



**SIGMA**

**Support for Improvement in Governance and Management**

A joint initiative of the OECD and the European Union, principally financed by the EU

**SERBIA**

**PUBLIC EXPENDITURE  
MANAGEMENT SYSTEM**

**ASSESSMENT MAY 2009**

## 1. Summary

### *Main Developments since last year*

The system for public expenditure management in Serbia has not changed much since last year's assessment. A new financial management information system has been introduced, which has improved the work in the phase of budget execution and reporting, but more substantial changes to the system have been postponed. A year ago there was a plan to amend the Budget System Law, but the unexpected parliamentary elections and the formation of the new coalition government interrupted the process.

The same amendments, with perhaps some small modifications, are planned to be submitted to parliament in the near future in 2009. These changes are necessary to build a comprehensive (multi-annual) budgeting framework.

### *Main Characteristics (strengths and weaknesses)*

The draft for amending the Budget System Law does not include significant changes to the timetable for budget preparation, however, and it thus does not address a major concern over the years with regard to the limited time – only six weeks – that parliament is given for discussing and passing the budget bill.

The budget documentation is still very detailed, and the annual budget is not well linked to the strategic planning processes within the government. Some ministries also include programme information in their budgets, but such information is not used throughout the budget.

Another issue is that all government expenditure is not included in the state budget. Most importantly, the budget does not include all donor funding, and the national investment programme is also separate from the budget discussions. Also, the own revenues are treated differently in the budget discussions, as these do not form a part of the budget ceilings agreed for the ministries.

The major issues in the budget execution phase have also remained unchanged in the past few years, with one of the main problems being cash management. It remains to be seen whether the new IT tools will help to improve the system.

The general rules and the IT tools for good budget execution seem to be in place, but in practice the system of payments still requires too much administrative effort from budget-users and from the Treasury as well. The information that is required for presentation to the Treasury is very detailed, even too detailed to enable the Treasury to perform effective controls.

A major concern and considerable shortcoming of the current financial accountability system is the fact that the supreme audit institution in Serbia (State Audit Institution) is not yet fulfilling its role of auditing the financial statement of the budget and providing parliament with an annual opinion and/or audit report on public finance management by the government.

### *Recommendations for Reform*

The planned amendments to the Budget System Law need to be finalised and presented to parliament for adoption as soon as possible. Among the amendments, the Serbian authorities should include some revision of the budget preparation timetable in order to give parliament more time to discuss and vote on the annual budget. In addition, the Budget System Law does not have to regulate some of the administrative issues that can be regulated by the government – e.g. the detailed tasks and responsibilities of the Treasury sector.

Regarding new strategic planning elements that are foreseen to be introduced with the new Budget System Law, it is even more important to start with the methodological support, guidelines and training if the authorities intend to be ready for the 2011 budget preparation process in early 2010.

The extra-budgetary funds are not all fully self-financed and a significant transfer of funds is made from the state budget. Budget discussions on these funds have been brought in line with the timetable of the state budget. This may not be sufficient, however, and there are strong arguments for considering a consolidation of these funds into the budget. .

A clear strategy for financial management system reform needs to be developed and approved, putting an emphasis (among other issues) on clarifying the roles and responsibilities of the various stakeholders in the financial management process and on creating proper co-operation mechanisms. This would require as a first step an assessment of the current state of play in this area. The aim of the strategy would be to set concrete goals and targets as well as planning measures to achieve the targets set.

Emphasis should be placed on setting effective co-ordination mechanisms within the administration so as to avoid duplication of activities and to ensure the setting of clear responsibilities.

## 2. Overall Fiscal Situation

For the year 2008 the level of consolidated public spending (including the extra-budgetary funds and the local governments) in Serbia was estimated to be 1.215 billion RSD, which amounts to 43% of GDP. The consolidated public sector balance, according to the methodology of the IMF General Finance Statistics (GFS) 86, has been in deficit since 2006. For 2008 the government had the aim of keeping the public deficit at the level of 0.6% of GDP; however, the weakening economic environment led to a total deficit of around 2.4% of GDP.

