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# ***POLICIES AND PROCEDURES OF EX-ANTE CONTROL FOR LEGALITY***

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**Abstract:** The ex-ante control for legality has been part of the introduced control activities for obligatory application in the public sector ever since the year 2000, as it has undergone alterations in the philosophy of its execution over the years. The latest amendments in the legislation in the year 2019 set a requirement to managers in the public sector to introduce policies and procedures of ex-ante control for legality. Such policies and procedures shall be based on several pillars. On the one hand, the ex-ante control for legality shall be executed in compliance with the instructions for the order and means of executing ex-ante control for legality set by the Minister of Finance. On the other hand, it shall be based on risk assessment in the enterprise. Last, but not least, the policies and procedures shall observe the cost of control based on the cost benefit analysis.

**Key words:** ex-ante control, financial controller, managerial responsibility.

**JEL:** H53, G38.

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**T**he ex-ante control for legality in Bulgaria's most contemporary history dates back to as early as the beginning of the 21<sup>st</sup> century and has undergone a number of changes.

The subject of this research is the activity on ex-ante control for legality as part of the controlling activities that shall be applied by managers of enterprises in the public sector.

The scope of the research is the normative and methodological development of ex-ante control for legality during this period.

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The purpose of this article is to make an overview and analysis of the existing for this period normative base regarding the regulations of ex-ante control for legality. For this purpose to be achieved, we have set the following tasks:

- to outline the provisional periods in our most contemporary history, during which the requirements for executing ex-ante control for legality were valid;
- to research and analyze the existing normative and methodological framework throughout the corresponding period;
- to draw up the benefits and drawbacks in the execution of ex-ante control for legality as of the corresponding period;
- to identify the necessary prerequisites for the implementation of policies and procedures of ex-ante control for legality applicable to enterprises in the public sector.

The implemented research methods are based on a study of literature, normative and methodological sources, methods of comparison and analysis.

The research is topical as it elaborates on the latest amendments in the Financial Management and Control Act in the Public Sector of 13 February 2019, which set requirements to the managers of enterprises in the public sector to introduce policies and procedures of ex-ante control for legality .

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The ex-ante control for legality is not a new controlling activity in the public sector in the Republic of Bulgaria. In its most contemporary history it was introduced in its current state in the year 2000. Bearing in mind the highly normative character of the topic, the author provisionally sets three stages in the development of ex-ante control for legality based on the valid legal regulations for the corresponding stage.

### **Stage one: 2000 – 2006**

The first stage is characterized by setting requirements to managers in the public sector to build systems for financial management and control regarding the funds granted to them by the republican budget. This is done through a promulgation of the law (Public Internal Financial Control Act, 2000) and regulation for its application (Regulation for the Application of the Public Internal Financial Control Act, 2001). During this stage, the systems of financial management and control shall include the system of ex-ante control and the double signature system. In 2003, the Public Internal Financial Control Agency imposes instructions (Instructions for Building and Functioning of the

Systems of Financial Management and Control, 2003) on the basis of which it elaborates on the type, means and scope of the implementation of ex-ante control and double signature system.

The ex-ante control for legality is executed on all documents and actions related to financial activity, before the manager of the enterprise can assume obligations or make expenses. It is carried out by a person who is specifically appointed to the position of financial controller and has the authority to approve or reject the manager's proposals for assuming obligations or making expenses. The provisions described in the acts, regulations and instructions at that time require the presentation of a written motivated position by the enterprise's manager if he/she disagrees with the rejection of the financial controller to approve a particular action. With a view of guaranteeing a competent opinion, the legislator has set certain conditions regarding the requirements that financial controllers shall meet. The employees shall be sui juris persons, Bulgarian citizens, not convicted for a general intent crime and not legally disallowed to occupy the corresponding position. The qualification requirements are limited to a Master's degree in Economics or Law. As regards their experience, they shall have experience in the field of accounting, finance, law, internal or external audit of three years for public enterprises and respectively five years – in the private or other field. There are also strict norms when the applicant for the position cannot combine the functions of financial controller with other controlling functions, functions of an authorizing officer and accountant (Public Internal Financial Control Act, 2000).

Summarizing the characteristics of ex-ante control for legality during this stage, we can point out that it is characterized by strict rules and requirements regarding the functional independence of the persons who shall execute it – the financial controllers. A number of imperative conditions are set as they are related to the appointment of such persons, their competence, as well as the power they have to carry out their duties. Furthermore, it regulates the right of the enterprise's manager to present a motivated position to the financial controller when he/she expresses a negative view on assuming obligations/making expenses, which in itself is a prerequisite for functional independence and significance of the ex-ante controlling activity.

