



SIGMA

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SERBIA

**PUBLIC INTERNAL FINANCIAL
CONTROL (PIFC)**

ASSESSMENT MAY 2009

1. Summary

Main Developments since last year

After some years of very slow development of public internal financial control (PIFC) in Serbia, there now has been some modest but tangible reform progress over the past year. Since autumn 2008 one of the state secretaries in the Ministry of Finance (MoF) has been officially responsible for PIFC. At the end of 2008, under the authority of the state secretary, an inter-ministerial working group was set up to finalise the PIFC strategy. A new version of the strategy paper for PIFC has now been produced by this working group without further external support; the strategy paper was submitted to the EC in April 2009 for comments.

The Internal Audit Department of the MoF (MFIAD) is now de facto acting as the Central Harmonisation Unit (CHU), but since the internal systematisation of the MoF has not yet been amended accordingly, the department still does not have officially the name and the authority towards budget-users to efficiently push the reform forward.

At the same time, in 2008 the MFIAD has not carried out any internal audits itself but has instead assisted internal auditors of other budget beneficiaries in carrying out audits as part of a training scheme for internal auditors. This training scheme comprises both theoretical and practical training and is intended in the future to lead to a certification in internal audit.

The legal basis for the function of internal controller in budget beneficiaries no longer exists, and internal control units have gradually over the past year been transformed into internal audit units. Their staff have been trained by MFIAD to exercise internal audit functions. However, the transition is ongoing.

Main Characteristics (strengths and weaknesses)

There is still a long way to go before an overall PIFC policy is reflected in practice. General awareness, at both senior management level and lower operational level, is not yet sufficient for concrete implementation of the PIFC concept.

Although formally the legal basis provides a good basis for establishing management accountability and delegation, this is not yet implemented in practice. To some extent the laws are ahead of the reality and it will require some time before the possibilities provided by the legal basis will be reflected in practice.

Useful instruments and significant new systems, such as the new Treasury system and the computerised public finance management system, have been developed and have contributed significantly to the general improvement of financial control. The introduction of the computerised public finance management system has not yet led to considerable changes in the centralised *ex ante* control practices of the Treasury, which still include sending paper copies of documents to the Treasury with payment requests. These practices show that the Treasury is not confident that internal control systems within budget beneficiaries would be reliable and robust enough to enable the release of centralised *ex ante* controls.

Internal audit is also still in an early stage of development in Serbia. Even where internal audit units are in place, they are not sufficiently staffed and auditors lack experience and acceptance from the heads of budget beneficiaries.

The MoF itself currently has no internal auditor exercising this function in the ministry, and this situation does not serve as a good example for other budget beneficiaries.

A public internal financial control policy so far only exists as a draft document and remains to be formally endorsed by the government. However, the draft seems to take into account the present state of affairs in Serbia and attempts to plan future development towards more modern principles.

Recommendations for Reform

The Ministry of Finance should continue to take the lead and maintain the momentum in the development of an overall concept for public internal financial control (PIFC). It is important in this regard that the new Budget System Law is passed in the near future and that the “Strategy for the Development of PIFC in Serbia” is endorsed in due time by the Serbian Government to demonstrate its commitment to PIFC reform.

For internal audit, an overall needs assessment, based on a risk approach, should be undertaken in order to design the most relevant system for setting up internal audit units. This system would probably involve maintaining the central internal audit function of the Ministry of Finance as long as resources to adequately staff and train internal auditors in line ministries and other direct budget beneficiaries (DBBs) are lacking.

The establishment of a central harmonisation function in the Ministry of Finance, with appropriate solutions for dealing respectively with internal audit and financial management and control, will also need to be confirmed, and the choice will have to be accepted and implemented by all concerned parties in the ministry, which implies a clear, politically endorsed solution. In the event that the CHU for financial management and control (CHU/FMC) is not established in the Treasury Administration for organisational reasons, (since the Treasury is not part of the core structure of the MoF), at least the experience and knowledge of this sector should be made available to the CHU for FMC.

The Internal Audit Unit of the MoF should be staffed as soon as possible to set an example for other budget beneficiaries.

