

EUROSAI-OLACEFS VII CONFERENCE

17 – 19 SEPTEMBER 2012

TBILISI

GEORGIA

SUB-THEME 2:

Public Finances Management Reform:

Trends and Lessons Learned

COUNTRY PAPER

ROMANIA

THE COURT OF ACCOUNTS

August 2012

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1. EXECUTIVE SUMMARY

In 1989, Romania launched a long chain of transformations, triggered by the transition from the centralised economy, specific to communist states, to the capitalist type economy, characteristic of democratic states. These transformations were reflected at the level of all state institutions and operation mechanisms, including public finances management.

Romania's accession to the European Union in 2007 involved a wide process to harmonise national legislation with Community acquis. In this context, public finances administration legislation and rules were modified and improved to fully comply with EU policies and principles on public finances. As a matter of fact, Romanian public finances may currently be considered an integral part of EU public finances.

Romanian *public finances* consist in the funds established by mandatory payments and are spend in a budgetary year, which in Romania is a calendar year, through the following funds: - the state budget; - local budgets; the state social insurances budget; - special funds budgets (unemployment and health); - the state treasury budget; - the self-managed public institutions budgets; - the budgets of public institutions financed integrally or partially, as applicable, from the state budget, the state social insurances budget and the special funds budgets; - the budgets of public institutions integrally financed from own income; - the budget of funds coming from external credits contracted or guaranteed by the state and the reimbursement, interest and other costs of which are ensured from public funds; - the budget of external grants.

The external auditor of Romania is the Court of Accounts, established in keeping with the Constitution to conduct public finances management audit. Despite what its name would imply, the Court of Accounts has no jurisdictional competences.

In the capacity as an external auditor of Romania, the Court of Accounts contribute to the enhancement of the way the state and public sector financial resources are established, administered and used and provide the Parliament and deliberative bodies of the administrative and territorial units annual reports which include:

- the observations of the Court of Accounts on the execution accounts of the budgets subjected to its control;
- the conclusions resulting from the controls ordered by the Chamber of Deputies or by the Senate or conducted at the level of self-managed regies, commercial companies with state integrally or majority owned capital and at other legal entities subjected to the control of the Court of Accounts;
- the law infringements found and the measures taken;
- other issues which the Court of Accounts deems necessary.

2. COMPETENCE AND DUTIES OF THE COURT OF ACCOUNTS IN THE PUBLIC FINANCES MANAGEMENT PROCESS

The competence of the Court of Accounts involves conduct by the latter of the control function over the establishment, administration and use of state and public sector financial resources, submitting to the Parliament and respectively to administrative and territorial units, reports on their use and administration, in keeping with the legality, regularity, economy, efficiency and effectiveness principles.

The duties of the Court of Accounts involve the conduct of:

- ❶ financial audit;
- ❷ performance audit;
- ❸ control;
- ❹ endorsement of normative regulations in the field of public finances, public accounting and of the ones specifically provided by law.

In the capacity as an external auditor, the Court of Accounts verifies whether public funds are correctly accounted for and spent in keeping with the applicable regulations, as well as whether due consideration is given to obtain value for money.

2.1. PUBLIC FINANCES MANAGEMENT

Public finances management is the art to administer public finances in keeping with the principles of legality, regularity, economy, efficiency and effectiveness. Decision-making in the process of public finances administration involves accessing a bulk of information available in an environment requiring correlation of a large volume of data to be found in scattered places. This can only be achieved through a

computerized information system, made of a set of tools consisting in procedures to forecast income and expenditure; to draft and execute budgets; to conduct financial accounting and reporting; to administer budget revenues, projects, programmes, processes or activities.

External audit ensures that public finances administration is in keeping with national legislation; this audit shall be conducted by an auditor independent from the auditee. The latter shall grant top decision-makers (the Parliament and the Government) and citizens assurance on the quality of reports on taxpayers' money and on the way the means and liabilities under public control have been administered.

The Committee for Public Finances Management Reform was set up in 2005, in order for Romania to comply with the requirements on public finances management ruled by the European Union for it to become a member as of 2007; the Committee was mandated to design and supervise the implementation of a Strategic Development Plan for Public Finances Management Reform, for the period 2005-2007.

