

PIFC: An integrated approach

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Speech by

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INTRODUCTION

Ladies and Gentlemen,

Dear Colleagues,

On behalf of DG Budget I would first of all like to thank the Ministry of Finance of Croatia and SIGMA for the initiative to organise this regional conference on Public Internal Financial Control here in Zagreb. This conference provides for an important opportunity to bring together the Central Harmonisation Units from the candidate countries and potential candidates and discuss various aspects of PIFC.

During this conference we will discuss the experiences you have had in introducing and implementing PIFC. We will also have a chance to hear about the experiences of some of our EU Member States. We will also exchange views about the established good practices and discuss the various lessons learnt over the years. And of course, we should not forget that this conference provides for an excellent opportunity to network among your colleagues.

The topic of my today's presentation is **PIFC: an integrated approach**. The viewpoints I am presenting here are based on the European Commission's experience in coaching on PIFC during the past over 12 years.

The key points that I would like to bring across are the following (**Slide 1**):

- PIFC is a well-known formula: **PIFC = FMC + IA + CHU**, and it is a re-engineering tool to move from a traditional control environment to a modern internal control environment.
- But to consider PIFC only as a technical fix, a stand-alone reform under Chapter 32 accession negotiations, is a very limited view on PIFC. And unfortunately this is still a rather common misconception in some of the countries we are coaching.
- Rather, PIFC is an integral part of Public Finance Management and Public Administration Reforms. PIFC reform affects these parallel reforms but also depends on them. Fundamentally, PIFC reform aims to make an important contribution for improvement of good governance.
- Based on our experience, if PIFC reform is perceived only as a technical fix, it will remain an artificial 'ticking the box' exercise. The PIFC reform will not be sustainable unless certain key conditions are in place.

PIFC IS A RE-ENGINEERING TOOL (SLIDE 2)

PIFC is an integrated and operational model developed by the European Commission for over past 12 years for re-engineering internal control systems in

the public sector in line with international standards. It is an accession requirement.

PIFC only applies to national funds. However, by analogy the same principles of sound financial management apply also to the management of EU funds, although there are specific and more detailed rules for the management of EU funds.

PIFC is a model to move away from the traditional inspection-based control environment, where the focus is primarily on **detection of occurred errors** in the set of underlying transactions, to a modern internal control system, where the managerial focus is on **prevention of possible future errors, fraud and corruption** as well as **3 Es (value for money)**.

Let me first look at **a traditional internal control environment**:

In most traditional internal control systems, the responsibility for control is typically centralised to the Ministry of Finance and in a specialised Inspection Service. Only financial transactions are controlled, and the approach to controls is very mechanical.

The predominant administrative culture is about strict adherence to detailed legal regulations. The operational staff is not really concerned about control as such other than being subject to inspections. It is all about compliance with rules. Therefore nobody really pays attention if the underlying procedures are effective and efficient or whether important risks are even being addressed or whether objectives are actually met.

In such a system the centralised inspection services play an important role. They detect errors after the events, they look for the "guilty ones" to be punished. They impose sanctions. They act often like a police force.

It is therefore no wonder that in such an administrative culture managers perceive efficiency and effectiveness mainly in terms of compliance with the detailed regulations. Budget spending is perceived to be efficient, if it is at the foreseen budget level. It is considered inefficient, if it is not.

So what does **a modern internal control environment** look like?

In an administrative culture based on PIFC, efficiency and effectiveness are perceived differently: Managers focus primarily on the delivery of services, delivering outputs, rather than controlling budgetary inputs.

The control structures put in place under PIFC take into account the risks of the organisation and are primarily preventive by nature, aiming to tackle problems of fraud and corruption before they can even materialise. In such an administrative culture managerial accountability goes together with increased authority to make

decisions. This means, untying the hands of managers and encouraging innovation. Surely this means more motivation and dedication.

In practical terms, Financial Management and Control refer to those systems, structures and procedures that the top manager of an organisation has to put in place in order to guarantee sound financial management of public funds.

Obviously the top manager cannot do it all himself, so he delegates and mandates this task to a specific Finance Directorate of the organization as well as eventually to his key managers, civil servants, who in turn sub-delegate specific responsibilities to middle managers in their respective directorates and departments. All managers further down in the hierarchy are responsible for the specific tasks delegated to them, and they are accountable to their immediate superiors for performing their tasks in line with the objectives set. The top manager, who delegated the tasks in the first place, still however remains ultimately responsible for the overall achievement of objectives and setting up the FMC system in his organisation.

The development of FMC systems entails setting objectives for the organisation and identifying risks that may have a negative impact for attaining the objectives. It further entails establishment of proper business processes and control measures to address the identified risks. FMC is therefore an integral part of your management processes of planning, executing and monitoring. It is not something that is built on top – it is something that is built in.

Finally, a Central Harmonisation Unit plays the key role in the PIFC model:

Beside a strong emphasis on the managerial accountability principle, a CHU structure is the other key component in the European Commission's PIFC model. The European Commission foresaw early on that introduction and development of PIFC would not work out in a coordinated manner in the public sector, unless there was the key driver for change.

There was therefore a need for a body that would be full-time dedicated for introduction of a modern internal control system. A body that would motivate and educate line ministries, monitor progress and report directly to the Minister of Finance and eventually to the Government.

PIFC IS AN INTEGRAL PART OF PFM/PAR REFORMS (SLIDE 3)

Ladies and Gentlemen,

I am now coming to a key point mentioned at the beginning: PIFC reform is not a stand-alone, technical fix, but it is an integral part of parallel Public Finance Management reforms, which in turn are part of overall Public Administration Reforms.