The training scheme for internal auditors, including practical training, is a promising concept and should be continued and further developed. The CHU/IA has to find a solution that will in the future leave the training to external training providers so that it is able to concentrate on its core function, which is the development and application of methodology and standards for FMC systems and internal audit in the public sector in Serbia. In the coming years, it will be necessary to pay more attention to the assessment of training needs in the area of financial management and control among budget beneficiaries. Appropriate training and awareness-raising for managers and staff in financial services should be organised.

2. Legal Framework

The reform of the public internal financial control system in Serbia was initiated in 2002 with the passage of the Budget System Law and a set of by-laws. The Budget System Law of 2002 (BSL), last amended in 2006 (*Official Gazette*, no. 86/2006), incorporates a series of provisions and introduces the framework for public internal financial control (PIFC) in Serbia, including the requirement to establish internal audit (IA) in the public sector.

The BSL relates to: central government; local governments; all public institutions; “other indirect beneficiaries of budget funds; public enterprises and legal entities established by public enterprises; and/or legal entities over which the Republic, or local government, has direct or indirect control of more than 50% of the capital or has more than 5% of the votes in the board of directors.”

Formally, the BSL provides a good basis for establishing management accountability and delegation, proper segregation of duties, and central government monitoring of financial regularity. Specifically, the BSL provides a legal basis for:

- assigning responsibility for legal, correct, economical and effective use of budgetary appropriations to the heads of Direct Budget Beneficiaries (DBBs), while granting them the right of delegation (art. 50);
- assigning responsibility for establishing sound financial services (art. 9) and internal control systems (art. 66a) in DBBs and Indirect Budget Beneficiaries (IBBs);
- segregating payment order authority, accounting and financial control functions (art. 51);
- establishing a central, government-wide Inspection Service in the Ministry of Finance (art. 68);
- establishing decentralised internal audit services in DBBs (art. 67);
- establishing a central harmonisation unit (art. 66).

In accordance with the BSL, the heads of DBBs assume responsibility for the legal, correct, economical and effective use of budget appropriations. DBBs are required to establish “financial services” to prepare and execute the budget. Legality is ensured via the double signature of the head of the DBB and the head of the financial service authorising commitments and payments. Ex ante checks are carried out by the Treasury Administration. Public funds’ beneficiaries are obliged to establish appropriate internal control systems (set of regulations, procedures and responsibilities of all employees) and to set up an organisationally and functionally independent decentralised internal audit unit.

According to article 66 of the BSL, a central harmonisation unit (CHU) for financial control, financial management and control, and internal audit is to be established in the Ministry of Finance. According to the law, the CHU is to undertake the following tasks:

- ensure centralised harmonisation and co-ordination of control and audit methodologies in the public sector;
- define standards of control in accordance with internationally recognised standards;
- define common criteria for the organisation and activities of internal audit in the public sector;
- define methodology directives and manuals for financial management;
- provide professional training, certification and supervision of the work of internal auditors;
- provide training for management and staff in the public sector in financial management and control, in accordance with internationally accepted standards;
- perform internal audit in budget beneficiaries, organisations, enterprises and/or legal entities specified in article 68, paras. 1 and 3 hereof, pursuant to the schedule issued by the minister;
- perform internal audit in budget beneficiaries for projects co-financed by the European Union.

The last two tasks in particular are not in line with good practice. The CHU should not be confused with the Internal Audit Unit of the Ministry of Finance. The operational internal audit function should be strictly separated from the CHU.

Taking on a reform activity that had started already in 2007 but could not be finished before the extraordinary elections in 2008, the Ministry of Finance is currently revising the BSL as a whole. This complex revision process, which covers not only PIFC but almost all areas regulated by this law, is now reported to be in its final stage, and it was envisaged to submit the draft law to the government in the weeks following the assessment mission. The provisions for PIFC have been revised in this context, and the proposed text would considerably improve the clarity of the regulations and bring them in line with the concepts of PIFC as promoted by the European Commission.

The new draft BSL with its provisions for PIFC will, after adoption, serve as a framework law for internal control systems, which include internal audit. It is no longer intended to adopt a special PIFC or internal audit law. Common criteria and standards for financial management and control as well as for internal audit are to be determined in secondary legislation.