### **Second stage: 2006 – 2019**

The requirements regarding the ex-ante control and in particular financial control remain valid in this form until 2006. As a result of the negotiation process of the Republic of Bulgaria and Chapter 28 "Financial

Control”, an entirely new approach for the organization of public internal financial control is adopted.

In 2006 the Financial Management and Control Act in the Public Sector is adopted; it defines the managers’ requirements regarding managerial responsibility and their direct responsibilities for the creation of systems of financial management and control (SFMC). It determines the necessity of regular updating of the system by conforming to the principle of “reasonable assurance” and cost of control (Financial Management and Control Act in the Public Sector, 2006).

The normative base as of that moment creates conditions for the development of an entirely different managerial culture based on the principles of good financial management and transparency, unlike the preceding control model which is based on subsequent investigations and sanctions.

The introduced philosophy of internal control is based on the base formulations in the Integrated Framework of Internal Control – COSO, by formulating a three-dimensional model with a direct dependence among the objectives, elements and structures, and the activities in the enterprise (COSO, 1992).

As a result, the legislation (Financial Management and Control Act in the Public Sector, 2006) defines the objectives which shall correspond to the systems of financial management and control. They are expressed in compliance with the legislation, internal acts and contracts; reliability and comprehensiveness of the financial and operative information; economy, efficiency and effectiveness of the activities; and preservation of the assets and information.

The elements of SFMC are analogous to the components of the COSO model. There are five interrelated elements defined as control environment, risk assessment, control activities, information and communication, and monitoring activities.

The third aspect of the model is presented by the structures and activities in the enterprise in which the processes flow and in which the model of internal control shall be implemented.

The change of the philosophy of internal control also reflects the ex-ante control for legality. It is now structured as part of the controlling activities element, which respectively is part of SFMC. The scope of ex-ante control is expanded and it is no longer limited to the financial activity of the enterprise, but it also involves the operative activity as well. In this respect, there are no longer requirements regarding the obligatory appointment of a financial controller, while managers are allowed to make a decision whether the ex-ante control for legality shall be executed by a financial controller or assigned to other persons. The exact order and means of implementation is determined by

the instructions given by the Minister of Finance (Minister of Finance, Instructions for the Execution of Ex-ante Control, 2006) and the directions regarding the elements of internal control (Minister of Finance, Methodological Directions Regarding the Elements of Financial Management and Control, 2006).

In order to achieve its purpose, the ex-ante control for legality is executed interminably and encompasses the whole activity of the enterprise. Its objective is to assure the manager beforehand that the decisions he/she is to make are legal, on the condition that the costs for this control shall not exceed the benefits from it.

The identified subjects of ex-ante control are divided into two categories. The first one includes the enterprise's manager or the persons who are authorized to make certain decisions. In other words, this is the end-user of the opinion on the basis of which the action is to be performed or the decision is to be made. The second one includes the persons who are appointed to execute ex-ante control for legality. They might be persons who are part of the operative management of the enterprise, or they might be persons with specific controlling functions regarding the processes and activities, as well as persons who are additionally appointed to execute ex-ante control for legality. Despite the wide range of the category, the main persons who execute ex-ante control for legality in the financial activity of the enterprise remain the financial controllers.

The formulated stages for the execution of ex-ante control for legality are three and are expressed in: providing complete documentation, executing particular inspections; expressing a written opinion by the person who executes ex-ante control regarding a particular activity/process.

Although ex-ante control for legality comprises the whole activity of the enterprise (operative and financial), the main activities are specifically defined in the instructions. They are related to procurement procedures, the purchase of assets and the acquisition of services, business trips home and abroad, the renting and sale of movable and immovable property, conducting job interviews for the appointment of employees and the very appointment of employees, as well as other specific for the organization activities.

As a result of the performed inspections on the three stages described above, an opinion on the legality of the upcoming decision/action is presented – this shall be documented.

The order and means of documenting the presented opinion from the executed ex-ante control shall be dully described. In this respect, the instructions by the Minister of Finance are clear that each public enterprise shall have internal rules which shall include detailed requirements for documenting the performed inspections in executing ex-ante control without specifically

naming them. The approved means of documenting the opinion are through issuing check lists, statements of findings, questionnaires, onsite inventory inspections, etc. Regardless of the selected means of documentation, the internal rules shall include samples of the particular documents. The performed inspections shall be verified by observing the specified requisites, namely: date of pronouncement, name and position of the person who performed the inspection and his/her signature.

