



SIGMA

Support for Improvement in Governance and Management

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ASSESSMENT

The former Yugoslav Republic of Macedonia

2010

PUBLIC EXPENDITURE MANAGEMENT AND CONTROL

Main Developments since Last Assessment

In 2009, the economic downturn reduced revenues and encouraged the government to contain spending in order to achieve its fiscal deficit targets. However, FYROM was not hit as badly as other countries of the region and it did not need to apply for support from the IMF. It might however only be a matter of time before the economic crisis begins to affect the country, negatively impacting on possibilities for further reform.

There have been some minor changes in the area of public expenditure management **PEM** over the last year. Positive steps include allowing the carry forward of unspent capital allocations into the next year and amending the rule whereby 20% - formerly 30% - of capital allocations must be spent in the first half of the year or be surrendered. . Some progress has been made in developing a consolidated cash-based budget statement incorporating state, local government and funds budgets, with consolidated municipality budget data available internally to the Treasury Department. Furthermore, the authorities have suggested that capital investment programmes are being better managed as the technical expertise of budget users has increased and output indicators are increasingly being used to evaluate expenditure programmes. While these are positive steps, data should be published to quantify the degree of improvement.

No progress was made in developing the budget preparation process to strengthen fiscal discipline, facilitate the process of prioritisation between the main policy areas, and improve expenditure and revenue projections. With two supplementary budgets in 2009, it is not surprising that no strategic changes to the formulation process were made. While the original budget deficit target was met, it seems to have been achieved mainly by deferring payment orders until January 2010 (thereby carrying forward costs into the next year) and by increasing emphasis on revenue collection, including through wide scale imposition of heavy fines. The importance of expenditure cuts deriving from genuine policy changes is unclear.

A new law on **PIFC** was adopted in July 2009. This law aims to clarify the PIFC concept and give clear responsibility to heads of budget users. It requires the adoption of a multitude of by-laws for procedures, standards and control activities. The CHU is currently working on 10 by-laws and guidelines with the help of the Dutch bilateral support. None of the by-laws has so far been adopted but the PIFC Department is optimistic regarding their finalisation before end of July 2010, as required. The law's implementation schedule has proved to be too ambitious regarding appointments to positions such as Heads of Financial Affairs Units and Regularity Officers. Only a small number of budget users have taken the required initiatives. The PIFC Department has organised awareness raising events of the new PIFC Law in twenty-five budget users and training in ten pilot budget users. A new version of the PIFC policy paper is being discussed internally within the Ministry of Finance (MoF).

In order to develop **External Audit**¹, the State Audit Office (SAO) of FYROM updated its Development Strategy and formulated its strategic goals for 2010-2014 in December 2009. A draft SAO Law and the Audit Authority (AA) Law, which will establish the AA as an institution independent from the SAO and from all managing and controlling structures for DIS were adopted and came into force in May 2010. Already in 2009, the SAO submitted the annual report for 2008 not in September (as was required by the old law) but in June, which is the deadline of the new SAO Law. To make reports more user-friendly, the SAO designed a new format for the annual report and regular audit reports. During a special government session in February 2010, the Government discussed the annual report in the presence of the General State Auditor and took decisions based on it, setting deadlines for activities to remedy shortcomings. The first examination for the qualification of Chartered State Auditor took place on 6 March 2010; 25 auditors passed the exam.

Main Characteristics

FYROM's public expenditure management system contains many of the attributes of an effective and efficient administration characterised by control of public funds and political commitment to fiscal discipline, as

evidenced by the measures taken to meet the original budget deficit target. Staff in all departments visited clearly have technical knowledge and ability. The treasury system tightly controls expenditures and produces timely and informative reports on budget evolution and deviations. The Liquidity Commission, which comprises senior staff from relevant Departments, has a good record of ensuring liquidity to meet essential expenditure commitments.

