



**SIGMA**

**Support for Improvement in Governance and Management**

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## **ASSESSMENT**

**SERBIA**

**2010**

# **PUBLIC EXPENDITURE MANAGEMENT AND CONTROL**

### ***Main Developments since last Assessment***

In the context of the economic crisis, severe financial constraints and an IMF Stand-by Agreement have necessitated significant budget revisions and considerable spending cuts. The government has been and still is facing mass protests. Most of the reforms and developments of the last 12 months have been motivated by conditions set by the IMF or the EC in order to meet financing agreements.

SIGMA has not assessed the fulfilment of any of those conditions.

The adoption of the new Budgetary System Law (BSL) in July 2009 was the main pillar of recent developments in the public expenditure management (PEM) system. The new law creates a stronger legal base for medium-term budgetary framework and clarifies the link between budget preparation and strategic planning. In 2010, the Ministry of Finance will for the first time attempt to define a limited number of priorities in the budget memorandum (the multi-annual budgetary framework). It will also be the first time that three year budgetary ceilings are proposed within the budget memorandum. An institutional change was carried out by taking the Budget Preparation Department away from the Treasury and back into the Ministry of Finance. The procedures for budget execution have also been optimised by decentralising the responsibility for ex-ante controls of payment documents (such as contracts and invoices) to the level of direct budget users. Improved quarterly planning of payments and the establishment of a good, cooperative working routine between the new Public Debt Agency and the Treasury have largely resolved the previous liquidity problems.

Some important formal steps have been taken since last year to further develop **PIFC**. The new BSL clarifies the coverage of PIFC, provides for the central harmonisation unit (CHU) on financial management and control (FMC) and internal audit (IA), and spells out its role and functions. The law does not however include a clear definition of the IA function. The Serbian government also adopted its first PIFC policy paper (July). The CHU was formally established in the Ministry of Finance in March, and is headed by an assistant minister and staffed by 3 employees for IA and 4 for FMC. A certification scheme for Internal Auditors has been finalised and the first exams are planned to take place in May 2010. The internal audit unit of the MoF is now staffed by one person.

Important steps have also been taken in the area of **External Audit**. The rules of procedures of the State Audit Institution (SAI), which, according to law needed to be approved by the Assembly, were adopted by the Council in March 2009. Following this adoption, the SAI, with its 8 auditors, audited the financial statement for 2008 and sent a report to Parliament in November 2009. It was the first time since 2001 that the state budget was audited at all. However, no audit opinion was as the SAI considered that due to the lack of trained and experienced audit staff, the audit performed and the evidence collected did not provide sufficient basis for expressing an audit opinion. In October 2009, and after having being housed in the Parliament building for over two years, the SAI moved into offices provided by the National Bank. This is problematic as the National Bank is one of the SAI's auditees. In December 2009, the SAI published vacancies for an additional 12 auditors, but the procedure has not yet been finalised. In February 2010, a proposal for amendments to the Law on SAI Serbia was introduced into the legislative process, the main purpose of which being to raise the salaries of the audit staff to deal with the difficulty of recruiting and retaining trained auditors in the SAI.

### ***Main Characteristics***

Despite recent progress, the PEM system needs to be strengthened and modernised. The authorities need to consider a few particular issues: (1) the number of direct budget users (60) is still relatively high to ensure meaningful ministerial ownership and good quality of strategic planning; (2) the number of line-items in the annual budget is also still very high; and (3) although in most cases the spending options for the 'own-revenues' of budget users are legally determined, they are still not included in the general budgetary ceilings. There are no signs of plans to strengthen the role of the parliament in the process of budget preparation. Although the practice of investment planning seems to be logical, the BSL is unclear in terms of the responsibility for public investment planning. In particular, the role of the MoF in coordinating the planning of public investments needs to be clarified in the legislation.

