3. Formality is more important than substance</p>	<ul style="list-style-type: none"> <li>• DE7 – Delegation model for smaller entities: smaller entities have been given the option of having internal auditing performed by the Federal Office of Administration as service by delegation</li> </ul>
<b>Regional/State government</b>	<p>#1. Lack of skilled internal auditors</p> <p>#2. Lack of internal auditors skilled in specific areas</p>	<ul style="list-style-type: none"> <li>• FR6 – Internal audit focused on dysfunctional internal processes: they are detected from internal or external audits (Brittany Region)</li> <li>• DE11 – Networking and cooperation: different audit units with different backgrounds (finance, construction and real estate, data processing) help carrying out a better IA (Hesse State)</li> <li>• DE12 – Structured audit procedures that ends with implementation of recommendations: a clear role and structure allows generating impacts in terms of creating culture and, thus, efficiency of administrative action (Hesse State)</li> <li>• IT11 – Learning and training programme developed internally (Lombardia)</li> <li>• IT12 – Diagnostic assessment system: providing an easily assessment of the control system (Lombardia)</li> <li>• IT13 – Risk recognition: getting managers to recognise that internal audit system is important to avoid risks, is key (Lombardia)</li> </ul>
<b>Local government</b>	<p>#1. Lack of IA assessment</p>	<ul style="list-style-type: none"> <li>• FR8 – Internal audits with important resources, reports to the mayor, its reports are public: since 1979 provided as an important governance piece (City of Paris)</li> <li>• DE17 – Guarantee of independence of IA body by law: often it is explicitly made visible to outside actors (for example in the City of Stuttgart)</li> <li>• DE18 – Increasing IA certified by external standard setters: on a voluntary basis, external certification may occur, by national association or ISO norms</li> </ul>

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		<ul style="list-style-type: none"> <li>IT17 – Independent IA unit: independence of the unit in charge of IA must be ensured (City of Milan)</li> </ul>
<b>Agencies</b>	#1. Lack of internal auditors skilled in specific areas	<ul style="list-style-type: none"> <li>DE23 – Periodic monitoring of risk management system by internal audit unit and external auditors: internal audit unit is outside the risk management process and supports/advises the heads of central/decentralized units (University Göttingen)</li> </ul>

- **IA1 – Guaranteeing independency for the internal audit body**

One main recommendation that emerges from the good practices is the need to guarantee independency for the internal audit body. This might be guaranteed by law (and explicitly communicated to the public) as it is in the case of City of Stuttgart in Germany (DE17), or by internal regulation as it is in the case of City of Milan in Italy (IT17), or by providing internal audit guidelines by the auditors' associations or by ISO norms certifiers as it is in some local governments in Germany (DE18). In France, the Court of auditors (national audit office) produces a report of internal control systems at the ministry level. An independent internal audit body may be particularly effective when monitoring risk management periodically, as it is at University of Göttingen, Germany (DE23). This recommendation does not tackle any of the weaknesses that have emerged during the field research in the Czech Republic; nevertheless, we suppose that represents a key aspect.

- **IA2 – Promoting awareness of the internal audit outcomes to managers and politicians**

The importance of internal audit must be brought to the eyes of managers and politicians. This may be done through training programmes developed internally to promote internal audit culture and to help manager recognizing the outcome of internal audit to assess the internal control system to avoid risks, as it is the case of Lombardia, Italy (IT11, IT13). Or the internal audit reports shall be provided to the highest executive level of the organization (e.g. a mayor in a municipality) and to the public, as it is in the City of Paris (FR8). These activities should foster awareness among relevant actors and, therefore, should stimulate a higher quality of internal audit (less formal and more substantial). This



recommendation tackles the weakness of formality (central government, #3) and the lack of internal audit assessment (local government, #1).

