
OPENNESS OF LOCAL GOVERNMENT AND GOOD FINANCIAL MANAGEMENT

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Abstract: The subject of the research is the local self-government, with a good reason, as it has much more contact with the daily life of citizens than the central government and it is mainly directly responsible for the state of healthcare, building maintenance, education, cleanliness and the environment, as well as for ensuring the functioning of basic systems, such as water and sewage. The third chapter is devoted to good public finance management. It is extremely important to recall the fact that the budget must integrate with other areas of financial operations, even if that business is carried out by a state body, regardless of the Treasury or the Ministry of Finance. The public sector debt has become a "deceptive factor" that achieves budget stability. Internal control measures should be introduced into each organization and incorporated into its procedures. The new concept of the budget system in public finances of the Republic of Serbia determines the efficiency of public expenditure management with the introduction of a multi-level control system. In addition to establishing a budget inspection and audit, one of the multi-level controls is the system of introducing internal control.

Keywords: local self-government, budget control, internal control, audit.

OTVORENOST LOKALNE SAMOUPRAVE I DOBRO UPRAVLJANJE JAVNIM

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Rezime: Predmet istraživanja ovog rada je local self-government, s razlogom, jer ona ima mnogo više dodira sa svakodnevnim životom građana, nego centralna vlada i ona je umnogome neposredno odgovorna za stanje zdravstvene zaštite, održavanje zgrada, obrazovanje, održavanje čistoće i životne sredine, kao i za obezbeđenje funkcionisanja osnovnih sistema, poput vodovoda i kanalizacije. Treće poglavlje je posvećeno dobrom upravljanju javnim finansijama. Izuzetno je važno da se apostrofira činjenica da budžet mora da se integriše sa drugim oblastima finansijskog poslovanja čak i ako to poslovanje obavlja državni organ, nezavisan od odeljenja trezora ili ministarstva finansija. Zaduživanje javnog sektora je postalo "varljivi činilac" kojim se postiže stabilnost budžeta. Mere unutrašnje kontrole treba da se uvedu u svaku organizaciju i uklope u njene procedure. Novi koncept budžetskog sistema u javnim finansijama Republike Srbije uspostavlja efikasnost upravljanja javnim rashodima uz uvođenje višestepenog sistema kontrole. Pored uspostavljanja budžetske inspekcije i revizije, jedna od višestepenih kontrola je i sistem uvođenja interne kontrole.

Ključne reči: Local self-government, budžetska kontrola, interni nadzor, interna kontrola, revizija.

1. INTRODUCTION

Local self-government is the form of governance and decision-making carried out by the citizens in local communities. It is actually a basic organization of governance in a country, exercised by local authorities. From the territorial and legal point of view, local self-government is local government with a certain degree of freedom, independence and material options for exercising its original functions, guaranteed by the Constitution. The primary, daily and long-term living interests of citizens are harmonized and satisfied in local communities in which the local self-government is usually exercised. Citizens themselves decide about those interests directly or through the elected representatives. That is why we say that the local self-government is one of the most significant political institutions.

Local self-government, as a category of the constitutional law, offers the possibility for citizen participation in decision-making and independent governance of the local community affairs. Established in feudalism, with the emergence of the third class, it was significantly developed with the victory of capitalism and forming of a civic legal state. It became an integral element of a unique state regulation with decentralization features. It is therefore considered that the local self-government represents a unique form of decentralism.

Basic values and institutions of the local self-government became the subject of protection and international documents. The best-known international document about the local self-government is the European Charter of Local Self-Government adopted in Strasbourg on October 15 1985.

2. OPENESS OF THE LOCAL SELF-GOVERNMENT

With the world becoming more and more urbanized, the role of local authorities is becoming more and more important. In many developing countries, population in cities makes more than one half of total population. In urban environments, there is an increasing civic participation in the work of democratic institutions, and the awareness on civic duties is developing. Local self-government authorities represent a new step at which the citizens meet administration. Decisions about urban planning, maintenance of roads, education, local public enterprises, local police and services of local departments issuing various types of permits usually fall within the scope of work of local self-government.

Local self-government is more involved with the daily lives of citizens than the central government and it is largely directly responsible for the status of healthcare, building maintenance, education, maintenance of cleanliness and the environment, as well as to ensure functioning of the basic systems like water supply and sewerage. The social integrity system functions at the state level. It is becoming more and more obvious that fighting against corruption can sometimes be more successful if managed from the “bottom”, therefore many anti-corruption programs are focusing on reforms at the local self-government level. At that level the citizens may feel the devastating effect of corruption, and at that level it is easy to make unions between all those interested in creating a more humane and sustainable living conditions. Many people agree that the city administration may be good only if there is a high level of transparency in the decision-making process and a high level of participation of civil society organizations in that process.