The most recent estimates show a deficit of over 3% (which is the general target under which the deficit level should be kept) in 2009 – including the planned corrections with the supplementary budget – and despite the plans of only a year ago to reach a surplus in 2010 at the latest, which in the current economic environment is unlikely in the medium term.

Serbia's public debt has been reduced in recent years. As a share of GDP it was brought down from 50.2% of GDP in 2005 to just 27.6% in 2008. This has been partly due to high nominal GDP growth, but also in absolute figures the consolidated public debt has been diminishing.

In the period 2006-2008 Serbia achieved excellent economic growth figures, which were partly boosted by significant inflow of foreign direct investment and financial sector growth. These positive macroeconomic results were accompanied by high inflation, a growing trade deficit, and wage growth that outpaced productivity growth.

The relatively good fiscal situation has been influenced also by the proceeds from privatisation. On average the annual benefits from privatisation were around 600 million EUR.

Serbia, as many other countries in the region, is currently experiencing the strong negative effects of the global financial and economic crisis. Revenues in the first two months of 2009 are considerably below forecast, and sources of financing to make up for any shortfall are not available from the financial markets. This has led to negotiations with the IMF, which may lead to reforms in economic and fiscal policy.

The fiscal policy of the government in the medium term has aimed to cut public spending as a share of GDP by 2.0 percentage points and to improve the fiscal balance by 1.2% of GDP compared to the levels in 2007. In order to achieve the goals of the fiscal policy, the main measures for reducing public expenditures were foreseen to be the following (in comparison with the year 2007):

- reducing public investments by more than 10%;
- reducing subsidies by 5%;
- freezing the real level of wages.

**Although the fiscal policy was aimed in a desirable direction (according to the fiscal strategy presented in the budget memorandum of November 2007), the relatively sudden macroeconomic developments have led to a situation where even much stronger reforms and fiscal corrections are not likely to enable the objectives of 2007 or 2008 to be reached.**

## 3. Legal and Institutional Framework

The new Constitution of the Republic of Serbia was adopted following the referendum in October 2006 and replaced the previous constitution that dated from 1990. The Constitution stipulates that Serbia must have a budget and that the procedures for adopting the budget must be regulated by law. The Constitution also specifies that budget implementation is to be audited by the State Audit Institution and that the National Assembly is to discuss the financial statement of accounts upon receipt of the evaluation of the State Audit Institution.

Fiscal matters in the Republic of Serbia are regulated by the Budget System Law originally drafted in 2002. –The law outlines the planning, preparation, adoption, execution, accounting, reporting and control of the central government budget, the budgets of autonomous provinces and the budgets of

local self-governments as well as the preparation and adoption of the financial plans of extra-budgetary funds. It is a very detailed law and also regulates various administrative issues between various government bodies, which are not commonly part of an organic budget law.

The law has since been amended a few times. Recently a new draft Budget System Law was prepared and presented to the National Assembly. The main changes proposed were related to creating preconditions for the management of EU funds and with respect to medium-term budgeting as well as programme budgeting. The draft was discussed and met with general approval but was not adopted before the dissolution of the National Assembly, decided in March 2008.

On the basis of the changes already proposed to parliament at the beginning 2008, the Ministry of Finance prepared by the end of March 2009 a new proposal for the amendment of the Budget System Law. The key changes, according to the draft, are:

- creation of a new legal base for the medium-term budgetary framework;
- creation of a more formal strategic planning framework by establishing a clear link between budget preparations and strategic planning (requirement for budget-users to prepare strategies that are part of the budget negotiation process);
- specification of the requirement that within the medium-term budgetary framework three-year expenditure ceilings are to be established for all budget-users;
- clear requirements for including EU and other assistance in the budget.

The new amendments to the Budget System Law have yet to be presented to parliament. However, the draft was said to be ready and the Ministry of Finance was committed to sending the draft for inter-ministerial consultation and then to the government in the near future.