Nevertheless, previously identified weaknesses remain, with no major changes having been implemented in the past year. These include difficulties in retaining staff (which may have been exacerbated by the need to apply a recruitment freeze in response to the financial crisis), the absence of information on the impacts of current budget decisions on the budgets of future years, and the fact that a consolidated set of accounts is not produced at year-end for parliamentary approval.

In particular, the detailed expenditure proposals presented in November cannot be robust since the overall budget and economic strategy framework is poorly defined and is based on macroeconomic projections prepared in May, despite the fact that the Macro-Economic Department clearly has the skills to provide updated data in a timely manner. There seems to be a mistaken belief that the accuracy of the initial projections is unimportant because supplementary budgets will ensure that the budget deficit target is met anyway. This approach ignores the serious weakness of relying on supplementary budgets; no strategic changes can be made to the budget process due to the resource and time constraints imposed by the supplementary budgets. Unless this changes, little improvement will be made in the area of public expenditure management. Plans to introduce advanced concepts such as full programme budgeting need to recognise the need to first address the more fundamental weaknesses of PEM.

The legal basis for **PIFC** has improved but the relationship and inter-linkage between the Law on Budgets and the PIFC Law are unclear with regard to financial management and control. In most organisations, the head of the organisation is also the “manager” for the whole organisation. Many managers believe that managerial responsibilities can only be carried out properly if the head of the organisation takes all decisions². PIFC arrangements cannot work effectively under such conditions. Although the new legislation encourages internal delegation, it will take some time for new internal control arrangements to turn into new management arrangements. Progress has been made in establishing and staffing internal audit units, but no evidence is available regarding the quality and of internal audit reports and their acceptance by managers. FYROM is at a relatively early stage in the development of PIFC, during which the importance lies in developing the basics for financial management and control systems and internal audit.

Although **External Audit** and the SAO are still not mentioned in the constitution, the new draft Law on SAO should provide the institution with better financial independence (its budget will be approved directly by Parliament) and opens possibilities for a more risk-based approach to the choice of audits. The impact of audit reports on the way in which audited budget-users carry out financial management is still rather limited, but efforts are made on both sides (SAO and government) to change this. No overall opinion is given on the annual budget execution report, and proper discharge procedures still need to be developed. Performance audit is in an early stage, but its importance is increasing for the SAO. While developing performance audit should in principle be welcomed, it should not divert resources necessary away from for the further development of financial audit methodology and skills. The impact of performance reports will remain very limited as long as the SAO cannot count Parliament as a real partner.

Reform Capacity

Lack of funding hinders the Ministry of Finance’s plan for an IT upgrade to further integrate data sharing between the Budget, Treasury, Debt Management and Macro-Economic Departments. While “technical assistance overload” of the system should be carefully avoided, this particular topic could be addressed through a technical assistance project. Apart from facilitating more rapid and automated production of data to enhance up to date analysis, an objective of such a project should be to produce consolidated budget data for all budget

2 See also SIGMA assessment 2010 “General Administrative Law Framework and Public Service”

users. Another objective should be the development of a process that allows for the timely incorporation of both macro updates from the Macro-Economic Department and the impact of new policy proposals into the budget formulation and monitoring process. The overly ambitious plan to introduce Programme Budgeting for 2012 should be carefully considered and evaluated in light of the more fundamental PEM weaknesses that need to be addressed. With ongoing support from the Netherlands, the CHU is further developing **PIFC**. While the legal basis continues to be improved and instructions for its implementation are prepared, there seems to be little political will in the MoF to commit itself, through a policy paper based on a gap analysis that would clearly outline objectives and the required activities to reach them, supported by time planning and distribution of responsibilities.

Through several years of support from the Netherlands Court of Audit (first under a Twinning, now under a bilateral support project), the **SAO** has continued to address the current shortcomings and further develop the professional capacity of its staff. While the SAO has proved its technical capacity for changes and improvements in audit work, an enhancement of its capacity to contribute to improving the system of financial management of the public administration is needed. Financial audit and audit of financial statements also has to be further aligned with international standards.