Governments are opting to decentralize their activities following the philosophy of “subsidiarity” in accordance with which decisions are made at the lowest level appropriate. However, there is a paradox here. Competences are transferred to local authorities, but instead of the corrupted bureaucracy at the state level, they are taken over by the institutions that are even less reliable. The local institutions frequently lack human and financial resources required for performing of local functions.

Like the central government, there are many tasks that the local self-government may carry out only in cooperation with the private sector. Thus, there is a possibility for the private interest to affect the decision-making process and redirect it in a way that is not in accordance with the interests of majority of citizens. Determining the zones for the use of city land is an area in which there is a constant threat to integrity. The price of land may increase significantly depending on the purpose of that land. In many countries, regardless of the level of their development, there is a tendency to bribe the city officials that can change the purpose of land. Also, at the local level, ties among people are much stronger than in the central state administration, therefore there is a higher possibility to favour cousins, friends, etc.

An equally powerful pillar is the local government originating from the local community. These two powerful structures need to control each other. Government should ensure consistent enforcement of the law, and local authorities should verify openness and adequacy of decisions of the higher levels of authority. Otherwise, our large country – with numerous nations living in it and numerous religious groups – will not be able to survive.”¹⁴⁸

Fair, transparent and efficient city administration is of key importance for achieving the best possible living conditions and trust in the method of governance. That is why fight against corruption and support to transparency and accountability should not take place only on national level, but the local level as well. The best solution to eliminate corruption is to establish a broad coalition to include local authorities, private sector and civic society representatives. The citizens informed about how, where and what for taxes they pay are spent may supervise activities, reduce wasting of funds and corruption and thus help achieve greater efficiency in budget spending. Some believe that such discussions can contribute to collection of taxes from citizens, as citizens will evade paying taxes less if they recognize the benefits of regular payment of taxes. When the local politicians include the civic society representatives in the development of their own communities and when municipalities present their ideas on the “market” to attract investments of the private sector, there is no doubt that the public will recognize and reward the leaders of reforms. Because of all these reasons, and as it is much harder to initiate changes at the local level, civic society organizations are increasingly focusing on changes at the local level. When positive changes are implemented at the lowest level of authority, the arguments for changes at regional or central state level become stronger, and then it is much easier to realize them.

¹⁴⁸ A. Solzhenitsyn in the interview to the Guardian (UK), 18 March 2000

One of the most powerful means in fighting against corruption is establishing a sound system of financial management, with timely and efficient accounting system in combination with precise, professionally prepared reports of internal and external auditors. One of the most important goals of a sound system of financial management is discovering the “white collar crime” and fighting against it. Some wrongly believe that it is enough to perform the audit once a year. Auditors’ hands are tied when, due to inadequate bookkeeping, traces they should follow while detecting irregularities and establishing accountability are blurred.

Responsibility of authorities does not stop with providing the corresponding financial management for funds of the central government in accordance with the stipulated standards and procedures. Authorities are responsible for ensuring implementation of standards and procedures in the whole public sector, including regional, district and municipal authorities, as well as all governmental institutions. Financial operations in the public sector are much more involved in harmonizing with legal powers. Therefore many key decisions within financial operations are based more on political reality, than on diligent analysis of the impact of the decisions made on the future. However, it is very important to keep harmonizing the goals of financial operations of the public sector, including financial operations in the field of internationally funded projects, with changes in the private sector. Financial management in public or private sector included funding, keeping, analytics and functions of reporting as the main elements.

In almost all countries there is the lack of cash for the obligations the government is in charge of. That is why financial operations focus on obtaining and managing cash, as budget objectives cannot be met without it. External economic influences that cannot be controlled, reduced reliability of traditional sources of state revenue and increasing demand for public services and broader role of government in economy have brought cash management and the policy of indebtedness to the focus of the public sector’s interest. Still, only a few countries realized appropriate and acceptable system of cash management. Even the developed and industrialized countries have just recently developed improved access to cash flow management.

