

E-Day: balloons are released at the Cinquantenaire arch in Brussels as part of the 1 May EU enlargement celebrations



Neophyte club

The European Union's 10 newest members had to submit to stringent financial control assessments before gaining entry. But have these countries continued their reforms now that they have passed the initiation test?

Neil Hodge investigates

Given the media's frequent mauling of the European Commission's accounting record and history of funding embarrassing projects such as the riding school in Spain that turned out to be a brothel, it's little wonder that some people are wary of the accounting capabilities of the EU's 10 newest members.

Bodies such as Transparency International, which campaigns for openness in democracy and business, have historically ranked some of these latest entrants high on the corruption index, so it's widely expected that funds will "go missing". Yet no scandal has emerged so far. In fact, some experts think that the newcomers could teach the older members a thing or two about effective financial management.

On 1 May the EU's ranks swelled to 25 when Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia were welcomed into the fold. With the exception of Cyprus and Malta, they have had only a decade's experience of actively managing their own economies and budgets – with mixed results. Cynics and supporters alike had serious doubts about the ability of these countries to manage their public funds soundly, and about whether they would continue with financial reform once the EC approved their entry.

The candidate countries had to meet the terms and commitments of 30 chapters laid down by the commission before they could join. Chapter 28 deals specifically with internal financial controls in the public sector and establishes the need for functionally independent internal auditing. The commission's main system for achieving this is its concept of public internal financial control (PIFC).

Because the financial management structures of the accession countries differed so much from those of the existing members, the commission created a framework under which the candidates could be helped to develop a modern style of management and audit. This included guidance on following the Institute of Internal Auditors' international standards. PIFC stipulates that candidate countries must develop adequate financial management and control systems. They should establish independent internal audit facilities in most – if not all – of the public spending authorities assessing the economy, efficiency and effectiveness of the mechanisms to be audited.

PIFC also makes it clear that the activities of the financial control function and of the internal auditor should be based on objective risk analysis techniques, and that the methods for financial control and internal audit systems should be based on internationally accepted and EU-compliant standards. Lastly, it provides for a central harmonisation unit that

is responsible both for the development of control and audit methods and for ensuring consistency throughout the public sector.

The introduction of PIFC in 1997 was the first time that the commission told candidate countries what financial management and audit procedures they needed to have in place before they could join. These measures are directed only at the control of funds coming from the EU and have no bearing on any other area of public spending. But hopes are high that the principles of financial control will be adopted by all government bodies.

"During previous accession negotiations there were never specific negotiation chapters on financial control. The general idea was that prospective member states already had well-developed control and audit structures," explains Robert Gielisse, head of the EC unit responsible for the control of resources and support given to candidate countries. "In many respects, the stance that the commission is now taking will probably result in a much more coherent approach to audit methods and financial management throughout the EU in the long run."

There are four main stages that an EU applicant must go through before it can satisfy the commission's PIFC requirements and gain entry, according to Gielisse. Stage one, known as conceptualisation, aims to ensure that the candidate is aware of the concepts of PIFC reporting. It has to write a policy to demonstrate how it would set about changing its internal control systems and establishing an internal audit function to comply with EC recommendations. The country's formal ratification of these changes in its own parliament secures a safe passage through stage two.

The third stage ensures that the candidate puts in place a central harmonisation unit designed to ensure that all government departments are using the same audit and financial control methods. The final stage is to ensure that sound governance is promoted.

Phil Tarling, risk and assurance services partner at risk consultancy Numerica, which advises candidate countries, believes that "the progress some of these new member states are making in terms of financial control and accountability leaves older EU members in the shade".

The PIFC initiative has encouraged other member states to review their financial management procedures, according to Tarling. "Unfortunately, the concepts of financial

management and internal control vary widely from one country to another," he says. "The UK's approach is fairly robust, although not perfect, but we have seen that general approaches to corporate governance across the EU can result in spectacular failings, such as at Ahold in the Netherlands and Parmalat in Italy. Some of the older members could learn a lot from the new entrants."

Tarling predicts that financial reforms will continue within the public sectors of the new member states. These countries are unlikely to stop trying to establish sound controls just because they are no longer scrutinised by the commission. But he stresses that there is "still a long way to go before civil service managers in these countries understand what good financial management is and what internal auditors can do to improve efficiency".

One of the main problems is that senior civil service managers believe that internal audit is a "budget-slashing operation that wields the axe on expensive projects", Tarling argues. "Such a mistaken attitude signals to public-sector workers that internal auditors recommend job cuts, which is hardly likely to mollify the fears of a workforce that once thought that a job was for life."

Nick Treen is senior adviser on audit and financial control at Sigma, a project funded by the Organisation for Economic Co-operation and Development and the EU to help candidate countries prepare for membership. He agrees that the improvements will continue, despite such misconceptions.

"As in all countries, public-sector resources are scarce and there are many competing priorities. I hope that financial control will remain a high priority – it definitely should do," he says. "The ministries of finance and the state audit bodies of new member states that I have worked with do understand what is required, and I see that development, changes and reforms are still taking place there."

Although the impetus to get best value for money in these countries is strong, Treen points out that the lack of management expertise in implementing good corporate governance and tight financial management could hamper their progress.

"There is a lack of professional accountants in the public sector and a lack of national accounting bodies covering public-sector issues," he says. "This is particularly worrying, since most of the countries have public-sector accrual accounting aspirations."

