

**NEGOTIATION POSITION
OF THE GOVERNMENT OF THE REPUBLIC OF BULGARIA
ON CHAPTER 28
“FINANCIAL CONTROL”**

OVERALL POSITION

The Republic of Bulgaria accepts and will apply in full the *acquis communautaire* in the field of financial control.

As a working hypothesis, the Bulgarian Government considers that the Republic of Bulgaria will become a member of the European Union as of January 1st, 2007.

No derogations or transitional periods are requested in this sector.

ACQUIS ADOPTION AND IMPLEMENTATION

The Republic of Bulgaria shares the EU principles and will accept the EU best practices in the field of financial control by the date of accession.

Bulgaria accepts the *acquis* in force as of 31.12.1999 and will fully implement it upon accession.

The existing legislative framework in the financial control sector covers:

1. The Public Internal Financial Control Act (PIFC), adopted on 27th October 2000 and in force as of January 1st, 2001
2. The National Audit Office Act of 1995.

A further degree of harmonisation will be achieved in the year 2001 through the adoption of:

- Regulation on the Implementation of the PIFC Act and Regulation on the Structure of the Public Internal Financial Control Agency (PIFC Agency)
- Ordinances of the Minister of Finance
- New National Audit Office Act

DESCRIPTION OF THE FINANCIAL CONTROL SYSTEM IN THE REPUBLIC OF BULGARIA

The system of financial control in the Republic of Bulgaria consists of the National Audit Office and the Ministry of Finance control authorities: the PIFC Agency, the Customs Agency, the Tax Administration, the control exercised by the National Fund and the Central Financing and Contracting Unit (CFCU).

I. Public internal financial control

I.1. Functional independence

The principle of functional independence is laid down in Financial Regulation 1231/77 of 21 December 1977 Applicable to the General Budget of the European Communities, enforced by virtue of Regulation No3418/93 of 9 December 1993 Laying Down Detailed Rules for the Implementation of Certain Provisions of the Financial Regulation of 21st December 1977. Furthermore, a definition of this principle is given by the INTOSAI auditing standards, where "functional independence" is defined as:

" The freedom of the Supreme Audit Institution (SAI) in auditing matters to act in accordance with its audit mandate without external direction or interference of any kind".

The functional independence of the auditors is guaranteed at all control/audit levels and involves the procedures for control and audit planning, reporting, advising the management and seeking advice from the PIFC Agency. The principle of functional independence is transposed into the Bulgarian Public Internal Financial Control Act, Art. 3, which provides for: "Independence in planning, assigning, performing and reporting of the control activity from institutions, bodies and persons, whose activities are to be checked."

As a result of audit activities, the budget of the Agency shall receive a 10% revenue of any concealed receivables as well as of any sums recovered from damages incurred to the state and the municipal budgets.

These funds shall be managed and spent by the Agency, in accordance with a Regulation issued by the Minister of Finance, only for capital investments, for facility improvement and equipment, as well as for training and retraining. These funds cannot be used for any kind of remuneration.

The present practice of partly financing the PIFC Agency out of funds recovered as a result of control and audit findings shall be reviewed as provided for in the Policy Paper and Art, 14 para. 4 of the PIFC Act with a view to fully harmonizing it with the EU practice.

This practice of financing the PIFC Agency shall be abolished by the end of the year 2004 at the latest.

I.2. Sound financial management

The Financial Regulation No 1231/77 and Regulation No 3418/93 require that the budget appropriations be used in accordance with the principles of sound financial management, and in particular those of economy and cost-effectiveness.

The sound financial management principles are embodied in the PIFC Act as follows:

The implementation of the financial and control management systems is the prime responsibility of the public spending centres. Ex-ante control is primarily carried out by centres such as the line ministries and the public agencies, but can also be performed by the PIFC Agency on its own initiative, based on its risk assessment.

In introducing such systems the line minister shall seek the guidance of the PIFC Agency and shall follow the recommendations of the PIFC Agency.

The correct application and functioning of the financial and control management systems within the line ministries/agencies shall be checked/audited by the PIFC Agency through systems audit (compliance and substantive testing), financial audit, performance audit, IT audit etc. The PIFC Agency is also responsible for ex-post auditing.

The PIFC Agency is responsible for harmonising control/audit rules throughout the public sector and for ensuring that these rules are being duly applied.

The Ministry of Finance through the PIFC Agency is responsible for analysing and summarising the control results at all government levels. It shall regularly submit reports to the Council of Ministers.