Procedures for parliamentary approval of the government's budget proposal are regulated in the Rules of Procedure of the National Assembly of the Republic of Serbia.

### ***3.1. Fiscal Relations and the Role of Parliament***

Fiscal relations in Serbia are characterised by a strong position of the government and a relatively limited involvement of parliament in fiscal affairs. According to the Budget System Law, parliament should approve the state budget and the financial plans of the extra-budgetary funds. Since the budget also includes limits on borrowing and on the total amount of guarantees that can be issued, parliament formally has to sanction all financial liabilities that the government incurs.

A few of the most influential provisions related to the role of parliament have remained unchanged over the past few years:

- In accordance with the Budget System Law, any amendment proposed by parliament that leads to increased expenditure in relation to the government's budget must be accompanied by a corresponding decrease of expenditure elsewhere in the budget or by a proposal for increased revenue. It is noteworthy that changes in the direction of greater expenditures proposed by parliament cannot be covered by additional state borrowing but have to be strictly compensated by the reduction of other expenditure or the creation of new revenue.
- Significant changes in current-year expenditure require parliamentary approval through a supplementary budget. According to the Budget System Law, the government has the mandate to make reallocations between appropriations of up to five per cent of the initial figure. More substantial changes must be approved by parliament.

Although parliament approves the state budget, it is not in a position to seriously challenge the government's proposal. According to the Budget System Law, the government should submit its budget proposal to parliament no later than 1 November. Parliament is required to adopt the budget by 15 December. Such a short time frame for parliamentary discussion is not in line with international good practice (for example, OECD Best Practices for Budget Transparency), and gives insufficient

time for a proper scrutiny of the budget. Therefore, time limitations and parliament's weak capacity to scrutinise the government's budget proposal are issues that should be addressed.

**In general, there is scope for strengthening parliament's role in fiscal matters – over the past few years no significant changes affecting the role of parliament have been made. Parliament should have more time for budget discussions.**

### **3.2. Scope and Transparency of the Budget and Quality of Budget Documentation**

During the past year the budget process and the budget documents have not undergone any visible improvements. Budget documentation is heavily focused on the line-item division of expenditure. However, the content of the budget documentation as it now stands constitutes a limiting factor to the role of parliament. The level of detail in the documentation makes it also less understandable and less transparent for both parliament and the general public.

The budget is divided into two parts, with the first part containing main fiscal parameters; the second part of the budget is made up of appropriations for first-line spending-units – direct budget beneficiaries – and second-line spending-units – indirect budget beneficiaries. All appropriations are classified according to an organisational, functional and three-digit economic classification. The Budget System Law also foresees a programmatic structure, although in practice this is the case for only some ministries. Appropriations for investment purposes are included in the budget.

In general the structure of the budget is very detailed, especially in terms of economic classification. This may be adequate to closely monitor expenditure, especially given the internal control systems in budget-users that are still to be improved. The inclusion of activity-related and/or performance-related information could nevertheless make the budget more accessible and could facilitate the discussions in parliament and by the public of the government's proposed policies and previous years' results, provided there is enough awareness in parliament to address these issues with benefit.

Some ministries have their budget divided according to a programme structure. In the 2008 and 2009 budgets this is the case for the five ministries (Ministry of Public Administration and Local Self-Governments, Ministry of Trade and Services, Ministry of Religion, Ministry of Education, Ministry of Health) that were pilots in the programme budget development initiative, which started in 2006 while the budget for 2007 was being prepared, with the support of a technical assistance project. For the budget year 2008 the annual financial statements had to also include a report on the outputs of programme budgets. The feedback has been different – some ministries (Ministry of Health in particular) are satisfied with the experience, but there is no real desire on the part of the Ministry of Finance and the government to receive programme information for all first-level budget-users. Today the use of programme and project levels in the budget structure of different ministries is inconsistent.

