

Standard Summary Project Fiche

Project Number LI 9906.02

1. Title

Internal Financial Control

2. Geographical Location

The Ministry of Finance, J. Tumo-Vaizganto 8a/2, Vilnius
Director V. Uziela, Treasury Department, Tel. +370 2 390060

3. Objectives

The wider objective of this **0.75 MEUR Project** is to develop internal financial control mechanisms in line with the medium-term objectives of the Accession Partnership and the NPAA.

Its immediate objectives are to:

- Support the Government's strategy for implementation of a financial control system throughout the public sector in compliance with EC standards and best practice before the end of year 2000;
- Develop and implement an audit methodology for the public sector of Lithuania and transfer the necessary audit skills to the internal audit units;
- Contribute to the Government's budget reform and to modernise financial management.

4. Institutional Framework

The principal recipient of this assistance and the host institution will be the Ministry of Finance. The direct beneficiary will be central management at the Ministry of Finance and staff in the Treasury and Budget Departments.

The Statutes of the Treasury Department are established by Order of the Minister of Finance (dated: 05.02.1999). The Audit Division under the Treasury Department is empowered to:

- Audit budget expenditures in public institutions including the National Fund,
- Review the internal control organisation and efficiency and make proposals for improvements,
- Make proposals for the organisation of Internal Audit Divisions in these institutions.

The Audit Division has the authority to make consultations with staff of Public Sector Internal Control Divisions and takes the lead in the organisation of Internal Control Divisions dealing with methodological issues. Budget, accounting and financial management staff, as well as senior policy personnel throughout the Government, will benefit from this assistance through leadership and direction provided throughout the Lithuanian Government by the experts and senior Ministry of Finance personnel.

5. Description

This **0.75 MEUR Project** consists of a **Twinning and Training Package to Strengthen Internal Financial Control**.

The allocation of time in-puts to the various advisers is purely indicative and is subject to review by Member States in preparation of their twinning offers.

5.1. Background

The Government of Lithuania has, since 1991, modernised several of the specialised technical areas under the Ministry of Finance's responsibility, and is in the process of modernising others. In many of these areas improved and automated information and control systems are already in place; others

are needed and will be introduced. The Government of Lithuania is intensively carrying out a major reform of its overall budgeting process, which is based on the Programme and Performance Budget methodology and develops the function of Financial Controls throughout Lithuania's public sector.

Improvements have been achieved particularly in treasury functions, with the implementation of the automated financial system, the Government Budgeting, Accounting and Payment System (the GBAP NAVISION system). The automated system had, by the end of 1998, been implemented Government-wide in Lithuania (in more than 500 Government organisations, including most of the principal ministries).

In the debt management area the Government has chosen to implement the United Nations debt management system, DMFAS, in the Ministry of Finance and the Bank of Lithuania (supported by the UNCTAD organisation), and to integrate this debt management system with GBAP NAVISION system. The DMFAS system should be fully implemented before the end of 1999, but additional training in debt management will be needed before and after full system implementation.

These actions coincide with the establishment by the Government of a Budget Commission to make recommendations on the structure of a new budget law. The Commission has proposed a strategy for budget reform based on the Programme and Performance Budgeting methodology.

IMF and SIGMA assistance is anticipated to provide support in relation to preparation of the implementation of the "Guidelines for conducting the internal audit of budgetary institutions". IMF and SIGMA assistance is expected from the middle of 1999, thus creating a bridge to the twinning arrangement. Further assistance may be requested from Phare under the 2000 Programme to ensure full implementation of the Government's strategy for financial controls in all budgetary institutions.

5.2. Strategy for Improvement of Financial Control

The GBAP NAVISION system provides automated tools for better financial procedures and control. To ensure that the expanded and integrated benefits of the new and improved system are integrated into the Ministry's institutions, financial procedures and control are being strengthened. Essential in this process is the establishment of a Government wide Internal Audit function, which would include establishing appropriate procedures and carrying out necessary training. The legal framework for establishing internal audit units is the "Programme for the establishment of Internal Control in the public sector" adopted by Government Resolution No 179 of 13 February 1998. In addition to this "Guidelines for conducting the internal audit of budgetary institutions" have been prepared with assistance from the IMF.