This Strategic Development Plan covered the following domains:

- **programme budgeting** which included:
 - ***budget planning*** three years ahead;
 - ***budget drafting*** based on: tax and budget policy objectives; framework-letter and pressures on budget income and expenditure of the year for which the budget draft has been established;
 - ***budget execution*** for Romanian funds - in keeping with national law, while for reimbursable and non reimbursable external funds - in keeping with the clauses agreed with creditors and donors;
 - ***monitoring*** programmes so as to allow programme managers to be permanently aware of the status of programmes and of individual projects.

- **accrual accounting and financial reporting** involved:
 - *new accounting regulations* based on the accrual accounting principle, applicable to all central and local public administration institutions;
 - *financial statements* established in keeping with the accrual accounting principle;
- **cash flow management** involved establishing organisational structures in charge of administering the state treasury general current account;
- **internal audit** was organised based on the deconcentration principle, respectively institutions which have a high level of expenditure shall have own internal audit functions, while smaller institutions shall be covered by the internal audit function of the institution under which they work. The activity of these functions shall unfold according to the audit plan;
- **financial management and control systems** involved the implementation of an *Internal Control Code, comprising standards on management/internal control at the level of public entities and to develop managerial control systems*;
- **the cooperation between external audit and internal audit** supposed the strengthening of the legal framework to ensure complementarity and improvement of audit activities' effectiveness between:
 - *the external audit* conducted by the Court of Accounts;
 - *the internal audit* conducted by specialized functions set up in public institutions.

The final objective of the Strategic Development Plan was to make it possible for public services in Romania, on accession to the European Union in 2007, to ensure operative management not only of national financial resources, but also of the ones financed from the European Union or from other sources.

Institutions involved in the implementation of public finances management

In keeping with the Law on public finances of Romania, *the Parliament* adopts annual budgetary laws and the budget review acts, drafted by the Government in the context of the macroeconomic strategy assumed by the latter. *The Government* ensures implementation of the tax-budget policy, which considers the economic perspectives and the political priorities included in the Governing Program endorsed by the Parliament. The main tasks of the Government to implement the tax-budget policy are as follows:

- establishing the report on the macroeconomic situation for the respective budget year and the latter's projection along the following three years;
- establishing annual budget laws and budget review acts and submitting them for approval to the Parliament;
- *unfolding the general management of the executive activity in the domain of public finances*; to do so, they periodically examine budget execution and set measures to maintain or enhance budget balance, as applicable;
- submitting law drafts on the general annual execution account to the Parliament for adoption.

The Government, through the Ministry of Public Finances, monitor budget execution, being directly accountable for the maintenance or enhancement of budget balance.

The Ministry of Public Finances analyse budget proposals during the budgets drafting stages, ensure monitoring of budget execution and, when deviations are found relating to income and expenditure at the authorized levels, they submit proposals for corrective measures to the Government. Furthermore, the Ministry of Public Finances

may block or limit the use of budget credits which are found lacking legal grounds or justification in the budgets of authorizing officers.

The Ministry of Public Finances set assessment and selection criteria on public investment objectives, based on methodological norms and coordinate monitoring of the overall investment programme.

The *National Agency for Tax Administration*, the main objectives of which are implementation of the tax policy and collection of the state tax income, operate under the Ministry of Public Finances.

The Ministry of Public Finances establish the general annual execution account of the state budget, of the state social insurance budget and the public debt general annual account.

The Government analyse and submit for adoption to the Parliament the general annual execution account of the state budget, of the state social insurance budget and the other annual execution accounts by the 1st of July of the year subsequent to the execution one. These accounts are approved by law *after they have been examined by the Court of Accounts*.

As to the way *public funds are administered at local level*, the entities with a role in the management of public finances are represented by *the local public administration authorities*.

The main competences and responsibilities of local public administration authorities are as follows:

- drafting and approving local budgets, within budgetary equilibrium conditions, as well as following up and reporting on local budgets execution during the budget year, in budgetary equilibrium conditions;

- establishing, ascertaining, controlling, following up and collecting local taxes and charges and setting options and priorities in the process to approve and unfold local public expenditure.

The execution of public budget cash accounts (collection of budget revenues and disbursement of amounts ordered by authorized officers of public institutions within the ceiling of budgetary credits and of the destinations approved in keeping law) is conducted through the *state treasury*, based on the methodological norms issued by the Ministry of Public Finances.

2.2. PUBLIC FINANCES MANAGEMENT REFORM

At the beginning of 2007, most of the measures included in the Strategic Development Plan were implemented in the field of public finances.