It is likely that programme budgeting will be given further positive support after the new amendments to the Budget System Law take effect and when the foreseen strategic planning framework starts to work (proposed amendments to the Budget System Law oblige main budget-users to prepare strategies that are part of the budget negotiation process). If all ministries need to present their sector-based strategies for a three-year period together with the basic performance information, it is likely that programme budgeting will undergo new developments. However, as the capacity for performance management and impact assessment is rather weak, the links between strategic plans and programme budgeting will most likely remain formalistic.

The new amendments to the Budget System Law foresee clearer requirements for expenditure ceilings for the 2011 budget, but the new Budget System Law has yet to be adopted by parliament.

In accordance with the existing Budget System Law, a three-year memorandum on the budget and fiscal policy has been prepared, which includes projections for a further two years. However, it does not include any details of expenditure ceilings for budget-users. It also does not include any detailed medium-term capital budget projections. However, in order to prepare for the challenges of the next year, already in 2009 (for the 2010 budget) the Ministry of Finance has asked line ministries to provide more substantial information for a three-year period.

In the background, the basic circumstances for developing the medium-term budgetary framework have improved, as the government has approved more and more mid-term strategies. However, these strategies are not part of a systematic strategic planning framework but are rather prepared at the initiative of the various line ministries. This can be explained by the fact that so far there has been no legal regulation for streamlining the strategic planning initiatives.

In the Serbian budget system there is a separate National Investment Programme (NIP). So far the expenditures related to the NIP are not fully included in the budget. Although full integration of the NIP and of other capital investment budget expenditures is unlikely to occur in the short term, it is important to take steps to ensure that all proposed investments (or some key investments if these are well defined) are fully included in the budget documentation and ideally also included in the expenditure ceilings established during the budget preparation process.

The initiative to bring the funding of investments more into focus is welcome, but the mechanism that has been created cannot work as a logical basis for budgetary decision-making (mainly due to the fact that decisions on the use of funds are not being made within the budget process and that decisions on what to finance from the investment budget affect the rest of the budget and vice versa). Furthermore, there is a potential contradiction between the initiatives of programme budgets and the mechanism that has been created to allocate funding for investments. If the key parts of programmes (all investments) are not actually described in these programmes, it is also difficult to develop and use valid performance information in the policy areas concerned. The authorities should consider merging investment planning with the standard budget process.

Also in respect to the extra-budgetary funds, the Serbian authorities have not reported any recent changes. The five social security funds – covering pensions and disability insurance, health care, and unemployment – constitute separate budget entities with their own revenue sources from social security contributions. Budget preparation for the extra-budgetary funds is regulated in the Budget System Law, and largely follows the procedures for preparing the state budget (see section below). The financial plans for the funds are submitted alongside the budget for parliamentary approval. Consequently, parliament has a full presentation of all expenditure and revenue affecting the central government's net lending. The funds are nevertheless not fully self-financed, and there is a significant transfer of funds from the state budget. Therefore it is important to incorporate these into the state budget.

The own revenues seem to be a major concern in ensuring comprehensive budget preparation, as these are largely not included in the expenditure ceilings established for budget-users in the process of budget preparation. In the case of some ministries, the own revenues constitute even up to half of all budget revenues. Consolidation of the rules for the use of own revenues is important in order to give to the government as a whole and to parliament better control over the use of all governmental revenues.

According to the Budget System Law, the budget should include an assessment of outstanding guarantees and other contingent liabilities and also contain a tax expenditure report, but such information has not yet been included in the budget.

Together with the annual budget two reserve funds have also been established – a permanent reserve and a current one. The Permanent Budget Reserve is used to cover expenditures incurred due to unforeseen circumstances (e.g. national disasters), while the Current Budget Reserve is used to finance any kind of legal acts approved by the government within the budget year. While the need for a reserve like the Current Budget Reserve is understandable in a rapidly changing and developing environment, it should be noted that the present system increases fiscal risks and reduces the transparency of the budget (also taking into account the fact that parliament is not provided with information on the entire plan of activities for the next financial year since the launch of new activities can be financed from the budget during the budget year without parliamentary approval). The system of budget reserves has not changed in the past year.