Fragmentation of functions of financial operations at the central government level is another characteristic of the public sector. Whereas in the business world, the qualified individuals are usually appointed as “chief financial officers”, there are not many governments that manage to appoint their key financial officers. The basic functions of financial management are frequently divided between several bodies fighting to strengthen their own influence, instead of working together on achieving common results. Financial information is frequently neither available nor prompt, and they are not used for making the key decisions. Awareness on financial management in the public sector needs to be increased. Every government needs appropriate philosophy of financial management and clearly defined scope of financial management functions. Expert management that can rely on appropriate staff and that will be supported by other state bodies should manage the finance. The need for coordinated professional financial operations increases with the development of a country. One of many needs of developed countries is the need to integrate primary functions of financial operations and responsibility in a single coordinated system led by expert management. New and cheaper microcomputer technology makes it possible for almost every country to use the systems of integrated financial operations. Certain state departments, even local authorities, are able to fund and maintain the integrated systems providing useful and timely information for key management decisions, along with greater accountability to higher levels of government and towards citizens. A sound system of financial reporting and accounting helps prevent, establish, prove and disclose corruption and persons engaging in it.

3. FINANCIAL MANAGEMENT

3.1. Budget management

It is very important to point out to the fact that the budget needs to integrate with other areas of financial operations, even if those operations are carried out by a state authority, independent from the Treasury of the Ministry of Finance. Data on execution of budget obligations should be based on the accounting system, and not a special system or data recording and processing. It is probably the most problematic and the most important area of the integrated financial operations system.

All the public sector departments should manage public funds within the budget. The principles of budget comprehensiveness require all state revenues and all planned expenditures to be included in the state budget, including all transfers to other levels of government, autonomous entities and state owned enterprises. Budgets of public enterprises and self-funding entities do not have to be centralized in the state budget, but they have to be presented to the body in charge of the state budget in an appropriate form. The budget sub-system should be planned simply and practically to enable operating and cooperation with other systems. Finally, it is very important to make sure that the figures of budget execution for the previous year do not differ significantly from those budgeted.

Lack of funds and increasing demand for public sector expenditure have pointed to the issues of the tradition to maintain numerous “idle” funds. In that case, state funds for different purposes remain unused on various bank accounts for a long time. In a modern, efficient system, all cash inflows have to be unified into something that is usually called a “single bank account”. Every financial inflow to the public funds should be added directly to one account of the state Treasury. In the same manner, all payments originate from the same bank account and made on the basis of the authorization in accordance with the Government’s expenditure plan. To provide flexibility of their activities, public enterprises and other important self-funding entities should not participate in the single system of state Treasury. Still, these entities, like the central government, should carefully plan and forecast their expenditures in order to avoid the unnecessary “idle” funds and ensure timely fulfilment of their obligations. In practice it looks like a set of inter-related accounts within which data are constantly available and may be unified at the end of the day.

As the countries are becoming more and more indebted, the state institutions taking over debts and guaranteeing for them are becoming more and more important. Debt planning is as important as the cash inflow planning, and many people find that these two sub-systems should be considered together as they are tightly connected. Unfortunately, present situation almost all over the world is such that debt planning is necessary for budget balancing. The public sector debt became the “deceptive factor” to achieve the budget stability. Public debt frequently results from political decisions not to increase tax rates and not to reduce expenditures of the state, but it may result from seasonal deviations in revenues and expenditures during one year.

Internal control, sometimes just another name for control performed by the managers, is very important within every sub-system. The appropriate internal control measures should be a part of every sub-system and their implementation should become an integral part of all transactions. Prior controls and approval of procedures and transactions are performed by employees responsible for working on those procedures and transactions. Internal audit (an important part of internal control) should perform additional supervision, consisting of reviewing and evaluating the internal controls performed. Because of such role, internal auditors should be professionally independent and they should not take part in adopting or approving of administrative documents and financial transactions. Internal auditors should study standards for the internal auditing (Standard for the Professional Practice of Internal Auditing) published by the Institute of Internal Auditors. Concept of internal auditing created by the accounting profession in the 1940s has spread so widely that it now covers the whole sphere of responsibility of the managers. That concept today represents a widely accepted framework for keeping and increasing the benefit of limited resources in the private sector, and it should also be accepted in the public sector.¹⁴⁹

Taxation transparency could be defined as openness to the public in terms of structure and functions of authorities, taxation policy, financial statements of the public sector and tax forecasting. Improved transparency of these areas contributes to the quality of public debate, better functioning of the market and increased responsibility of authorities in creating and implementing the taxation policy. Better sharing of information about plans and intentions of authorities is useful for both the decision makers and the citizens, even in the most developed economies. When there is no openness, accountability of authorities is rather limited. In order to promote transparency in the tax sphere, IMF adopted Code of Good Practices on Fiscal Transparency in 1998. The Code is very important as it is the first attempt to establish a framework for international standards in this field. Activities of authorities pertaining to taxation and spending are the core of exercise of authority. They influence the economic development and equity the most and they represent the largest possible source of corruption. IMF encourages all countries to adopt the rules proposed by the Code, but the process is voluntary. Anyone can use framework for transparency in the taxation sphere developed by the IMF. Still, although the IMF encourages transparency through technical assistance programmes, the impact of the Code will be the largest if it is implemented by a broad circle of governmental and non-governmental organizations when evaluating the success of the activities undertaken, or as the means of pressure to promote the work of the authorities.¹⁵⁰