- **IA3 – Fostering focus on relevant aspects of internal audit**

Internal audit should be guided by the relevance principle. The focus should be on those processes that has already proved to be dysfunctional from previous internal and external audits as it is the case of Brittany Region, France (FR6). Like what happened in Lombardia, Italy, the diagnostic tools should be structured in a way that are easy-to-understand and deploy evaluation systems that are not sophisticated (IT12). In a structured audit procedures that ends with implementation of recommendations, what is key is represented by a specific session of discussion of the IA report before final issuance: this promotes the real implementation of the IA process avoiding IA as a formal exercise (DE12). This recommendation tackles the weakness of formality (central government, #3) and the lack of internal audit assessment (local government, #1).

- **IA4 – Clear step-by-step process for internal auditing activities**

A well-structured auditing procedure that ends with implementation of recommendations is in place in Hesse State, Germany (DE12). A clear role and structure of internal audit not only clarify for all what is internal auditing, but also allows generating impacts in terms of creating culture and, thus, efficiency of administrative action. This recommendation tackles the insufficiently defined activities of internal audit (central government, #1), weakness of formality (central government, #3) and the lack of internal audit assessment (local government, #1).

- **IA5 – Fostering a network of internal auditors with multiple backgrounds**

Hesse State, Germany, provides an interesting example of networking and cooperating among internal auditors with multiple backgrounds (DE11). In fact, different audit units with background in such fields as finance, construction, real estate, and data processing, help carrying out a better internal auditing. This recommendation tackles the lack of skilled internal auditors (central government, #2; local government, #1;

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agencies, 1) weakness of formality (central government, #3) and the lack of internal audit assessment (local government, #1).

- **IA6 – Providing a “delegation model” for smaller entities**

In Germany, smaller entities have been given the option of having internal auditing performed by the Federal Office of Administration as service by delegation (DE7). This allows those entities where would be difficult, for economic reasons, to have skilled internal auditors. This is a sort of hybrid system, where external auditors provide internal auditing. This recommendation tackles the lack of skilled internal auditors (central government, #2; local government, #1; agencies, 1) weakness of formality (central government, #3) and the lack of internal audit assessment (local government, #1).

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## Acronyms

3Es	Economy, Efficiency and Effectiveness
FC	Financial Control
IA	Internal Auditing
IC	Internal Control
ICS	Internal Control System
NPM	New Public Management
SMEs	Small and Middle-sized Enterprises

### France

LOLF	Systematic Law of Laws on Finances (Loi Organique Lois de Finances)
CHIA	Committee for the Harmonization of Internal Audit (Comité d'Harmonisation de l'Audit Interne de l'État)
PBAM	Public Budgeting and Accounting Management decree (Décret relative la Gestion Budgétaire et Comptable de l'État)
RGPP	General Revision of Public Policies (Révision Générale des Politiques Publiques)
MIAC	Ministerial Internal Audit Committee, (Comité Ministériel d'Audit Interne)
MMAI	Ministerial Internal Audit Mission, (Mission Ministérielle d'Audit Interne)
NOTRe	Law on the New Territorial Organization of the Republic, (Nouvelle Organisation Territoriale de la République)
RCB	Rationalization of Budgetary Choices (Rationalisation des Choix Budgétaire)
GICP	General Inspectorate of the City of Paris (Inspection Générale de la Ville de Paris)

### Germany

AktG	German Stock Corporation Act (Aktengesetz)
BA	Federal Employment Agency (Bundesagentur für Arbeit)
BAFA	Federal Office for Economic Affairs and Climate Action (Bundesamt für Wirtschaft und Ausfuhrkontrolle)