There are rules in place requiring an explanation to be attached to any new draft legislation, containing an estimate of the financial resources required for implementation. According to the

Budget System Law, all new initiatives must be submitted to the Ministry of Finance for its opinion before being submitted to the government. In practice these requirements seem to be formally complied with, but the costing provided is often seen as inadequate and the Ministry of Finance (together with the Treasury) is only allowed limited time (often some hours only) to comment on the explanation, which is clearly not enough to ensure meaningful quality. Efforts should therefore be made to create working procedures and to improve administrative capacities (at the level of both line ministries and the Ministry of Finance) for carrying out impact assessments of new legal acts or amendment proposals.

The fiscal data is largely based on GFS 86 standards. The National Statistical Office is also producing some data according to the basic requirements of European System of Accounts (ESA) 95, but there is a clear need to establish a systematic development process for these issues.

**There are continuous challenges in terms of improving the quality and transparency of budget documentation. Given the government's subsidiary responsibility for the financial commitments of the extra-budgetary funds, there are strong arguments for considering a consolidation of these funds into the budget. Medium-term budgeting and programme budgeting do not work properly now, but it is important to continue both of these developments, with the support of the foreseen strategic planning framework. It is also important to use the new strategic planning rules to link existing strategic planning efforts to the budget process.**

### **3.3. Budget Preparation Process**

Budget preparation is to a large extent still an incremental bottom-up process heavily focused on a division of expenditure into line items, with limited attention given to performance-related aspects. A more top-down approach can be developed along with the foreseen strategic planning framework (linking strategic plans to budgeting and thus providing the Ministry of Finance with systematic information for a top-down approach).

Despite the suggestions of recent years, the draft for amending the Budget System Law does not include significant changes in the timetable for budget preparation.

Today the process starts with a forecast of relevant macroeconomic parameters and a specification of fiscal objectives for the medium term. For the first time, in 2009 budget-users are asked to indicate their financial requirements for the following three years (2010 to 2012). This initial phase culminates in a budget memorandum, containing a medium-term macroeconomic framework, main fiscal parameters for the upcoming years, and information on the government's main policy priorities. According to the Budget System Law, the budget memorandum has to be adopted by the government by 15 May, and should constitute the basis for the continued preparation of the state budget and of the financial plans of the extra-budgetary funds.

Once the Ministry of Finance has finalised the draft budget, it is submitted to the government for approval. By 1 November the government is required to submit the proposed budget to parliament. Parliament approves the budget, in a single voting session, by 15 December at the latest. The unchanged calendar for preparation and approval of the budget is summarised below.

***Budget Preparation and Approval in Serbia***

30 April	Minister of Finance proposes a budget memorandum with main macroeconomic parameters, fiscal policy and main government priorities for the upcoming three-year period.
15 May	Government adopts the budget memorandum.
1 June	Based on the budget memorandum, the Minister of Finance issues instructions for the preparation of budget proposals
1 August	Direct budget beneficiaries and extra-budgetary funds submit their budget proposals to the Ministry of Finance.
1 October	The budget memorandum is updated with the most recent macroeconomic projections.
15 October	Minister of Finance submits the draft Law on the Budget and draft decisions on financial plans of the extra-budgetary funds to the government.
1 November	Government adopts the budget and submits it to parliament.
15 December	Parliament adopts the budget.

Even though the budget preparation calendar is set by the Budget System Law, in the past few years it has not been possible to fully follow the calendar. Despite the dissolution of the Assembly and the formation of a new government in 2008, the 2009 budget was adopted within the year 2008.

Over the last few years the budget memorandum has seen significant improvements in terms of the comprehensiveness and quality of information provided. Nevertheless, the memorandum is still plagued by some deficiencies that prevent it from being an effective instrument for guiding the budget preparation process.