On the basis of the above-mentioned principles, the following public internal financial control system (relating to expenditure and income) has been introduced by virtue of the PIFC Act:

All public spending centres establish financial and control management systems containing the double signature system applicable for all decisions resulting in financial consequences (one signature is of the Manager responsible for programme implementation and the other is of the Accountant in Chief, who enjoys a statutory functional independence from the manager). Both the Manager and the Accountant in Chief shall be liable for their individual approvals of such decisions and shall be subject to administrative and legal proceedings in case of deliberate irregularities and/or fraud. The Accountant in Chief is responsible for the day-to-day checking of the legality and regularity of the financial transactions before executing them.

The PIFC Agency shall appoint to the spending units delegated auditors, who shall have access to the documentation relating to financially relevant issues. The delegated auditor may take the initiative to advise the Manager and the Accountant in Chief, while both may seek independently advice from the delegated auditor on any financial matter in case of conflict of interests between them.

The PIFC Agency is responsible for carrying out ex-post systems audit and all kinds of ex-post audits (financial audit, performance audit and IT audit) with the aim of complying all financial activities in the public sector with the financial and control management systems established under the Agency's guidance. The PIFC Agency gives instruction to the delegated auditors on these matters. After having given the relevant manager the opportunity to comment on the findings and recommendations of the audit report, the delegated auditor reports its findings together with the manager's comments to the PIFC Agency.

On the basis of its own risk assessment, the PIFC Agency may temporarily establish and implement preventive (ex-ante) control system in the public spending centres, thus exercising control on all aspects of the commitments and disbursements to be made. A team of the PIFC Agency's internal auditors, other than the delegated auditor shall carry out the temporary preventive control system. The Delegated Internal Auditor shall not be entitled to simultaneously perform preventive control and internal audit.

The PIFC Agency shall report the financial control results ensuing from the exercised preventive control and ex post audits to the Minister of Finance and via him to the Council of Ministers.

The PIFC Agency is furthermore responsible for establishing adequate audit manuals and audit trails.

I.3. Procurement

The PIFC Agency and the National Audit Office perform audit on the compliance with procurement procedures as laid down in the 1999 Law on Public Procurement. The public procurement IT based register was established on 01.01.2001. In cases of detected irregularities, both control bodies shall impose administrative penalties.

I.4. Administrative capacity

The Public Internal Financial Control Agency has the structures and qualified personnel necessary for the implementation of the EU legislation in the field of public internal financial control. In parallel with the introduction of the new public internal financial control model, training of the auditors regarding new forms and methods of performing the public internal audit has been undertaken. Various training seminars with the participation of experts from the financial control institutions of the EU Member States have been held. Training on the implementations of the EU best practices in the field of public internal financial control is presently being carried out.

The training is organised and financed under 1997 Phare GTAF, 2000 Phare and SIGMA.

The PIFC Agency shall implement twinning project under Phare 2000 with the Ministry of Economy and Finance of the Republic of France. The project duration is 2 years. It has four components, which are: legal framework development; developing management capacity and administrative structures; human resource development and information technology.

II. External Audit

The independence of the National Audit Office derives from the INTOSAI Auditing Standards as defined by the Declaration of Lima. The definition states that the freedom of the SAI in auditing matters means that it can act in accordance with its audit mandate without external direction or interference of any kind. This principle is laid down in the Constitution of the Republic of Bulgaria and the National Audit Office Act of 1995.

The NAO shall act independently, i.e. without interference from the Government or other authorities when choosing the audit approach, examining the auditees and reporting on the audit activities performed.

The NAO shall carry its audit on ex-post basis and in accordance with the INTOSAI international auditing standards. The NAO shall have the right to an unrestricted access to the auditees. The auditee's officers shall be obligated to co-operate with the NAO authorities when performing their ex-officio obligations. While carrying out audits the Auditee's officers may not invoke arguments of state, business, trade, bank or other secrecy defended by the law. In case of refusal for co-operation sanctions shall be imposed.

By virtue of Art. 21, para. 1 of the current NAO Act, the President of the NAO shall send to the Minister of Finance and to the first class centres responsible for budgetary and extra-budgetary expenditures a report on the audit findings. The report may contain recommendations for the elimination of the irregularities. In case of a failure to meet the obligation for elimination of the irregularities, the President of the NAO shall report to the National Assembly and make recommendations for a resolution (Art.27, para. 3).

II. 1 Administrative Capacity

The National Audit Office of the Republic of Bulgaria has the necessary structures and qualified personnel to perform independent external audit on public funds and on EU funds. A special Department for Audit of EU Funds has been established. As regards the INTOSAI auditing standards and the European guidelines for their implementation a Department for Development of Audit Standards and Methodology has also been established.

With a view to ensuring proper implementation of the *acquis* the recruitment requirements for new staff in the NAO have been toughened. Training on implementation of the EU best audit practices is held through joined training seminars with the participation of experts from SIGMA and the EU Member States' SAIs.