3.2. Internal control, budget control and audit – the most frequent reasons for mistakes

A set of specific occurrences that impacted the increase in the new types of fraud in our conditions should be considered if we want to understand the intense activities of state bodies, independent controls and other institutions in the field of researching the negative occurrences from the previous period in our country and the remains of the previous political and economic system, particularly special phenomena such as corruption and frauds. Large frauds

¹⁴⁹ Fraud and corruption can never be eliminated completely, but they can be fought against and they can be reduced through the implementation of sound financial management.

¹⁵⁰ For Transparency International and its branches throughout the world, Code and the accompanying materials are very useful means for evaluating the integrity of tax systems in certain countries.

started happening in our country at the beginning of 1990s, after the UN sanctions against our country were introduced, when amendments to the Law on Accounting in 1996 created the possibility for various “manipulations” with funds of enterprises and banks, their illegal taking out of the country and into another countries, failure to register in official and legal business books, thus encouraging various types of frauds, tax evasion, illegal use of social capital, a form of stealing of property and funds from the foreign accounts abroad, without any legal sanctions, therefore contributing to the development of the infrastructure of financial crime in the country.

Regulations about revalorization have also contributed to increase in frauds and legalization of stealing of social capital, along with suspicious privatizations. Lack of will and interest of all factors at the national level for adopting the integral Law on parliamentary control of public expenditure and independent audit of enterprises and banks mostly contributed to that. Consequences of weak control and almost no auditing functions in Serbia are high level of corruption, misuse of public funds and high level of crime.

New concept of the budget system in public finances of the Republic of Serbia establishes efficiency of public expenditure management with the introduction of multi-level control system. Apart from establishing the budget inspection and auditing, one of the multi-level controls is the system of introducing the internal control. Internal control is an organized system of procedures for all persons involved in financial and business processes in direct and indirect users of budget and organization of mandatory social insurance. The task of the internal control is to control all transactions.

Budget control and audit are an essential segment of budget execution through supervising the persons issuing orders and executing the budget who have large responsibility, as they are responsible for legal spending of budget for the planned purpose. Insufficient control of procurement may cause material damage to enterprises and other institutions with developed material operations.

Inventory control is completely neglected in our country, as inventories are made by simply copying the lists from the accounting departments. This means that an inventory is not performed by actual counting or measuring, and that direct thefts and other forms of frauds are enabled. Large warehouses are a good example for manipulations and frauds. Frequent reversed entries make the books less transparent. Reversed entries are suspicious, as they may be the sign that the books are not properly kept, and they should be reviewed and controlled with care as they may be used as an excuse for irregularities.

In terms of errors and frauds, it is not possible to eliminate all options for frauds, but it is important to minimize them and prevent major scandals from happening. Preventive measures against frauds are the vital element of business policies of enterprises in the existing transition conditions. An organization with a well designed plan of preventive protection against frauds that also reached a high level of protection, improved the organizational culture and successfully created the culture of loyalty of management and other staff, achieves numerous positive effects. First of all, it increases business rating more easily, but it also gets jobs and wins tenders in the public sector, wins business trust of its clients, consumers, customers, depositors, contributing to a greater success – profit.

4. CONCLUSION

Based on the research carried out for this paper, we reached the general conclusion that the challenges the auditing profession faces today are much larger than before, and that all those engaged in research in the field of auditing should pay a special attention to the field of public expectations that will soon be primarily emphasized in our country as well. It is often said that “the public has the right to know”, but what can really be done to make such a right recognized, protected and given effect?

James Madison, one of the American constitutional fathers, said the following to support the right of the public to know: “A popular government without popular information or the means of acquiring it is but a prologue to a farce or a tragedy maybe or perhaps both. Knowledge will forever govern ignorance, and people who mean to be their own governors must arm themselves with the power that knowledge brings.”¹⁵¹ A public that is better informed can better participate in a democratic process.

Public expenditure audit is a guarantee that the state accounting system, as well as the public expenditure (at all levels of government) will be subjected to independent and professional supervision performed not according to intuition, but using auditing standards, methods and procedures that represent (in the current situation) the most important achievement of theory and practice in the field of public expenditure.

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