BaFin	Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht)
BAM	Federal Institute for Materials Research and Testing (Bundesanstalt für Materialforschung und -prüfung)
BB	Brandenburg
BHO	Federal Budget Code (Bundeshaushaltsordnung)
BMF	Federal Ministry of Finance (Bundesministerium der Finanzen)
BMI	Federal Ministry of the Interior (Bundesministerium für Inneres)
BMWi	Federal Ministry for Economic Affairs and Climate Action (Bundesministerium für Wirtschaft und Klimaschutz)
BSR	Berliner Stadtreinigungsbetriebe
BVA	Federal Office of Administration (Bundesverwaltungsamt)
BVG	Berliner Verkehrsbetriebe
BW	Baden-Wuerttemberg
BWB	Berliner Wasserbetriebe
BY	Bavaria
DIIR	German Institute of Internal Auditors (Deutsches Institut für Interne Revision)
DP	Data processing
FAO	Federal Audit Office (Bundesrechnungshof)
GemHVO	Municipal Budget Regulation (Gemeindehaushaltsverordnung)
GemKVO	Municipal Cash Ordinance (Gemeindekassenverordnung)
GG	Basic Law (Grundgesetz)
GGO	Joint Rules of Procedure of the Federal Ministries (Gemeinsame Geschäftsordnung der Bundesministerien)
GO	Municipal Regulation (Gemeindeordnung)
GoBS	Principles of Proper Computerised Accounting Systems (Grundsätze ordnungsmäßiger speichergestützter Buchführungssysteme)
GV	Municipal Constitution (Gemeindeverfassung)
H	Hesse
HGB	German Commercial Code (Handelsgesetzbuch)
HGO	Hessische Gemeindeordnung
HGrG	Budgetary Principles Act (Haushaltsgrundsätzegesetz)
HSK	Budget Consolidation Concept (Haushaltssicherungskonzept)

## ACRONYMS

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KomHKV	Municipal Budget Regulation (Kommunalhaushalts und kas- senverordnung)
KomHVO	Municipal Budget Regulation (Kommunalhaushaltsverord- nung)
LHO	State Budget Regulations (Landeshaushaltsordnung)
MaRisk	Minimum Requirements for Risk Management (Mindestan- forderungen für Risikomanagement)
MoF	Ministry of Finance (Finanzministerium)
MV	Mecklenburg-Vorpommern
NDS	Lower Saxony
NHG	Lower Saxony Higher Education Act (Niedersächsisches Hochschulgesetz)
NRW	North Rhine-Westphalia
RLP	Rhineland-Palatinate
RPA	Municipal Audit Office (Rechnungsprüfungsamt)
SAL	Saarland
SH	Schleswig Holstein
SN	Saxony
SNL	Saxony-Anhalt
StWG	Stability Act (Stabilitäts und Wachstumsgesetz)
TH	Thuringia
VV	Administrative Regulation (Verwaltungsvorschrift)
WU	Economic Assessment (Wirtschaftlichkeitsuntersuchung)

### **Italy**

ANAC	National Anti-Corruption Authority (Autorità Nazionale Anti-Corruzione)
DEFR	Document of Regional Economy and Finance (Documento Economia e Finanzia Regionale)
DUP	Single Programming Document (Documento Unico di Programmazione)
IGRUE	General Inspectorate for Financial Dealings with the European Union (Ispettorato generale per i rapporti finanziari con l'Unione Europea)
INPS	National Social Security Institute (Istituto Nazionale della Previdenza Sociale)
NIV	Independent Assessment Organism (Nucleo Indipendente di Valutazione)

OIV	Independent Supervisory Body (Organismo Indipendente di Valutazione)
ORAC	Regional Body for Control Activities (Organismo Regionale per le Attività di Controllo)
PEG	Executive Management Plan (Piano Esecutivo di Gestione)
RPCT	Head of Corruption Prevention and Transparency (Responsabile della Prevenzione della Corruzione e della Trasparenza)
RSPP	Prevention and Protection Service Manager (Responsabile Servizio Prevenzione e Protezione)
SICOGE	Management Accounting System (Sistema di Contabilità Gestionale)
SIRGS	Information System of the State General Accounting Department (Sistema Informatico della Ragioneria Generale dello Stato)
TUEL	Consolidated Act on Local Governments (Testo Unico degli Enti Locali)