Public finances management involved, subsequent to this date, continuing the reform process, correlated with:

- ⇒ the provisions of the new financial instruments used by EU member states, respectively: The National Strategic Framework for Reform 2007-2013, the National Development Plan for 2007-2013, the Convergence Plan;
- ⇒ the implementation of the requirements relating to EU member states' budgetary frameworks;
- ⇒ the observance of the conditions agreed with the International Monetary Fund and with other international creditors;
- ⇒ launching the implementation of the International Financial Reporting Standards (IFRS) by the banking system;

- ⇒ supplying the information requested by the European Institute for Statistics - EUROSTAT- and by the International Monetary Fund;
- ⇒ the need to complete the categories of entities included in the definition of public interest legal entities, entities the annual financial statements of which are subject to statutory audit.

A series of rules had to be adopted in this respect:

- 👍 **taxation** ones, to be found in the Law on fiscal-budgetary accountability, which provides that the public policies of the Government Programme need to be transposed in the medium term Fiscal-budgetary Strategy and in the income and expenditure budgets for the same term;
- 👍 **accounting** ones, which have completed the Accounting Law.

In the context of the completion of the first stage of the technical assistance on the Functional/Operational Analysis of public administration in Romania, assumed by the Romanian Government within the Memorandum of Agreement between the European Commission and Romania, at the end of 2010 the Government approved a memorandum including action plans with concrete measures to enhance the quality of public administration in Romania, including improvement of public finances management.

The project provided in the Memorandum of Agreement on June 23rd, 2009 involved that, based on these action plans, the Government of Romania would draft and adopt a *plan of reforms*, as a conditionality to unblock the loan tranches from the European Commission.

The main objectives provided in the action plan for the Ministry of Public Finances are as follows:

| Reform area | Objectives |
|---|---|
| I. Enhancing budget credibility and tax-budgetary discipline | <i>1. Institutionalising prudent assessment of budgetary income</i> |
| | <i>2. Institutionalising top-down budgeting (strategic prioritisation)</i> |
| | <i>3. Verifying and monitoring the budgetary impact of the new normative regulations</i> |
| II. Strengthening expenses prioritisation in relation to public policies | <i>1. Synchronising the budgetary calendar</i> - integrating strategic planning processes with budgetary process |
| | <i>2. Focussing discussions on budget on policies and efficiency</i> |
| | <i>3. Enhancing the budgetary analysis capacity within the framework of the budget function</i> |
| III. Further modernising the treasury and budgetary execution roles | <i>1. Further fluidisation of bank trading services</i> |
| | <i>2. Enhancing the financial reporting capacity</i> |
| | <i>3. Reorganising the budgetary execution functions</i> |
| | <i>4. Further developing public debt management and liquidities administration</i> |
| IV. Accelerating EU funds absorption | <i>1. Enhancing the financing capacity</i> |
| | <i>2. Enhancing the administrative capacity</i> |
| V. Modernising income administration | <i>1. Consolidating the voluntary compliance policy</i> |
| | <i>2 Minimising the administration costs of ANAF</i> |
| | <i>3. Reducing administrative (compliance) costs of tax payers</i> |
| VI. Organisational reform | <i>1. Strengthening the top level of the management structure</i> |
| VII. Updating IT | <i>1. Strengthening IT governance</i> |
| | <i>2. Developing an integrated financial management IT system</i> |
| VIII. HR strategic management | <i>1. Enhancing HR strategic management</i> |
| | <i>2. Strengthening institutional communication</i> |

Mention shall be made that concrete actions, institutions and persons in charge as well as deadlines were defined for the above mentioned objectives to implement the reform plans established by the Government and by the European Commission.

3. TRENDS AND LESSONS LEARNED

➤ The Court of Accounts was, until 2003, the supreme financial control and jurisdiction authority in the field of finances. The constitutional modifications of October of that year, the consideration given to the Lima Declaration, to the INTOSAI recommendations in the field and to the requirements of the EU in the field of external audit prompted the reformation of the Court of Accounts' organisation and operation, so that the priority activity became external public audit (financial audit and performance audit).

Financial audit and performance audit, either conducted individually, or as an overall audit jointly with compliance audit, make it possible for external public auditors to establish recommendations on measures to be taken in order to rule out errors/deviations from legality and regularity and to alter the legislative framework, as well as recommendations resulting in the minimisation of costs, enhancement of efficiency in resources use and fulfilment of the set objectives.

