Report on Implementation of the Public Financial Management Reform Program 2016 – 2020 for the period from December 2015 to December 2017

Ministry of Finance
Disclaimer

In 2018 the Ministry of Finance and partner institutions will conduct revision of the Public Financial Management Reform Program. The new Action Plan will cover the timeframe 2019-2021. The revision process has started in May 2018 and has been supported by SIGMA. The new Action Plan will be adopted by the end of 2018.

The next Public Financial Management Implementation Report will be prepared in the first quarter of 2019.
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Introduction

The monitoring report on implementation of the Public Financial Management Reform Program 2016-2020 (hereinafter: PFM Implementation Report) was prepared by the Ministry of Finance (MoF) of the Republic of Serbia, with active participation of other line ministries and institutions represented in the Working Group for preparation and monitoring of the implementation of the Public Financial Management Reform Program (hereinafter: Program Working Group) and the Technical Secretariat of the Program.

The Report on implementation of the Program covers the period from December 2015 until December 2017, providing detailed information on achievements during the first two years of Program implementation.

The fourth reporting cycle has been improved both quantitatively and qualitatively. The new methodology developed with the generous support from SIGMA consultants and the Guidelines for preparation of reports\(^1\) developed in the second half of 2017, contributed to the improvement of the Report. Significant step towards improving the quality of reporting has been made with the previous PFM Implementation Report adopted in December 2017. Current Implementation Report, as well as all subsequent reports, will represent an update of the previous Report, with particular emphasis on what has been achieved since the last reporting period in order to make sure that this document presents an adequate source of information for monitoring progress of the PFM, as well as for planning the next steps.

Taking into consideration the time period since the preparation of the Program in 2015, all relevant stakeholders recognized the need to revise the Program and prepare the new Action Plan for the period 2019-2021. Thus, 2018 will be dedicated to revision of the PFM Reform Program and the current PFM implementation report will serve as one of the tools for achieving this goal.

“Serbia is on the right track, and macroeconomic results give the right to continue with the hitherto responsible economic policy. There is always room for improvement, which is why we are implementing additional changes which will alleviate the work of the economy and improve the quality of life of all citizens.”

\(^1\) The Technical Secretariat of the Program has prepared and distributed “Guidelines for preparation of implementation reports of the Public Financial Management Reform Program 2016-2020” to the members of the Working Group, in December 2017. During preparation of this document, the recommendations of the European Commission (EC) and the Delegation of the European Union in Serbia (DEU), as well as recommendations received from the OECD / SIGMA experts, were taken into account.
EXECUTIVE SUMMARY

The Public Financial Management Reform Program 2016-2020 (PFM RP) was adopted by the Government of the Republic of Serbia on 28th of November 2015. The main goal of the PFM Program is to attain a better balanced and sustainable budget whilst reducing the level of public debt, improve financial management and control, and ameliorate audit control processes. The Program follows the budget cycle on the whole with the aim to ensure a better connection of the budget execution with various Governmental policies, thus contributing to increased transparency. Public Finance Management is pivotal to the process of European integrations, and it is related to several negotiating chapters, most of which are currently open (e.g. Chapter 5 Public Procurement, Chapter 29 Customs Union and Chapter 32 Financial Control). The program is divided into six areas and contains a total of 19 different measures.

Most significant improvements in the observed period are linked with the following measures:

- **Improvement of the credibility of macroeconomic predictions;** Percentage of deviation of macroeconomic projections from the Fiscal Strategy of the Republic of Serbia (GDP and deficit) compared to projections of relevant international institutions (IMF and EC) was 3.1% in 2017. The target level was set at below 7%.

- **Further implementations of multi-annual program budgeting on all levels of governing;** Percentage of compliance of Program structure of budget beneficiaries with guidelines for preparation of program budget reached 85% in 2017 compared to 82% in 2016 and 61% in 2015.

- **Improvement of strategic and legislative framework for implementation of financial control in the public sector;** Preparation and adoption of the Strategy of Public Internal Financial Control Development in the Republic of Serbia for the period 2017-2020 in May 2017 set the basis for further improvement of financial management and control and internal
audit in the public sector. The goal of the Strategy is the integration of financial management and control and internal audit into the overall public sector management system, for the purpose of improving efficiency and effectiveness, as well as transferring national policy goals to goals of public sector institutions. This will ensure an efficient risk assessment in relation to defined goals and establishment of adequate controls.

- **Improvement of regulations and procedures for public procurement.**
  Number of contracting authorities announcing procurement plan at the Public Procurement Portal reached 90% in 2016, thus exceeding the target set at 85%. The percentage for the first half of 2017 amounts to 87%.

Significant number of results is related to capacity building through new employment and knowledge enhancement, which was achieved through trainings and various forms of technical support. For example, nine training sessions for budget preparation and reporting took place in 2016 and 2017 for more than 150 participants. Nine training sessions were organized for 519 participants in the field of internal financial control in the Public sector and additional ten training sessions for more than 300 managers of public beneficiaries. In the future, special attention should be given to sustainability of administrative capacities.

Crucial for successful reform process, is a timely preparation of strategic documents, legal and other regulations and their successful implementation. Challenges in the process were mainly related to development of legal framework (which needed to be in line with the wider framework of public administration reform) and coordination of preparation of strategic documents.

In order to achieve planned results, the Ministry of Finance and partner institutions are conducting alterations in the administrative culture, primarily in the field of financial management and control. It is important to fully develop a concept of managerial responsibility, improve administrative capacities of all actors, and strengthen their coordination, with an emphasis on developing the IT component. Improvement of IT sector is not only financially demanding, but also very complex, due to the necessity to secure a mutual compliance of various users.

Apart from regular budget financing, significant support during the preparation and implementation of the Program, has been provided by the European Commission (various IPA projects, TAIEX) and Germany though “Public Financial Reform” project implemented by GIZ. Assistance was also provided by the World Bank, IMF, SIGMA, OECD and UNDP. IMF Fiscal Affairs Department prepared several reports concerning this matter during 2015/2016, more specifically on budget preparation and reporting, Report on the Budget System Law and Report on Public Investment Management. Regional councilor for PFM (IMF/SECO) was at Ministry of Finance’s disposal, and resident councilor for PFM (IMF/SECO) was also available during 2016. The World Bank created a vertical functional analysis of the Ministry of Finance in 2016, with recommendations for the improvement of the PFM, especially underlining the IT sector. Support has also been provided by governments of Sweden, Switzerland, United Kingdom, Slovakia, Slovenia etc. Taking into account severe financial burden of the reform, which will be assessed in detail during the revision of the Program, significant support will be needed in the future in order to successfully implement the Program.
The most precise existing cost estimation for the PFM Reform Programme can be found in the PAR sectoral MTEF document, first prepared in 2056 and updated on an annual basis, which is updated in parallel with the Fiscal Strategy and Budget Law (submitted as part of the documentation in the Self-Assessment Report on the Implementation of PAR Sector Reform Contract (Sector Budget Support)). However, as already agreed with the EC and SIGMA, costing will be an integral part of the PFM revision process in 2018 and the new Action plan.
**PILLAR I**
Sustainable medium term macro fiscal budgetary framework

**SUCCESSFUL IMPLEMENTATION OF FISCAL CONSOLIDATION PROGRAM**

**ACHIEVED PRIMARY SURPLUS OF 3.9% GDP IN 2017**

**PRIORITIES 2018:**
- Strengthening administrative capacities of those employed in the field of macroeconomic analysis and projections, as well as custom officers
- Establishing basis for implementation of an efficient accounting system and paying own and traditional means

**PILLAR II**
Planning and budgeting of public expenditure

**CITIZEN BUDGET**

**PERFORMANCE BUDGET MONITORING**

**GENDER-RESPONSIVE BUDGETING**

**PRIORITIES 2018:**
- Further development of budget process and IT systems
- Implementation of legal basis for planning capital investment and preparing methodology for costs and medium term planning of public policy

**PILLAR III**
Efficient and effective budget execution

**COUNTER “YOUR TAX COLLECTOR”**

**PUBLIC DEBT REDUCED BY 12.5% BETWEEN DECEMBER 2015 AND DECEMBER 2017**

**E-PUBLIC PROCUREMENT**

**PRIORITIES 2018:**
- Further implementation of the Tax Administration Transformation Program
- Software development for controlling public debt and improvement of IT system
- New regulatory framework for public procurement establishing

**PILLAR IV**
Effective financial control

**PIFC STRATEGY 2017-2020**

**EFFICIENT IMPLEMENTATION OF IPA PROJECTS BY MEANS OF IMPROVED REVISION OF THE EU FUNDS MANAGEMENT SYSTEM**

**EXTENSION OF BUDGET INSPECTION AND AFCOS GROUP JURISDICTION IN ORDER TO SUBDUE IRRIULARITIES AND PROTECT BUDGET FUNDS**

**PRIORITIES 2018:**
- Managerial responsibility
- Implementation of AFCOS Strategy

**PILLAR V**
Accounting, monitoring and financial reporting

**MODERNIZATION AND EXPANSION OF IT SYSTEMS FOR EXECUTING THE BUDGET (ISBE) AND RINO SYSTEM**

**ESTABLISHING CENTRAL REGISTRY OF INVOICES**

**PRIORITIES 2018:**
- Publishing IPSAS standards and their formal adoption for the purpose of switching to accrual accounting

**PILLAR VI**
External scrutiny of public finances

**INCREASE IN NUMBER OF AUDIT PRODUCTS, NUMBER OF AUDITORS AND COVERAGE OF AUDITING ENTITIES**

**IMPROVED PARLIAMENTARY OVERSIGHT OVER PUBLIC FINANCES**

**PRIORITIES 2018:**
- Preparation of Action plan for introducing and implementing standards relating to the quality of audits and procedures and guidelines for the quality of audits;
- Continuous sessions of subcommittee and Committee for discussing the report on the performed audits by the State Audit Institution
AGGREGATE OVERVIEW

Through measures of fiscal consolidation and structural reforms, the Government of the Republic of Serbia established stable public finances, as well as stable macroeconomic environment. The fiscal consolidation measures have been supported by a three-year IMF stand-by arrangement. Final (eighth) review by the IMF board took place on December 20th 2017. The program received very positive reviews both in terms of its comprehensiveness and fiscal and monetary performance, which constantly exceeded expectations. Formally, the Program was concluded on February 21st 2018, with the acceptance of final documents, which include macroeconomic data as well as laws and Government decisions passed until December 31st 2017. Credit Ratings Agency Standard&PoorRatings raised its long-term foreign and local currency sovereign credit ratings on Serbia to 'BB' from 'BB-', with a stable outlook. The upgrade reflects Serbia's stronger fiscal metrics, underpinned by years of cost-containing efforts and better revenue collection. The ratings agency affirmed the 'B' short-term foreign and local currency sovereign credit ratings of Serbia and revised the country's Transfer and Convertibility (T&C) assessment to 'BB+' from 'BB'.

“We raised the rating because Serbia has displayed stronger fiscal metrics after years of containing costs and better revenue performance than anticipated, amid a steady economic recovery and limited current account deficits. Despite a temporary slowdown in growth in 2017, Serbia is likely to post its lowest general government deficits in almost a decade.”

Standard&Poor's

The National Alliance for Local Economic Development (NALED), selected Serbian Finance Minister Dušan Vujović as reformer of the year. The NALED Board of Directors presented the award in recognition of the results achieved by the Government in 2017 in the field of suppressing the grey economy, reforming non-tax levies and creating stimulating conditions for the development of entrepreneurialships. At the third national conference “Way out of the Grey Economy”, a survey results were presented showing that the share of the grey economy has dropped from 21.2% to 15.4% of the GDP in the past five years.

The fiscal consolidation along with a broader program of related structural reforms launched in October 2014 set the frame and context of the PFM design and implementation progress. Although initiated on the basis of a much more modest reduction in public sector wages and pensions (on average by 10% and 5.8% respectively) than previously anticipated by analysts and international financial institutions, the fiscal consolidation program drastically improved the fiscal balance

and the overall macroeconomic performance. Fiscal deficits were reduced from 3.5\% at the end of 2015 to 1.2\% in 2016. Furthermore, in 2017 Serbia recorded a fiscal surplus of 1\% of GDP. Permanent improvements in the fiscal deficit exceeded the most optimistic expectations as Serbia achieved more than 4\% of structural fiscal adjustment in two years compared to a 4\% three-year target set by the IMF.

These results were achieved through a well-balanced set of expenditure reducing and revenue enhancing measures. In combination with improved investment climate and better credit rating (credit worthiness on 5-year bonds in Serbia fell from over 500 basis points in 2014 to merely 130 basis points today), Serbia managed to attract Foreign Direct Investments of close to 2 billion euros annually.

Most importantly, during the years of fiscal consolidation, Serbia managed to achieve real GDP growth of 3.3\% in 2016 and 2\% in 2017. The slowdown in growth in 2017 was caused by unfavorable weather conditions and temporary one-off factors. As a result of fiscal consolidation measures, debt to GDP started falling from the high 71.2\% in 2015 to 58.7\% in 2017.
There is a continuous effort to move towards the European semester system, with participation of the Republic of Serbia in European semester “light” through drafting the Economic Reform Programme. The budget process has been broadened and the budget planning improved with an aim of starting the budget process early in the year, more specifically in February, as stipulated in the Budget System Law. The transparency of the budget process has gained importance, especially in recording capital expenditure commitments early in the project cycle. However, the nature of the three-year precautionary arrangement with the IMF imposed a constraint on the budget preparation cycle, as indicators for the next year budget can only be released upon the analysis of the actual fiscal and macroeconomic results of the first three quarters and

3 Initiative “European semester” provides framework for coordination of macroeconomic and fiscal policies across the European Union. It allows EU countries to discuss their economic and budget plans and monitor progress throughout the year. For more information visit https://ec.europa.eu/info/strategy/european-semester_en
agreements with the IMF which can only be reached by early November at the earliest. During the duration of the IMF program, this significantly reduced the available time for budget preparation and consultations prior to a debate in the National Assembly.

Within the implementation of the public finance reform, the analytical capacities of the Ministry of Finance and other relevant institutions involved in the reform have been significantly strengthened. Introduction of new models and analytical instruments, softwares, staff trainings, improved exchange and transparency of data, led to an increase of the public's insight into the movement of public finances and at the adoption of EU standards in this area. Great challenges in the filed of strengthening administrative capacities are limited possibilities for employment of new people, as well as the outflow of staff from public administration. The next challenge is to invest in upgrading and linking IT capacities which is preconditional for every modern public administration and the basis for efficient and effective management of the public finance system. This risk was specifically explained in the Vertical Functional Analysis of the Ministry of Finance prepared by the World Bank, and significant efforts have been made in the MoF for a coordinated approach on this matter.

The main areas in which progress has been made in implementation of the PFM Reform Program and its Action Plan during previous period relate to: improvement of credibility of macroeconomic projections; better mid-term planning by budget beneficiaries; further improvement of program budgeting; improvement of the financial control of public funds through adoption of the Strategy for Development of Internal Financial Control in the Public Sector in RS 2017-2020; improved coverage and quality of fiscal reports and reports on budget execution; further improvement in the area of public procurement; improvement of SAI work. Despite certain delays in relation to the foreseen deadlines, large number of activities were implemented even before deadlines, which indicates great dedication of all stakeholders to implementation of the reform. It also indicates the need to assess the risks and prepare reactive measures, as well as the need for greater flexibility of the Action plan.

Major progress under Pillar I

During the period of Program implementation, capacities of the Ministry of Finance for macroeconomic forecasting have been improved. A Group for managing the EU own resources has been established within the Department for macroeconomic and fiscal analyses and projections. Additionally, in order to improve the macroeconomic forecasting, the Department for Macroeconomic and Fiscal Analyses and Projections developed “the Bridge“ model for the purpose of improvement of the GDP projections. This model enables quick assessment of GDP per month or quarter, based on high-frequency indicators, and is monthly published on the website of the Ministry of Finance. It is used in preparation of strategic documents such as the Fiscal Strategy and the Economic Reform Programme.

Major progress under Pillar II

Over the previous two years, the Ministry of Finance made significant effort to improve quality and transparency of the budget process.
Particularly significant progress in the reform of public finances has been achieved in improving the multi-annual program budgeting, introduced for all budget beneficiaries in 201, which provides comprehensive information to the public on the budget funds spending. The quality of the program budgeting continues to improve every year, due to the fact that public funds users receive adequate training and gain more experience and knowledge in this area. Further progress has been made with the introduction of new Methodology for monitoring and performance reporting, prepared in 2016. The coverage of the state budget and budget documentation has been increased through inclusion of project loans in the budget, as well as through submission of the financial plans of Public Enterprises Roads of Serbia and Corridors of Serbia together with the Law on Budget to the Government Expanding the coverage of the national budget provides better base for more realistic planning of expenditures of indirect budget beneficiaries. Additionally, gender sensitive indicators were introduced in 2016. Gender sensitive budgeting refers to a gender-based assessment of budget, incorporating a gender perspective at all levels of the budgetary process and restructuring revenues and expenditures in order to promote gender equality, in accordance with Article 4 of the Law on the Budget System.

BIS (Budget Information System) software was developed and it ensures easier and more efficient way of entering financial plans and easier process of analyses and unification of financial plan of budget beneficiaries. In order to improve planning and ensure efficient and effective implementation of capital projects, on June 27, 2017, the Government adopted the Decree on content, preparation method and assessment, as well as on monitoring of implementation and reporting on the implementation of capital projects, which is applied as of January 1, 2018. It is expected that this will contribute to a significant increase in the percentage of capital expenditures in budget execution. A special challenge is to familiarize a large number of budget beneficiaries with reform steps (implementation of instructions, methodologies, regulations, software), which was done by the Budget Sector through designing and providing a series of trainings organized by the Government HRM Service, etc.

Transparency has been increased through the introduction of a legal obligation to publish program information and performance report by budget beneficiaries. The Ministry of Finance issued Citizens Budget of the Republic of Serbia which provides sufficient information to the public on the structure of the budget, and how funds are collected and spent. Citizens Budget was published on the Ministry of Finance’s website in 2015, 2017 and 2018.

It is expected that, the link between public policies and the medium-term expenditure framework will be established in the upcoming period. The adoption of the Law on the Planning System is a prerequisite for the adoption of the Decree on methodology for medium-term planning. Co-ordination of planning and programming

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5 This activity was one of the targets for variable indicators in PAR sector budget support from IPA 2015
of the external assistance with the budget calendar remains to be a challenge, given that different governments have their own dynamics in budget preparation.

