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FINLAND

Public Internal Control

No major changes in the period 2011-2013.

1. Brief history of the public internal control (PIC) system

Since the 1990s, the internal control of central government finances and related legislation in particular, has undergone significant reform and development. The concepts of internal control and, to some degree, its principles, have been reformed during this period. Budget statutes define and enact internal control as an activity to be carried out under the responsibility of top management. Nowadays internal control is an integral part of management and the related risk management in accordance with the principles of sound governance, and as such it is an essential element of performance management and accountability systems.

By the beginning of the 2000s, basic requirements for internal control had been included in budget statutes. However, there were still shortcomings with internal control in terms of guidance and uniform operating policies. In practice, internal control had not yet been sufficiently integrated into management systems and procedures as part of performance management. In addition, no uniform system existed at the level of government and central government finances as a whole to ensure the adequacy of internal control. For this reason, the Ministry of Finance set up a working group on 18 December 2001 to examine ways of improving end-of-year accounting procedures in central government and to propose legislative changes as necessary. The working group cooperated closely with another working group on the reporting process established by the Speaker's Council of Parliament.

The importance of internal control was further emphasized in the accountability reform in 2003 and the related amendments to budget statutes. These changes included the following:

- the basic criteria for accountability and performance were redefined in legislation;
- the government's financial status report and the State's financial statement and report were merged into a new report on the central government final accounts, to be presented to Parliament;
- the structure of financial reporting by government agencies and ministries was clarified in terms of accountability and performance and, in particular, the preparation of performance reports on the achievement of the performance targets set;
- an obligatory declaration assessing the functioning of internal control and risk management was included in financial reporting by government agencies and ministries;
- the responsibility of ministries in steering their administrative and policy sectors and implementing accountability was emphasized by requiring them to provide an

annual evaluation and opinion on the final accounts and audit reports of their subordinate units responsible for preparing their own accounts;

- a joint government financial controller position was established at the Ministry of Finance for preparing the report on the central government final accounts, ensuring that a true and fair report is given, carrying out internal control of the state of central government finances, using reports and evaluations as well as developing steering and reporting systems for central government operations and finances;
- an advisory board for internal control and risk management was set up in order to develop internal control and in particular to plan cross-sector cooperation and prepare its implementation, with all ministries and certain key internal control bodies being represented;
- an internal audit division was established for coordinating and developing internal auditing, with a representative from the internal auditing function of each ministry.

2. Public internal control environment

2.1. Principles of budget preparation

After any changes, Parliament approves the budget presented by the government as well as any supplementary budgets. The budget is prepared for one financial year at a time. The financial year corresponds to the calendar year. The estimates of annual revenue and the appropriations for annual expenditure are entered in the budget as gross amounts, deducting neither the expenditure from revenue nor revenue from expenditure (*gross budgeting*). Provisions can be laid down by law that, in the case of certain revenue and expenditure, only the estimated revenues or appropriations equalling the balance between them may be entered in the budget (*net budgeting*).

The budget may contain three types of appropriations:

1. A fixed appropriation, which cannot be exceeded or transferred to a later financial year.
2. An estimated appropriation, which cannot be transferred to a later financial year. Permission to exceed an estimated appropriation may be granted if the excess is based on a statutory or comparable need or on some other compelling unforeseen need or a need that is difficult to estimate.
3. Transferable appropriations, which cannot be exceeded. A transferable appropriation may, in accordance with what is decided in the budget, be carried over for use during a period not exceeding two financial years following the financial year in question.

In the budget, items of revenue or expenditure are allocated to the financial year to which they primarily apply. Allocation is generally made on the basis of the delivery of a product or service or the receipt of a factor of production. For example, procurement expenditure is budgeted for the calendar year when the purchased product or service is received. Expenditure is not carried forward in the budget.