III. Control measures relating to the EU Own Resources

The Customs Agency, under the authority of the Minister of Finance, carries out the customs duties' collection in the Republic of Bulgaria. The tax authorities have the power to determine and collect taxes. The PIFC Agency controls both the Tax and Customs administrations regarding their obligations for effective and timely collection of customs duties and taxes.

Control on the collection

The Customs Act and its Implementing Regulation are fully harmonised with the *acquis* in the field of Customs union and they provide the legal basis, regulating the relations between the importer and the customs administration. The Regulation provides for the establishment of a system for daily monitoring of the process of revenue collection. One of the main principles of the European customs legislation has been implemented, namely that the goods should not be released until either the payment has been made or the bank guarantee of the customs debt has been issued.

A system for customs debt registration has been set up. The Register for Customs Debt records information on both the debts due and the payments made. The customs debt is repaid through bank accounts of the respective customs administration, thus creating conditions for effective control over the customs debt payment.

Collection Control Information System

The Bulgarian Integrated Customs Information System (BICIS) will be in place and become fully operational in the year 2002. The core element of the BICIS is the "Customs debt" module. The system has been designed to enable the proper registration of the customs debt in terms of amount, debtor, terms of payment as well as payment control procedures.

Presently, the BICIS ensures the customs debt calculation and provides an easy reference to the available information. The setting up of a finance module is envisaged, designed to cover all the aspects of the customs debt:

- incurrance
- customs debt registration
- security to cover the customs debt
- payment
- remission

This module will become operational by the end of the year 2001 (stage 2).

VAT and excise duty control

The VAT and excise control is regulated in the tax legislation, Art.58, 75 and 144 of the VAT Law and Art.7, 5 of the Excise Law. Presently, the payment certification of the VAT and excise is done through written confirmation by the debtor's bank, bearing identical requisites as those of the payment document (Art. 75, p.4 of the VAT Law and Art.5, p.2 of the Excise Law). In this respect, the Minister of Finance is entitled to enforce a special procedure for the tax payment (§16 of the Temporary and Final Provisions of the VAT Law, by analogy §4 of the Excise Law).

The control on the enforcement of the VAT Law is exercised by the Tax administration through:

1. Tax audit. They are performed only in cases when a risk of infringement is identified. The risk assessment is based on the following criteria: deviations from the usual amount of VAT declared for refunding; substantial differences between the turnover of goods and the reported amount of sales income; lack of or relatively small amount of owned fixed tangible assets; identified tax infringements in previous tax audits, etc. In case, where as a result of a tax audit, the tax liabilities exceed the assets, measures for preliminary collateralisation of the tax receivables may be taken.
2. Checks. This is done with regard to the refunding of declared VAT; on-the-spot checks on the VAT registration; cross checks of the tax-liable persons; checks on the inventory, etc.
3. Ex-officio de-registration under the VAT Law of persons that do not meet their obligations as laid down in the VAT Law, such as: regular submission of incorrect tax declarations, usage of incorrect or false invoices, non payment of tax liabilities, etc.
4. Monitoring and analysis of the data on tax-liable persons that do not submit declarations and do not pay the taxes due.

When performing control on VAT, the following information systems are used:

1. As regards the submitted VAT declarations a VAT tax account for each taxpayer has been set up where all obligations and payments are registered. It is maintained at regional level (territorial tax directorate or office).
2. An information system for the Purchases and Sales Ledgers of all the VAT registered persons is established and maintained at national level. The system allows for cross checks and tracking of the commodity flows from the manufacturer/importer to the final consumer.

3. A system for performance assessment of tax audits has been set up. The tax audit findings are summarised in an electronic database thus enabling the multi-level processing of the information. The system allows for determining the average duration of each VAT audit, depending on the size of the tax-liable persons, as well as the average amount of discovered unpaid liabilities. The information has fundamental importance in taking managerial decisions as regards the VAT administration.

Control on collection of tax liabilities

The tax authorities perform the activities on the collaterisation and collection of overdue tax liabilities. A software has been developed which allows for the automatic processing of invitations for voluntary payment.

The tax liabilities established on the basis of tax audit reports, tax declarations and penalty decrees, issued by the tax authorities, are monitored on a **monthly** basis. A report on the total amount of the overdue tax liabilities is drafted. The main indicators, which are taken into account, are in compliance with the EU recommendations of 1999. These are: effectiveness of the gross tax liabilities pay-off; estimate of effective collection; total sum of executable tax liabilities in relation to the total sum of collected tax liabilities; gross collected liabilities in relation to gross liabilities.

The main taxpayers engaged into **standing and overdue liabilities** are monitored, as well as 2200 companies - compliant taxpayers, which secure 70% of the budget revenue.