**Major progress under Pillar III**

**More efficient tax collection and control of taxpayers brought visible results and this trend is expected to continue in the upcoming period.** Target value of Tax collection in 2017 was 87%, whereas the realized value in 2017 was as high as 96%. During 2017, the Tax Administration Transformation Programme was revised and new Action Plan was prepared for the period 2018-2023. The objective of the Tax Administration Transformation Programme is to improve the organizational structure, business processes and services provided to taxpayers. **Combined efforts have been made to improve voluntary compliance with tax legislative through change in legislation, increased capacities and raised awareness.** Due to the reforms undertaken in 2016 voluntary tax collection reached the level of 96% of total (voluntary) tax collection out of total tax income assessed in the budget. In 2016, a marketing campaign was conducted, the risk management system was improved, and intensive development of integrated IT system was continued, aiming to introduce electronic services for taxpayers. Modernization of Customs Administration is underway in several important areas, including risk management and anticorruption measures, as well as modernization of Customs laboratory. Customs Administration monitors the activity of improving anti-corruption measures through negotiating chapter 23. Special set of trainings on Methods of Investigating Corruption was provided for customs officers in 2016 and 2017, for 15 employees of the Internal Affairs Department of Customs Administration.

Major challenge in the reporting period was to prepare new Tax Administration Transformation Programme in line with the IMF recommendations. In the future, significant effort is required in order to timely implement all defined actions. The main challenge for the full implementation of the ERIAN system is the full introduction of automated systems of import and export of AIS and AES and their further integration with the ERIAN system.

Trajectory of public debt of the Republic of Serbia has been reversed since 2016 and, according to preliminary data, **public debt share in GDP has been reduced to 58.7% in December of 2017**, contributing to the overall stabilization of public finances. In order to continue its successful work, the Public Debt Administration recognized the importance of continues capacity building through trainings and software development. Major challenge will be to secure sufficient funds for implementation of all activities. Despite the improvement of public debt management system, major challenges are linked to global risks related to financial market and may influence the affect the completion of the planned targets.

During 2018, the development of software for public debt management should be completed and further development of the methodology for conducting the analysis of public debt sustainability.

The progress made so far, in terms of improving the overall system of procurement has contributed to the opening of negotiations in the Chapter 5 – Public procurement, in December 2016. **In the field of public procurement, the significant progress has**
been made through the development of primary and secondary legislation which led to increased transparency and efficiency of public procurement procedure. Transparency of procurement planning has increased after the legislative changes adopted in 2015, by introducing an obligation for contracting authorities to publish procurement plans on the public procurement portal. The total number of contractors announcing procurement plans on the portal reached the level of 90% in 2016 (which is more than the aimed amount of 85%). Latest changes in legal framework included harmonization of national legislation with relevant EU Directives. As planned, partial harmonization took place in 2015 and full harmonization is expected to be completed by mid-2018.

Further institutional strengthening of the Public Procurement Administration, by increasing the number of employees, will be completed in 2018 through the implementation of the employment process. Progress in increasing the technical capacities of the contracting authorities in order to carry out procurement procedures with more efficiency and further strengthening of the Public Procurement Administration remains a challenge in the upcoming period.

**Major progress under Pillar IV**

The greatest progress in the field of public financial control has been achieved with the adoption of strategic framework – The Strategy of Public Internal Financial Control Development for the period of 2017-2020, in May 2017. The accompanying Action Plan was adopted for 2017 and 2018. The Central Harmonisation Unit (CHU) continues to provide trainings to budget beneficiaries, developing software and produces reports in this area. CHU performed an overview of IA work quality in ten ministries for 2016 which represents preparatory work for amending the legislation in order to implement quality control of the IA in line with the Standards. At the central level, until the end of 2016, in 80 public funds beneficiary institutions, the internal audit was established with 281 systematized internal auditor positions, out of which 230 were filled. The audit was established in all the 16 ministries and three mandatory social insurance funds. At the level of the units of territorial autonomy and local self-governments, the internal audit function was established in 77 out of 174, with 182 systematized and 141 filled up internal auditor positions. By the end of 2017 at the central level, the internal audit function was established in 83 institutions of public funds beneficiaries with 296 systematized and 243 filled auditor positions.

Continuous upgrading of the existing methodological manuals and guidelines in accordance with the best international practice will ensure further improvement in this area. The system of certification and professional development of internal auditors, will be further improved through the twinning project in early 2018. FMC Rulebook and Manual will be updated in order to harmonize the concept of managerial accountability.

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7 This activity also represents one of the variable indicators for Public Administration Reform Sector Budget Support from IPA 2015
with the principles of good governance and introduce the function of managing irregularities in the FMC framework.

**Irregularity management, antifraud coordination in dealing with the EU funds is relevant and important both for the interest of the Republic of Serbia and the European Commission.** The Budget Inspection (hereinafter BI) and the Anti-Fraud Coordination Service (hereinafter AFCOS), as of January 2016, form a part of the Department for the control of public funds of the Ministry of Finance. The Strategy for combating irregularities and fraud in dealing with EU funds for period 2017-2020 (hereinafter: Anti-Fraud Strategy) was prepared and adopted. Decree on authorization and work of the BI was adopted at the end of October 2017. The Draft of the legal framework for (re)institutionalization of the Governmental Audit Office of EU Funds was prepared. Adoption and implementation of the legislative framework for (re)institutionalization is expected to be realized in 2018, in accordance with EC recommendations. It should provide the basis for the further strengthening of the administrative capacities of the Office.

Major challenge related to the function of the Government Audit Office for EU funds is lack of adequate retention policy and delays in adoption of legislative framework for re-institutionalisation of the Office. Further steps will include adoption of legislative framework and preparation of internal staff retention strategy. Additionally, sufficient number of employees is required in order to secure effective functioning of Department for control of Public Funds.

**Major progress under Pillar V**

In accordance with the PFM RP, the scope and quality of reporting on budget execution and fiscal reports has been improved. In accordance with the planned deadlines, the Treasury Administration has made all necessary adaptations of business processes, organizational changes and provided technical conditions for inclusion of indirect beneficiaries in the system of the republic budget execution. The budget execution system of the Treasury Administration included 318 additional indirect budget beneficiaries in 2016 and 2017. The system now covers all courts, public prosecutors, judiciary institutions, criminal correctional facilities and cultural institutions. In 2018, additional 246 Social Protection Institutions will be included. Integration of indirect budget beneficiaries to the budget execution system of the Treasury Administration enables better control of intended expenditures, contributing in that way to one of the key goals of PFM RP i.e. improvement of the coverage and quality of budget execution reporting. The improvement of budget accounting reform is underway. The Law on Amendments to the Law on the Budget System was adopted in December 2017 (Official Gazette of the Republic of Serbia, No. 113/2017) presents the basis for establishing the Commission for the Application of International Public Sector Accounting Standards. Introduction of international accounting standards will contribute to providing the necessary information for the preparation of fiscal reports and balance sheets, and consequently lead to further improvement of public funds management and lead to a more transparent budget policy. Monitoring and reporting on outstanding amounts was improved by expanding the RINO system to transactions between public
enterprises starting from January 2016. **Treasury Administration established the Central Registry of Invoices.** The establishment of the Central Register of Invoices will contribute to a more efficient settlement of liabilities within the deadlines defined by law, a reduction in the number of late payments and an improvement in planning and managing public funds. The main goal is to improve the system of tracking the issued invoices, as well as to have a better control over settlement of financial liabilities. The Law on Amendments to the Law on Deadlines for Fulfilment of Financial Obligations in Commercial Transactions stipulates, inter alia, the obligation, valid as of March 1, 2018, to register invoices and other payment requests issued by creditors in commercial transactions between the public sector and business entities, or between public sector entities, in which public sector entities are debtors. The biggest challenge in this field is establishing the adequate IT structures which are, at the same time, complex and financially demanding. It is necessary to improve not only the capacities of the Treasury Administration of the Ministry of Finance, but also of the budget beneficiaries in order for them to be able to answer new demands and standards.

**Major progress under Pillar VI**

In order to secure stable public finances, it is necessary to ensure effective external oversight and monitoring mechanisms, including firm rules on reporting and transparency. **Significant improvement was achieved in the work of State Audit Institution – SAI.** through increasing the number and quality of audit products, the number of auditors, and coverage of auditees (see the chart 3 under measure 18), through the implementation of the audit guidelines, giving professional assurance to the National Assembly and the citizens of the Republic of Serbia that the public funds are spent effectively, efficiently and economically. **The State Audit Institution has published 220 out of 231 planned audit products in 2017, while the target number of the planned audit products is 253 until the end of 2020. The European Commission’s Progress Report 2016⁸, as well as SIGMA Report on monitoring the principles of public administration from November 2017⁹, supports the progress achieved in this area, stating that “constitutional and legislative framework of the SAI complies with the INTOSAI standards”**. The expansion of the audit coverage was also noticeable.

Committee for Finance, State budget and Control of Public Spending of the National Assembly has established the Subcommittee of the National Assembly for consideration of reports on audits performed by the SAI in 2015, and first session with new membership was held in September 2016. In order to improve the cooperation between these two independent institutions, the Guidelines for reviewing audit reports on public funds beneficiaries were adopted in August 2017.

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*Implementation of the PFM RP has been successful. However, having in mind that the Program was prepared in 2015 with the ambitions Action Plan covering the*

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entire duration of the Program, it became evident that revision of the Action Plan could improve the quality of the document, either by including new elements or revising the existing. Therefore, after consultations with the European Commission and SIGMA, a decision was made to revise the PFM RP in 2018. The changes will mostly concentrate on an update of activities, proper choice/formulation of indicators and reliable costing estimation. It is already agreed with SIGMA to provide expert support to the Serbian Ministry of Finance throughout this process. The new Action Plan will be prepared for the period 2019-2021

Main areas to be addressed for realization of the Program in 2018 are further improvement of budget preparation process, improvement in efficiency of the revenue collection and budget execution authority, strengthening of the parliamentary supervision over the public finances and strengthening the capacities of the Governmental Audit Office of EU Funds.
PILLAR I – SUSTAINABLE MEDIUM TERM MACRO-FISCAL AND BUDGETARY FRAMEWORK

The first pillar of Public Finance Management Reform Programme (hereinafter: PFM RP) refers to the improvement of credibility of macroeconomic forecasting and strengthening the capacity of the coordinating body for managing the EU’s own funds and other competent institutions. The leading institution responsible for achieving these goals is the Ministry of Finance – Department for Macroeconomic and Fiscal Analysis and Projections, and for the EU’s own resources includes both Customs Administration and Tax Administration, as well as the Treasury Administration.

The measure is in line with the requirements of the Acquis in Negotiating Chapter 17 – Economic and Monetary Policy, and 33 – Financial and Budgetary Provisions, and will help Serbian administration to prepare for the EU membership.

Increasing the credibility of macroeconomic forecasting will improve the quality of the information necessary for decision-makers, and establish improved bases for international cooperation with the EU institutions (such as requirements of the European Semester, etc.), international financial institutions, creditors and other interested parties, thus underpinning fiscal and macroeconomic stability, as one of the major long-term key objectives of the PFM RP.

Measure 1 – TO IMPROVE THE CREDIBILITY OF MACROECONOMIC FORECASTING

The capacities of the Ministry of Finance for macroeconomic forecasting have improved over the last two years through the development of a new model for GDP projections, as well as the establishment of the basis for improving administrative and technical capacities for managing the EU’s own funds.

Implementation of the PFM RP Measure 1 improves the capacities of the MoF and quality of work, and at the same time, it is closely connected to the fulfilment of the Acquis requirements of Negotiating Chapter 17 – Economic and Monetary Policy, and 33 – Financial and Budgetary Provisions. The activities within this measure have been implemented on time, as planned in the PRF RP.
During 2016 and 2017, in order to improve the macroeconomic forecasting, the “Bridge” model was developed for the purpose of improvement of GDP projections, as envisaged in the PFM RP. This model enables quick assessment of GDP per month or quarter, based on high-frequency indicators. Bridge model has significantly improved the work of the Department for Macroeconomic and Fiscal Analysis and Projections of the MoF, enabling quicker and more precise assessments. The activity was implemented based on the internal capacities of the MoF, in the early 2016. Results of this model are published monthly on the website of the MoF\textsuperscript{10} and presented in the Fiscal Strategies for 2017-2019\textsuperscript{11}, and 2018-2020\textsuperscript{12} which is the basic mid-term document on the economic policy of the RS Government, as well as in the document Economic Reform Programme 2017-2019\textsuperscript{13} and 2018-2020\textsuperscript{14}.

Also, within the reporting period, the MoF provided the basis for further strengthening of the capacity to manage the EU’s own resources. On September 1, 2017, in accordance with the changes in the organizational structure and systematization of the Ministry of Finance, within the Department for Macroeconomic and Fiscal Analysis and Projections, a special unit has been set up – the Group for Coordination and Management of the EU’s own resources. The group is responsible for establishing the necessary mechanisms, developing procedures, training employees that will work on tasks related to the EU's own resources, defining and establishing necessary databases. The Unit will coordinate the preparation activities of all institutions involved in the EU own resources system so that they are fully prepared to take over the duties when the Republic of Serbia has joined the European Union. The group consists of three working positions, two of which are filled. In the coming period we will work on capacity building and continuous training of employees.

Within the reporting period in order to strengthen the capacity for carrying out long-term fiscal sustainability analyses and manage the EU own resources, employees in the Ministry of Finance attended numerous trainings, such as: trainings in the fiscal sustainability (with special emphasis on medium-term objectives, fiscal framework, [Insert Footnotes]

\textsuperscript{10} http://mfin.gov.rs/pages/issue.php?id=3
\textsuperscript{11} http://mfin.gov.rs/UserFiles/File/dokumenti/2017/Fiskalna%20strategija%202017%20engleski.pdf
\textsuperscript{12} http://www.mfin.gov.rs/UserFiles/File/strategije/2018/Fiskalna%20strategija%202018.pdf
\textsuperscript{13} http://mfin.gov.rs/UserFiles/File/strategije/ERP%202017%20-%202019%20final_Eng.pdf
\textsuperscript{14} http://www.mfin.gov.rs/UserFiles/File/strategije/2018/ERP%202018-2020%20SRB%20FINAL.pdf
and population aging, etc.); TAIEX workshop “Establishing the system of own traditional resources”; training in traditional EU’s own resources – “Experiences from the Republic of Croatia”, training in statistical-econometric analysis.

<table>
<thead>
<tr>
<th>Performance indicator</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reducing the percentage of the deviation of macroeconomic projections from the Fiscal strategy (GDP and deficit) compared to the projections of relevant international institutions (IMF, EC)</td>
<td>10.4%</td>
<td>Achieved real deviation 4.6%\textsuperscript{15}</td>
<td>Achieved real deviation 3.1%\textsuperscript{16}</td>
</tr>
</tbody>
</table>

**Financing of the measure**

The Bridge model has been developed based on internal capacities of the MoF and financed by regular budget resources, i.e. salaries of employees. Conducted trainings and study visits were financed by GIZ PFR project and the EU. Further trainings will be organized with support of the IMF and EU/TAIEX and other donors.

Upon opening of Chapter 33 – Financial and Budgetary Provisions, capacity building costs will be calculated.

**Key challenges**

- Deficiency of donor funds for development of the Bridge model. The model was developed based on the MoF own capacity, technical knowledge, and regular financing.
- Ensuring new employment for further strengthening of administrative capacities for managing the EU own resources.
- Strengthening the administrative capacity of the Customs Administration for managing the traditional own resources.

**Next steps**

- In 2018 further strengthening of technical capacities of employees in the field of macroeconomic analysis and forecasting will be conducted with additional trainings.
- The existing capacities are adequate for the preparatory phase of establishing a system of coordination and management of the EU’s own funds. By the date of its accession to the European Union, the Republic of Serbia will continue enhancing its administrative capacity in order to establish an efficient system for the calculation and payment of its own resources. In 2018, it is planned to undertake activities for the purpose of analyzing the legal framework and administrative capacities for the full implementation of EU regulations for traditional own resources, as well as to launch activities regarding the implementation of specific training programmes aimed at customs officers for managing the EU’s traditional own resources.

\textsuperscript{15} Target deviation in MoF projections compared to the IMF & EC projections below 10%

\textsuperscript{16} Target deviation in MoF projections compared to the IMF & EC projections below 7%
PILLAR II – PLANNING AND BUDGETING OF PUBLIC EXPENDITURES

The basis for public expenditures management, namely the law which defines the entire budget process (planning, preparation and approval phases, as well as the process of execution and reporting) is the Budget System Law. The Law applies to the autonomous provinces, local self-governments, public enterprises, as well some independent agencies. The Law was changed, through amendments over the previous years.

One of the key elements which contributes to better planning of budgetary resources and increases the transparency of spending public resources is the implementation of programme budgeting. Implementation of mandatory programme budgeting in the Republic of Serbia started in 2015 (except for five pilot ministries which used this methodology earlier). The quality of programme budgeting keeps increasing year after year, both due to the fact that public funds beneficiaries have more experience and knowledge regarding preparation of annual programme plans, and due to constant improvement of the process by the MoF Budget Department, in terms of improvement of methodology of budget preparation, improvement of the software for public finance management and organizing trainings for the beneficiaries. Under this pillar, during the reporting period a baseline was established for further improvement of the budgetary process through the introduction of a legal base for capital investment planning and preparation of methodologies for costing and medium-term planning of public policies.

Measure 2 – TO IMPROVE THE COVERAGE OF THE NATIONAL BUDGET

Improved coverage of the national budget provides a better basis and more reliable information on the execution of the budget, on the basis of which the Budget Department of the Ministry of Finance can more precisely plan the expenditures of indirect budget users.

Illustration 1: Structure of the Public Sector
In accordance with the planned deadlines, the Treasury Administration has made all necessary adjustments of business processes, organizational changes and provided technical conditions for inclusion of indirect beneficiaries in the system of the republic budget execution.

Measure 2 is envisaged in the PFM RP to be implemented by 2020. During the reporting period the coverage of the execution of the national budget of the Republic of Serbia has been increased through the inclusion of judiciary administrations, criminal correctional facilities and cultural institutions into the IT system for budget execution. Also, the coverage of the budget and budget documentation has been increased through inclusion of project loans.