Technical assistance needed to establish and implement the internal audit function in accordance with the new law has been identified and the recommendations from the project have been incorporated in the present project description. (See DFC's report "Developing the function of internal audit in the state sector of Lithuania" dated August 10th 1998 prepared with Phare funding.)

The Government's resolution on financial control strategy states that an Internal Controls Division has to be established in all Ministries, Heads of Administration of regional districts, departments of the Government and Ministries, State Tax Inspection and any Public Sector Enterprise or Institution which has more than 500 employees. The proposed implementation and integration of the GBAP NAVISION system, the DMFAS system, and the Budget Reform system will provide the Government of Lithuania with a strong financial system. The indicative timetable for the establishment of these units is:

In 1999 Reorganisation of existing structures in Ministries and other public sector institutions, which already have Internal Control Divisions, and

In 2000 in remaining ministries, departments of Government and ministries, Heads of Administration of regional districts and any Public Sector Enterprise or Institution with more than

500 employees.

Other important elements of the Government's strategy for improvement of financial control are:

Legal framework

- Amendments and supplements to the Law on State Control
- Government Resolution on "Approval of standard (sample) provisions and work regulation of an authority of internal control of the public sector"
- Preparation of methodology requirement for evaluation of internal control of the public sector

Organisational framework

- Review of the status of internal control of the public sector and preparation of proposal on implementation of the internal audit system in budget organisations
- Draft standards of internal control in the public sector
- Preparation of a manual on internal control
- Training of staff of the internal audit structure

The State Control, the Ministry of Public Administration Reforms and Local Administration, the Ministry of Finance and the Audit and Accounting Institute of Lithuania are the Institutions responsible for the implementation of the strategy. However, there is a need for strengthening the integrated use and analysis of financial information to improve the Government's planning and management efforts. This is the core purpose of this Project.

5.3. Relation to other Projects

This proposed Project would build on the improvement activities in the Treasury Department and the computer information assistance provided by the Government of Denmark to update and computerise Lithuania's Treasury System. The Danish assistance should be completed by the middle of 1999. The Project will also follow on from and build upon the achievements coming from the twinning arrangement with the Danish Ministry of Finance. This twinning, which is financed under the 1998 Phare National Programme, covers areas within Budget Automation and has links to the above mentioned Treasury System.

The proposed Project will also co-ordinate with the assistance being provided by USAID to the Ministry of Finance in the area of Budget Policy and Management Reform. The strategic objective of USAID's assistance was focused on introducing programme and performance methodology; this objective was accomplished during the 1999 budgetary process.

This Twinning Project has to be closely co-ordinated with the component "Sound Financial Management" component of the Phare 1998 SPP for Structural Funds twinning, which is anticipated to start in September 1999.

In addition, due to the fact that the Treasury Department of the Ministry of Finance will use IMF and SIGMA assistance as a bridge from now to the start of this Twinning, it should be ensured that this Project's inputs be in line with the outputs and achievements of these donors.

5.4. Project Activities

The system of Financial Control is normally defined to encompass three areas:

- i) Internal control, which is closely related to and incorporated in the procedures for daily operations. In the Glossary of the European Court of Auditors, the definition of an internal control system is:

An internal control system comprises the control environment and the control procedures. It includes all policies and procedures adopted by an entity to ensure:

- the economical, effective and efficient achievement of the entity's objectives;
- the adherence to external rules (laws, regulations,...) and to management policies;

- the safeguarding of assets and information;
 - the prevention of the detection of fraud and errors;
 - the quality of accounting records and timely production of reliable financial and management information.
- ii) Internal audit, which is an independent function of the programme/project management and the actual implementation (including payment) of the programme or project,
- iii) External audit carried out by the State Controller function. The State Controller function should partly build its work on the results of the work of the internal audit units.