➤ The Court of Accounts conduct the competences and duties to assess the internal control and audit activity of the examined entities, to establish the confidence level which may be placed on the internal control system upon setting the audit procedures to be used during the overall verification actions. In this context, both internal audit functions and the Court of Accounts may reciprocally consider their activities, thus

ensuring the complementarity and the efficiency enhancement of the two structures' audit activity.

➤ The existence of reliable and complete public accounting practices for all public administration subsectors is a prerequisite to establish quality statistics, consistent with those of EU member states. Independent external audit conducted by Supreme audit Institutions (the Court of Accounts, in the instance of Romania) should encourage the best practices at international level.

➤ The Court of Accounts take part, based on the competences and duties established by law, in the verification of data and information listed in statistical reports.

➤ The economic and budgetary policy of the latest years, characterized by excessive public expenses, especially payroll and pensions, generated tax imbalances, increasing the budgetary deficit which reached levels much beyond the one set by the Treaty of Maastricht, which involves that in order to strengthen tax discipline, a law on tax-budgetary accountability should be adopted, connected with public sector salaries reform and pensions reform.

➤ The Court of Accounts, in the unfold of the activities within their competences and duties, verify whether the payroll policies and agreements are in compliance with: the principles of tax accountability; tax regulations; the objectives and ceilings of the tax-budgetary strategy. Furthermore, they verify whether the general consolidated budget expenditure, less the financial assistance from the EU and other donors, were supplemented on budget adjustments only for the payment of public debt service and for the payment of Romania's contribution to the budget of the European Union.

➤ In the capacity as beneficiaries of the loans contracted with the International Monetary Fund and with the World Bank, debtor states are included in the Program to assess Public Expenditure and Financial Accountability: "PEFA", which is targeted at strengthening the debtor's and the creditor's capacity to assess the situation of the

following systems: public expenditure, public procurement, financial accountability, as well as to develop actions to reform and build the institutional capacity which would allow for public finances management performance monitoring.

➤ The competence and duties of the Court of Accounts allow them to unfold, under the law, external audit (financial audit, performance audit and compliance audit) of the annual execution accounts of budgets the results of which are recorded in an annual public report, which ground the debate in the Parliament of the laws on annual execution accounts of the budgets making up the national budget. This report is posted on the website of the Court of Accounts, so as to ensure transparency. The Court of Accounts are also directly involved in the follow up of the implementation of the other indicators within the framework of public finances management performance indicators.

4. RESULTS

The Court of Accounts are part of the public authorities and institutions group which insure the reform of the public finances management through the competence and duties awarded by the Constitution of Romania and by the organisation and operation law, as follows:

- **acting** in keeping with the organisation and operation law, the Court of Accounts **find errors/deviations** from legality and regularity, **deeds** relating to which there are indications that they were perpetrated by infringing criminal law, **instances** of failure to observe the principles of economy, efficiency and effectiveness in the use of public funds and in the diminishment of public and private patrimony of the state and of the administrative- territorial units, **recommend the measures** to

be taken in order to rule out the deficiencies found upon unfold of verifications **and make proposals for the law framework improvement;**

- **through publishing the annual public report**, which includes the *observations, conclusions and violations of the law* resulting from the examinations made, *direct access* of all persons interested in the activity of the Court of Accounts (the Parliament, the Government, the verified entities, mass-media, taxpayers, the academic environment etc.) is *ensured* as well as *the dissemination of the results* of verifications, which make people aware of the consequences of possible errors/deviations in their activity.

The Court of Accounts is the public authority set up to conduct the finances of Romania. In the capacity as an external auditor of Romania, they contribute to the enhancement of financial management and play the role of an independent guardian of the financial interests of the citizens of Romania.

5. RECOMMENDATIONS/SUGGESTIONS

- swift mobility in the organisation and conduct of the actions to verify the new objectives set by the Government to improve Public Finances Management;
- focussing external public auditors' professional training on Public Finances Management specific subject matters;
- involving in such actions, trainee auditors along with external public auditors with acknowledged professional experience and judgment;
- making concrete, well grounded recommendations, with explicit references to legal provisions needing correction on deficiencies found;

- strictly following up the implementation of measures ordered to correct the deficiencies found and to restore legality;
- disseminating good practices identified by all external public auditors in the verification process.