The legal basis now provides a good basis for establishing management accountability and delegation for **PIFC**. However, general awareness and implementation, at both senior management level and lower operational

level, is not yet sufficient for the concrete implementation of the PIFC concept<sup>1</sup>. Useful instruments and systems, such as the new computerised public finance management system, have been developed and have contributed to the general improvement of financial control. *Ex ante* control is now *de facto* the responsibility of direct and indirect budget users. *Ex post* controls of the legality of spending budget funds is still however conducted by the budget inspection, a separate organisational unit within the Ministry of Finance. The budget inspection service needs to be reformed and harmonised in line with the PIFC concept. The borders between internal audit and inspection need to be clearly defined and implemented, making sure that the budget inspection focuses on detecting fraud and irregularities. The recently established CHU still has to find its role, especially in coordinating and harmonising financial management and control in relation to the Treasury. Currently, the CHU is concentrating on providing training for internal audit, which is also still at an early stage of development. Where internal audit units are in place, they are not sufficiently staffed and auditors lack experience and legitimacy in the eyes of heads of budget beneficiaries.

Preparations for the **management of IPA** funds under decentralised implementation system (**DIS**) have to a large extent been carried out according to the broad timeframes foreseen. However, the establishment of an Audit Authority for IPA funds has not taken place and it seems that there is no real ownership of the matter among the authorities. As is common in many countries, the preparations for DIS are carried out relatively in isolation from the initiatives in the area of PIFC.

Because of the extremely long time it took to be established, (four years separated the adoption of the Law and the publishing of the first audit report) the SAI Serbia is still a very young institution and at an early stage of institution building. In 2010, the SAI employs 11 auditors, the 5 members of the council and 7 administrative staff. So far, only two of the six planned audit sectors actually exist. There seems to be some confusion within the MoF regarding the role of the SAI. Considerable efforts will be needed to increase trust in the SAI and raise awareness of the function and role of external state audit.

### **Reform Capacity**

Capacity exists for bringing changes to the **public expenditure management** system. In particular, reform momentum is visible in the Treasury, which leads most of the developments in the system of financial management. There are a number of different ongoing and planned IT developments to facilitate the reforms in Treasury and in its relations to budget users.

Although the authorities are in general satisfied with the new Budget System Law, a well-advanced plan to introduce new changes to the BSL already exists – in particular to introduce more formal fiscal rules (both procedural and numerical) but also to clarify the role of internal audit.

The recruitment restrictions and staff spending cuts decided by the government as a response to the financial crisis, which hit Serbia hard in 2009, will restrict the reform capacities<sup>2</sup>. There is no sign so far that the budget restrictions will be seen as an opportunity for reforms to increase the efficiency and effectiveness of public financial management.

The adoption of the **PIFC** policy paper and the formal establishment of the CHU were milestones in the development of PIFC in Serbia – at least at the technical level. The CHU recognises its need for external support, and a technical assistance project is being prepared and will support the CHU in further developing the system. However, this assistance can only address the technical level. It remains to be seen whether political support for this reform is sufficiently strong and sustainable to ensure the necessary changes.

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<sup>1</sup> See for the general situation in the public administration SIGMA assessment “General Administrative Law Framework and Public Service”

<sup>2</sup> For more details, see SIGMA assessment “General Administrative Law Framework and Public Service”

The **SAI** has been benefiting from a 3 year support project with the Norwegian National Audit Office since October 2009. With this support, the SAI plans, in 2010, to develop the strategic plan for 2010-2015 and the methodology for financial audit. After a very difficult start, the SAI Serbia now seems to have found its way for slowly fulfilling its mandate. However, the SAI's professional capacity still needs considerable development before it can play a significant role in the country's financial accountability system. Although the current Law on SAI has some weaknesses, especially with regard to its size and the level of description of procedures, and some questions remain regarding the practical efficiency of some of the provisions, the law is considered to be broadly in line with international standards. Revising the law substantially would withdraw the few existing resources available for implementing it by reinforcing the SAI as an institution, recruiting auditors, and training them - ideally "on the job"- to execute the SAI's mandate. Recruitment and additional practical audit experience are also prerequisites for acquiring the necessary capacity to fully benefit from external support through technical assistance or Twinning.