<table>
<thead>
<tr>
<th>Performance indicators</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reliable financial plan of Indirect Budget Beneficiaries included in the execution of the national budget</td>
<td>0</td>
<td>247</td>
<td>318</td>
</tr>
<tr>
<td>Percentage of external/donor funds included in the national budget and budget execution documentation</td>
<td>14%(^{17})</td>
<td>28%</td>
<td>TBC(^{18})</td>
</tr>
</tbody>
</table>

The budget execution system of the Treasury Administration included 318 additional indirect budget beneficiaries in 2016 and 2017. Now it covers all courts, public prosecutors, judiciary institutions, criminal correctional facilities and cultural institutions.\(^{19}\)

In accordance with the PFM RP, the gradual inclusion of donor funds in the annual and multiannual national budget as well as the budget execution documents is planned until the end of 2020. According to available data, the percentage of donor assistance that has been included in the national budget, as well budget execution documentation represents 28% of total donor funds included in the ISDACON\(^{20}\) database.

Significant progress has been made by including project loans into the Budget Law for 2017. In the previous period, only a small portion of project loans was presented in the annual budget because the loans were presented as part of the general government deficit. The Budget Law for 2017 introduced a significant methodological change – large infrastructure projects (such as the construction of corridors X and XI), the so-called project loans have been integrated into the budget of the Republic of Serbia, thereby making it more comprehensive and transparent.

Also, great progress has been made in relation to the previous years by including the financial plans of public enterprises in the budget documentation for 2017. Compared to the previous period when the financial plans were adopted several months after the adoption of the Budget Law, the Ministry of Finance gave a positive opinion in a timely manner so that the financial plans could be adopted together with

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\(^{17}\) The percentage of external funds included in the budget compared to the donor funds included in the ISDACON database of the Ministry of European Integration. Data on development aid contained in ISDACON information system are stored on the basis of information received from representatives of the donor community and data received from Public Debt Administration, in terms of concessional loans.

\(^{18}\) Collected data is still being processed.

\(^{19}\) For more details see measure 16.

\(^{20}\) Percentage of external funds included in the budget compared to the donor funds included in the ISDACON database of the Ministry of European Integration. Data on development assistance contained in the ISDACON information system are collected on the basis of information obtained from representatives of the donor community and data obtained from the Public Debt Administration, in terms of concession loans.
Financing of the measure
No additional funds were foreseen in the PFM RP. All activities are implemented within existing national budget for regular activities of the Ministry of Finance.

Key challenges
✓ Lack of information from international donor organisations regarding their planned assistance, due to varying programming cycles and ad-hoc additional funding provided to the Republic of Serbia through various bilateral development aid.

Next steps
In 2018 and 2019, the Ministry of Finance will continue to expand the coverage of indirect budget users by finalising inclusion of the remaining users currently outside the IT system for budget execution, i.e. it is planned to include social welfare institutions and indirect beneficiaries of the Ministry of Labour, Employment, Veteran and Social Affairs.

Measure 3 – TO FURTHER IMPLEMENT MULTI-ANNUAL PROGRAMME BUDGETING ACROSS ALL LEVELS OF GOVERNMENT

The Ministry of Finance continued to improve the programme budgeting, as a tool for managing results with limited resources within the reporting period, in line with the Budget System Law22. The programme-based budget was introduced in 2015 to cover 100% of budget beneficiaries in the Budget of the Republic of Serbia, and 100% of budget users in the Decision on the budget of local self-government units.

<table>
<thead>
<tr>
<th>Performance indicator</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage of compliance of programme structures of budget beneficiaries with Guidelines for the preparation of the Programme Budget</td>
<td>61%</td>
<td>82%</td>
<td>85%</td>
</tr>
</tbody>
</table>

The compliance of structures of the programme budget of budget beneficiaries with Guidelines for the preparation of the Programme Budget issued by the Ministry of Finance, Budget Department, is increasing, because the quality of the programme information defined by budget beneficiaries is more in line with the above-mentioned Guidelines; in 2015 it was 61%, in 2016 it was 82%, and in 2017 it reached 85%. Also, percentage of local self-governments units (LGSU) compliance of budget structures is

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21 The aforementioned financial plans were adopted by the Government of RS – Corridors of Serbia on December 7, 2016, and Roads of Serbia on December 15, 2016.

22 Indicator 6.1. for 2016 for monitoring the implementation of the Sector Reform Agreement (Sector Budget Support) for Public Administration Reform within IPA 2015 – Financial Plans of PE Roads of Serbia and Corridors of Serbia doo are included in the budget documentation for 2017, which is submitted to the assembly.
increasing comparing to values from 42.06% out of total number (170) of LGSU in 2015 to 46.5% in 2016 and 61.53% in 2017, i.e. 104 towns and municipalities.

By introducing multi-annual programme budgeting for all budget beneficiaries, clearer information is available to the public regarding purpose of the budget funds spending. Programme budgeting is a transparent mechanism for monitoring budget expenditures and outlays which enables decision-makers to easily understand the connection between the approved funds and strategies, programmes and outcomes. In this way, the budget becomes a more efficient instrument for public finance management.

Over the past two years significant developments have been achieved in programme budgeting:

- **Improved Guidelines for the preparation of the programme budget.** The changes are directed towards the improvement of programme information and monitoring of the achievement of key objectives, as well as clearly defined roles and responsibilities in the annual cycle of programme budget preparation. Improvements in methodology started with the application of the Budget Law for 2017, and are supported through the new information system for budget preparation (Budget Information System – BIS).\(^{23}\)

- **Improvement in the programme structures.** The Ministry of Finance worked together with budget beneficiaries on improving the quality of their initial programme structures. These improvements have been made in order to improve compatibility between programme structures and key jurisdiction of budget beneficiaries with their strategic documents and to increase budget transparency.

- **Improvement of programme information.** Based on lessons learned during the programme budget implementation, the Ministry of Finance defined types of programmes and programme activities which do not require defining goals and indicators. The reason behind is because those are administrative activities.

\(^{23}\)The improved methodology for drafting 2017 annual budget was prepared in October 2016 and published on the website of the Ministry of Finance, thus fulfilling the indicator for monitoring the implementation of the Sector Reform Agreement (sectoral budget support) for public administration reform within IPA 2015.

for which it is not possible or not necessary to create objectives and quality indicators. Every year the Ministry of Finance works together with budget users to improve goals and indicators.

- **Performance-based reporting started in 2017.** Obligation of monitoring and reporting on programmes performance has been introduced, which will show achievements with the spent budget funds. Monitoring and reporting represents an upgrade of the planning system and the creation of programme budget that allows beneficiaries to use information about achieved effects of the programmes to improve the efficiency and effectiveness of public spending and quality of public services. Performance-based reports for 2016 budget has been received in the first quarter of 2017 from all budget beneficiaries, and currently are processed and used for preparation of the draft Law on budget for 2018. **Methodology for Monitoring and Programme Performance Reporting**, which was tested during the preparation of the Priority Areas of Financing in the first and second quarters of 2017, was prepared and published on the website of the Ministry of Finance in May 2017. During 2017, budget beneficiaries at the republic level reported twice on the impact of the programme. The prepared and submitted reports on the programme performance in 2016 (annual report) and in the first six months of 2017 (semi-annual report) were used by the Ministry of Finance during the preparation of the budget for 2018. The reports were used for a more precise projection of expenditures for the coming period, as well as for further improvement of programme structures and programme information.

**Illustration 3:** Calendar of reporting on budget beneficiaries' performance

- **Gender-sensitive indicators were introduced in 2016.** The Ministry of Finance published the Plan for introducing gender budgeting in the process of preparation and adoption of the budget of the Republic of Serbia for 2017 and 2018. For the first time, it was planned that 25 budget beneficiaries should prepare gender-sensitive indicators for 2017 budget. Plan for 2018 budget has specified 35 budget beneficiaries obliged to define at least one gender sensitive
goal and one gender-sensitive indicator. The idea is to increase the number of budget beneficiaries with gender-sensitive goals and indicators every year.

- **Budget Information System (BIS) for budget preparation was developed in 2016 and successfully tested in 2017.** BIS ensures easier and more efficient way of entering financial plans of budget, and the process of analysis and unification of the financial plans of budget beneficiaries has been improved.

- **Trainings for programme budget preparation and reporting.** In 2016 and 2017, nine training sessions were held with more than 150 participants. Monitoring and reporting procedure, content of performance report and key roles and responsibilities in reporting procedure were key topics that were discussed during the trainings. Six employees in the Budget Department obtained a certificate for trainers for programme budgeting.

- **Citizens’ Budget produced and published.** The Ministry of Finance produced the Citizens Budget of the Republic of Serbia, which in clear and comprehensive way provides information to the public on budget structure, collecting and spending budget funds. The citizens’ budget was published at the Ministry website for 2015 and 2017, as well as for 2018.

- **Transparency of the budget has been increased through the introduction of a legal obligation** to publish programme information and report on the achieved performance at the websites of budget beneficiaries.

**Financing of the measure**

During the reporting period, in addition to regular budget expenses, additional amount was spent on trainings on programme budgeting for civil servants, organized in cooperation with the Human Resources Management Service of the Republic of Serbia (HRMS), which cost around 160,000 RSD. Development of the information system for budget preparation (BIS) was funded by the USAID project (50,000 USD). Support is also provided through the implementation of the Exchange 5 IPA 2014 project. Also, the Budget Law of the Republic of Serbia for 2018 envisages funds in the amount of 3.5 million RSD for the development of a module for examination and reporting on the programme performance.

**Key challenges**

- Delay in publishing call for public procurement for maintenance and further development of the IT system BIS, and administrative procedures related to the transfer of ownership, lasted longer than planned.

- Integration of the existing budget execution software with the new BIS system, and other systems, such as the Single IT System for planning and reporting on public policies, which will be established by the end of 2018.

**Next steps**

- Further improvement of programme information, structures and reporting.

- During 2018, the main goal will be further improvement of the IT system. It is planned to correct errors detected during the application of the software in the budget procedure and development of new modules for software. It is necessary

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26 For more information, see measure 5
to develop a module for monitoring and reporting on performance of budget programmes (report on goals and indicators), module for capital investments, module for salaries and module for expenditure projections, as well as a module for entering financial plans of organizations for compulsory social security.

**Measure 4 – TO IMPROVE CAPITAL PROJECTS PLANNING**

The establishment of a legal framework for public investment management was recognized in the previous period as a strategic priority of the RS Government in order to prevent ad hoc decision making on investments so that decisions on financing capital projects are based on systematic planning and prioritization.

The Regulation on Content, Preparation Method and Assessment, as well as on monitoring the implementation and reporting on capital projects implementation (hereinafter Regulation) was adopted by the Government on June 27, 2017.27

The Regulation is applied as of January 1, 2018, i.e. during the preparation of the Budget Law for 2019. It is expected that the application of selection criteria based on the strategic relevance and degree of project readiness greatly increases the probability of successful implementation of projects and leads to a significantly higher percentage of budget execution of capital expenditures from 2019 onwards. According to the available data, the percentage of budget execution of capital projects in 2017 was around 75%.

Also, the Ministry of Finance is currently drafting five accompanying regulations, which include criteria for: project selection, capital maintenance, development of an integrated database, project documentation requirements, ranking of capital projects.

By adopting the Regulation, Reform Measure 4 of the PFM RP, which provides for the establishment of a single platform for planning capital projects and methodology for the analysis of public investments, was not fully implemented but the main precondition for improving the planning of capital projects was fulfilled, which was also recognized in the Concluding Statement of the IMF Mission for 2017, Article IV Consultation28.

<table>
<thead>
<tr>
<th>Performance indicator</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share of capital budget spent by the end of the budget year</td>
<td>66%</td>
<td>74.5%</td>
</tr>
</tbody>
</table>


In addition, improved capital investment management has been recognized as a priority structural reform in the Public Finance Management area of the Economic Reform Programme document for the period 2016-2018 and 2017-2019, and for the period 2018-2020, adopted by the Government of the Republic of Serbia.

It is important to note that in the case of infrastructure projects financed by the EU, the Methodology for Prioritization and Selection of Investment Projects (adopted in the last quarter of 2013) is applied, thus identifying the Single Pipeline of Investment Projects in four sectors, which is further accepted by the National Investment Committee (set up to improve systematic management of capital projects in 2014), chaired by the Minister of Finance and the Minister of European Integration – NIPAK.

In order to establish the Single Pipeline of Projects and single selection procedures, which will cover all public and EU financed investments, a constant interaction between the Ministry of Finance and the Ministry of European Integration has been established together with the EU Delegation in order to merge and combine these two procedures.

Financing of the measure
The cost of activities implemented under measure four includes regular activities, i.e. salaries of employees in the Unit for evaluation of capital projects of the Budget Department within the MoF. In addition, technical support was provided by USAID for the development of the Regulation.

The PFM RP provides for 161,626 EUR in donor funds for financing a software, but the funds have not yet been agreed, and will be used to set up an integrated base of capital projects.

Key challenges
- Insufficient human resources for analyzing the cost-effectiveness of projects, evaluating and prioritizing proposed projects and managing investment projects. It is necessary to improve the system of human resources management and to conduct continuous education of employees.
- Establish a functional system for managing capital projects from different sectors to ensure effective and efficient management of public funds.

Next steps
- Adoption of Rulebooks as defined by the Regulation:
  - Rulebook on conditions, manner and procedure of capital maintenance, according to type of capital project;
  - Rulebook on the content of an integrated capital project base;
  - Rulebook on the content, deadlines and procedure for submitting investment documentation;
  - Rulebook on more detailed conditions, method, criteria and measures for evaluation and selection of capital projects;

http://www.mfin.gov.rs/UserFiles/File/dokumenti/2016/ERP_2016_ en.pdf at page 64, and
http://www.mfin.gov.rs/UserFiles/File/strategije/ERP%202017%20-%202019%20final_Eng.pdf on page 71
Information system established at the Ministry of Finance and serves as support for the management of capital projects in the territory of the Republic of Serbia.
- Rulebook on more detailed conditions, method, criteria and measures for ranking capital projects;

✓ Procurement and customization of the module for managing capital projects within the existing BIS budget preparation system for the purpose of which the technical specification is currently being prepared;

✓ Training for budget users for implementation of the Decree.

**Measure 5 – TO IMPROVE BUDGET PLANNING**

The basis for linking public policies with medium-term expenditure framework should be established by late 2018, as envisaged in the PFM RP. In that regard, mid-term plans of budget beneficiaries shall be provided in a comprehensive planning document which covers a period of three years and facilitates linking public policies to the medium-term expenditure framework. Medium–term plans shall be prepared on the basis of documents of public policies in force, taking into account priority goals of the Government, available capacities, resources as well as a change in the actual situation in relation to the time when these documents of public policies were adopted.

Although the planned deadline for the implementation of Measure 5 has not expired yet, significant progress has already been achieved, which represents a good basis for timely implementation of the remaining activities.

<table>
<thead>
<tr>
<th>Performance indicator</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage of mid-term plans of budget beneficiaries based on the new methodology</td>
<td>0%</td>
<td>TBD</td>
</tr>
</tbody>
</table>

, significant developments in the previous period have been achieved through:


✓ The public procurement procedure of the Republic Secretariat for Public Policies has been successfully implemented for the purpose of developing and implementing a single information system for planning and monitoring the implementation of public policies (SIS). SIS will be a unique electronic system at the level of state administration authorities in which the planning system participants will enter the contents of their public policy documents and medium-term plans, and report on their implementation.

✓ Preparation and testing of the draft Methodology for baseline estimates and policy costing. A draft methodology for baseline estimates and policy costing were prepared by the PFM regional adviser and tested during preparation of priority areas for financing for 2018-2020. The purpose of this methodology is to provide better inputs to the process of defining limits for budget users in the medium term.

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✓ **Preparation of the draft Methodology on medium-term planning.** Budget beneficiaries of the Republic of Serbia shall prepare medium-term plans in accordance with the budget preparation timetable and process, including the established programme-based budget elements and taking into account the limitations set by the medium-term expenditure framework. The medium-term plans shall contain the following elements: general and specific goals; overview of measures to achieve the set goals for the entire validity period of the plan, linked to budget programs, as well as programme activities and projects, under which the funds for their implementation are planned; harmonization of public policy or development planning documents; referring back to these documents if the measures and activities were taken from them; the funds required for the implementation of measures set by program-based budget, detailed overview of the activities (including normative activities that are carried out within a certain measure for the first year of validity of the plan); indicators for monitoring performance and evaluating the achievement of the general and specific goals and risks and prerequisites for the implementation of measures.

✓ **Sectoral Mid-Term Expenditure Frameworks for the Public Administration Reform sector, Education sector and Integrated Border Management sector, have been developed.** The documents represent an overview of the allocated funds from the RS budget as well as donor funds for the reform of these three sectors and are taken into account when drafting the Budget Law and Fiscal Strategy. The drafting of the two documents is a significant step towards the creation of a medium-term budgetary framework for policy and budget planning. The reforms are supported through the EU funds and are subject of the Sector Reform Agreements, which have provided sectoral budget support from IPA 2015 and IPA 2016.

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33 During the reporting period, a draft document was produced – Medium-Term Expenditure Framework for the Integrated Border Management Sector.

34 Indicator 7 for monitoring the implementation of the Sector Reform Contract for 2016 (*The Sectoral Medium Term Expenditure Framework (MTEF) was developed for another sector (*) (EDUCATION) and is taken into account when preparing the Fiscal Strategy 2017-2019 and the Budget Law for 2017, and for 2017 (A sector medium-term expenditure framework (MTEF) developed for one additional sector (*) (Justice), and is taken into account during the preparation of the Fiscal Strategy 2018-2020 and Budget Law 2018) were completed by producing MTEF for the Education Sector and Integrated Border Management within the agreed timeframe.
Adoption of the Law on Planning System of the Republic of Serbia represents the precondition and legal basis for the adoption of the Decree on methodology for medium-term planning by the Government of the Republic of Serbia. In the reporting period, all the formal requirements for submitting the draft Law on Planning System in Serbia to be discussed and adopted by the Government have been met (consultations with EU, SIGMA, EU delegation in the Republic of Serbia, as well as with state administration in Serbia, civil society organizations, field experts, professional and business associations, had been conducted, and public debate procedure carried out, attended by more than 170 representatives of the state administration, autonomous province, local self-government units, non-governmental organizations and citizens). Following the consultations, the draft Law on Planning System of the RS was sent to all public administration authorities that were supposed to give their formal opinions. At the session held on August 31, 2017, the Government established the Draft Law on the Planning System of the Republic of Serbia and submitted it to the Parliament.