2.2. Principles of central government accounting and preparation of central government final accounts

The State is required to keep accounts on its budget economy. The budget economy is divided into accounting units, which comprise ministries, government agencies and public

bodies. Accounting data from the accounting units are compiled into the State's consolidated accounts for the preparation of the central government final accounts. The State treasury collects the accounting data and manages consolidated accounting.

The accounting units are responsible for their payment transactions and accounting and, as government agencies and public bodies, prepare their annual accounts and report on their operations.

Central government accounting comprises budget accounts and general accounts. The accounting must comply with good accounting practices. Budget accounting monitors the implementation of the budget, while the general accounts show income and expenditure as well as the financial position regarding assets and liabilities.

Government agencies and public bodies must provide true and fair information on their compliance with the budget, their revenues and expenditure, their financial position and their operational performance in their annual accounts and in the report on their operations, which is compiled in order to implement accountability.

For each financial year, the government submits the report on the central government final accounts to Parliament. The report includes the central government final accounts and other necessary information on central government's financial management and compliance with the budget, as well as information on the most important aspects regarding the societal effectiveness of central government activities and the development of performance. The report also includes key information on trends in societal effectiveness and performance in the ministries' areas of responsibility.

The central government final accounts include:

a. a statement on the implementation of the budget, broken down by budget section or sector and chapter and item;
b. a statement on revenue and expenditure;
c. a balance sheet illustrating the financial position on the final day of the financial year;
d. a cash flow statement showing cash flows;
e. any notes required to provide true and fair information.

2.3. External audit

The National Audit Office of Finland (*the audit institution*) is an independent body operating within Parliament. The remit of the National Audit Office is to audit national financial administration in order to ensure that it is appropriate and complies with legislation and the budget. In addition, the National Audit Office handles the tasks laid down in the Act on the implementation of the legislative provisions in the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, on the application of the Treaty and on the requirements for the Multi-annual Budgetary Frameworks.

By the end of September each year, the National Audit Office submits a report to Parliament on its operations, and special reports when necessary.

3. Public internal control

3.1. Managerial accountability and responsibility

In central government, internal control refers to procedures included in the agency's guidance and operating processes, organisational solutions and operating methods that can be used to obtain reasonable assurance of

1. the legality of operations;
2. the security of funds;
3. operational performance; and
4. the production of true and fair information on finances and performance

in accordance with Section 24 b of the Budget Act, government agencies and public bodies must ensure that appropriate arrangements are made for internal control in respect of their own operations and activities for which they are responsible.

Risk management identifies, evaluates and manages factors that may hinder the achievement of objectives included in the four categories mentioned above. Risk management has the same goals as internal control.

Ideally, internal control and risk management procedures are integrated into the agency's usual planning, management and operating processes. Typical examples of such procedures are:

- the planning of objectives and operations and the identification and evaluation of risks that may hinder the achievement of objectives;
- management of information required in operations using information systems;
- technical control and reporting procedures for exceptional situations, included in information systems;
- differentiation of tasks.

In accordance with Section 24 b of the Budget Act, the management of each agency is responsible for organising internal control and for its appropriateness and adequacy.

The top management of an agency bears primary responsibility for organising and managing internal control, in the same way as it is responsible for meeting the organisation's targets and organising related activities. Management carries out the necessary measures by delegating tasks to various levels of the organisation in accordance with their management system. With regard to internal control, delegation often means allocating tasks and responsibilities to sub-units, making them responsible for their own operations and the identification, management and reporting of related risks.

Pursuant to Section 65 of the State Budget Decree, the report on operations included in the final accounts of an accounting office must include an assessment of the appropriateness and adequacy of internal control and related risk management, as well as a declaration on the status of internal control and key development targets, drawn up on the basis of the assessment (*assessment and declaration of assurance of internal control)*.

The assessment should be:

1) Genuine – not apparent;

2) Systematic – it should be based on a comparison of the present state with accepted criteria in the framework;
3) Sufficiently extensive — it should cover all relevant operational and support processes in activities for which the agency is responsible;
4) Documented — it should cover all relevant operational and support processes in activities for which the agency is responsible;
5) Approved by the management — it should enable the evaluation of internal control, which is the management's responsibility.