Firstly, overall fiscal parameters, such as central government revenue and expenditure and central government and general government net lending, are presented in the memorandum. However, the budget memorandum does not include information on budget ceilings, which means that these ceilings are not necessarily debated among the members of the cabinet. This information is presented in the budget circular prepared by the Ministry of Finance on the basis of the budget memorandum. If the budget ceilings were to be adopted by the government, there would be reason to believe that budget-users would take the expenditure ceilings more seriously.

The institutional arrangements in the budget preparation process, where budget-users' expenditure proposals are not restricted by firm ceilings, may lead to a deterioration of government finances, as the Ministry of Finance is unable to restrain pressure for increased expenditure.

Secondly, although the budget memorandum contains a medium-term framework, the budget is only prepared in a one-year perspective. According to the Budget System Law, the budget proposals that budget-users submit to the Ministry of Finance should contain information on the two fiscal years beyond the upcoming year. These projections should then be consolidated into the government's budget proposal, and parliament should be presented with a full picture of the development of government finances in a three-year perspective. In practice, the budget is still prepared strictly on a one-year basis, and there is no medium-term information on individual appropriations or revenue items in the budget-users' proposals or in the government's budget bill.

**In order to provide stability to the budget process, promote fiscal discipline and ensure sustainable public finances, consideration should be given to the introduction of clear top-down elements. A considerable challenge for the Serbian administration is to enhance the capacity to make medium-term macroeconomic and fiscal forecasts, both in the Ministry of Finance and in line ministries.**

### 3.4. Budget Execution

The area of budget execution has improved over the past year, mainly due to the new financial management information systems that have been in use while new modules are still being introduced.

The state budget, the financial plans of the extra-budgetary funds, and the budgets of local self-government units are executed by the Treasury through a treasury single-account system. Since the merger in August 2005 of the Treasury with the Public Payments Administration (PPA), budget execution has been fully managed by the Treasury. The creation of a single organisation responsible for all treasury-related functions has improved the conditions for a secure and efficient management of government funds.

The Treasury performs detailed control of all payment requests to ensure that the detailed line-item classification of the budget is complied with, that monthly cash apportionments are not exceeded, and that sufficient liquidity is available in the treasury single account to execute the payment. At the same time, the Treasury also registers all transactions in the treasury general ledger (see below for a discussion on government sector accounting). Through the centralisation of budget execution, a stringent control of transactions is possible. One of the recent developments has been the creation of a new Treasury IT system, which has been operational since 1 January 2008. The new IT system seems to be working well and also is appreciated within line ministries.

All invoices and contracts are sent to the Treasury, although according to the legislation responsibility for the correctness of expenditure lies with budget-users. This detailed level of financial control within the Treasury – although necessary at this stage – might not be the most effective way of ensuring the necessary control over payments in a longer perspective. In the medium term, targeted risk assessment-based, ex ante controls should be sufficient to reduce the administrative burden, both for the Ministry of Finance and for line ministries. It is also likely that real accountability would improve within line ministries.

The management of liquidity in the Serbian administration has improved with the creation of a unified Treasury under the Ministry of Finance and the development of a treasury single account that includes all budget entities. Nonetheless, the availability of liquidity continues to be a problem, and the Treasury is forced to resort to cash-rationing on a regular basis. Since the inflow and outflow of cash to the government do not coincide on a daily, or even weekly, basis, the Treasury has to take into account its cash position before approving a payment. To some extent, this problem can be circumvented by cash planning, where payments have to be registered beforehand to allow the Treasury to assess the necessary liquidity to cover all financial obligations.

Progress is being made to develop cash forecasting capacity. A new financial planning module has been developed in the Treasury IT system, and all direct budget-users have been asked to submit their cash plans online by means of the module. The testing phase of the new module is now coming to an end and in May 2009 the new system for cash planning will be operational. For the moment it is too early to assess the extent to which the administration can take advantage of the new treasury system and improve the situation regarding cash management. In the longer term, the access to financial markets where short-term liquidity positions can be managed is a precondition for efficient financial management.