No additional secondary legislation has been adopted since last year. Joint criteria and standards for financial management and control and for internal audit are still regulated in the two respective rulebooks adopted in 2007, which contain provisions concerning the common elements pertaining to PIFC: “Rulebook on Common Criteria and Standards for Establishing and Functioning of the Financial Management and Control Systems in the Public Sector” (August 2007) and “Rulebook on Common Criteria and Standards for Establishing and Functioning of the Financial Management and Control Systems in the Public Sector” (September 2007). It is not clear to what extent these documents are currently being used.

A *User Manual on the Public Finance Management System*, issued in January 2008, defines the procedures for appropriations, budget execution, quota plans, procedures for the assumption of liabilities, and procedures for payments and transfer of funds. An *Internal Auditing Handbook* has been produced by the project “Internal Financial Control and Internal Audit – Phase 2”. The handbook is divided into four parts:

- Part One: Internal Auditing Principles, Standards and Policies – instructions on the key issues of policies in the area of internal audit management and of internal audit work;
- Part Two: System Auditing – description of the steps to be followed in system auditing;
- Part Three: Internal Audit Skills – guidelines on a series of interpersonal skills and techniques required for internal auditors; and
- Part Four – Internal Audit Tools (Instruments) – basic audit tools and other instructions designed to facilitate some of the most typical audits.

The user’s manual and handbook are used in training organised for internal auditors and are provided to them as working materials.

A technical assistance project in the area of PIFC took the initiative in 2004 to produce a first draft PIFC strategy/policy paper and a supporting draft action plan. No further action was taken for some time afterwards, and it was only in mid-2007 that the PIFC strategy was reviewed by another PIFC support project. Following the advice of DG-Budget in October 2008, an inter-ministerial working group was established by the MoF under the authority of the secretary of state responsible for budget inspection and internal control. The working group submitted the reviewed strategy for the development of PIFC in Serbia to DG-Budget for comments in April 2009. The current draft is based on the version that had been produced by the PIFC support project but seems to have been adapted considerably to the Serbian reality; its ownership by the Serbian authorities is much more apparent than was the case of the previous versions.

The legal framework for PIFC is already relatively sound and will be further improved with the adoption of the new draft Budget System Law. The main problem lies in its implementation, due to a lack of political will in the past and a weak awareness and understanding of the

principles on the part of budget beneficiaries. A strategy for the development and implementation of PIFC in Serbia has now been drafted by the Serbian authorities, but the designated responsible persons will be able to take the lead in this reform only once the strategy has been officially endorsed by the government.

3. Institutional Framework

Since Sigma's assessment report on PIFC of May 2008 there have been some changes in the institutional framework.

3.1 Central Harmonisation Unit

In June 2006 it was decided to establish a Central Harmonisation Unit (CHU) within the Treasury, which currently is an "administration" related to the Ministry of Finance (MoF) but not directly within its core structure. The systematisation of the Ministry of Finance was amended to that effect, and the unit still formally appears on the organisational chart of the Treasury, although in practice it was never established.

The draft amendments to the Budget System Law are supposed to clarify this situation and locate the CHU within the core body of the MoF. Once these amendments are adopted, the systematisation of the MoF should be changed accordingly and the CHU should be formally established at the level of a department in the MoF, with its head at the level of an assistant minister. According to the draft PIFC strategy, the MoF will establish the CHU for financial management and control and internal audit by reorganising the Internal Audit Department of the Budget Inspection and Internal Audit Sector. It is planned to include in the CHU the following two departments:

- Internal Audit Department – responsible for the preparation and updating of methodologies and standards, organisation of training, certification and supervision of the establishment and development of public sector internal audit, consolidation of the annual internal audit statements, and preparation of the consolidated annual report on PIFC, with proposals for necessary improvements to increase the efficiency of public sector internal financial control;
- Department for Financial Management and Control – responsible for the preparation of methodologies and standards, organisation of training of managers and employees engaged in financial management and control operations, supervision of the establishment and development of the internal financial control system in the public sector, monitoring of the evaluation of the current situation, and consolidation of the annual reports on the internal control system of the public funds' beneficiaries.