As regards the part of the measure related to the improvement of coordination and alignment of donor assistance with the public policy priorities, it is important to underline that on the initiative of the Ministry for European Integrations, the process has been started to improve the mechanism of the Sectoral Working Groups in terms of using them and in the function of the forum for discussing the topic of progress in the implementation of sectoral policies, planned measures and activities in the coming period, and the need for funding between national institutions and donors. The initiative was launched with the aim of additional linking of donor funds with priorities and measures from sectoral strategies within the existing system of coordination of EU aid and development assistance. In addition, for the purpose of quality alignment of donor assistance with public policy priorities, Ministry of European Integration uses the document “National Priorities for international development assistance to the Republic of Serbia 2014-2017 with the projections until 2020. This is one of the key instruments within the system of international development assistance coordination in the Republic of Serbia, it is prepared by the Ministry of European Integration in coordination with
other relevant institutions and interested stakeholders, and it is based on the priorities defined in the relevant sectorial strategies. The new multiannual planning document for coordination of international development assistance 2019-2025 is currently in the process of preparation.

Nevertheless, alignment of planning and programming of external assistance with the budget calendar has been recognized as a challenge. It is not realistic to align dynamics in planning and programming of development assistance provided from different donors, since different governments have their own dynamics in budget preparation and consequently the programming timeframe is different.

**Financing of the measure**
The cost of activities implemented under Measure 5 includes regular national budget expenses. Additional funds have been provided through IPA 2011 Project on Reforming Government Policy Coordination amounting in total 1,860,400 EUR, through the support provided by IMF, United States Agency for International Development (USAID) – Business Enabling Project (BEP), and GIZ Public Administration Reform Project. In order to establish a single information system for planning and monitoring the implementation of public policies (SIS), which will include: Action Plan for Implementation of Government Program, public policy documents, Information System for Planning and Reporting on Government Work and Medium-Term Plans, about 306,000 EUR has been allocated from the Budget of the Republic.

**Key challenges**

- The complex nature of this reform measure makes it very challenging for implementation. There have been some delays in adoption of the Law on Planning System of Serbia, which represents the legal basis for the adoption of the Regulation on Medium-Term Planning Methodology.
- Alignment of planning and programming of donor funds with the budget calendar has been recognized as a challenge. **It is not realistic to align dynamics in planning and programming of development assistance provided from different donors with national budget calendar.** In that sense, the more adequate formulation/revision of this activity should be considered.
- In terms of successful implementation of medium-term plans, **introduction of the policy dialogue with the donors** should be recognized as very relevant part of the development. In that sense, it is planned to formalize these consultations within the Sector Working Group system, coordinated by Ministry of European Integration.

**Next steps**
The priority activity for the improvement of budget planning in 2018 is the adoption of the Law on the Planning System of the Republic of Serbia by the National Assembly, which will also fulfill the formal prerequisite for adopting the Regulation on the methodology of medium-term planning. The National Assembly is expected to adopt the Law on the Planning System of the Republic of Serbia by the end of the second quarter of 2018, while the Government, on the proposal of the Republic Secretariat for Public Policies, will adopt a Regulation on Medium-Term Planning Methodology, up to and including the second quarter of 2018. Also, bearing in mind successfully implemented public procurement procedure, the Republic Secretariat for Public
Policies will establish by the end of the fourth quarter of 2018 the Single Information System (SIS) for planning and monitoring the implementation of public policies\(^{35}\).

**Measure 6 – TO IMPROVE OPERATIONAL CAPACITIES FOR PUBLIC INVESTMENT COORDINATION AND BUDGET PLANNING**

Within the reporting period, continuous efforts were expended to strengthen the administrative capacity of the Budget Department of the Ministry of Finance as well as to improve the analytical skills of civil servants in order to enhance capacities for planning and budgeting strategic and operational plans of public authorities.

<table>
<thead>
<tr>
<th>Performance indicators</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Budget Department fully staffed</td>
<td>67%</td>
<td>70%</td>
<td>70%</td>
</tr>
<tr>
<td>Percentage of public administration bodies that introduced analytical and planning units</td>
<td>/</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

In order to strengthen the budget process, the Budget Department’s capacity for budget preparation, coordination and monitoring of budget execution needs to be enhanced. The PFM RP envisages increase in the number of employees as well as continuous strengthening of operational and analytical capacities. During the reporting period the Budget Department reached employment rate of 70% systematized job positions\(^{36}\), and employees attended two training sessions related to the baseline expenditure projections and new policy costing.

The PFM RP Action Plan also provides for establishing internal organizational units in charge of providing expert support in planning and budgeting strategic and operational plans of public authorities by the end of 2017. However, in the reporting period, the necessary prerequisites for the realization of this result have not been met. In order to establish these organizational units, it is necessary to amend the legislative framework, or amend the Regulation on the principles of internal organization and systematization of jobs in ministries, special organizations and civil services.\(^{37}\)

In addition to the legislative framework, it is necessary to provide sufficient operational capacities to ensure efficient budget planning and coordination of public investments, and during the reporting period, activities were undertaken to improve existing analytical skills at the level of state administration bodies. The Republic Secretariat for Public Policy has made significant efforts in building its own analytical capacities and skills as well as those of other state administration bodies. In this regard, the following trainings were organized:

- During 2016, in cooperation with the Human Resources Management Service, five trainings for civil servants and managers were organized on analyzing the

\(^{35}\) Setting up of the SIS is provided for by the Draft Action Plan for the implementation of the Public Administration Reform Strategy for the period 2018-2020 (Measure 1.3, Activity 3).

\(^{36}\) Part-time contracts not taken into account.

\(^{37}\) The new Public Administration Reform Action Plan will extend the deadline for the adoption of the said Regulation.
effects of regulations, managing the legislative process, role of managers in strategic and financial planning in the state administration. A total of 71 civil servants and managers were trained.

- During 2017, in cooperation with the Human Resource Management Service and GIZ, trainings were conducted in the following areas: 1. Programme of general continuous professional training of civil servants on the topic: Managing the public policy system and Managing the legislative process and administrative acts; 2. Programme of general professional development of managers on the topic: Training programme for civil working on an appointed position – Public Policy Management, Training of managers of focus internal units – Fundamentals of public policy and legislative process management and Training programme for civil servants preparing for performing tasks at managerial positions – Fundamentals of Public Policy Management and Legislative Process Management. In this regard, 27 trainings were held and 232 civil servants and managers were trained.

- A total of 32 trainings were held and a total of 303 civil servants and managers were trained within the state administration bodies in order to improve analytical skills and build capacity of state administration bodies.

**Financing of the measure**

In the PFM RP it was envisaged to invest 1.6 million EUR from the national budget for implementation of activities under Measure 6, but so far only regular financing from the budget has been used. Trainings were organized by the Government Human Resource Management Service (HRMS) in order to improve analytical capacities of public administration, and the funds in the amount of around 200,000 RSD were provided from the national budget. Trainings for the Budget Departments were organized by the USAID and GIZ.

It is not possible at the moment to calculate the cost of establishing new analytical and planning units before the introduction of necessary legal changes.

**Key challenges**

- Adoption of adequate legal bases for establishment of analytical and planning units. The proponent in charge to amend the Regulation on Principles for internal organization and systematization of jobs in ministries, special organizations and government services is the Ministry of Public Administration and Local Self-government. The Republic Secretariat for Public Policy launched in April 2017 an initiative with the Ministry of Public Administration and Local Self-Government to amend the wording of the Regulation on Principles for Interior Organization and Jobs Systematization in Ministries, special organizations and Government services. However, instigation of that initiative was premature taking into consideration that the Law on Planning System was not adopted by the Government. For the aforementioned reasons, MPASLG did not deliberate on the initiative.

**Next steps**

- It is expected that in the following period the appropriate steps will be taken in order to change and amend the Regulation on Principles for Internal Organization and systematization of workplaces in Ministries, special organizations and Government services. The purpose of this change is to create
preconditions for the introduction of the obligation of public administration bodies to organize study analytical work of drafting documents of public policies and medium-term planning. This will lead to better public policies planning and organization of adequate trainings, which represents a precondition for the complete implementation of this measure.
PILLAR III – EFFICIENT AND EFFECTIVE BUDGET EXECUTION

In order to have efficient and effective public financial management, public funds should be spent in a timely and predictable manner. Over the years, many factors resulted in less than desired budget execution efficiency. Various fiscal constraints, outdated procedures and lack of administrative capacity prevented the Government from efficiently utilizing the Budget. Although steps have been taken in order to secure more efficient and effective budget execution, PFM RP addresses this issue in a systematic and comprehensive way and provides guidelines for improvement. As envisaged in this pillar, more efficient and effective budget execution will be reached through improvement of revenue collection, commitment control and cash management, capacities for public debt management and public procurement legislation and procedures.

Measure 7 – TO IMPROVE REVENUE COLLECTION

The Tax Administration and the Customs Administration of the Ministry of Finance have expended their efforts to achieve the set goals since the beginning of the implementation of the PFM RP. Although the target value of tax collection in 2017, as seen from the performance indicators table, is 87%, the realized value in 2017 was 96%. During 2017, the Tax Administration Transformation Programme was revised and Action Plan was prepared for the period 2018-2023. The objective of the Tax Administration Transformation Programme is to improve the organizational structure, business processes and services provided to taxpayers. In 2017, the planning documents for the development of the customs service by 2020 were adopted: Development Plan for the RS Customs Service for the period 2017-2020 and the Action Plan for Implementation of the Development Plan of the RS Customs Service. Also, progress has been made in the area of risk management and anti-corruption measures, as well as in the modernization process of the customs laboratory. This measure is closely linked to negotiating chapters 16 – Taxation and 29 – Customs Union.

The European Commission in the Progress Report for 2016, within the negotiating chapter 16 – Taxation, concluded that Serbia was moderately prepared in the area of taxation, while for the negotiating chapter 29 – Customs Union, the progress was highlighted in the transit system, with initiations of mutual transit procedure, after the implementation of the New Computerized Transit System (NCTS) started.

However, the Report indicates that Serbia has to upgrade the customs declaration processing system and integrate risk management, as well as to improve and modernize Customs Administration management. Negotiations on Chapter 29 was opened in January 2017.

<table>
<thead>
<tr>
<th>Performance indicator</th>
<th>2014</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage of share of total regular tax collection against total tax revenue estimated in budget</td>
<td>85%</td>
<td>86%</td>
<td>87%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Performance indicator</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase in revenue collection (collected by the Customs) as % of GDP</td>
<td>10.17%</td>
<td>10.27%</td>
<td>10.56%</td>
</tr>
</tbody>
</table>

More efficient collection and control of taxpayers has produced visible results and this trend is expected to continue in the coming period. The decline in tax discipline observed in 2013 was reversed in 2014, and the trends observed so far indicate that tax collection has improved. The decline in tax discipline was stabilized in the first half of 2014, while 2015 saw increased tax collection. The increase in public revenue is mostly attributed to the increase in excise and VAT revenues. There is much scope for additional improvements in tax collection in the coming period. Notwithstanding the improved tax discipline, the Tax Administration will be further strengthened through consistent implementation of the Action Plan of Tax Administration Transformation Programme 2018-2023.

There is a continuous work on strengthening the management and improving the organizational structure and tax processes, and the Transformation Programme of the Tax Administration is a basis for strategic and organization changes of Serbian Tax Administration. Special attention and effort is directed towards taxpayers’ voluntary compliance with tax regulations. This was achieved by amending tax laws, strengthening the capacity of the Tax Administration (100 new employees) and raising the awareness of taxpayers (through the campaign “Pay Your Tax and Expect Benefits”).

Development of the Tax Administration, as a stable institution with a modern organizational structure and efficient tax administration is defined by the Tax Administration Transformation Plan through achieving three strategic goals:

1. Improve the efficiency and effectiveness of basic business processes and increase the rate of tax collection
2. Improve the quality of services and reduce the costs of fulfilling tax obligations
3. Establish a modern infrastructure and work environment within the organization.

New Action Plan of the Tax Administration Transformation Programme for the period 2018-2023 and Decision on Basic and Secondary Activities of the Tax Administration has been adopted on December 5th 2017\(^3\), which means the Tax Administration shall focus on the basic tax activities and the next phase of the consolidation of organizational units. Further simplification and unified tax procedures as well as the improvement of operational activities to reduce the informal economy should contribute to reduced costs of meeting tax liabilities, easier and fairer business conditions and more efficient tax collection.

In the past two years there have been several organizational changes in the Tax Administration. In order to establish a structured approach to the management of the Tax Administration of the Republic of Serbia, three Committees have been formed that are operational: the Tax Administration Management and Supervision Committee, the Risk Management Committee under the Regulatory Plan and the Committee for the Implementation of the Transformation Program.

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\(^3\) The RS Government conclusion 05 No. 021-12037/2017
Through the adopted Act on Internal Organization and Job Systematization in the Tax Administration in August 2017 the Department for Strategic Risks and the Sector for Providing Services to Taxpayers and Education was formalized. The number of organizational units of branch offices was reduced to 78. The next phase is the unification of basic tax functions into smaller organizational units by June 2019, followed by a continuation of the consolidation process by 2023.

**Combined efforts have been made to improve voluntary compliance with tax regulations through changes in legislation, increased capacities and raised awareness.** Due to the reforms undertaken in 2016, the voluntary tax collection reached the level of 96% of total (voluntary) tax collection out of total tax income assessed in the national budget. In order to increase the percentage of voluntary compliance with tax regulations in the overall tax income, the analysis of the rules on tax procedures and tax administration is jointly conducted by the representatives of the Ministry of Finance and Tax Administration.

Progress has been made in relation to the development of strategic framework for improving services to taxpayers and overall organizational arrangement. A special Department of Tax Administration has been established for providing services to taxpayers. It is expected that this transition from the “traditional model” based on regulatory compliance control to a client-oriented approach will make it easier, simpler and cheaper for taxpayers to meet their tax liabilities.

**The Transformation Committee adopted the Strategy for Providing Services to Taxpayers** in December 2016. The concept of the Sector for providing services to taxpayers was also prepared, which was formalized in August 2017 through the adopted Act on Internal Settlement and Job Systematization in the Tax Administration, and was named the Sector for Providing Services to Taxpayers and Education. The strategy and concept envisage increased functionality of the existing Contact Centre, as well as the preparation of support programmes for newly registered taxpayers.

In two years of full implementation of consolidated collection of withholding taxes and contributions, which began on March 1, 2014, a total of 7,444,597 correct Individual tax return applications were submitted electronically. On a monthly basis, an average of more than 300,000 applications were submitted through the online service of Tax Administration. E-Taxes service is operating successfully and the technical capacities for the receipt and processing of applications are all set for the further development of new services.

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In 2016, a marketing campaign consisting of 40 five-minute educational episodes was conducted as another applied mechanism for increasing tax collection. It was broadcast on two television stations with a national frequency in the Republic of Serbia. During 2017, the marketing campaign was continued, through publishing complete versions on social networks and posting the information.

Illustration 5: Marketing Campaign “Pay Your Tax and Expect Benefits”

Due to the great success of the first cycle of “Take the Receipt and Win a Prize” sweepstake, which took place in the first quarter of 2017, when almost 40% of citizens participated and more than 85 million receipts and slips were sent, the Government of Serbia decided to organize together with NALED a new round of “Take the Receipt and Win a Prize 2018” sweepstake.

The sweepstake is organized as part of a wider media education campaign along the announcement of 2018 as the year of the fight against informal economy and is one of the key measures of the National Programme for Reducing Informal Economy.

The aim is to raise the awareness of citizens and the economy about the importance of reducing informal economy, promote non-cash payments as an instrument of combating informal economy, strengthen tax culture and motivate citizens and the economy to comply with regulations.

In 2017, a counter called “Your Taxpayer” was set up in 37 branches and its main purpose is to provide assistance and services to taxpayers.

Within the Transformation Programme, it is planned to conduct an analysis of the working procedures and standard operational procedures of tax inspectors. This will make it possible to check if their functions and prerogatives are clear, which reduces the number of arbitrary decisions.\(^{42}\) In addition, drafting a methodological manual for recording the turnover by using fiscal cash registers has led to a lower number of arbitrary decisions.

The Plan for the compliance with tax regulations for 2017 has been prepared and adopted. For the first time, the OECD risk management model related to compliance with the regulations was used for development of the Plan.

Finally, with support of the GIZ PFR project, 255 field inspectors were trained on transfer prices. In order to implement advanced specialist training to cover case studies, it is necessary to provide the appropriate software support.

The implementation of ERIAN (Risk Analysis Management System)\(^ {43}\) is underway. The ERIAN system for control of transit procedures of national (NT) and common transit (T1, T2, T-), carried out through NCTS (New Computerized Transit System) has been in place since February 2016. The project for the introduction of automated import and export systems has been initiated, which is a prerequisite for the integration of ERIAN into AIS&AES and related control systems. Additional Protocol 5 on facilitating trade between CEFTA member countries was signed.

Strengthening of anti-corruptive measures is an activity monitored by the PFM RP, as well as through the Action Plan for negotiating chapter 23 – Judiciary and Fundamental Rights. Customs Administration has carried out the analysis on corruption risks of the

\(^{42}\) The control list was published on: [http://www.purs.gov.rs/aktuelnosti/Ostalo/3525/inspekcijski-nadzor---kontrolne-liste.html](http://www.purs.gov.rs/aktuelnosti/Ostalo/3525/inspekcijski-nadzor---kontrolne-liste.html)

\(^{43}\) ERIAN is an expert system – module whose general goal is to ensure on-line evaluation of declarations processed within the declaration process system according to the specifications of a model (profile) of risk, drafted by risk analysts in ERIAN central archive of risk profile.
legal framework of customs system\textsuperscript{44}, and continued to strengthen its capacities through trainings. The first part of the training programme organized by the GIZ project for PFR on “Methods of Investigating Corruption in Customs” took place at the Academy of Criminalistics and Police Studies for 15 employees of the Internal Affairs Department of Customs Administration in December 2016, and the second part was held in January 2017.

To address one of the recommendations of the EC Progress Report 2016 related to modernization of the Customs Laboratory, the twining light project “Creating Conditions for Strengthening the Capacities of Customs Administration Laboratory of the Republic of Serbia”, financed from IPA 2013, started in June 2017 and ended in December 2017. The most important results of this project were: recommendations for the draft Action Plan with activities to be carried out in the future (legal framework of Customs Laboratory, organizational and functional structure, necessary infrastructure and investments, procurement of equipment and training of employees); all technical requirements for the future premises of the Customs Laboratory (size, safety and security requirements of the premises, infrastructure) have been defined and submitted; a list of analytical methods for examining samples of goods was submitted; a list of necessary analytical equipment for testing in the laboratory were submitted; a proposal was submitted for the manner of cooperation with customs laboratories in the EU, as well as with other analytical institutions at the national and international level in line with EU requirements. Two study visits to customs laboratories in Spain were successfully conducted, involving 10 customs officers. This has strengthened the capacities of the human resources of the Customs Administration, which will participate in future modernization projects of the Customs Laboratory. The draft final report of the project was submitted in December 2017. The final and financial Reports of the project have been adopted and signed in March 2018.