The proposed Twinning arrangement will provide assistance in the areas of internal control and internal audit. This Twinning should include the following activities:

- | | |
|--|---|
| • General assistance | • Implementation of internal audit planning based on audit objectives |
| • Performance measurement | • Transfer of skills by joint auditing |
| • Internal control | • Training activities |
| • Development of a top-down approach to internal audit | |

These activities are explained in more detail in the following sub-sections.

5.4.1. General Assistance

The team of advisers, in particular the Pre-Accession Adviser (PAA), should provide assistance to the Ministry of Finance in general and to the Treasury and Budget Departments in particular regarding financial control policy issues, the organisation of financial control units and the structure of control procedures and manuals. The team of advisers is also expected to advise at management level of the Ministry of Finance regarding general management issues and issues related to EC integration in the field of financial control.

5.4.2. Performance Measurement

The reform of the budgeting process is based on the Programme and Performance Budget methodology. An important element of this approach is the use of financial and performance data in the assessment of the quality of the financial management at all levels of the budget institutions. In order to make a proper assessment of the financial management and to improve the planning and management efforts the advisers should assist in strengthening the integrated use and analysis of financial information. This can be achieved through introduction of a system of Performance Measurement.

In the areas of Performance Measurement and Budget Evaluation the advisers are expected to:

- Analyse the requirements for timely and reliable budget related financial performance data for programme decision making, monitoring and evaluation at all organisational levels including line Ministries, Ministry of Finance, Chancellor's Office and Parliament.
- Prepare policy and procedures (both managerial & administrative) for evaluation of budget proposals in the Government and Parliament before passing the Finance Act. The evaluation must include advice on the use of performance measurements, macro-economic data etc.
- Prepare policy and procedures (both managerial & administrative) for periodical budget evaluation during the fiscal year at all organisational levels. The evaluation must include advice on the use of performance measurements, macro-economic data etc.
- Advise the Ministry of Finance on which information technology to use for budget evaluation purposes, with a view to using the existing information systems in the Government sector such as the Budget and Performance Measurement system and the Treasury system.
- Assist in the implementation of an evaluation policy/procedure (again both managerial & administrative), including training of staff in the Ministry of Finance and selected pilot institutions at different organisational levels.

5.4.3. Internal Control

Although internal control systems are in place in many areas under the Ministry of Finance's responsibility there is a need to:

- Update the organisational set-up and the control procedures,
- Take full advantage of the computerised budget and information system and
- Implement internal control systems **with similar standards and procedures** in all spending units throughout the Government.

Furthermore, financial control procedures have to be in compliance with EC requirements (and the definition by the European Court of Auditors as mentioned above) and standards in order for the Ministry of Finance to fulfil its obligations as administrator of EC funding, e.g. through the National Fund. In this area the twinning advisers, in close co-operation with the Ministry, should specifically:

- Review the existing control organisation and procedures in the Ministry of Finance;
- **Study and analyse the aspects of present functional/professional independence of the internal auditor in implementing agencies as well as the systems of appeal in case of conflict of professional interests;**
- Assist the Ministry of Finance in developing/review a policy for financial control in the public sector and general financial control procedures in line with EC requirements and in accordance with the Government's strategy on internal control;
- Advise, in addition to the activities specified in section 5.4.2. *Performance Measurement*, on how to design appropriate management **and financial** control systems **including proper functional/professional independence of internal auditors**; and
- Identify needs for additional financial and programme performance information on different levels of management and different levels of Government, as well as ways of presenting the data.

5.4.4. Development of a Top-Down Internal Audit Approach

The guidelines for conducting the internal audit of budgetary institutions establish manual systems audit procedures. This "bottom up" approach can, in close co-operation with the State Controller function, be further developed with the use of mathematical samples. In addition, especially with regard to the new systems like the General Budgeting and Payment System, there is a need for developing a modern "top-down" audit approach. The Twinning advisers should assist in developing such a methodology to achieve:

- Operational audit (efficiency)
- Compliance audit (accordance with laws and regulations)
- Financial audit (audit of the financial statements as far as they are available).