Some consideration might be given, however, to how best to ensure the availability of sufficient experience and knowledge for the further development of financial management and control in a department that has always dealt with inspection and audit (see below). Previous assessment reports have suggested that the treasury control sector might be the appropriate nucleus for the CHU/FMC. This option does not seem to be considered by the MoF, which might be explained by the fact that the Treasury Administration is organised outside of the core structure of the MoF.

A Central Harmonisation Unit has still not been formally established, although the Internal Audit Department of the Ministry of Finance (MFIAD) is currently acting de facto as the CHU for internal audit.

3.2 Internal Audit and Inspection

According to the systematisation of the MoF, an internal audit unit responsible for the internal auditing of the ministry itself is foreseen, placed directly under the minister. This unit has never actually been staffed. Instead, an Internal Audit Department was established within the Budget Inspection and Audit Sector. This Internal Audit Department of the MoF (MFIAD) was not only

responsible for internal audit of the ministry but also of other budget beneficiaries at the central state level (central internal audit function).

After the changes in the BSL in 2006, the Ministry of Finance Budget Inspection Department (MFBID) and the Ministry of Finance Internal Audit Department (MFIAD) were merged to form a single Budget Inspection and Audit Sector comprising the two respective departments.

MoF Budget Inspection Department (MFBID) within the Budget Inspection and Audit Sector

The 2006 Budget System Law clearly separates the functions of internal audit from the functions of inspection, describing as follows the tasks of the MFBID:

“The function of budget inspection is the *control* of the application of the law in the area of material and financial business transactions and earmarked and lawful use of budget beneficiary’s funds, organisations, enterprises and/or legal entities specified in the law.”

If, in the course of inspection, unlawful acts are determined, the budget inspection orders their elimination by taking decision measures and by undertaking other procedures established by law. If direct budget beneficiaries, mandatory social insurance organisations and public enterprises fail to comply with the effective decisions of the budget inspection, the minister responsible for finance may issue an order to freeze the transfer of budget funds for the current period, except funds for salaries, up to the amount of unauthorised spending ordered for repayment by the final decision of the budget inspection. The MFBID produces annual plans, reports for each control activity carried out, as well as annual reports, and job descriptions are now in place, but no procedure manual exists yet.

Of the 19 posts that are foreseen in the systematisation, the MFBID has currently nine staff, including the Head of Budget Inspection. Almost all of the staff had previously been employed in the Public Payment Agency as financial inspectors. In January 2009 some of the inspectors left the ministry to take up other posts in the public sector, whereas some of internal auditors left for much better paid positions in the private sector.

As also stated in the draft PIFC strategy paper, in the medium term consideration could be given to whether budget inspection operations should focus on anti-fraud and anti-corruption activity based on reports and complaints, by amendments to the existing legal framework or by adopting a separate legal framework.

MoF Internal Audit Department (MFIAD) within the Budget Inspection and Audit Sector

The MFIAD currently has seven staff, including the Head of Internal Audit (out of nine posts in the systematisation). Almost all of the staff had previously been employed in the Public Payment Agency as financial inspectors, like their colleagues in MFBID. The Internal Audit Department of the Ministry of Finance’s Budgetary Inspection and Audit Sector currently acts as the Central Harmonisation Unit (CHU), although this is not yet in accordance with the systematisation of the MoF. According to the draft strategy paper, this department should be formally established as the CHU.

In 2008 the MFIAD gave up its audit activities and concentrated on organising and conducting theoretical and practical training for decentralised internal audit units in budget-users. The internal auditors of the MFIAD, who under the previous support project had been trained as trainers, organised in 2008 theoretical and practical training for internal audit units in budget beneficiaries.

A draft certification scheme for internal auditors has been elaborated. It foresees that certified internal auditors will have to undergo the prescribed theoretical and practical training before being admitted to a final examination, which should take place only after the internal audit reports that have been produced in the framework of the practical training have been approved by a special expert commission. The certification scheme still has to be adopted, however.

In 2008 activities concentrated on the training of internal auditors, but as from May 2009 it is planned to organise training for the heads of finance departments of budget-users.

In the preparation of its first annual report, in 2008 the MFIAD elaborated two questionnaires for self-assessments of internal audit and financial management and control and submitted them to budget-users. At the time of writing the analysis of the responses is still underway.