**Percentage of adopted appeals in relation to the total number of resolved appeals in the period from January 1 until June 30, 2017 was 36.75%,** bearing in mind that out of 5,633 resolved appeals in the mentioned period, 2,070 appeals were accepted, which is an increase compared to 2016, when the achieved percentage was 35.5% (the planned level for 2016 was 33.47%).

The Law on Amendments to the Law on Tax Procedure and Tax Administration (Official Gazette of RS no. 108/16) prescribes that the second instance tax procedure shall be conducted by a separate organizational unit established in the MoF, and starting from July 1, 2017 the jurisdiction of the TA shall cease in terms of the authorization for settlements in the second instance tax procedure.

In line with the requirements from the negotiating chapter 16 –Taxation, the IT mission of Directorate-General for Taxation and Customs Union – DG TAXUD assessed the IT capacities of Tax Administration in December 2016. The given recommendations of DG TAXUD from the initial report will be reflected in the IT strategy of Tax Administration, and serve as a bases for programming IT projects.

\textsuperscript{44} The Customs Administration has done a risk analysis on the corruption of the legal framework of the customs system based on the Risk Analysis of corruption in the customs regulations, conducted by the Agency for Fight against Corruption. Conclusion of Risk Analysis has pointed out to the necessity of expanding the powers of the customs officers primarily by passing the Law on the Customs Service, as well as through the adoption of amendments to the Criminal Code Procedure.
One-stop shop system of economic entity registration has been fully established in cooperation with the Business Registers Agency (BRA). The system provides the possibility for a newly established economic entity to submit the VAT registration form, as well as a request for the presumptive tax. As of January 1, 2017, a newly established entrepreneur can decide on the personal income calculation within the single registration form. Regular update of the Unique Register of Taxpayers was completed according to the data obtained from BRA, within the “one-stop shop” system. For those taxpayers who are not registered through BRA (less than 5%), the updating procedure is manual. Those are institutions, state bodies, trade unions, and lawyers. In order to improve the quality of data on taxpayers entered into the Unique Register of Taxpayers, the project Integrated Information System 2014 was initiated, financed from the budget of the Republic of Serbia.

The risk management system has been improved. In line with TADAT recommendations, the structured process of risk assessment and defining priorities of risk voluntariness were introduced. Risk analysis criteria for VAT has been developing and improving constantly. Also, the risk analysis for profit tax control is in progress. The target value of indicator for 2016 and the first six months of 2017 has been accomplished. The percentage of controls with irregularities based on risk analysis in 2016 was 35.66%, which marks an increase compared to 2015, and in 2017 it was 37.93%, exceeding the target value of 36%. This increase clearly shows constant improvements of conducted risk analyses, according to which control plans are prepared at monthly and annual level. Consequently, this leads to more efficient controls and more effective work of inspectors.

The implementation of Tax Collection System within the Integrated Information System of Tax Administration is in progress. This system enables, among other things, faster and more efficient realization of regular and forced tax collection, which will have an effect on tax debt reduction.

In order to obtain updated information on arrears, control mechanisms are improved with amendments to the LTPTA, that is, it is provided that the off-balance tax accounting keeps tracks on unpaid tax arrears: of taxpayers who have been erased from the relevant registers (unless the other party is responsible for fulfilment of those obligations); in case of absolute statute of limitations; for those that are the subject of settlement in accordance with the law which regulates insolvency procedure through bankruptcy until the completion of insolvency procedure; based on disputable and dubious debts.

Financing of the measures:
In accordance with the recommendations of the IMF Mission, a revision of the Transformation Programme was conducted in July 2017. The most demanding task in terms of securing funds is the implementation of the Tax Administration Transformation Programme. According to PFM RP, the amount needed is about 22,000,000 EUR. However, the necessary funds for the implementation must be revised, which will be done by the end of 2018 when the PFM RP is revised. Once the

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45 TADAT – The Tax administration Diagnostic Assessment Tool
assessment is completed, it will be estimated how much of these funds can be secured from the state budget and how much from donors.

Based on the adopted final financial report for the project “Creating Conditions for Strengthening the Capacities of Customs Administration Laboratory of the Republic of Serbia”, the total value of the project is 225,000 EUR (EU financing 95% and national co-financing 5%) in the contract from IPA 2013. Trainings were organized by GIZ and TAIEX.

**Key challenges:**

- In accordance with the adopted Action Plan of the Tax Administration Transformation Programme for the period 2018-2023, in order to continue the successful transformation of the Tax Administration in terms of effective control over the main elements of the tax system and efficient risk management for basic tax forms, and aiming to implement the first consolidation phase by June 2019 it is planned to reduce the number of branches;
- The main condition for the full implementation of the ERIAN system for all customs clearance procedures by the Customs Administration is the introduction of automated systems of import and export of AIS and AES and their further integration with the ERIAN system. The AIS and AES system is implemented through IPA 2013 project since June 2017.

**Next steps:**

- The Tax Administration is fully committed to continuing the implementation of the Tax Administration Transformation Programme. The identification of the basic activities of the tax administration and separation of secondary activities into specific areas of work. Planned activities of the Program require a new organizational structure of the Tax Administration, in which the basic and secondary activities will be separated;
- By June 2019, there is an estimated consolidation of the functions of administering basic taxes on a smaller number of locations (36) and continuation of the merger process to a maximum of 12-14 locations by 2023;
- The ERIAN system for empty vehicles control will be analysed and a solution provided for integration with other systems. There are two possible ways to implement this system: first—to enable the integration of ERIAN into the ISSC (Information System of Serbian Customs) with the vehicle's input/output records. The other is to enable ERIAN integration with SERP (systematic electronic data exchange). The choice of solution depends on the technical capabilities and it is necessary to perform testing, as well as apply the chosen solution;
- There was an application for the workshop/expert mission of the experts of the Customs Laboratory of Croatia within TAIEX assistance, with the aim to develop guidelines for the successful implementation of the recommendations of the completed project “Creating Conditions for Strengthening the Capacities of the Customs Administration Laboratory of the Republic of Serbia”. The applied for visit was approved by the European Commission and the confirmation of the time and additional details of the organization is pending.
It is planned to launch an initiative to define a legal framework that would regulate the competencies, roles and activities of the Customs Laboratory. It is planned to prepare a proposal for the organizational and functional structure of the Customs Laboratory in accordance with the recommendations of the project “Creating conditions for strengthening the capacity of the Customs Administration Laboratory of the Republic of Serbia”;

✓ Organization of specialized trainings, such as advanced trainings for the methods of customs anti-corruption investigations of corruption, as well as joint trainings, that will include, apart from customs officers, employees of the Prosecution Office and Courts in the field of criminal charges, methods of evidence collecting in pre-criminal proceedings with an emphasis on corruption in the customs.

**Measure 8 – TO IMPROVE COMMITMENT CONTROL AND CASH MANAGEMENT**

All activities were carried out bearing in mind that at the end of 2017, amendments were made to the Rulebook on the System of Execution of the Budget of the Republic of Serbia, and that the new Information System for the Implementation of the Budget (ISIB) was released into production on 01.01.2018, thus creating the conditions for the new indirect budget users (IBU) users to be included in the budget implementation system, what has improved financial planning for all direct and indirect users of budget funds included in the budget execution system of the Republic, and it allows to the competent direct budget users (DBU) scheduling and control over the appropriations of their indirect users.

Consequently, the planning of the cash flows has been improved by the fact that DBU, based on the needs of the IBU, can allocate the funds from the appropriation of one indirect user to the appropriations of the second indirect user, within the Budget Law where appropriations are determined. In this way, DBU was provided with enhanced control of the plans for the execution of the budget and established quotas of their indirect beneficiaries, as well as assumed obligations and realization of assumed obligations, which led to improved planning for all users.

In addition to the Treasury Administration, the bearers of these activities are direct users of the budget funds and their indirect beneficiaries of the budget funds.

**Financing of the measure**

There were no funding costs.
Trajectory of public debt of the Republic of Serbia has been reversed since 2016 and public debt share in GDP, at the level of the general government, has been reduced to 58.7% at the end of 2017, contributing to overall stabilization of public finances. In the last two years, thanks to fiscal and structural measures taken by the Government, the debt growth was first slowed down in 2016, and for the first time since 2008 there was a drop of the public debt share in GDP. The trend of public debt reduction in GDP continued in the second half of 2017 and, according to preliminary data, the share of public debt of the central government level in GDP at the end of December 2017 amounted to 58.7%, which is around 12.5 percentage points less compared to the end of 2015.

Over the past two years of implementation of the PFM Reform Programme, capacity of the Public Debt Administration (PDA) has been improved by strengthening human capacities, learning from best practice experiences, and the initial steps that have been implemented relate to the introduction of a new methodology for risk monitoring and public debt management software.

Further strengthening of the PDA is of paramount importance for further improvement of efficiency and effectiveness of public debt management in the Republic of Serbia. Since the introduction of the Programme, great progress has been made in increasing the average maturity of RSD government securities and reduction of the cost of funding, which reduced the exposure to the refinancing risk. Public Debt Management Strategy defines the key measures for further continuation of development of the market for government securities in dinars, since the development of this market will create one of the necessary preconditions for increasing the credit rating of the Republic of Serbia and decreasing the exposure of public debt to FX risk.

http://www.javnidug.gov.rs/eng/default.asp?P=27
The graph above shows the share of public debt at the general government level, while data at central government level for 2015 - 70%, for 2016 - 67.8% and for 2017 - 57.9%.

The PFM Reform Program envisages improvements of the legal framework, administrative capacities, and IT systems, which has largely been the focus of the activities carried out. Even though there is a short deviation from the timeframe planned in the PFMRP, implementation of all seven activities under this measure is underway.

Development of the tailor made methodology for carrying out long-term public debt sustainability analyses is in progress. Development of this new methodology will further improve the PDA work, having in mind that the PDA is currently using standard MTDS and DSA models for debt analyses.

With the support of the GIZ PAR Project, training for standard IMF models for debt analyses was held in 2017. Representative of Israel Debt Management Office presented the model and methodology of the debt sustainability analysis. Once the methodology is developed and model have been defined, the IT system for risk management will be upgraded to include the risk management module by the end of 2020.

The public debt management software is being developed. The first three phases have been completed. In the second quarter of 2017 the second phase was completed (Joint Design Phase), in which software requirement specification was created and the project organization workflow designed. Phase 4 is in progress, the phase of software development. It is estimated that the PDM software will be in place in the first quarter of 2018. The introduction of the PDA software will help in overcoming the largest operational problem in the work of the PDA, and enhance its analytical capacities.

<table>
<thead>
<tr>
<th>Performance indicators</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public debt/GDP (in %)</td>
<td>71.2</td>
<td>68.8</td>
<td>58.7</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Performance indicators</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual public debt servicing costs (interest payments) as a share of GDP.</td>
<td>2.65</td>
<td>2.9</td>
<td>2.8</td>
<td>2.5</td>
</tr>
<tr>
<td>Average time of maturity on dinar debt (years)</td>
<td>1.8</td>
<td>2.1</td>
<td>2.2</td>
<td>2.4</td>
</tr>
</tbody>
</table>

The project is implemented with the support of Swedish International Development Agency (SIDA) and supervised by UNDP which carried out the first phase of the project, the tender were selected contractors, a domestic consortium for the company Asseco SEE Serbia.

47 Medium Term Debt Management Strategy and Debt Sustainability Analyses
48 The project is implemented with the support of Swedish International Development Agency (SIDA) and supervised by UNDP
Another important step towards further development of local government securities market is to introduce Primary dealer system. The PDA is working intensively together with IMF to develop local market and create “benchmark” emissions of government dinar bonds as a precondition for the introduction of the primary dealers.

The IMF mission which took place in April and May 2017 carried out the analyses of the current situation regarding the introduction of the primary dealers system. The IMF recommendations were submitted in January 2018 and envisage a phase approach in the introduction of primary dealers at the auctions of dinar state bonds.

The Government of Serbia established the Working Group (WG) for ISDA negotiations in 2017. The members of the WG are representatives of the Ministry of Finance and the National Bank of Serbia, and they have been working with legal advisors on the final ISDA and they work with legal advisers on ISDA agreements that will be signed with foreign commercial banks with adequate credit ratings.

Regulation on content, method of preparation and evaluation, and monitoring and reporting on the implementation of capital projects was adopted in June 2017. The regulation also covers the monitoring of implementation of projects financed from loans. Adoption of this regulation leads to improved monitoring system and enhanced coordination of activities within the MoF. Further actions will be undertaken in 2018 in order to build proper capacities in the Ministry of Finance to implement the Regulation. Details on the adopted Regulation are explained in more details under Measure 4.

The envisaged strengthening of the PDA capacity is underway. Trainings for civil servants in the PDA are ongoing. A number of trainings have been provided to the PDA employees during the reporting period. In cooperation with the Swedish Debt Office, GIZ, World Bank Treasury, SECO, IMF, Joint Vienna Institute and Israel Debt Management Unit, training has been carried out in the following areas:

- operations with financial derivatives;
- debt management strategy;
- debt sustainability analyses;
- primary dealers system.

Financing of the measure
In total, 300,000.00 USD has been invested in strengthening of the PDA capacity. Additional 125,000.00 USD is required in order to successfully implement all activities envisaged under this measure by 2020. Most of the funds came from the Swedish International Development Agency (SIDA), implemented by UNDP. Funds required for further steps must be allocated from the national budget, EU support (including SBS and complementary assistance) and support from other bilateral donors.

Key challenges
The biggest implementation challenges under the measure are:
Securing funds for implementation of all activities;
Global risks related to financial market, even though those are outside of the direct control of the PDA, MoF or Government of Serbia, but may influence ability to reach the planned targets.

Next steps
By the end of 2018, the development of software for public debt management should be completed. Further activities will be undertaken in order to continue developing the methodology for conducting the analysis of public debt sustainability in order to finalize it by 2020 through the upgrade of the IT system.

Measure 10 – TO IMPROVE PUBLIC PROCUREMENT LEGISLATION AND PROCEDURES

Over the past two years, development of primary and secondary legislation has led to increased transparency and efficiency of the procurement procedures. Those activities were undertaken in order to complete the legal framework of the public procurement system in Serbia.

Three out of four activities within the measure have been successfully implemented. All the preconditions for the implementation of the activities “Implementation of the institutional strengthening of the Public Procurement Administration in order to increase its operational capacity”, as the only activity that was not realized, have been fulfilled. The Decision on the maximum number of permanent employees in the system of state bodies, the public service system, the system of the Autonomous Province of Vojvodina and the system of local self-government was adopted, as well as the Budget Law for 2018, which created conditions for strengthening the institutional capacity of the Public Procurement Authority and an increase in the number of employees. Further institutional strengthening of the Public Procurement Administration, by increasing the number of employees, will be completed in 2018 through the implementation of the employment process.

<table>
<thead>
<tr>
<th>Performance indicators</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share of Contracting Authorities (CA) that published procurement plans on PPP per all CA announcing procurement on the Portal</td>
<td>N/A</td>
<td>N/A</td>
<td>90%</td>
<td>89%</td>
</tr>
<tr>
<td>Average time to perform open procurement procedure (in days)</td>
<td>77</td>
<td>68</td>
<td>61</td>
<td>64</td>
</tr>
<tr>
<td>Share of terminated procurement procedures in total number of procurement procedures</td>
<td>13%</td>
<td>11%</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>Average number of bids per procurement procedure</td>
<td>2.6</td>
<td>2.9</td>
<td>2.9</td>
<td>3.3</td>
</tr>
</tbody>
</table>

Latest changes in legal framework included harmonization of national legislation with relevant EU Directives. As planned, partial harmonization took place in 2015 and full harmonization is expected to be completed by mid-2018.
Transparency in public procurement planning has increased following the changes in the legislative framework adopted in 2015 by introducing the obligation of the contracting authorities to publish public procurement plans at the Public Procurement Portal. The total number of contracting authorities announcing procurement plans at the Portal reached a level of 90% in 2016, exceeding the target of 85%, as originally planned by the Programme. In the first half of 2017, this percentage was 89%.

Progress has been made in increasing technical capacities of the entities to more efficiently execute procurement procedures. In 2016 and 2017, four trainings have been carried out for more than 80 designated persons and decision makers. The number of certified procurement officers has been increased. Out of 2,300 persons initially planned to be certified by the end of 2017, a total of 3,762 persons obtained certificates, demonstrating increase of 63% above the target value. As a result of training provided to the procurement officers, combined with other measures undertaken, the number of terminated procedures decreased from 13% in 2014 to 10% in 2016, and in 2017 it remained at the level of 10%.

By the end of 2017 seven trainings were conducted for representatives of police officers, prosecutors and judges in the area of public procurements. The scope of the training was to build capacities for more efficient investigations, and sanctioning of irregularities in the public procurement procedures by the judiciary.

The progress made so far on improving overall procurement system contributed to opening of negotiations in Chapter 5 – Public Procurement in December 2016.

49 http://portal.ujn.gov.rs/Pretraga.aspx?tab=1
50 Main topics of trainings delivered to designated persons and decision makers included as centralized public procurement and implementation of the framework agreements, green procurements, forms and methods of negotiation in negotiating procedure, technical evaluation of the bids, use of criteria of most economically advantageous tender, protection of rights in procurement procedures as well as issues related to the use public procurement portal.
The Public Procurement Development Strategy 2014-2018\textsuperscript{51} serves as a proper strategic framework for the long-term development of the procurement system.

**Financing of the measure**
In total, it has been planned to invest 40.7 million RSD, i.e. 331,000 EUR in the implementation of activities under Measure 10.

**Key challenges**
The biggest implementation challenges under the measure are:
- ✔ Further prevention of corruption in public procurement procedures;
- ✔ Improvement of legislation (full harmonization with EU Directives) in order to increase competitiveness, efficiency and transparency in public procurement procedures.

**Next steps**
Further activities to be undertaken with a view to the implementation of Measure 10 are:
1) Adoption of the new Law on Public Procurement which should take place in the second quarter of 2018;
2) Training for designated persons, decision-makers, police, prosecutors and judges will continue during 2018;
3) Adoption of the Rulebook on Internal Organization and Job Systematization in the Public Procurement Administration;
4) Capacity building in the Public Procurement Administration through recruitment of new employees.

**PILLAR IV – EFFECTIVE FINANCIAL CONTROL**

Effective financial control represents a key reform step towards establishing budget discipline and increasing the responsibility in public funds management. The progress of this reform pillar directly depends on the public funds beneficiaries, who have a legal obligation to apply standards of internal financial control and provide capacities for the internal audit function.