During this stage, the philosophy of internal control and the COSO framework (COSO, 2013) is altered and updated as a result of which a new strategy for its development on a national level is adopted (CM<sup>2</sup>, 2017).

Bearing in mind the researched norms regarding ex-ante control in its present state, we shall note that they have their benefits and drawbacks (Lecheva, 2015). Some of the benefits are: the preventive nature of this type of control, the flexibility of the control in accordance with the specific activity of the enterprise, as well as the possibility for personal assessment by the manager. Some of the negative aspects are: the framework for executing ex-ante control is too general, which will allow the performance of formal inspections and is a prerequisite for omissions in certain risk activities. The lack of firm regulation of the position of financial controller is a prerequisite for neglecting the activity of ex-ante control and lack of understanding of the usefulness and value added by the management.

The second stage is characterized by decentralization of managerial responsibility regarding internal control and in particular ex-ante control for legality. The responsibility for the introduction and execution of ex-ante control shall be taken by the public enterprises' managers, as the order and means of their execution depend highly on their understanding. The new normative base avoids the imperative norms of appointing a financial controller as well as the requirements for qualification and experience of the persons. The order, scope and means of documenting the results of the performed inspections are determined by the corresponding manager based on the instructions given by the Minister of Finance.

### **Stage three: 2019 – present**

As a result of the changes in the COSO framework and the adopted strategy of internal control, the latest amendments in the Financial Management and Control Act in the Public Sector of February 2019 essentially provide a new interpretation on the execution of ex-ante control for legality. The

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<sup>2</sup> Council of Ministers

regulation of Article 13, paragraph 3, section 3 sets the following requirement: the managers of public enterprises shall introduce policies and procedures for the execution of ex-ante control for legality as part of the controlling activities of the enterprises (Financial Management and Control Act in the Public Sector, 2019).

A new and essential moment in the introduction and provision of ex-ante control is determining its order and means of execution. It shall be determined by the enterprise's manager, but not only by conforming to the instructions by the Minister of Finance, but also based on risk assessment and cost and benefit analysis.

The aforementioned regulation plans a drastic change in the order and means of the execution of ex-ante control for legality in the public sector for several reasons.

In the first place, this suggests a subjective managerial assessment by any public enterprise manager. Furthermore, currently, the instructions of execution of ex-ante control for legality have not been changed since 2006 where it is pointed out that the whole activity of the enterprise is subject to ex-ante control for legality.

Secondly, in order to determine correctly the order and means of the execution of ex-ante control, it is stated that the same shall be based on risk assessment and cost benefit analysis.

The introduced in 2006 risk management process, part of the risk management element, involves risk assessment in enterprises. The assessment is carried out on the basis of valuation of each identified risk on the indicators of probability and influence. As a result of the risk assessment, the enterprise prioritizes them and decides what reactions to take on each of them. Based on the consolidated annual reports on internal control of the last three years and researching the processes of risk management on national level, the Minister of Finance reports on the necessity of making additional and constant effort regarding the provision of stability and commitment to the identified objectives of the enterprises (Minister of Finance, Consolidated Annual Reports on Internal Control in the Public Sector in the Republic of Bulgaria for the years 2015, 2016 and 2017). Bearing in mind the difficulties and misunderstanding of the process of risk management in part of the public enterprises, in practice, the possibility for adequate and efficient determining of the process of ex-ante control is to undergo certain difficulties.

The cost benefit analysis is a complicated practical technique which is a totality of approaches, methods and procedures of analysis, assessments and choice of projects in the public sectors, sifted through the prism of alternative economic states.

It is thought that in order for the analysis to be reliable, it shall be based on one or a combination of several of the following indicators/methods: Net present Value (NPV); Economic Value Added (EVA); or Internal Rate of Return (IRR); Profit Index (PI); and Payback Period (PBP). Those indicators/methods measure the value of money towards the particular time period, which is the reason why the results are useful in the condition of economy marked by low inflation and stable currency (Stoychev, 2010).