The MFIAD has benefited from numerous manuals and other working tools provided by consultants in the framework of technical assistance. The extent to which this material is applicable as such to the current context of the MFIAD's operations remains to be seen, as well as whether it will be used at all by internal auditors.

The decision of the MFIAD to discontinue audit activities and concentrate on training and other typical tasks of a CHU is a good step forward for the development of the CHU, but it causes concern at the same time that there will no longer be a central internal audit function available and no internal auditor for the MoF itself.

The devotion of the MoF to introducing internal audit as part of the PIFC framework comes into question when the ministry responsible for developing internal audit for all budget-users does not find it necessary to ensure that proper internal audit arrangements are in place for its own organisation. Since the MFIAD is now acting as CHU it is a correct consequence that its staff no longer act as internal auditors for the MoF. On the other hand, it is very important that the MoF – as all other budget-users – finds a way to assure an internal audit function for the MoF itself. This means that the Internal Audit Unit, which is placed under the minister and still exists in the systematisation, has to be staffed once again.

Concerning the tasks of the CHU, it has to be stated that a CHU should be responsible for the development and application of methodologies and standards for FMC systems and internal audit in the public sector in Serbia rather than for the training of relevant staff. While it is understandable and maybe necessary at this stage for the CHU/IA to undertake seminars and training measures itself, the objective for the future has to be to develop training schemes that no longer involve the staff of the CHU, but are rather left to external training providers, such as training centres for the public service or the local Institute of Internal Auditors (IIA).

The Central Harmonisation Unit should focus on the development of the procedures and audit trails for FMC and on the preparation and development of manuals and methodology guidelines, evaluate activities performed by internal audit and FMC, monitor execution of the requirements and analyse the functions of the internal audit units and the FMC in ministries or in other authorities of the public administration.

Internal Audit Units within Direct Budget Beneficiaries (DBBs)

With the amendments to the BSL in 2006, the position of internal controller no longer exists. The provision in article 66 of the 2002 BSL stated that “mandatory social security organisations, as well as direct budget beneficiaries that are organisationally complex entities, shall organise a separate service of internal controllers.” This provision was replaced in article 66 a of the 2006 BSL with the following: “Direct and indirect budget beneficiaries, mandatory social insurance organisations and ... (other budget users) ... shall establish systems of internal control for all transactions on the income and expenditure account, financial assets and liabilities account and financing account, as well as management of state property.” Thus the 2002 BSL related internal control to individuals, whereas the 2006 BSL introduced internal control as a system. In addition, it introduced the necessity of establishing internal audit in direct budget beneficiaries and mandatory social insurance organisations, which in organisational and financial terms represent complex entities (art. 67, BSL 2006).

Direct beneficiaries of the state budget are to establish relevant forms of internal audit for indirect budget beneficiaries under their jurisdiction. Direct beneficiaries of local government budgets are to establish relevant forms of internal audit. Internal audit is also established in public enterprises established by the state and/or local government, legal entities set up by such public enterprises, and/or legal entities where the state or local government holds direct or indirect control exceeding 50% of the capital share or more than 50% of the votes on the management board, as well as in other legal entities in which public funds comprise more than 50% of aggregate revenue.

Internal auditors are directly responsible to managing officers of direct budget beneficiaries, managing officers of mandatory social insurance organisations and/or managers of public enterprises and legal entities.

In fact, internal audit units have been established in a number of DBBs, but they still have to develop their practices in line with international standards. As a matter of fact, they are still referred to in some documents as “internal control units”, which is a clear indication of the current state of awareness of the internal audit function in Serbia and still needs to be improved.

Following the changes in the BSL in 2006 and an evaluation of the status of the internal auditing function in the public sector at central level in April 2008, which covered 23 major public fund beneficiaries, the decentralised internal auditing function was basically established by transforming the former internal controllers of DBBs into internal auditors.

At the beginning of 2007, in the public sector at state level, there were 101 internal controllers in 24 public fund beneficiaries and 11 internal auditors in the MoF. The latest reliable figures date from April 2008, when an evaluation of the internal audit function in the public sector at state level determined that six beneficiaries had established an internal audit function, with 43 internal auditors in total, whereas in 17 beneficiaries the process of internal audit establishment was underway. It is not clear to what extent decentralised internal audit currently exists in Serbia. The acting CHU in the MoF is aware of its obligation to monitor this process and plans to assess the establishment of internal audit in the course of 2009.