In the event of more permanent liquidity concerns, the government has the authority to suspend part of the expenditure for up to 45 days. During this period, if necessary, the government should submit to parliament a supplementary budget.

Expenditures related to foreign currencies currently being paid from special accounts outside the TSA are not being recorded properly as budget expenditures. The budget execution module of the Treasury IT system is currently being modified to allow it to record details of foreign currency expenditures (currently it can only handle dinar-related expenditures). This revised module should allow direct budget-users to enter details of these transactions, which can then be consolidated into the accounts. The module is expected to be operational by May 2009.

Consideration should be given to allowing less stringent rules for carrying the funds over to the next budgetary year in order to avoid the so-called “December fever”. Up to a certain level the higher expenditure levels at the end of the year are justified (e.g. due to tendering processes), but current execution figures indicate a clear motivation for budget-users to make use of all available funds by the end of the year so that they are not lost.

An area where the status of the reform process is somewhat unclear is the administrative responsibility for the management of public debt. The Public Debt Agency (PDA) referred to in the Public Debt Law was established by a government regulation specifying its functions and responsibilities, internal organisation and staff requirements. However, the Debt Management Division is currently located in the State Treasury. In order to ensure greater integration of the cash and debt management functions, it is important to ensure excellent co-operation between the two organisations. Logically, however, it would seem even more convenient if the tasks of debt management were handled by a separate entity within the State Treasury.

**Consideration should start to be given to making ex ante controls performed by line ministries and the Treasury more efficient by introducing a risk-based approach. In order to avoid inefficient end-of-year spending, consideration should be given to setting rules that would allow a carryover of certain funds to the next year.**

### **3.5. Accounting and Reporting**

The Treasury is responsible for keeping a record of all transactions executed from the treasury single account. In this treasury ledger, there is a full record of all payments according to an organisational, functional, six-digit economic and source-of-financing classification. The budget and accounting classification, based on the GFS 86, has not changed in the past few years.

In addition to the treasury ledger, first-line budget-users are required to keep accounting records of their own operations and the operations of subordinate second-line budget-users. Through this records, it is possible for budget-users to submit a report on the basis of the charts of accounts for the budget system, and, consequently, to satisfy the requirement for specific information.

The Treasury produces reports on the execution of the budget, which are presented to the government within two weeks of the end of each month. Currently, direct budget beneficiaries are required to submit annual reports to the Treasury by 31 March; an end-of-year report should be produced and a draft law on the end-of-year report of the Republic should be prepared and presented by the Ministry of Finance to the government by 15 June. This report also includes the end-of-year accounts for the extra-budgetary funds. By 15 July the government should submit the final accounts to parliament (the final accounts of the state budget and the decisions on the final accounts of the financial plans of the social security organisations separately). According to the State Budget Act, the consolidated report must be sent to parliament only by 30 September. It is advisable and – according to the practice of many other countries – also realistic to present the consolidated report sooner to parliament.

Consolidation of fiscal reports is currently being co-ordinated by the Macroeconomic and Fiscal Analysis Department in the Ministry of Finance. The Budget Accounting and Reporting Department in the State Treasury is primarily responsible for reporting on the state budget. The social security organisations and local self-government units submit their reports to the Treasury, which performs their consolidation.

The Budget System Law also requires the government to submit an external audit report together with the final accounts. Although the executive is required to submit final accounts to parliament, such accounts are currently of limited value. In the absence of an operational supreme audit institution, there is no independent statement on the reliability and quality of the accounts provided by the government. Parliament lacks resources to evaluate the contents of the final accounts, and this is a precondition for a meaningful approval. Therefore there is also a lack of support from the external audit function to budgetary decision-making in general. In 2009 the State Audit Institution is planning to audit the final accounts for 2008, but the quality of the audit remains to be seen, as in previous years the supreme audit institution has not provided parliament with the necessary report.