5.4.5. Implementation of Internal Audit Planning based on Audit Objectives

The availability of audit objectives creates the possibility to implement audit planning. This means that at each level (state, ministries, budgetary institutions) for each type of audit (financial, operational and compliance) the focus and the deliverable of the respective audit activities (in general) have to be defined. The Twinning Advisers should assist in the setting of the objectives and the preparation, in conjunction with the availability of staff, an audit planning programme and mechanisms to monitor the audit process.

5.4.6. Transfer of Skills by Joint Auditing

The Twinning Advisers should also provide systematic transfer of skills by auditing the new systems with the use of a modern approach and methodology. In addition to the planned training activities, the advisers should transfer audit skills through on-the-job training. It is envisaged that this will be accomplished by forming joint audit teams staffed by short-term advisers and internal audit staff. If appropriate, the short-term advisers could be provided by external audit firms.

5.4.7. Training Activities

Staffing of the internal audit units and training of the staff will be critical for the success of the implementation of the new structure. The Twinning Advisers should help in the development of a general long-term training programme and specialised short-term courses. Co-operation has to be established with external suppliers, e.g. universities, business schools and the Institute of Auditors and Accountants, and with the Training Centre at the Ministry of Finance. Assistance from the twinning partner will include:

- Development of the curriculum for a comprehensive training programme for internal auditors;
- Preparation of training programmes in internal financial control procedures for control officials in ministries and other relevant spending units and implementation of a training of trainers programme;
- Training relevant staff in using the automated budget system in the budget analysis and planning process;
- Training relevant staff in using the information in the planning and management functions;
- Training relevant staff in using the Performance Measurement system.

5.5. Inputs and Profile of the Experts

This Twinning assignment should comprise a team from an EU Member State(s), with sound, working knowledge of EC regulations and enforcement regarding financial control. The PAA (12 calendar months) should have broad work experience of financial control in a Member State, experience in project management and excellent inter-personal skills. Other members of the team (approximately 25 person-months) should be short-term advisers with in-depth experience in relevant areas, such as: internal control, internal audit, and management control systems.

The team members should all be fluent in English and should be capable of providing various sorts of training activities, e.g. work shops, classroom training, on-the-job training, as well as personal advice at a high level of the Ministry of Finance and other institutions involved. A chart showing the estimated inputs from the team is reproduced below.

Activity with indicative inputs	PAA	STAs	Total Days
5.4.1. General Advice & Project Management	56	-	56
5.4.2. Performance Measurement (STA-A)	30	80	112
5.4.3. Internal Control (STA-B)	50	70	120
5.4.4. Internal Audit (STA-C)	25	160	185
5.4.5. Audit Planning (STA-D)	25	50	75
5.4.6. Joint Auditing (STA-E)	-	70	70
5.4.7. Training (STA-F)	45	120	165
Total (person-day inputs)	231	550	781

5.6. Expected Outputs

The expected output and guaranteed results should be:

- General management advice regarding financial control;
- Policy for performance measurement prepared;
- Techniques and tools for performance measurement developed;
- Financial control procedures developed;
- Training of trainers programme in internal control implemented;
- Review carried out of the organisation of existing control and audit units;
- Annual audit plan for year 2001;
- Audit manual for the Government sector;
- **Report on the present status of functional/professional independence of internal auditors/controllers, perceived weaknesses and suggested solutions for relevant legislation and organisation;**
- Transfer of modern audit techniques and tools;
- Description of a comprehensive training programme for internal auditors, including involvement of external training institutions;
- Training activities, work shops, traineeships etc. for internal auditors;
- Manual for trainers in internal audit and a training of trainers programme developed and implemented;
- Textbooks for employees of internal audit units;
- Additional software for a database for performance measurement.