Internal audit units have been established in DBBs and in the major mandatory social security organisations, with no apparent assessment of needs and levels of risk. The staff have received training in internal audit from an EAR-funded technical assistance project and in 2008, as described above, from the acting CHU. They were provided with rulebooks on IA and FMC as well as with the relevant manuals. However, these units will need some time before they are able to really work effectively.

In 2007 training in financial management and control was carried out in seven cycles and included 141 participants from 60 public sector organisations; 100 of these participants attended a course to acquire the theoretical skills for performing internal audit. For the training, conducted by consultants of the project “Internal Financial Control and Internal Audit – Phase 2” and local skilled instructors from the MFIAD, appropriate documentation was provided. The training comprised the following four modules:

- – Introduction to internal control;
- – Risk management system;
- – Managerial control system;
- – Implementation of financial management and control.

Internal auditors from the MoF organised in 2008 four circles of theoretical training for 94 internal auditors from 24 budget-users, entitled “The Use of Internal Audit Tools”. In addition, practical training for 68 internal auditors from 12 budget-user organisations has started. This practical training consists of assisting internal auditors in planning, carrying out and reporting on two concrete audit procedures, following a mentoring scheme. In practice this means that each internal auditor has an experienced internal auditor from the MoF as a mentor by his/her side when planning and carrying out the audit. The mentor also supports the drafting of the audit report.

Decentralised internal audit is still in a very early stage of development. Internal audit units do not yet exist in all budget beneficiaries and where they do exist, the internal auditors lack experience and training. Support from the acting CHU started only last year in the form of theoretical and practical training. Since the internal auditors were previously inspectors and internal controllers, on the one hand they need time to become acquainted with their new role, but on the other hand time is also required for the management and their colleagues who play a

role in inspection or financial management to understand the new concept and their own respective roles.

The MoF does not have internal auditors for the ministry itself, which might be considered as an indication of a lack of commitment as to the necessity and importance of this function for the management of the ministry. The ministry responsible for the development of internal audit as a part of PIFC should set a good example for other budget beneficiaries.

3.3 Financial Management and Control

According to article 50 of the BSL, the head of a direct (minister or equivalent) or indirect budget beneficiary is to be responsible for entering into commitments, verifying commitments, issuing orders for payments to be covered by the budget of the body of which he/she is the head, and issuing orders for the collection of funds to be credited to the budget. He/she is to assume responsibility for legal, correct, economical, and effective use of budget appropriations but may delegate individual powers to other persons in the direct or indirect budget beneficiary.

Financial Services of Direct Budget Beneficiaries

According to article 9 of the BSL, direct budget beneficiaries (DBBs) are to set up services to prepare and execute the budget and to perform other tasks related to the management of state assets under the responsibility of DBBs (financial services).

DBB finance departments are to provide the heads of DBBs with the basic financial management support they need in order to prepare and execute soundly the budgets they are responsible for, and to report on implementation. A review of sample finance departments by the 2007 PIFC technical assistance revealed a number of shortcomings in the functioning of these services, including: the failure to follow the manuals for the execution of the budget (the "Blue Book", generally considered to be a useful document); controls that were not related to the perceived risks; and qualifications of staff that at times left something to be desired. Further efforts are required to develop the financial management and control capacity of DBBs.

The organisational structure of finance departments varies, depending on their needs and capacities. According to the BSL and the rulebook, all financial departments perform five basic financial functions, as follows:

- preparation of budget/financial plans;
- definition of the financial control framework;
- management of budget execution and assets within the responsibility of the beneficiary;
- business bookkeeping;
- financial reporting.

Some budget beneficiaries have adopted internal acts that regulate certain business processes or special activities, but most of the business processes are not described in operating procedures, although this would ensure their implementation in accordance with the principles of legality, economy, effectiveness and efficiency. Furthermore, no audit trails have been prepared so far. Beneficiaries of public funds have started to adopt the methodology of risk management, but have not yet established a written risk management system, which includes identification, assessment and control of potential events and circumstances that may have adverse effects on achieving goals and targets. They have also not elaborated, a strategy of risk management or created a risk register.