The collection of the tax liabilities is exercised on a case-by-case basis as regards each tax debtor. In case the debtor has temporary financial difficulties but still complies with the provisions of the law, permission for rescheduling of the tax liabilities may be issued in compliance with the provisions of the Tax Procedures Code.

According to the provisions of the Tax Procedures Code, the tax authorities may also permit urgent payments to debtors, against whom measures for collection of overdue liabilities have been undertaken. These actions allow the debtor to continue his main activity and to pay off his liabilities.

Measures, such as taking away international passports, notifying the licensing authorities, etc. are taken against companies having large amount of liabilities, which are not collateralised.

The tax authorities report on their activity through **activity cards**, which are summarised and analysed on a daily basis and are subject to ex-post control performed by the "Collection" Department in the General Tax Directorate.

IV. Pre-accession funding and future Structural Action

With a view to preparing itself for the EU Structural Funds management and control upon accession Bulgaria has developed a sound financial control on the use of the EU Pre-accession funds. On 26.02.1998 Memorandum of Understanding for the Creation of a National Fund and a Central Financing and Contracting Unit has been signed between the Government of the Republic of Bulgaria and the European Commission. On 11.02.1999 the National Assembly has ratified the Memorandum of Understanding for setting up a National Fund as a central treasury body responsible for management of the aid provided by the European Communities. The Memorandum defines the National Audit Office as an external audit body regarding the implementation of the financial agreements. Every year an audit plan and a resume of the audit shall be presented to the European Commission. With the amendments from 19.09.2000 to the Structural Regulation of the Ministry of Finance (enforced with the Council of Ministers' Decree 215/1999 and Decree 186/2000) the National Fund has become a structural unit with a status of a Directorate within the Ministry of Finance. The Central Financing and Contracting Unit's functions include: support for the Program Leaders, management of Phare programs and projects; payments after checking of all documents; monitoring over the Phare procedures. Art. 4(1) of the PIFC Act states that "the scope of the Public Internal Financial Control shall cover the financially related activities of all class units responsible for the State Budget and EU funds expenditure". Thus, the audit, performed by the PIFC Agency on the EU funds and on the National budget funds is applied on a unified basis.

By virtue of Council of Ministers' Decree 132/14.07.2000 the SAPARD Agency has been established. The Minister of Finance and the Minister of Agriculture have been nominated as the competent authorities. A Multi-annual Financial Agreement has been signed between the Republic of Bulgaria and the European Commission on 18.12.2000. This Agreement complies with Regulation No 1268/1999 and its main target is to define the technical, legal and administrative framework for the implementation of the Special Agricultural Program for Rural Development. On the basis of the Multi-annual Financial Agreement and by virtue of the PIFC Act, the PIFC Agency has been entrusted with the function of a certifying body of the SAPARD annual accounts.

The PIFC Act stipulates regular reporting to the EC Commission on audits performed on EU funds and on the certification of the SAPARD annual accounts.

The National Audit Office, being the audit body of the legislative power, performs the external audit on units in charge of EU funds.

V. Protection of the financial interests of the European Union

The term "irregularity" is defined in EC Regulation No 2988/95. The auditor's responsibility does not generally require him to search specifically for irregularity unless required by the specific terms of the audit engagement. However, in case of an audit of financial information where the auditor gives an opinion on the legality and regularity and compliance with applicable laws and regulations, the auditor plans and carries out the audit

in accordance with the purpose of obtaining competent, reasonable, and relevant evidence as to the extent to which the financial information concerned contains material error including error arising from irregularity. These requirements are introduced in the PIFC Act by virtue of provisions, guaranteeing that the main task of the public internal financial control is to provide an opinion on the compliance with the legislation.

The PIFC Act contains provisions on imposing administrative measures. In case of suspected crime the Prosecution is informed.

In accordance with the provisions of Regulation No 2185/96/EC Concerning On-the-spot Checks and Inspections, the performance of joint on-the-spot checks on the funds granted through EU programs is provided for in both the PIFC Act and the Administrative Co-operation Agreement, signed between the State Financial Control (now Public Internal Financial Control Agency) and DG Budget.

Art. 8, para. 1, point 15 of the PIFC Act provides that the PIFC Agency summarises and reports to the European Commission the results of its activities relating to the European Union funds. Thus, the PIFC Agency communicates to the EU Commission irregularities detected in performing its control/audit activities.

The designation of the central contact point, which will have the task to cooperate with the European Anti-Fraud Office (OLAF) will be made by the end of the year 2002 at the latest.

The Republic of Bulgaria proposes the negotiations on this chapter to be provisionally closed on the basis of the existing *acquis communautaire*.

Should new elements of the *acquis* make it necessary, the Republic of Bulgaria recognises the possibility of opening supplementary negotiations before the end of the Intergovernmental Conference.