Within this pillar, the Central Harmonization Unit (CHU) has a leading role in promoting, advising and improving requests in the area of internal control, as well as the practice of internal audit, that is, providing assistance to relevant institutions within this pillar, so they could mutually build capacity within their jurisdiction.

The Programme monitors progress within the area of Public Internal Financial Control (PIFC) as its integral part, but the reform of this area must not be observed as an isolated technical reform. It is rather seen as a part of wider area of public administration reform, changes in the budget system, as well as as well as the inclusion of the existing management and control system, which is an integral part of the system for indirect

management of the EU pre-accession instrument in a comprehensive system of internal financial control in the public sector. The EC report on progress of Serbia, in a part of Chapter 32 – Financial Control, states that significant efforts must be made for the purpose of implementation of management responsibility and internal control at all levels of public administration and in public enterprises.

In line with the activities aimed at streamlining the proper control of all public funds, special attention is focused on management and control of EU Pre-Accession Assistance fund and establishment of a legal and administrative base for efficient control.

**Measure 11 – TO IMPROVE STRATEGIC AND LEGISLATIVE FRAMEWORK FOR IMPLEMENTING PUBLIC INTERNAL FINANCIAL CONTROL**

In order to facilitate effective, efficient and economic operations, Serbian Government adopted the Strategy of Public Internal Financial Control Development for the period of 2017-2020 (hereinafter, PIFC Strategy) in May 2017, which aims to embed FMC and IA in the overall management system within Serbian public administration. This will be achieved by aligning them with the policy objectives at the institutional level, which will enable effective risk assessment against defined objectives and putting in place the appropriate controls to manage risks.

The conference on the adoption of the Strategy was held on October 4, 2017, in the Palace of Serbia. The meeting was opened by the Minister of Finance, stressing that the implementation of the Strategy meant better use of taxpayers’ funds and a better public dialogue on how to spend these funds. Besides the representatives of the RS Government, the conference was attended by the Ambassador and the Head of the EU Delegation and a representative of DG BUDGET, who gave a strong impetus to this reform area as part of the general reform of the state administration.

Delay in adoption of the PIFC Strategy occurred due to the longer than expected consultation process with internal and external stakeholders. The accompanying Action Plan includes the period for 2017 -2018.
During the second quarter of 2017, more precisely on June 12, two working groups were formed:

- Working group for internal financial control in the public sector, in charge of monitoring the implementation of the Action Plan of the PIFC Strategy\(^{52}\);

- Working group for financial management and control and internal audit, in charge of coordinating the cross-sectoral approach to FMC and IA within the Ministry of Finance\(^{53}\).

The first meeting of the working groups was held on January 25, 2018. Since this was the initial meeting of both working groups, its main purpose was to provide opportunity for the members of the working groups to introduce themselves to each other, and the conclusion was that it was necessary to maintain continuity in order to achieve the goals and tasks of the working groups as efficiently as possible. Also, the representatives of the CHU introduced the members in detail about all the activities from the Action Plan of the Strategy that had been carried out, as well as about the upcoming tasks to be completed in 2018. An agreement was reached on the schedule of meetings and the working methods of working groups, and it was highlighted that any initiative of the working group members for additional meetings was welcome. Among other things, some of the topics that should be the subject of future work were identified: special training programs for managers, management of irregularities, managerial accountability, as well as the relationship between internal and external audit.

During the reporting period, overall completeness of the legislative framework was scored 3/5 according the SIGMA PFM progress assessments, which indicate a clear intention of further improvements on the PIFC strategic and regulatory framework by the Ministry of Finance and especially responsible Unit for implementation, the Central Harmonization Unit (CHU).

<table>
<thead>
<tr>
<th>Performance indicator(^{54})</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Completeness of the regulatory framework for Internal control SIGMA</td>
<td>N/A(^{55})</td>
<td>N/A(^{56})</td>
<td>3/5</td>
</tr>
<tr>
<td>Number of internal control reports (PFB annual reports on FMC and IA submitted to the CHU)</td>
<td>1,000</td>
<td>1,097</td>
<td>1390(^{57})</td>
</tr>
</tbody>
</table>

Legislative framework improvements in the area of FMC envisaged for the fourth quarter of 2016 in the PFMRP have not been adopted yet, but numerous preparatory activities have been implemented such as: the Risk Management Guidelines prepared

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\(^{52}\) Report on the implementation of AP PIFC Strategy should be adopted once a year by the Government of the Republic of Serbia as an integral part of the Consolidated Annual Report, in accordance with measure 18 of the PIFC Strategy. Members of the RG are representatives of: CHU, SAI, Audit Office of EU funds, Management System, RSPP, Ministry of European Integration, Ministry of Justice, Ministry of Public Administration and Local Self-Government, Ministry of Interior, Ministry of Culture and Information, Ministry of Defense, Ministry of Education, Science and Technological Development, Ministry of Trade, Tourism and Telecommunications, the Ministry of Mining and Energy, the Ministry of Economy, the Ministry of Health, the Ministry of Youth and Sports, the Ministry of Agriculture and Environmental Protection (since August 2017, two separate ministries), Ministry of Foreign Affairs, Ministry of Labor, Employment, Veterans' and Social Affairs, Ministry of Construction, Transport and Infrastructure.

\(^{53}\) In accordance with Measure 1 of PIFC Strategy. Members of the WG are representatives of the Treasury Administration, the Budget Sector, the Sector for Contracting and Financing Programmes from EU funds, Sector for EU Funds Management, the Financial System Sector and the Public Funds Control Sector.

\(^{54}\) The indicators are taken from the SIGMA Report on the Principles of Public Administration Management.

\(^{55}\) This is a new SIGMA indicator that is not available for 2015

\(^{56}\) This is a new SIGMA indicator that is not available for 2016

\(^{57}\) The data will be available by March 31 of the current year for the previous year, in accordance with the provisions of the Budget System Law.
and published at the PIFC\textsuperscript{58} official website and it will be base for the improvement of the FMC Manual; consultations were conducted with the experts of the PLAC project to introduce the concept of irregularities management, which will contribute to the improvement of the legal framework; the CHU performed an overview of IA work quality in ten ministries for 2016\textsuperscript{59} and eight ministries and three compulsory social security organizations for 2017\textsuperscript{60}, which also represents preparatory work for amending the legislation in order to implement IA quality control line with IIA Standards.

The review of the IA quality control includes the verification of the fulfilment of the prescribed requirements for the establishment of internal audit units, scope of audit, competencies and skills of internal auditors, functional and organizational independence of internal audit, internal audit charter and code of ethics, knowledge of internal audit standards, strategic and annual plans of internal audits, implementation of internal audit methodologies, risk management within internal audits, internal quality control, the need for trainings and memberships in professional associations. This overview is based on individual reviews carried out by employees of the Internal Control and Internal Audit Sector of the Ministry of Finance (Central Harmonization Unit).

The reviews were submitted to the Minister of Finance for 2016 and 2017 and published on the official website of the Central Harmonization Unit.\textsuperscript{61}

The lack of administrative capacities was identified in the CHU, as responsible Unit for implementation of the PIFC objectives, which with the recently adopted Rulebook on Internal Organization and Job Systematization of August 2017, increased the number of employees by three (a total of 13 systematized jobs), and the filling of these positions is currently being prepared.

**The existing CHU capacities have been constantly improved** through employees’ participation at all relevant trainings, as well as through participation at all regional and international conferences (PIC annual conference, RESPA conferences, WB Pem-Pal conferences, CEF education and trainings, etc.).

In order to improve the recognition and promotion of the CHU in 2016, the logo of the Internal Audit and Internal Control Sector was designed.

\textsuperscript{58} http://ifkj.mfin.gov.rs/user_data/posts/SZUR.pdf

\textsuperscript{59} A review of the quality of IA for 2016 was carried out in: Ministry of Finance; Ministry of Construction, Transport and Infrastructure; Ministry of Trade; Ministry of Agriculture and Environmental Protection; Ministry of Mining and Energy; Ministry of Culture and Information; Ministry of Health; Ministry of Justice; Ministry of Education, Science and Technological Development; Ministry of Labor, Veterans’ and Social Affairs, and the Ministry of Economy.

\textsuperscript{60} An overview of the IA quality reviews for 2017 was carried out in: Ministry of Internal Affairs; Ministry of Defense; Ministry of Foreign Affairs; Ministry of Environmental Protection; Ministry of Trade, Tourism and Telecommunications; Ministry of State Administration and Local Self-Government; Ministry of European Integration; Ministry of Youth and Sports; Republic Health Insurance Fund; Republic Fund for Pension and Disability Insurance; National Employment Service.

\textsuperscript{61} Indicator 8 for 2016 – The Central Harmonization Unit publishes a report on the results of its programme of reports on the quality of internal audit which covers at least 10 ministries, for the purpose of monitoring the Sector Reform Agreement, it has been fully implemented. Link to the document: http://ifkj.mfin.gov.rs/user_data/posts/Konsolidovan%20godisnj%20zv%20CES%5%11aj%20za%202016%20godinu%20stanje%20%20FK%20h%20Republic%20Srbije.pdf. Сагледавање квалитета рада интерне ревиZE за 2017. годину, линк ка документу: http://ifkj.mfin.gov.rs/WP/wp-content/uploads/2018/01/Pregled-kvaliteta-ZBIH.pdf.
Special software for the purpose of collecting the annual reports of public funds beneficiaries, adjusted to the operational needs for analysis and preparation of the Consolidated Annual Reports, was developed and tested. The improved software will provide to the public funds beneficiaries easier and faster electronic submission of annual reports to the CHU in e-form via online access, and thus improve quality of the submitted data.

With the improved software the CHU will develop its reporting and analytical potentials. During 2018, CHU will continue to work on software development based on the results of the test phase. In addition, the analytical approach, content and form of the last Consolidated Annual Report have been improved in cooperation with SIGMA experts. Improved Consolidated Annual Report for 2016 on the state of internal financial control in the public sector of the RS was adopted in September 2017. The CHU is going to continue to improve the reporting system.

At the end of 2017, an e-learning platform was implemented that enables better exchange of knowledge in the field of FMC and IA. The platform is continuously updated with new content and enables users to learn from training materials that cover both theoretical and practical part. Financial management and control training materials were uploaded – all four modules and it is available to all interested parties.

As regards the planned activity of outsourcing of trainings and professional development programs for officials and civil servants on FMC and IA, the CHU is still considering different possible options. Communication with potential international

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organizations and experts in order to upgrade the existing content of training programmes is ongoing. Cooperation was established with an international expert, former president of the European Confederation of Institutes of Internal Auditing (ECIIA), which considered possible ways of improving the training in the FMC and IA. It was concluded that, at this moment, the international IA certification is not achievable since it requires additional funds.

The gap assessment will be carried out with the support of a twinning partner selected through the project “Support to Further Development of the PIFC” financed by the EU from pre-accession funds in order to improve the system of certification and professional development of internal auditors through an approach involving professional organizations and the academic community in preparation and transfer of knowledge.

At the end of 2017, the gap analysis, which contained a cross-section of the situation in the area of financial management and control and internal audit in the public sector, was also realized with the help of a twinning project, which contains recommendations for overcoming the observed weaknesses and improvement of the PIFC system.

**Financing of the measure**

Most measures related to Measure 11 are supported, in addition to regular budget funds, through the UNDP project “Improving Public Finance Management”, funded by the SDC. During 2016 and 2017, about 70,000 USD was invested in software development and the upgrade of the CHU official internal website, training of CHU employees, and PIFC workshop for raising awareness.

**Key challenges**

The biggest implementation challenges under the measure are:

- More intensive political and institutional support for the implementation of the PIFC in order to further emphasize the importance of implementing internal financial control in the public sector. The CHU has already carried out a number of awareness-raising activities through: enhanced activities on the official internal website, distribution of promotional material, customized financial management and control (FMC) for the users of the public funds on central government level, organization and participation in numerous conferences.

- The overall strengthening of the CHU as a trigger for change has to be generally recognized by the highest levels of government and management since in the previous period there was lack of full institutional support and understanding. To overcome this, the CHU actively organized various events for specific target groups in order to raise awareness (specific workshops and trainings for FMC managers and coordinators on risk management and management related responsibilities, IPA internal auditor training, trainings for local self-government units, etc.). In addition, a number of publications has been prepared and distributed (FMC and IA brochures, Risk Management Guidelines, FMC training and presentation scripts, etc.). This is seen as a long-term issue that will require attention and work throughout the rest of the reporting period.
Next steps
Further activities that need to be undertaken in order to carry out Measure 11 are closely connected with the implementation of the PIFC Strategy 2017-2020, through the following Measures/Activities defined in the accompanying Action Plan for 2018:

- Continuous upgrading and updating of the existing methodological manuals and guidelines in accordance with the best international practice and ensuring adequate visibility through the CHU website, starting from the second quarter of 2017;
- Implementation of the gap assessment in order to improve the system of certification and professional development of internal auditors, through an approach involving professional organizations and the academic community in the preparation of training and knowledge transfer through the twinning project;
- Improve the content and quality of consolidated annual reports on the state of internal financial control in the public sector of the RS;
- Establish a Working Group led by the CHU with the Ministry of State Administration and Local Self-Government, Ministry of Economy, Ministry of Justice and Public Procurement Directorate for the purpose of dealing with the coordination of FMC and IA in relation to public sector reforms in Serbia through cross-sectoral strategy, as a subgroup of the Public Administration Reform Council;
- Amend the FMC Rulebook and Manual to harmonize the concept of managerial accountability with the principles of good governance and introduce the function of managing irregularities in the FMC framework;
- The CHU should update the existing guidelines for the implementation of risk management with PFBs;
- Introduce annual statement on internal control by the head of PFB 2018;
- Define continuous professional development of internal auditors by a regulation;
- Regulate the external assessment of the quality of the internal audit of PFB by a sub-legal act (regulation).

Measure 12 – TO ENHANCE THE IMPLEMENTATION OF FINANCIAL MANAGEMENT AND CONTROL

Over the years, Serbian Government has been ensuring a systematic approach in implementing Financial Management and Control system (FMC), which contributes to better understanding of Public Internal Financial Control (PIFC) system itself. This approach will upgrade the management responsibility, and transfer focus from the legality and regularity of financial transactions to their efficiency and effectiveness.
Average rating of the FUK system of all PFBs in the RS for 2015, 2016 and 2017 by elements of the COSO framework (in %)

Table 1: Comparative overview of the average estimates of individual elements of the FMC system for 2015 and 2016

<table>
<thead>
<tr>
<th>Parameters</th>
<th>Year</th>
<th>Control environment</th>
<th>Risk management</th>
<th>Control activities</th>
<th>Information and communication</th>
<th>Monitoring, supervising and evaluation</th>
<th>AVERAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2015</td>
<td>72</td>
<td>69</td>
<td>66</td>
<td>74</td>
<td>49</td>
<td>67</td>
</tr>
<tr>
<td></td>
<td>2016</td>
<td>73</td>
<td>75</td>
<td>67</td>
<td>76</td>
<td>48</td>
<td>69</td>
</tr>
<tr>
<td></td>
<td>2017</td>
<td>85</td>
<td>76</td>
<td>77</td>
<td>88</td>
<td>62</td>
<td>79</td>
</tr>
</tbody>
</table>

Table 1: Comparative overview of the average estimates of individual elements of the FMC system for 2015 and 2016

<table>
<thead>
<tr>
<th>Performance indicator</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average Grade of FMC System Elements in RS – COSO model</td>
<td>67%</td>
<td>69%</td>
<td>79%</td>
</tr>
</tbody>
</table>

The above stated is in line with the aims of the new PIFC Strategy 2017-2020, which includes the principles of the COSO framework, especially regarding to raising awareness on financial management and control as an integral part of the management process with an emphasis on managerial accountability, risk management and quality assessment.

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64 Data
65 The source of data is the CHU database created on the individual annual reports of public funds beneficiaries on the PIFC system; In accordance with the Budget System Law, the head of the organization shall report to the Minister of Finance on the PIFC system, by March 31 of the current year for the previous year, and the CHU is in charge of consolidating individual annual reports
66 The data will be available by March 31 of the current year for the previous year, in accordance with the provisions of the Budget System Law
67 Link to the strategy: http://ifki.mfin.gov.rs/user_data/posts/Strategy%20of%20public%20internal%20financial%20control%20development%20of%20the%20Republic%20of%20Serbia%20for%20period%20of%202017-2020.pdf
The progress made in the field of financial management and control implementation during the reporting period is best reflected through the assessment of the key FMC elements based on the COSO model.

Within the scope of measure 12, there are two defined results that apply to continuous support of the CHU, through workshops aimed at the managers of public funds beneficiaries, FMC coordinators and groups in charge of financial management and control, in order to reach better understanding of financial management and control system.

In order to achieve the defined results and make progress in the field of FMC implementation, the CHU has implemented the following activities during the reporting period:

- In May 2017, the Working Group for the Improvement of Financial Control was formed by the decision of the Minister of Finance. The working group aims to exchange information between the organizational units of the Ministry of Finance in charge of budget execution and control and the State Audit Institution, as well as strengthening the system of controlling public funds and providing assistance to the Negotiating Group for Chapter 32 – Financial Supervision. The working group is headed by the State Secretary of the Ministry of Finance, the other members are: representatives of the Sector for Control of Public Funds, the Sector for Internal Control and Internal Audit, the Budget Department, the Sector for International Cooperation and European Integration of the Ministry of Finance, and representatives of the State Audit Institution. So far, four Working Group meetings have been held, within which the topics discussed in this field are discussed.

- Five-day basic trainings on FMC were held during nine cycles for 519 participants, with enhanced materials (presentations and manuals) for training (main topics: introduction to internal financial control in the public sector, integrated internal control framework – COSO model, risk management system, management control system); Four out of nine trainings were held in local self-government units (towns of Kragujevac, Niš, Subotica and Kruševac);

- the Minister of Finance forwarded to all line ministers enhanced materials on the basics of FMC training;

- Support to managers of PFBs at all government levels and FMC coordinators was provided through 10 workshops and trainings attended by over 300 participants (main topics: basic principles of FMC system, accountability of managers, business process documentation, drafting procedure, risk and risk management strategies, risk management guidelines, the role of internal audit in establishing the risk management process, the EU Assistance Management System (IPA) – training for internal auditors);

- During the workshops and meetings, the FMC coordinators were given special practical assistance in drafting the charts of business processes and for adapted road maps for the further implementation of financial management and control in their institutions;

All listed activities undertaken by the CHU raised awareness of the significance of FMC implementation and 82 more reports were submitted for 2016, which is an
increase of 12% compared to 2015. For 2017, a total of 936 users of public funds submitted the report, which is an increase compared to 2016 for 212 new reports, or 23%.