6. Budget (in million EUR)

Sub-Project	Investment	Institution Building	Total Phare (= I + IB)	Recipient	IFI	TOTAL
Twinning and Training Package to Strengthen Internal Financial Control		0.75	0.75			0.75
TOTAL		0.75	0.75			0.75

7. Implementation Arrangements

The CFCU is the Implementing Agency responsible for tendering, contracting and accounting. Responsibility for technical preparation and control will remain with the beneficiary, the Ministry of Finance.

It is planned to conclude one contract: a twinning agreement.

8. Implementation Schedule

Start of twinning arrangements 2Q/00

Completion 2Q/01

9. Equal opportunity

The institutions involved in the project execution will observe equal opportunity of men and women in its recruitment and human resources development. The beneficiaries will ensure equal access of men and women to the project activities and results.

10. Environment

N/A

11. Rates of Return

N/A

12. Investment Criteria

N/A

13. Conditionality and Sequencing

A draft law on Internal Audit was submitted to the Government in early 1999 and was recently returned to the Ministry of Finance for amendments. The revised law should be resubmitted in June.

The successful implementation of the twinning envisaged in this project is dependent upon the law being adopted by Seimas. It is also dependent upon the success of the current twinning assistance which has been designed to prepare the groundwork for the activities detailed in this fiche.

The beneficiary institutions will be fully committed to ensure and maintain the benefits of personnel training/skills development.

The beneficiary, the Ministry of Finance, will provide the team of experts with necessary facilities and counter-part support for implementing the Project.

Logframe Matrix

Annex 1

Internal Financial Control	Project Number: LI 9906.02	Date of Drafting: 04/99	
	Contracting Period Expires: 31/10/2001	Disbursement Period Expires: 31/10/2002	
	Total Budget: 0.75 MEUR	Phare Contribution: 0.75 MEUR	
Wider Objectives	Indicators of Achievement	Sources of Information	Assumptions and Risks
Develop financial control mechanisms in line with the medium term objectives of the EU Accession Partnership	<ul style="list-style-type: none"> EC standards and best international practices introduced and implemented regarding Financial Controls Improved performance of the Ministry of Finance and other key Government institutions in relation to the state budget with regard to programme decision making, monitoring and evaluation 	<ul style="list-style-type: none"> Opinion of the European Commission OMAS reports Assessment of the development by the Government and the line Ministries 	It is assumed that the Government and the Ministry of Finance are fully committed to improve policies and procedures on Financial Controls by implementing the "Programme for the establishment of Internal Control in the public sector" and are willing to support the process with the necessary legislative and institutional framework
Immediate Objectives	Indicators of Achievement	Sources of Information	Assumptions and Risks
<ul style="list-style-type: none"> Improvement of financial controls Development and implementation of an audit methodology for the public sector Contribution to the Government's budget reform and modernisation of financial management 	<ul style="list-style-type: none"> Audit and control systems based on modern principles introduced and implemented Existing audit units reorganised and new units established Policy, techniques and tools for Performance Measurement prepared and implemented 	<ul style="list-style-type: none"> Audit reports Internal ministerial development reports OMAS reports 	<ul style="list-style-type: none"> Political and institutional decisions are expected to be in place to support the projects Ministries, units and institutions involved in the development process must allocate the necessary resources of manpower to participate in working groups
Outputs	Indicators of Achievement	Sources of Information	Assumptions and Risks
<ul style="list-style-type: none"> Organisation of internal audit units and preparation of manuals and audit programs. Internal control procedures improved Annual audit plan for year 2001 Training programs and textbooks for relevant staff in new procedures, techniques and tools Training of trainers Additional software for a database for Performance Measurement 	<ul style="list-style-type: none"> Internal audit units established Audit programs prepared Manuals and instruction books developed and new procedures implemented Number of staff trained Database for Performance Measurement established 	<ul style="list-style-type: none"> Audit reports Manuals and training programs Project progress reports Project evaluation reports 	<ul style="list-style-type: none"> Continued commitment by the Lithuanian side to support the process by making the necessary decisions and implementation
Inputs			
<ul style="list-style-type: none"> Twinning arrangement Study tours Training activities Computer software 	<ul style="list-style-type: none"> Twinning agreement established with EU Member State Technical assistance planned and delivered Working groups and beneficiaries involved 	<ul style="list-style-type: none"> Work programs Inception reports Progress reports Project monitoring reports 	<ul style="list-style-type: none"> Continued commitment by the Lithuanian authorities to allocate the local resources Phare support available for the whole development period