Another major common problem of all financial departments is still a lack of staff, and therefore the principle of segregation of duties is not always adequately ensured. So far training in the area of financial management and control has only targeted a narrow circle of public servants. The training did not involve senior managers, and participation was limited to a small number of middle managers and other public servants.

Treasury Control Co-ordinators (TCCs) and Treasury Internal Control Department (TICD)

Detailed checking of all payment requests is still performed by the Treasury 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. 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 system, which has been in operation since January 2008.

All invoices and contracts are sent to the Treasury in paper form although, according to the legislation, responsibility for the correctness of expenditure lies with budget-users and in any case the data are transferred electronically.

The 12 TCCs are in the Budget Accounting Department of the Ministry of Finance Treasury Administration and the seven executors (senior controllers) of TICD are in the Ministry of Finance Treasury Administration. The TCCs check all payments of less than 10,000 RSD (approximately 115 EUR), while the TICD checks all payments over this threshold. The TCCs and the TICD both perform ex ante checking of documents provided by DBBs to check budget approval and availability. This work involves the checking of about 8000 payment requests per week.

The reasons for the separation of functions between the TCCs and the TICD remain unclear. With the further development of the Financial Management Information System (see Sigma's 2009 assessment report on Public Expenditure Management in Serbia), more efficient control procedures have to be found, which also would support the principle of managerial accountability at the level of DBBs. However, before the existing treasury control mechanisms can be reduced it is important to ensure that sufficient control of financial resources can be provided by alternative control systems.

The Treasury control units, notably the TICD, could in the future form the nucleus of a Central Harmonisation Unit for the financial management and control (FMC) system in Serbia, as they should have the necessary experience and knowledge to further develop FMC.

The existing controls focus on legality and correctness, but not on economy, efficiency and effectiveness. The existing system of controls has not been established in relation to the goals that public funds' beneficiaries plan to achieve and to the risks affecting the fulfilment of such goals. While this is normal for the current state of play of FMC in Serbia, it should nevertheless be made clear that in the medium and long terms the goal is to seek value-for-money in the management of public funds within the framework of legality.

The detailed level of centralised financial ex ante control in the Treasury cannot be the most effective way of ensuring the necessary controls over payments. Furthermore, this system hampers the development of a notion of real responsibility on the part of the heads of budget-users and of financial services, since they can always rely on the controls of the Treasury. In the medium term, targeted risk assessment-based ex ante controls should be sufficient to reduce the administrative burden, for both the Ministry of Finance and line ministries.

4. Reform Agenda and Capacities

In the EU Council Decision of 13 February 2008 establishing the European Partnership with Serbia including Kosovo under UNSCR 1244/99¹, certain priorities regarding financial control are mentioned:

- Key priorities:

¹ In accordance with UN Security Council Resolution 1244, since June 1999 Kosovo has been governed by the UN Interim Administration Mission in Kosovo (UNMIK).

- Step up the fight against corruption at all levels and develop a comprehensive public system of financial control to increase transparency and accountability in use of public finances;
 - Continue reforms of public finance management in order to strengthen control, transparency, accountability and efficiency.
- Short-term priorities:
 - Develop a strategy for Public Internal Financial Control;
 - Develop procedures and administrative capacities to ensure the effective protection of EU financial interests.
 - Medium-term priorities:
 - Develop and implement the principles of decentralised managerial accountability and a functionally independent internal audit system, in accordance with internationally accepted standards and EU best practice;
 - Further develop procedures and administrative capacity to ensure the effective protection of EU financial interests.

In line with the above priorities, the National Integration Programme was adopted by the government on 9 October 2008.

The reform agenda is thus clear but will prove to be difficult to put into practice, as absorptive capacity is weak, at least in quantitative terms. Whatever the point of application, the basic issue is to strengthen the Ministry of Finance so that more local resources, both quantitatively and qualitatively, are allocated to the development of PIFC in Serbia.