We have become increasingly aware during the past years that the introduction of managerial accountability principle and moving to a new type of internal control environment both affects a number of other areas beyond PIFC and depends on parallel reforms.

One such area is **centralised budget inspection**: It is not part of PIFC, but it so fundamentally affects PIFC – either by potentially interfering with the managerial accountability principle or being potentially confused with internal audit – that it has to be reformed parallel. It is for this reason that nowadays during Chapter 32 accession negotiations DG Budget also monitors that necessary changes are introduced in the relevant legislation regulation centralised budget inspection.

At the same time, the ongoing civil service reforms may have an important impact on the PIFC reform. Namely, development of managerial accountability presupposes a **depoliticised civil service** and a culture of real delegation, where the top manager is not responsible for all decisions, but where effective delegation of decision-making powers to middle management is in place. Those responsible for PIFC reform should therefore closely coordinate and communicate with the architects of the Public Administration Reform: The Civil Service Laws will need to effectively regulate depoliticisation and delegation of responsibilities.

You CHUs play of course an important role in ensuring that PIFC is not marginalised into a technical and sectoral reform but that it is fully understood to be an integral part of an overall Public Administration Reform.

PIFC CONTRIBUTES TO GOOD GOVERNANCE (SLIDE 4)

Efforts in PIFC, PFM and PAR aim ultimately to improve good governance, which is increasingly in the spotlight nowadays. More and more, the public expects government to focus on tangible results, responsible spending, and accountability. Notwithstanding this high public expectation, public bodies are faced with fiscal constraints, hence systematic and disciplined internal control of public funds is not only urgent but fundamental.

What is good governance? It is probably best defined according to seven principles, recommended by the Committee on Standards in Public Life (the Nolan Committee) in the United Kingdom in 1997. These several principles of conduct should ideally underpin the work of public authorities in any country:

- Selflessness – Acting in the public interest
- Integrity – Being straight in using public money
- Objectivity – Choices are made on merit
- Accountability – Facing public scrutiny

- Openness – Giving reasons for decisions
- Honesty – Resolving conflicts of interest

One of the elements of good governance would also be that public organisations are operated at all time in a manner that takes account of risk, achieves objectives and acts in accordance with sound financial management. And this is exactly what PIFC is all about.

PIFC contributes to the operational framework for putting governance into practice. It sets out the responsibilities and the processes that have to be followed to achieve good governance. It represents the building blocks for good governance and for helping organisations to reach their objectives.

By creating a state-of-the-art internal control environment with checks and balances, PIFC is preventive in nature and thus helps reduce the occurrence of fraud and corruption. The benefits for all citizens and businesses are clear.

Effective internal control systems are essential to the success and well-being of government organisations. Not only as a safeguard of ensuring that the policies laid down by top management are properly implemented by the organisation. But more fundamentally, as a safeguard against waste, abuse, and fraud.

In addition, today's global financial crisis means that public resources are tighter than ever. Nonetheless, the public are expecting higher and better standards of public service. This increasing pressure on the funding available to meet these expectations has led to more and more emphasis on **value for money**: It is not enough that the outputs produced are legal, they have to meet also the requirements of economy, efficiency and effectiveness.

This is where the PIFC brings the added value:

- PIFC helps to prioritise, manage risk and make the right choices;
- PIFC helps to optimise service delivery;
- PIFC helps to manage funds according to the principles of sound financial management;
- PIFC helps to safeguard public funds against waste, abuse and fraud.

The Ministry of Finance will have a key role to play, not just through the promotion, development and harmonisation of guidelines, but also by setting a clear and good example.

PIFC – CONDITIONS FOR SUCCESS (SLIDE 5)

Based on our experience during over 12 years in coaching on PIFC, it has become evident that there are certain key conditions that will determine whether PIFC reform will be sustainable:

Ownership:

Among the most important conditions is the **firm political commitment from the outset**. There needs to be a widespread political agreement within the Government that change is necessary. There needs to be political willingness to engage in a reform process, which goes beyond a mandate of one Government. There needs to be acceptance that things can be done better.

The technicians can go hand in hand with the politicians, but they cannot take a lead or replace the political leadership.

There also needs to be a **commitment from the top public sector managers** and civil servants in general. The top leadership of the organisation needs to be committed to the effective management of the entity and demonstrate personal integrity and professionalism.

This also means an acceptance of the need to move away from a comprehensive programme of inspection, with its focus on 'ex post' checks for procedural compliance and focus on PIFC as a preventive system.

Ensuring change in administrative culture:

It is also important to ensure a real change in the administrative culture towards decentralised managerial accountability. What this means is that PIFC is not just about changing laws and mechanically following the new rules. If there is no real delegation of responsibilities from political appointees and top managers to civil servants and middle managers, there has not been any real PIFC reform. What is needed is a real delegation.

An adequately resourced and skilled CHU:

As I said already earlier, a CHU has been an important invention in the PIFC model. The European Commission foresaw early on that introduction and development of PIFC would not work out in a coordinated manner in the public sector, unless there was the key driver for change.

But the CHU of course needs to have sufficiently resources and technical skills to drive the change process.

An integrated approach:

I discussed this already and I would like to stress it again: **PIFC needs to be better integrated with the ongoing Public Administration and Public Finance Management Reforms.** PIFC is not a stand-alone, technical fix, but part of these reforms.

In fact, we may go even as far as to state that other PFM reforms should take PIFC and development of managerial accountability as their starting point, in order for those reforms to bring full benefits.

CLOSING WORDS

Ladies and Gentlemen,

I hope that I have been able to convey to you the key message about PIFC as an integrated approach as well as provide for a general framework for our further discussions during this conference.

I wish all the success for this conference and look forward to fruitful exchange of opinions.

Thank you for your attention.