**Financing of the measure**

Most of the activities in relation to Measure 12 were supported, apart from regular budget resources, through the UNDP project “Improving Public Finance Management” financed by SDC. In 2016 and 2017, approximately 40,000 USD were invested in FMC trainings and distribution of FMC promotional materials as well as basic FMC training for local self-government units.

**Key challenges**

The biggest implementation challenges under the measure are:

- Frequent institutional changes and fluctuation of PFBs managers and FMC Coordinators reduced potential improvement in FMC area. In order to minimize this negative challenge, CHU has constantly included new PBFs participants through its regular FMC trainings, as well as through its specialized FMC workshops and meetings;

- The lack of CHU capacities was partly overcome by appointing the Minister's Assistant, and additional systematized jobs within the Sector that need to be filled, as well as by the continuous improvement of the knowledge of the CHU employees in the field of internal control by participation in domestic and international conferences (PIC annual conference, RESPA conferences, WB Pem-Pal conferences, CEF education and trainings, etc.). Once the new organisation structure has been approved by the competent authorities, the CHU will proceed with recruitment procedure for hiring the new staff.

**Next steps**

Further activities that need to be undertaken in order to carry out Measure 12 are implemented in PIFC Strategy 2017-2020, through the following Measures/Activities defined in the accompanying Action Plan for 2018:

- Continuously improve professional knowledge of employees in the CHU by adopting the best international practices in FMC and IA, participating in at least two relevant trainings per year;

- Improve the content and form of the CHU questionnaire in order to improve the quality of analytical data provided by PFBs;

- Develop guidelines on the managerial accountability of managers explaining the role of individual participants in the financial management and control;

- Develop a model for FMC practical application, which will be available to PFBs for download via e-learning platform on the CHU website;

- Organize workshops for senior managers on the role of financial management and control, continuously starting from the third quarter of 2017;

- Update and redesign all FMC training materials in line with the amended FMC and IA regulations;

- Update the existing guidelines for the implementation of risk management at PFBs;

- Through the e-learning platform the CHU should provide for the downloading

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67 The data source is the CHJ database created on individual annual PFBs reports on the PIFC system
of the risk management model in order to enable the practical implementation by PFBs.

In addition, the CHU will continue to carry out activities related to conducting basic FMC trainings, as well as providing practical support and advisory services to the PFBs managers and FMC coordinators during meetings and specialized workshops.

**Measure 13 – TO SUPPORT THE INTRODUCTION AND FURTHER DEVELOPMENT OF THE INTERNAL AUDIT FUNCTION**

The Budget System Law prescribes that the functionally independent and decentralized internal audit is the obligation of all public funds beneficiary institutions. The Law defines the internal audit as the activity that provides independent objective assurance and advice to the management, whose purpose is to contribute to the improvement of business operations of organizations; it helps the organization to achieve its goals, by its systematic and disciplined assessment and evaluation of risk management, controls and management of the organization.

At the central level, until the end of 2016, in 80 public funds beneficiary institutions, the internal audit was established with 281 systematized internal auditor positions, out of which 230 were filled up. **The audit was established in all 16 ministries and three compulsory social insurance funds.** At the level of the units of territorial autonomy and local self-governments, the internal audit function was established in 77 of them, with 182 systematized and 141 filled up internal auditor positions.

At the central level, by the end of 2017, in 83 institutions of public funds beneficiaries, an internal audit was established with 296 systematized internal audit positions, 243 of which were filled. **The audit was established in all 18 ministries and three funds of the compulsory social insurance.** At the level of territorial autonomy and local self-government units, the internal audit function was established with 100 users of the public funds, with 204 systematized and 154 filled positions of internal auditors.

Public funds beneficiary institutions that utilize the EU pre-accession funds (IPA) do not have the required number of auditors (minimum 3), but it is a part of a wider

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63 As for the total number of internal auditors and IA units, due to the decentralized internal audit system, as well as the overall regulatory framework, CHU does not have precise data. According to IA Rulebook, internal audit shall be set up by PBFs in one of the following ways: 1) by organizing a separate functionally independent organizational unit for internal audit; 2) by organizing a joint unit for internal audit at the proposal of two or more PBFs; 3) by having the internal audit unit of another PBF perform the internal audit, based on an agreement. A separate functionally independent organizational unit for internal audit shall be set up within the PBFs in the following situations: 1) by the direct budget beneficiaries at the central level that have indirect budget beneficiaries within their competence; 2) by ministries; 3) in the autonomous provinces, the City of Belgrade and towns; 4) within the PBFs having more than 250 employees. The internal audit unit may not have fewer than three internal auditors. The number of internal auditors shall be determined by the PBF in an internal general act, based on the assessment of risks, scope and complexity of business processes, the amount of available funds and the number of its employees.

However, the IA Rulebook have defined certain exceptions, in the following situations: 1) if there are no conditions for organizing the internal audit unit, the activities of the internal audit unit may be carried out by an internal auditor employed with PBF; 2) in indirect budget beneficiaries that did not set up internal audit in one of three prescribed manners, internal audit activities shall be performed by the internal audit unit of the competent direct budget beneficiary. In addition to the above exceptions, there are some general institutional changes affecting the total number of PBFs, thus the number of internal auditors and the number of internal audit units, such as: changes of the laws on ministries and other special organizations, changes in PBFs jurisdictions, changes in the number of employees within organizations based on internal systematization updates, etc.
problem of the availability of auditors, which points to the fact that audit is not among the priorities of the managerial structures of public funds beneficiary institutions. As regards ministries that are pillars of IPA implementation, the IA units are filled as follows: in 8 ministries 1 auditor is employed, in 2 ministries 2 auditors are employed and in the remaining 6 ministries there are 3 and more auditors.

<table>
<thead>
<tr>
<th>Performance indicator</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>The number of internal audit recommendations for business improvement</td>
<td>4916</td>
<td>5901</td>
<td>6167</td>
<td>6102</td>
</tr>
</tbody>
</table>

In order to increase genuine understanding of the role and purpose of Internal Audit in the reporting period, the CHU organized practical trainings of performing internal audit at 52 PFBs for 88 candidates for obtaining the title of a certified public auditor in the public sector. The theoretical part of seven-days training for internal audit covered 132 employees of PBFs. In four examination periods, the exam was passed by 99 candidates, who acquired the title of a certified public auditor in the public sector. By the end of 2017, a total of 377 internal auditors were certified in the public sector. During the reporting period, the number of internal auditors at the local level increased by 39, and in the Audit Authority Office of EU Funds by 4.

As part of the cooperation with the project “Improving Public Finance Management” of UNDP, funded by the SDC, training was conducted for managers of local self-government units in the field of financial management and control, internal audit and programme budget and two-day workshop for the heads of internal audit units on the topic “Guidelines for Risk Management” for 30 participants. With the support of experts from the Policy and Legal Advice Centre project (PLAC), a one-day workshop “The Role of Internal Audit in Establishing a Risk Management Process” was organized for 33 participants.

In order to encompass audits of EU funded projects during 2016, the CHU organized in cooperation with the EU Funds Management Department of the Ministry of Finance and the State Audit Institution two three-day workshops “IPA Pre-Accession Assistance System (IPA)”, which were attended by 30 participants.

In cooperation with the twinning project “Support to Further Development of PIFC”, a two-day workshop was held on the topic: “New Standards in Internal Audit”, which was attended by 40 internal auditors.

**Financing of the measure**

Most activities in relation to Measure 13 were supported, apart from regular budget resources, through the UNDP project “Improving Public Finance Management” financed by SDC. In 2016 and 2017, about 20,000 USD was spent on organizing two IA conferences and IPA training in audit. In addition, support was obtained by the PLAC project.

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69 The data source is the CHU database created on individual annual PFBs reports on the PIFC system. In accordance with the Budget System Law, the Head of the CHU is obliged to report to the Minister of Finance on the PIFC system, by March 31 of the current year for the previous year, and the CHU is in charge of publishing Consolidated Annual Reports on the Status of Public Internal Financial Control (PIFC) in the Republic of Serbia;

70 The data will be available by March 31 of the current year for the previous year, in accordance with the Budget System Law.
**Key challenges**

- Due to the low level of the internal audit capacity of IPA users, the CHU has undertaken numerous activities in the form of conferences, meetings and trainings, together with the Government Audit Office of EU Funds, the EU Funds Management Department and the Department for Contracting and Financing of EU Funded Projects of the Ministry of Finance, with the aim of improving internal auditors skills and knowledge.

**Next steps**

Further activities that need to be undertaken in order to carry out Measure 13 have been recognized in the PIFC Strategy 2017-2020, through the following Measures/Activities defined in the accompanying Action Plan:

- Organize joint seminars with the Department for Contracting and Financing of EU Funded Projects and the Department for EU Funds Management, in order to exchange experiences in the field of development of financial management and control and internal audit in the use of EU pre-accession funds (IPA), at least once a year;
- Organize meetings to exchange experiences of internal auditors from the IPA beneficiary institutions, the Government Audit Office of EU Funds and CHU, once a year;
- Carry out gap assessment with aim of improving the system of certification and professional development of internal auditors, through an outreach approach to including professional organizations and academic community in training preparation and delivery, the first quarter of 2018;
- Develop guidelines for the establishment of IA function in small PFBs, regarding the establishment of joint IA units, the fourth quarter of 2018.

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**Measure 14 – FURTHER STRENGTHENING OF THE LEGISLATIVE FRAMEWORK OF THE INSTITUTIONAL AND OPERATIONAL CAPACITIES OF THE GOVERNMENTAL AUDIT OFFICE OF EU FUNDS**

Measure 14 refers to the adoption of relevant legal framework, carrying out of a functional analysis for the purpose of improvement of organizational capacities of the Governmental Audit Office of EU Funds.\(^{71}\)

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During the reporting period, all three planned activities were accomplished in line with the PFMRP timeframe, apart from the adoption of the legal act for (re)institutionalization of the Governmental Audit Office of EU Funds.

**Draft legal framework for the (re)institutionalization of the Governmental Audit Office of EU Funds** was prepared in January 2016, but the final phase of adoption was postponed due to organizational changes of the competent institution for the proposer of the aforementioned legal framework. With the establishment of the new Government in June 2017, there was a change in the institution as the proposer of laws and bylaws[74] under which the Governmental Audit Office of EU Funds was established as an Audit Authority. The jurisdiction has been transferred from the Ministry of State Administration and Local Self-Government to the newly established Ministry of European Integration. Changes within the new Ministry for European Integration and consultation with the Ministry of Finance on the content of the document also affected the extension of deadlines and postponement. The draft law on the audit of the system of management and control of programs funded by the European Union is currently in the process of gathering opinions by relevant institutions, which is followed by the adoption by the Government of the Republic of Serbia and submission of proposals to the Assembly at the next session.

**At the beginning of 2016, a functional analysis aimed at improving capacities and increasing the functionality of the Governmental Audit Office of EU Funds was conducted by the national authorities** within the IPA structure[75], in accordance with the Framework Agreement for IPA II, as well as in line with the workload analysis, and finalised it before the deadline set in the PFM RP (Q I 2017). Recommendations of the above-mentioned Functional Analysis served as a basis for preparation of legal acts for

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[72] In accordance with the Rulebook on internal organization and job systematization, which came into force on October 20, 2016


[74] Two regulations: Regulation on establishing RT and Regulation on appointing RT

[75] In January 2016, the NAO, the Director of the Audit Office of EU Funds and the NIPAC, carried out a functional analysis of the Audit Office of the EU Funds.
The project on technical assistance “Capacity Building Support of the Audit Authority Office of EU Funds” financed by the EU Delegation in Serbia, contributed considerably to the further improvement of audit procedures, and technical specification for development of audit software, as well as capacity building since it provided 10 workshops (the Project started in 2014 with 5 auditors, and finalized in July 2016 with 17 auditors36). Upon completion of the project, in the second half of 2016, a new project was proposed for the development of the aforementioned software from the pre-accession funds. Personnel changes in the EUD and obsolescence of the specifications produced caused a delay and a new version of the tender documentation is currently being prepared.

Organizational, technical and administrative capacities of the GAO were also improved in line with the requirements of the European Commission, thus increasing the functionality for implementation of audit activities. In 2016 the GAO filled up around 85% of vacancies. In line with recommendations of the latest version of the Workload Analysis, the GAO employed adequate number of competent civil servants.

Today, the GAO has 27 civil servants, 25 of whom are employed on permanent basis, and two additional employees engaged by contract. There are seven certified internal auditors, and four are undergoing practical training – preparations for taking the exam. The target value of the Office has been achieved at its full capacity.

In order to strengthen the network of national audit bodies in the region, a two-day workshop was held in Skopje in October 2017 for the purpose of exchanging best practices, experiences and potential challenges related to the revision of IPA funds. Experiences in the implementation of the audit of pre-accession assistance instruments in the RS were presented by the representatives of the Audit Authority Office of EU Funds.

The European Commission’s 2016 Progress Report for Serbia supports the progress “achieved in the strengthening institutional and operational capacities of the Audit Authority Office of EU Funds, especially through the recruitment of the Head of the

36 The total number of auditors of the Office who benefited from the project.
Audit Authority with the appropriate competence, knowledge and the experience in the field of audit”.

Financing the measure
For the implementation of Measure 14, the Office allocated and spent 59,000 EUR from the state budget for recruiting new employees. In order to further strengthen the administrative capacities, the Office has prepared a project proposal in the amount of EUR 300,000, and the assistance of various donors is being considered.

Key challenges
The biggest challenges refer to the following:
✔ Lack of adequate staff retention policy, since there is a need to prevent staff outflow through systemic reforms in human resource management. As of the second half of 2017, there has been no changes in terms of the Office staff, and the topic is generally considered for the entire state administration;
✔ Delay in the adoption of the proposed legislative framework for the (re)institutionalization of the Office. The competence of the proposer of the legislative framework has been transferred to the newly established Ministry of European Integration, and the adoption is expected by the end of the first quarter of 2019.

Next steps
✔ Further strengthen the administrative capacities of the Office in order to provide relevant recommendations for the IPA structure to improve the decentralized/indirect management of the EU pre-accession funds, as well as for the implementation of programmes and projects financed from IPA funds;
✔ Adopt and implement the legislative framework for (re)institutionalization, in accordance with EC recommendations, and providing the basis for the further strengthening of the administrative capacities of the Office;
✔ Preparation of the internal Staff Retention Strategy within the Audit Authority by the fourth quarter of 2018;
✔ Preparation of three-year internal audit strategies for each IPA programme (TAIB, NAP, cross-border cooperation) that are audited annually, serving as a tool for planning audit processes.

Measure 15 – TO IMPROVE IRREGULARITY MANAGEMENT, ANTIFRAUD COORDINATION AND COOPERATION, AND PROTECTION OF FINANCIAL INTERESTS OF THE EUROPEAN UNION

Irregularity management and anti-fraud co-ordination in relation to the EU funds is relevant and important for the interests of both the Republic of Serbia and the EC.

In line with this, the Budget Inspection (hereinafter BI) and the Group for Combatting the Irregularities and Fraud in Dealing with EU Funds (hereinafter AFCOS) are responsible for the implementation of this measure.  

The Budget System Law (hereinafter: BSL) was amended in December 2016 and in December 2017 providing a wider scope of responsibilities and the necessary legal basis for both BI and AFCOS. Pursuant to these amendments and supplements to the BSL, the work of the BI (Article 90) is now based on the Working Program, which consists primarily of complaints, reports, objections and requests for inspection control received from bodies, organizations, legal and natural persons, while in the previous period the work of the BI was carried out on the basis of the Working Plan in which no clear distinction was made between the work and the function of the BI and the internal audit. By amending Article 68b of the BSL, besides its coordinating role, AFCOS has the authority to conduct administrative checks of the reported irregularities in using EU funds. The same BSL article also provides that the Ministry of Finance will submit to the Government an annual report on activities, which will be submitted to the National Assembly by 31 March of the current year for the previous budget year.

Strategy for reducing irregularities and fraud in managing EU funds in the Republic of Serbia for the period 2017-2020 (hereinafter: the Strategy) and the Action Plan for its implementation were adopted at the Government session on October 26, 2017 and published in the Official Gazette of the Republic of Serbia No. 98 of November 3, 2017. The Strategy is the first strategic document in the Republic of Serbia which has a comprehensive approach to the protection of the EU financial interests by determining the field of application and connecting a wide range of public authorities and institutions that contribute to more effective management of identified irregularities and the prosecution of criminal perpetrators through cooperation and exchange of relevant information.

Also, in October 2017, the Regulation on Work, Powers and Features of the BI was adopted. The aim of this document is to establish an efficient system of planning control at the level of the Republic of Serbia which provides a complete legal mandate for the BI. The Regulation regulates the work, powers and features of the budget inspection, the budgetary inspection service of the autonomous province and the budgetary inspection service of the local self-government unit. On the day of entry into force of this Regulation, the Regulation on the Work, Powers and Features of the BI (Official Gazette of the Republic of Serbia no. 10/2004 and 84/2007) shall cease to be valid.

Trainings, workshops, study visits for employees of the Sector who have contributed to the improvement of the functions of the BI and AFCOS were organized. During the reporting period, AFCOS employees participated in the following trainings: 2016 and 2017 AFCOS seminar, workshop on ARACHNE-IT tool,  

78 The Rulebook on internal organization and systematization of jobs of the Ministry of Finance (hereinafter: MoF) dated January 21, 2016 established the Public Revenue Control Sector, which is under the direct responsibility of the Minister of Finance, consisting of BI, AFCOS and the Public Procurement Group.  
79 Official Gazette of the RS no. 99/16  
80 Official Gazette of the RS no. 113/17  
82 Regulation on Work, Powers and Features of the BI http://www.pravno-informacioni-sistem.rs/SiGlasnikPortal/reg/viewAct/b5f0c595-fbe4-4f2f-895f-aa9d0013f8d4
presentation on risk management handbooks, seminar on IMS training on typology of fraud and other irregularities related to IPARD projects, Ethics and integrity of employees in the public sector, outset of the implementation of the new Law on General Administrative Procedure, CEPOL exchange program.

BI employees participated in trainings in the following fields: budget accounting and financial planning; more effective inspections; public procurement workshops; criteria for the most advantageous offers in economic sense – in practice with examples; IMF FAD’s Technical Assistance Mission in Serbia – workshop on expenditure review; ethics and integrity of employees in the public sector; lobbying in the EU – diplomatic practice; workshop – preparation of the Report on the implementation and improvement of the Public Financial Management Reform Program.