In 2005, the advisory board for internal control and risk management, established by the government, prepared a recommendation for government agencies and public bodies on approaches to internal control and risk management and assessing how they function.

The recommendation is intended as a tool to help government agencies, public bodies and funds evaluate and develop their own internal control and risk management processes. Efficient internal control and risk management enhance the operating unit's performance and are an essential element of sound governance. In 2008, a more concise version of the recommendation was issued, which can be used as an alternative to the more extensive framework, for instance in smaller agencies.

When applying the evaluation frameworks, the functionality of internal control and risk management is assessed by examining the following aspects influencing it:

1. the agency's operating environment;
2. the setting of objectives;
3. the identification, evaluation and management of risks;
4. controls (control measures);
5. communication and the flow of information; and
6. the monitoring of internal control and risk management performance.

Government agencies and public bodies can also use other commonly approved evaluation frameworks (for instance COSO, COSO-ERM, CoCo) to evaluate the the functioning of internal control and risk management. Using a generally approved framework makes for the systematic and documented evaluation of internal control. The evaluation framework should always be adapted to meet the agency's needs.

The internal control assessment can be carried out in different ways. These include self-assessment by the management group, decentralised self-assessment, assessment supported by an internal audit or information gathering and assessment with the help of an external specialist. Responsibility for the evaluation of the various aspects can be assigned in a number of ways.

Information obtained in the assessment must be utilised in the planning and execution of the agency's operations On the basis of the assessment findings, the agency can prepare the assessment and declaration of assurance of internal control and risk management, to be included in the report on operations.

The assessment and declaration of assurance of internal control included in a government agency's report on operations should feature the following elements, set out in brief:

- a statement on managerial responsibility;
- the method of assessment implementation (reference to the framework, for instance);

- conclusions on the state of internal control; and
- possible development targets.

3.2. Internal auditing

Internal auditing supports the efficiency of internal control and risk management at ministries and government agencies. Management within ministries and agencies are responsible for the due implementation of internal control and risk management.

As laid down in Section 70 of the State Budget Decree, internal auditing is organised at the discretion of the ministry's and agency's management. In their consideration, the management should evaluate the need for an internal audit in the light of internal control needs and the requirements of European Union law. The internal audit may be carried out by the ministry or agency or outsourced partly or entirely.

The ministry's and agency's management must organise an internal audit if there is justified need for an audit on the basis of internal control procedures. The purpose of an internal audit is to clarify for the management the appropriateness and adequacy of internal control and to perform the auditing duties prescribed by the management.

Common standards and recommendations concerning internal auditing must be taken into account when organising the internal audit.

The rules on internal auditing procedures and the status of internal audits in the organisation of the government agency or public body are provided in the rules of procedure on internal auditing, which are confirmed by the government agency or public body itself. The rules of procedure on internal auditing must be notified to the ministry concerned and the National Audit Office.

A model of the rules of procedure has been drawn up for the purpose of an internal audit organised independently by an agency. Government agencies and public bodies must critically evaluate the model's applicability to their own operations and, where necessary, add or remove content or adapt it to better suit their own operations. The model may also be used when preparing rules of procedure on an internal audit that is carried out as an outsourced service, provided that it is first ascertained that the rules of procedure apply to the agency's operations.

The agency's management decides on the organisational status of the internal auditing unit, if applicable. Most commonly, internal auditing is directly subordinate to a ministry or the senior officials of an agency. In this case, the internal auditing unit reports directly to top management, from which it also receives its powers.

3.3. Coordination of internal control

Since 2004, a government financial controller has operated within the Ministry of Finance.

The government financial controller is the government's joint supervisor of performance and finances. He/she serves as an advisor to the government and top management at ministries, as an administrative controller and as an independent supervisory authority in guaranteeing and developing the quality of the control and reporting system on central government finances and in ensuring financial accountability.