**The fact that the State Audit Institution of Serbia has not yet been able to audit the realisation of the budget and has so far not transmitted to parliament an independent opinion on the reliability of the information provided by the government is a considerable gap in Serbia's reporting and accountability system, which has to be addressed. All stakeholders (Ministry of Finance, parliament and the SAI itself) should co-operate in order to solve this problem for the financial statement of 2008.**

#### **4. Reform Agenda and Capacities**

In overall terms the capacity for sustainable reform needs to be enhanced and a clear strategy for financial management system reform needs to be developed and approved, putting an emphasis (among other issues) on clarifying the roles and responsibilities of the various stakeholders in the financial management process and on creating proper co-operation mechanisms. The strategy would include an assessment of the current state of play in this area, and would set concrete goals and targets as well as planning measures to achieve the targets set.

The existence of a clear reform agenda is especially needed, as currently strong emphasis should be placed on setting effective co-ordination mechanisms within the administration so as to avoid duplication of activities and to ensure the setting of clear responsibilities. Emphasis should also be placed on sequencing the activities for reform – the ambition and calendar of activities should be determined in proportion to the relative (political) instability in the country.

There is a need to increase capacity in the area of expenditure prioritisation and to include expenditure decisions within a medium-term budget framework. These improvements can potentially be achieved with a proper design for the planned strategic planning framework. The work on further roll-out of programme budgeting should continue, especially as a useful start has been made with the five pilot ministries.

The Budget Preparation Department is currently situated in the Treasury (a relatively independent administration under the Ministry of Finance). Discussions are ongoing for moving the department to the core Ministry of Finance in order to have all of the core policy co-ordination tasks within the ministry.

While the Macroeconomic and Fiscal Analysis Department in the Ministry of Finance is performing the tasks of consolidating the reports on expenditure, it is unusual for a macroeconomic forecasting department to be responsible for such a task. It would appear more logical if these particular tasks were fulfilled by the Treasury.

The issue of the most appropriate institutional placement of the debt management function remains to be resolved. Today the relevant regulations foresee a separate agency for these functions, although in practice the Treasury is exercising many of the core functions in these matters.

Changing the division of functions is nevertheless more difficult due to the fact that the functions of the Treasury are described in the Budget System Law and in surprisingly great detail. In the course of amending the existing law, it would be advisable to leave the detailed description of the duties and responsibilities of the Treasury sector out of the organic budget law.

**The reform process should continue, as financial management in Serbia is still some way from good European and international practice. Understaffing and lack of administrative capacity remain problems in many key areas.**

#### **5. External Assistance**

Reform in the area of financial management has been supported by technical assistance projects. A project for the development of a financial management and information system for the Treasury was financed by the European Union. The EU also financed a project aimed at developing budget preparation, with the special objective of introducing programme budgeting. To better assess the preconditions for performance-oriented budgeting in the Serbian administration, the project focused on a limited number of pilot ministries. The objectives of the project were to better link government

policies to actual expenditure and to increase the efficiency of public expenditure. Although the project is now completed and only a few ministries use programme structure in their budget analysis and planning, it is important to maintain support to the Ministry of Finance to ensure the sustainability of the project and the development of the programme structure in other ministries as well.

Apparently no new projects are foreseen in the area of public finance management in the upcoming programmes of component I of the Instrument for Pre-Accession.

The IMF has provided a senior budget advisor to help the Ministry of Finance to address issues primarily focused on budget planning and preparation. The advisor is expected to provide strategic advice and guidance to improve the budget process, including programme budgeting, medium-term budgetary framework, capital budgeting, and mechanisms for in-year expenditure prioritisation in times of fiscal crisis.

The World Bank has supported a wide range of issues related to the development of public expenditure management. Bilateral support in the area of financial management has included a DFID-financed project aimed at developing capacities for producing medium-term macroeconomic and fiscal projections.

**It is logical that any new support by the EU in the area of public finance management will need first of all close co-ordination with other donors. Prior to any new assistance a more coherent reform plan should be approved by the government at some level. However, even in the absence of such a reform plan, if the government still recognises a concrete need for assistance, it may be worthwhile to try to find flexible resources to support these activities.**