Cumulative Contracting and Disbursement Schedule for the Project (MEUR)**Annex 2 a)****LI 9906.02****Cumulative Quarterly Contracting Schedule (MEUR)**

Project	4Q/99	1Q/00	2Q/00	3Q/00	4Q/00	1Q/01	2Q/01	3Q/01	4Q/01	1Q/02	2Q/02	3Q/02	Total
Internal Financial Control			0.75						-----	-----	-----	-----	0.75

Cumulative Quarterly Disbursement Schedule (MEUR)

Project	4Q/99	1Q/00	2Q/00	3Q/00	4Q/00	1Q/01	2Q/01	3Q/01	4Q/01	1Q/02	2Q/02	3Q/02	Total
Internal Financial Control			0.26	0.4	0.55	0.69	0.75						0.75

Detailed Implementation Chart – LI 9906.02

Annex 2 b)

Year	1999			2000												2001												2002											
	O	N	D	J	F	M	A	M	J	J	A	S	O	N	D	J	F	M	A	M	J	J	A	S	O	N	D	J	F	M	A	M	J	J	A	S			
Twinning and Training Package to Strengthen Financial Control																																							
- Launch Twinning Request to Member States (after Management Committee – 23 July 1999)																																							
- Selection of Member State(s) for Twinning	X	X	X																																				
- Elaboration of Twinning Covenant	X	X	X	X	X																																		
- Submit Twinning Covenant to the Commission & Steering Committee for Approval				X	X	X																																	
Implementation of Twinning Package							X	X	X	X	X	X	X	X	X	X	X	X	X	X	X																		

**Relation of Project with Previous Phare Activities
and On-Going Projects Financed from Other Sources
LI 9906.02**

Annex 4

Under the Programmes LI 94.05.03 and LI 96.08, Phare has provided assistance to the Budget and Treasury Departments at the Ministry of Finance. The objectives of the assistance were to improve the performance of the Budget and Treasury functions through:

1. technical assistance to advise on domestic debt management,
2. training and
3. the definition and procurement of IT hardware for Treasury Operations.

The project on debt management, LI 96.08, was launched in June 1996 and was closed in March 1998. The project for procurement and installation of computers was launched in August 1994 and completed at the end of 1998.

In addition to that, the Ministry of Finance has received comprehensive technical assistance from the Danish Government regarding implementation of an automated financial system: The Government Budgeting, Accounting and Payment System (the GBAP NAVISION System).

With the NAVISION system and the computers provided by Phare in place, the Ministry of Finance has the infrastructure for developing a modern financial system and further Phare assistance will build upon the results already achieved.

Phare has been requested assistance in strengthening the budgetary processes through a twinning arrangement financed under the 1998 Phare Programme. Currently, a twinning programme between Lithuania and Denmark is under preparation covering elements of the budget reform process.

The Performance Measurement component of the budget reform process included in the present project will be closely co-ordinated with the activities of the Lithuanian-Danish twinning project.

As far as financial control is concerned, the development will build on the existing control system and on the assistance provided by IMF regarding the "Guidelines for conducting the internal audit of budgetary institutions". IMF assistance on the guidelines was completed in 1998 and a follow-up should be launched from the middle of 1999 with assistance on implementation of the guidelines in the Ministry of Finance and a few selected budgetary institutions.

Introduction of internal audit units in all governmental spending units and implementation of financial controls in a broader context should then be covered by the present Project. The Project is based upon the results of the analysis carried out in 1998 under the Phare project: "Developing the function of internal audit in the state sector of Lithuania".