The technical assistance project, which terminated in early 2008, took steps to help Serbian authorities respond positively to the EU priorities by producing a proposal for a draft Law on Internal Audit and Internal Control, which was not endorsed by the counterpart. The project then prepared a draft Strategy Paper on PIFC (the previous project had taken a similar step in 2004) and made procedural recommendations for its adoption. However, this proposal also remained unimplemented for various reasons, including of course the political context. In the period prior to the resignation of the government, some operational steps had been taken by the Ministry of Finance, including the appointment of a state secretary responsible for PIFC, a position that had been missing for a long time; this appointment was made in autumn 2008.

Since the Budget Inspection and Audit Sector of the MoF now seems to have taken over responsibility for the further development of PIFC in Serbia, and its Internal Audit Department is de facto already acting as the CHU, there now seems to be a clear ownership and leadership within the MoF, supported by the responsible state secretary.

The draft strategy for PIFC contains an action plan with a timetable that seems to be too optimistic, as it foresees the implementation of a full-fledged PIFC system by the end of 2012. Experiences in other countries have shown that the development of PIFC needs to be planned over at least five to seven years. In this connection, it is also important to consider proper phasing in view of the complexity of the system, e.g. in an initial phase to have more simplistic FMC controls and types of audit (leaving complex value-for-money assessment of policy to a later date, along with specialised audit roles, e.g. IT audits).

The key Serbian actors demonstrated in 2008 some commitment to the process of introducing and developing PIFC by forming an inter-ministerial working group, which has produced a draft strategy paper for PIFC. It remains to be seen whether the strategy will now be adopted and implemented without further delay. Its adoption and the formal establishment of the CHU are preconditions for the beginning of a new support project for PIFC.

5. External Assistance

Since 2002 there have been two well-funded technical assistance projects for PIFC development in place, which have achieved few results. After the formal establishment of the CHU, which will hopefully be realised in the next month, a different support approach other than technical assistance should be considered. Before starting another external support project, however, it is advisable to take stock of the current state of play in PIFC in order to better define the needs and tailor the support. Such a project should focus on awareness-raising, for both internal audit and financial management and control, on the concept of managerial accountability, and on the basic requirements for the PIFC system before attempting to introduce sophisticated concepts that are not yet realistic in Serbia. Concerning internal audit, support for pilot audits should be considered in order to provide internal auditors with practical training for systems audit.

The European Agency for Reconstruction (EAR) has supported four projects in related areas: the implementation of effective public internal financial control (PIFC), in particular the establishment of effective internal audit (IA) throughout the government sector in Serbia; the creation and establishment of a supreme audit institution (SAI); the development of the Treasury function in the Ministry of Finance; and public procurement.

The PIFC assistance project was split into two phases. The first phase, which ended in 2004, brought some improvements and certainly contributed to a better understanding of the key PIFC concepts. However, due to the feeble commitment and absorption capacity of the recipient, the absence of operative IA units and prioritisation for the Treasury project, and basically the absence of a solid counterpart and a change champion in the Ministry of Finance, the project's results did not live up to the initial expectations. Nearly all of these obstacles were present at the start of the second phase, which was entrusted—like the first phase—to a private consultancy firm. After a first inception period, a better response was given to the input of the assistance provider, which—as mentioned above—took steps to place the current development of PIFC into a clear EU accession-driven perspective.

The process, unfortunately, again slowed down, in particular because of the political agenda but also for internal reasons, including the lack of strong high-level support within the Ministry of Finance. The project terminated at the beginning of 2008. A new support project is now being planned, either as technical assistance or as a twinning, to support the Serbian CHU in implementing the PIFC policy. Obviously, the precondition for this project is the adoption of the PIFC policy paper and the political commitment to the reform.

It seems necessary to take serious stock of all that has been achieved so far before starting any new substantial assistance. It is clear that the elusiveness of the counterpart has been a major hindrance in the smooth implementation of the project, a factor of course worsened by the political instability and the lack of unitary views, within the Ministry of Finance, on the ways and means of developing PIFC, if not on the objectives as such. Since last year, the situation seems to have improved. A PIFC peer review might help to get a clearer picture of the current state of affairs of PIFC in Serbia and would help to better tailor the next support project for PIFC.

Before starting another external support project, it is advisable to take stock of the current state of play in PIFC in order to better define the needs and tailor the support.