The cost benefit analysis is used by the management in making decisions on whether to take actions on the execution of a particular project (Brusarski, 2003). Within the context of the presented rate, Article 13, Paragraph 4 of the Financial Management and Control Act in the Public Sector rather describes activities, not projects. There are few budget spending authorities who implement a programme-oriented budget and can use the whole arsenal and opportunities of the cost benefit analysis. When doing detailed research on the range of public enterprises, we come across an instruction for the year 2019 for providing three-month reports applying programme format of the Minister of Finance's budget (Minister of Finance, Regulation № BU № 2 for determining the format, content and terms for providing three-month information on the costs on budget programmes for the year 2019 by first level budget spending authorities who apply a programme format, 2019). It is clear that the addressees are the same number – 24. These are: the Council of Ministers, all seventeen ministries, the State Agency for National Security, the State Intelligence Agency, the State Agency State Reserve and War-time Stocks, the State Agency of Technical Operations, the State e-Government Agency and the State Fund Agriculture. In comparison, in 2019, 317 public enterprises are first level budget spending authorities in accordance with the Budget Act (the Republic of Bulgaria 2019 Budget Act , 2018).

The particular order and means of exercising ex-ante control for legality on the basis of risk assessment and cost benefit analysis will be the scope of the future instructions by the Minister of Finance in accordance with Article 13, Paragraph 4 of the FMCAPS.

Until the Minister of Finance provides updated instructions, we apply several simple basic steps which will facilitate the process of execution of cost benefit analysis through the prism of ex-ante control for legality. To complete those steps, we shall try and answer certain questions regarding certain activities and we shall also receive information about:

1. identifying the set goals and sub-goals which shall be achieved in long-term and short-term order;
2. what actions we shall take to achieve the goals and sub-goals;
3. whether alternative solutions to the determined actions exist and what they are;

4. determining all costs related to a particular activity, including further costs and impacts on all structural units in the enterprise;

5. assessment of the benefits, for which all arguments in favour of each alternative shall be considered. Of all listed factors we shall be able to draw up the future benefit from each of the alternatives which shall possibly have financial expression;

6. comparison of the financial value of costs and benefits;

7. comparison of the alternatives based on the results of the preceding step. Assessment of the costs and motivating the benefits with several arguments, for instance, from one to three.

8. decision for the choice of measures, actions and in particular controls which shall be taken by the public enterprise's management.

Regardless of the order and means by which instructions will be given for the execution of the cost benefit analysis for the purposes of ex-ante control for legality, each enterprise shall come up with policies and procedures for ex-ante control for legality. Clearly the definition in Paragraph 1, Section 10 of the Additional Provisions of the FMCAPS, the ex-ante control for legality is expressed as *all inspections of documents, facts and circumstances related to providing assurance for conforming to the applicable legislation before a decision is made or action taken by the enterprises' managers*. It is also pointed out that it is executed by financial controllers and/or by other persons appointed by the enterprises' managers.

In order to observe those legal regulations and at the lack of updated instructions for their implementation, the public enterprises' managers shall take actions to approve the corresponding policies and procedures. They could be in the form of internal rules or other type of documents approved by a manager's administrative act. The internal rules shall draw a clear and concrete line of movement of the documentation by delegating rights and responsibilities to each participant, the terms and documents which shall be secured, inspected and drawn up.

From the point of view of the efficient execution of the ex-ante control for legality and the structuring of actions, the internal rules shall encompass areas and issues related to the general regulations on the basis of which the control is executed. Essentially, this is the policy of the enterprise's management which shall be effected in executing the ex-ante control for legality.

Significantly, the content of the general rules shall regulate the objective of the executed ex-ante control, its types and the subjects who are involved in its execution. What will their duties, responsibilities and rights be as a result of executing the control? What will the order and means of execution be, as well as the stages which the process will go through? Documenting the executed ex-ante control is also an important aspect of the enterprise's policy. The creation

of sample documents with specified controls will aid the subjects, as well as the users of the opinion expressed by the ex-ante control about the characteristics and important aspects regarding the legality of the upcoming decision or action. In this line of thoughts, the regulation of the specific actions regarding the control before making a commitment, expense and profit can be part of the integrated procedures. The aforementioned characteristics, as well as several additional such, are the ingredients of the author's Model for the Execution of Ex-ante Control for Legality (Lecheva, 2019), which presents the base framework and concept for the execution of this specific control for legality.

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In conclusion, we shall point out that the ex-ante control for legality on a national level in our most contemporary history has undergone significant development. Bearing in mind the vast range of its implementation in public enterprises, it shall be elaborated on as instructions shall be given for the order and means of its execution. Allowing each public enterprise's manager to solely determine the order and means of securing the policies and procedures for the execution of ex-ante control for legality based on risk assessment and cost benefit analysis, hides certain risks for going to both extremes; on the one hand, letting the key processes in the enterprise escape from the range of ex-ante control, while on the other hand, introducing excess controls that burden the enterprises' activities.

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