The government financial controller's role is to ensure that the report on the central government final accounts provides a true and fair picture of central government finances

and performance. The government financial controller steers, coordinates and develops the reporting and assessment of central government finances and financial performance. The range of duties includes the assessment of performance and finances, strategic accounting, and steering and developing the assessment of the financial implications of legislation. The controller also sees to the guidance, coordination and development of internal control and related risk management, and to the organisation of government-level activities and reporting related to controlling and preventing the misuse of EU funds for which the State is liable.

In carrying out its duties, the government financial controller draws on the expertise of the Ministry of Finance and other ministries and authorities.

An advisory board for internal control and risk management operates within the Ministry of Finance. The advisory board's remit includes:

1. monitoring and evaluating the state and procedures of internal control and related risk management within central government and its methods and general development, as well as the functioning and use of internal control procedures in guiding and managing finances and operations;
2. taking initiatives to improve internal control and related risk management;
3. coordinating the procedures of various authorities and government agencies and public bodies in internal control and the administrative monitoring of financial management, and preparing the required measures;
4. monitoring and evaluating the state of internal audit arrangements, the quality and performance of internal auditing, its utilisation in management and guidance, as well as the procedures and general development of internal auditing and taking the initiative to improve internal auditing and its utilisation;
5. organising cooperation between internal auditing at different government agencies and public bodies and, where appropriate, coordinating the internal audit operations and the utilisation of results in different agencies;
6. monitoring and evaluating the control and audit of EU funds in Finland, as well as related reporting, and coordinating and developing the related measures and procedures of various authorities, government agencies and public bodies, while preparing measures required for coordination and development;
7. preliminary handling of Finland’s reply to the Commission of the European Communities regarding the Court of Auditors’ annual report, as referred to in Article 143(6) of Council Regulation (EC, Euratom) No 1605/2002 on the Financial Regulation applicable to the general budget of the European Union;
8. monitoring and evaluating the situation concerning misuse or violations committed in the operations of government agencies and public bodies or aimed at State funds or assets, or funds or assets for which the State is responsible, and coordinating and developing the operations and procedures of various authorities and government agencies and public bodies, as well as reporting on misuse and errors;
9. preliminary handling of the information on Finland, compiled for the report referred to in Article 280(5) of the Treaty establishing the European Union; and
10. organising training and cooperation and compiling and disseminating good practices, as well as preparing proposals for recommendations and issuing statements on matters falling within the board’s sphere of competence.

The advisory board for internal control and risk management is chaired by the government controller general, with the government deputy controller general acting as deputy chair. The government appoints the advisory board and its members and their

deputies for three years at a time, so that the advisory board includes a representative from each ministry as well as representatives from key cooperation partners in the sector, if necessary.

The advisory board has an internal audit division for the assessment and development of internal auditing, with representation from all ministries and the State treasury. The division develops internal audit procedures by preparing joint recommendations and describing good practices for internal auditing. It does not, however, have authority over the internal audit units of ministries and government agencies.

4. Financial inspection

No such body exists in Finland.

5. Ongoing and forthcoming reforms

Amendments regarding internal control and risk management may be made to the budget statutes. There have been discussions on the need to focus operations more clearly, particularly as regards the tasks of the government financial controller and the advisory board for internal control and risk management.

With regard to internal auditing, it has been debated for some time whether ministries and government agencies should be required to organise internal audits and how this should be done.

The following arrangements have been considered, among others: centralising sector-specific internal auditing in ministries, for example, centralising internal auditing at the government level, creating an internal audit service centre and cooperating more closely at the administrative sector level, and coordinating internal auditing.

The current recommended model for an internal control framework is based on the COSO-ERM model. Recently, discussions have been initiated on whether ministries and government agencies should be supported in the possible implementation of the ISO 31000 risk management standard and related standards.