The planned increase in the number of employees will contribute to a more efficient and functional work of the Public Funds Control Sector, in terms of increasing the number of controls performed in relation to the number of received reports, complaints and requests for control, which will lead to a better protection of both EU financial interests and national interests.

<table>
<thead>
<tr>
<th>Performance indicators</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>BI AFCOS</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>No. of controls performed</td>
<td>21</td>
<td>19</td>
<td>21</td>
<td>14</td>
</tr>
</tbody>
</table>

In addition, as of January 2017, the BI and AFCOS can receive, via the official MoF website, electronic complaints about irregularities in using EU funds, complaints, reports, objections and requests for control, which has enabled their faster handling.

Illustration 8: Homepage of the Ministry of Finance website with a separate section for reporting irregularities

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In this way, the application process is simplified and provides an opportunity for anyone who has some information on irregularities to send it anonymously.

**Financing of the measure**
The measure was financed from regular budget resources. The trainings were organized through cooperation with and support of: OLAF, TAIEX, DIS III project from IPA, GIZ, UNDP, USAID, CEPOL, PARAGRAF, OSCD, IMF and Human Resource Management Service of the Government of the Republic of Serbia. The amount required for the newly-employed will be provided for by 2018 budget.

**Key challenges**

- Insufficient number of employees to perform all envisaged functions.
  According to the MoF Vertical Functional Analysis carried out by the World Bank in 2016, there was a difference in the number of necessary and existing staff in the Department for Control of Public Funds. The MoF has prepared amendments to the Rulebook on increasing the number of employees working in BI by 10 persons and for those working for AFCOS by 5 persons. It is expected that this increase in the number of employees will additionally contribute to the positive trend of identifying and reporting irregularities related to the use of national funds as well as EU funds.

**Next steps:**

- Signing of the Administrative Cooperation Agreement (ACA) between the MoF and the European Anti-Fraud Office (OLAF) is planned for the first half of 2018 and at this moment additional consultations are ongoing between the Ministry of Finance and the European Anti-Fraud Office (OLAF) regarding the changes in the Budget System Law.
- In the second quarter of 2018, BI methodology will be prepared. The Budget Inspection of the MoF will be in charge of full harmonization and coordination between BI and budget inspectors of local self-government, as well as BI and provincial budget inspectors. More precisely, the methodology will prescribe uniform standards and procedures for performing inspection controls.

**PILLAR V - ACCOUNTING, MONITORING AND FINANCIAL REPORTING**

The fifth PFMIP pillar refers to the coverage and quality of reporting on budget execution through improving accounting based on IPSAS\(^{\text{83}}\) standard. The leading institution responsible for achieving these goals is the Ministry of Finance – Treasury Administration.

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\(^{83}\) _IPSAS_ – International Public Sector Accounting Standards.
These obligations arise to a large extent from the requirements of negotiating chapter 17 – Economic and Monetary Policy, while the relevant set of measures is included in the adopted National Programme for the Adoption of the EU Acquis (NPAA)\(^\text{84}\).

Integration of indirect budget beneficiaries into the budget execution system of the Treasury Administration will provide improved control over their earmarked spending, thus contributing to achieving one of the key objectives of the PFM Reform Programme, improved coverage and quality of budget execution reporting.

Altering the fundamentals of accounting towards implementation of accounting international standards, will contribute to providing the necessary information on the coverage of fiscal reports and balance sheets. Consequently, this will lead to further improvement of public funds management and more transparent budget policy.

**Measure 16 – TO IMPROVE COVERAGE AND QUALITY OF BUDGET EXECUTION REPORTING**

When the PFMGRP was prepared, one of the most important challenges regarding budget execution was to increase the coverage of indirect budget beneficiaries, and improve monitoring and reporting related to public enterprises and arrears. The certain gaps in budget transparency and comprehensiveness demanded further efforts on improving the fiscal reporting framework in order to better align it with the recommended international practices. **In the second half of 2017, the integration of indirect budget beneficiaries into the budget execution system continued. To this effect, both activities planned for the last two quarters of 2017 have been implemented.**

The relevant values for the performance indicators, as defined below, will be subsequently entered.

<table>
<thead>
<tr>
<th>Performance indicators</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share of budget organizations included in the consolidated financial statement</td>
<td>TBC</td>
<td></td>
</tr>
<tr>
<td>Quality of annual financial reporting on the use of public finances (SIGMA, based on audit opinion of the SAI)</td>
<td>TBC</td>
<td></td>
</tr>
</tbody>
</table>

**Coverage and quality of reporting on budget execution and fiscal reports is being improved in several steps.** The budget execution of the Republic of Serbia is performed through the information system of the Treasury Administration. Budget beneficiaries connect to this system and administer financial and operational processes, based on their jurisdiction, through services and support provided by the Treasury Administration. The improvement of coverage and quality of reporting is reflected in the following achievements:

Currently, **318 indirect budget beneficiaries** are included in the budget execution system;

On January 1, 2016, a total number of 247 indirect budget beneficiaries were integrated in the budget execution system as planned. More specifically, courts, prosecutors and judicial institutions were included then;

As of December 10, 2017, another 71 indirect budget beneficiaries (criminal correctional facilities and cultural institutions) were integrated into the ISIB (ex FMIS) Budget Execution System;

For the purpose of further integration of indirect budget beneficiaries, a complete analysis of administrative and technical capacities has been carried out;

Due to the fact that extended coverage of indirect budget beneficiaries requires modernization and upgrading of IT systems, the Treasury IT system is being continuously improved. The production of the new budget execution system started on December 28, 2017. In addition, EU support through pre-accession funds has enabled establishment of secondary/backup centre for data storage.

In the second half of 2017, monitoring of public companies’ operations continued. In this regard, after the expiration of the deadline for submitting 2016 annual financial statements of public companies (at latest by June 30 of the current year for the previous or, by July 31, for consolidated financial statements), the Ministry of Economy updated the Preliminary Analysis of public companies operations for the period from January 1 to December 31, 2016. The final business analysis was published on the official website.

The Ministry of Economy prepared and published on its website an analysis of public companies’ operations for the period from January 1 to June 30, 2017. The analysis covers the planned and implemented business indicators of public companies that had obtained the approval of the business programme founder for 2017, until the deadline for submission of reports.

**Monitoring and reporting on arrears has been improved** by extending the RINO system to include public-to-public transactions (starting from January 1, 2016). The Treasury Administration has prepared and issued a circular reminder to all budget users of their obligation to register contracts in RINO and FMIS systems, as soon as these are signed.

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85 IPA 2013 project – Procurement of goods necessary for the implementation of the secondary / back-up centre for storing data of the Treasury Administration.


88 Web application and instructions for RINO system: [https://www.trezor.gov.rs/rino-cir.html](https://www.trezor.gov.rs/rino-cir.html)
It is planned to implement the Analysis and improve the system of penalties for non-execution of the stipulated financial control by the end of 2016. This activity is also envisaged in the Tax Administration Transformation Strategy. Despite short delays, on June 20, 2017, the kick-off meeting of the operational team initiated the analysis. Based on the conclusions to be defined in the analyses, amendments to the Law are proposed. Supervision of the implementation of the Law on deadlines for fulfilling financial obligations in commercial transactions for economic entities is carried out by the Tax Administration, while the Department for Budgetary Inspection of the Ministry of Finance supervises public funds beneficiaries. The Rulebook on the Manner and Procedure for Supervision\(^\text{89}\) has been adopted.

The penal provisions of the Law on Deadlines for Fulfilment of Financial Obligations in Commercial Transactions are conducted by the Economic and Misdemeanour Courts, depending on the subject of supervision. During 2016, the Tax Administration obtained 53 notifications for which competent tax inspectors initiated the request for a misdemeanour procedure. During 2016, the Division for Budget Inspection issued 252 decisions on temporary suspension of transferring the corresponding part of income tax and profit tax of the local self-government units.


Source: [http://www.trezor.gov.rs/rino-cir.html](http://www.trezor.gov.rs/rino-cir.html)
The goals in question are also subject of the project “Reconstruction and Optimization of Public Administration in Serbia”\(^9\), a vertical functional analysis of the Ministry of Finance conducted by the World Bank, as well as the Memorandum on Economic and Financial Policies (MEFP), which stipulates a review of economic measures that the Government of the Republic of Serbia and National Bank of Serbia intend to implement within the stand–by (extended) arrangement with the IMF. The progress in this area was presented within the First Reporting Period of the PFM Reform Program.

The Treasury Administration established the Central Register of Invoices. The Law on Amendments to the Law on Deadlines for Fulfilment of Financial Obligations in Commercial Transactions (Official Gazette of the Republic of Serbia No. 113/17) stipulates, inter alia, the obligation valid as of March 1, 2018 to register invoices and other payment requests issued by creditors in commercial transactions between the public sector and business entities, or between public sector entities, in which public sector entities are debtors, and therefore, the Ministry of Finance – the Treasury Department established the Central Invoice Register (CIR) as a database for the registration of underlying invoices and other requests for payment.

This amendment to the Law obliges creditors to register in the CIR issued invoices and other requests for payment in commercial transactions in which debtors are public sector entities, before delivering them to debtors, by entering data from the invoice or other request for payment into the Treasury IT system.

In addition, it is stipulated that creditors shall submit to debtors the registered invoices or other requests for payment within three working days from the date of the registration, with instructions for payment of the invoice or other request for payment, and that debtors shall settle their financial obligations as per invoices and other requests for payment only if they are properly registered in the CIR, which is established by checking the database.

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\(^9\) IPA 2014 project – Optimization and Restructuring of Public Administration in the Republic of Serbia, funded by the EU, and implemented by the World Bank.
This provides a better system of reviewing creditors’ claims from public sector entities in commercial transactions in which public sector entities are debtors, as well as obligations of public sector entities in commercial transactions towards creditors.

The system of monitoring and supervision over the settlement of the stated obligations of the public sector entities in the timeframe prescribed by the Law is being improved.

The registration of invoices, as well as other payment requests issued by creditors in these commercial transactions, is in the interest of the creditors, bearing in mind that this improves the efficiency and security of collecting creditors’ claims. Also, debtors are able to check the validity of the invoice before making the payment to the creditor, and make payments only if the invoice is properly registered, i.e. if it corresponds to the invoice issued or other request for payment.

Registration of invoices, as well as other payment requests, enables better planning and management of liquid assets, both to economic entities and in the public sector. This will also enable better transparency of data on creditors’ claims against public sector entities in commercial transactions, as well as transparency of data on public sector entities’ obligations in these transactions.

Registration of invoices and other payment requests shall apply in the first stage to invoices and other payment requests issued by creditors in commercial transactions between the public sector and economic entities, or between public sector entities, in which debtors are public sector entities that make payments through accounts maintained with the Treasury Administration, starting from March 1, 2018, and in the second phase to invoices and other payment requests issued by creditors in commercial transactions between the public sector and economic entities, or between public sector entities, in which debtors are other public sector entities that make payments through the account maintained with banks, after establishing technical and technological conditions.

Bearing in mind that the Law on Amendments to the Law on Deadlines for Payments in Commercial Transactions stipulates that creditors shall register in the central invoice register issued invoices and other payment requests in commercial transactions in which public sector entities are debtors before delivering them to debtors, we believe that this decision provides creditors with additional security of recording and collecting their receivables, because until now the obligation to register and record monetary liabilities belonged to the debtor’s, and the new legal solution introduces the obligation to report the monetary obligation on the part of the creditor.

**Financing of the measure**

The PFMRP does not indicate any amount for financing the activities, as many of them are implemented with the support of the IMF and the WB missions, and with the capacities of the Ministry of Finance.

**Key challenges**

The biggest implementation challenges under the measure are:

- Administrative and technical capacities of indirect budget beneficiaries that are connected to the budget execution system. In order to overcome these challenges, the Treasury Administration provides details on information –
communication and technical requirements necessary in order to connecting to the budget execution system and training for indirect budget beneficiaries.

Next steps

Measure 17 – MOVING GRADUALLY AND SYSTEMATICALLY TOWARDS ACCRUAL BASIS ACCOUNTING

The authorities are actively pursuing transparency of public finances and are therefore, in favour of adopting the accounting IPSAS standards. This is an important step, in line with the recommendations by international institutions, including the IMF and the WB, to prepare financial statements in accordance with IPSAS standards. Changes in the accounting basis and implementation of international standards contribute to providing necessary information on which the fiscal policy will be based, the scope of fiscal reports and balance sheet, and additional improvement of public funds management, as well as more transparent budget policy.

The relevant values for the performance indicators, as defined below, will be subsequently entered.

<table>
<thead>
<tr>
<th>Performance indicators</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Extent to which cash flows are forecast and monitored</td>
<td>N/A</td>
<td>A (^{91})</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The level of harmonization of national accounting systems with IPSAS standards (percentage of standards adopted to the national accounting system)</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
</tbody>
</table>

During the reported period, following steps have been taken to fulfill the envisaged activities:

- Analysis of shortcomings of the current accounting practice and IPSAS standards was conducted with the technical assistance of IMF.
- Draft of realistic Road Map for transferring to accrual accounting in the public sector was prepared with the technical assistance of IMF.
- The Report on the Enhancement of Public Sector Financial Reporting (REPF) has been prepared. This report assesses the institutional framework for accounting in the public sector, as well as the gap between publicly accepted accounting principles in the public sector of the Republic of Serbia and the IPSAS. The results of the REPF analysis will be included in the road map for the further development of national

"A gradual and systematic transition to accrual accounting based on the IPSAS standards will be carried out by the phase design of accounting policies according to the IPSAS standards, which will be the basis for the preparation of financial statements in accordance with the IPSAS standards."

Public Finance Management Reform Program

\(^{91}\) The year in which the PEFA Assessment was published (assessment period 2011-2013).
(domestic) accounting legislation and guidelines, taking into account Serbia's needs and capacity constraints. The REPF analysis provided a general overview of areas such as the professional capacity of accounting staff in public sector entities.

- **The Law on Amendments to the Law on the Budget System** was adopted in December 2017 ("Official Gazette of the Republic of Serbia", No. 113/2017). In accordance with the Article 75a of the Law, the Government, on the proposal of the Ministry, establishes the Commission for the Application of International Public Sector Accounting Standards. The Commission gives an opinion on the draft acts of the Minister relating to the application of International Public Sector Accounting Standards (IPSAS), which are required to be applied by all users of public funds, in accordance with the Law, other than public enterprises and other organizational forms of the public sector applying International Accounting Standards (IAS).

- **“Pro forma” financial report for 2015** was prepared in accordance with cash basis accounting IPSAS standards for central government level, thus contributing to better reporting and the overall transparency.

Some of the activities foreseen to be implemented in 2016 and 2017 have not yet been started, and the reason for the delay is the need to train the staff in order to prepare financial statements in accordance with the standard for the cash basis for the central and local government level. In the forthcoming period, through the new and detailed Action Plan, the application of the calculation base would be delayed and based on the experience of the countries in the region and put it in frames until 2034.

Within the framework of strengthening the human and technical capacities of the Treasury Administration for the implementation of the accounting reform, the establishment of a new Unit for the methodology and implementation of IPSAS standards was included in the Act on the systematization of the positions of the Treasury Administration, which was adopted in August 2017. A new Department for the Methodology for the Application of International Public Sector Accounting Standards has been established. The department has five systematized jobs, and up to now three employees. The IMF has already provided expertise and advice on accounting and reporting in accordance with the IPSAS for all the employees in the Budget Accounting Department and reporting of the Treasury Administration.

**Financing of the measure**

The PFMRP does not indicate any amount for financing the activities, as many of them are implemented through the support of the IMF and WB missions and the existing capacities of the Ministry of Finance.

**Key challenges**

Major constraints in the implementation of this measure are:

- Limited knowledge of the IPSAS standards in Serbia can hinder the harmonization with the latter. Potential long term challenge is the capacity of the staff to learn and apply the new standards. The lack of qualified professional
staff may present a constraint for the improvement of accounting in the Republic of Serbia and subjects under its control. Continuous trainings for improving the skills of accountants in the public sector are therefore required;

✓ Taking the current state of the accounting system into consideration, the lack of capacities in the Ministry of Finance on the whole, Treasury Administration, as well as public fund beneficiaries, clearly indicate the insufficiency for an effective transfer to accrual basis of accounting. Based on this, strengthening the capacities is imperative;

✓ Translation of IPSAS standards - standards were translated by the Serbian Association of Accountants and Auditors (a body that is a member of the IFAC). However, there are certain technical shortcomings and the translation must be fully harmonized in order to be ready for official approval. The Ministry of Finance is in the process of consulting with the IFAC to take measures to improve the translation.

**Next steps**

✓ In accordance with the assessment and suggestions made by SIGMA experts, transfer to accrual accounting requires gradual and long term implementation which demands building an adequate starting basis. In order to secure an appropriate path of accounting reform and attain adequate results, a good starting point would be strengthening the cash based accounting in accordance with IPSAS.

✓ As mentioned previously, it is necessary to prepare new and detailed Action Plan which would postpone the implementation of the accrual accounting and frame its implementation around the year of 2030. In accordance with this, it is necessary to shift the focus on the improvement and stability of the existing cash based accounting based on IPSAS cash basis.

✓ Taking into consideration the fact that uniform accounting practices in the EU member states do not exist and that EPSAS standards as IPSAS equivalent are still in the preparatory phase, it is necessary to conduct a detailed analysis of the justification of accounting system based on accrual basis in relation to the cash based accounting. According to the European Commission, preparation of financial reports, budget, IT trainings, communication strategy and data conversion represent a serious constraint on the Public Sector, therefore the introduction of EPSAS standards would be one of the biggest reforms in the history of Europe (website: https://www.epsas.eu/en/).

✓ Introduction of accrual accounting is a very expensive and long term reform that needs to be developed further, therefore in the upcoming period, it is imperative to conduct an additional analysis of options, risks, costs, etc. (Cost benefit analysis) in terms of a gradual transfer to accrual accounting in Serbia. This analysis will be very important as a guideline for further steps in the whole process of accounting reform, taking into account that the transfer to accrual accounting is very costly and long reform, as well as the fact that there does not exist a uniform practice in the EU member states as far as basis of accounting is concerned.

✓ Taking the aforementioned into consideration, the current state of the overall accounting system insofar as the lack of capacities in the Ministry of Finance on the whole, Treasury Administration and public funds beneficiaries, clearly
indicates that it is necessary to alter the activities and deadlines within this measure.

PILLAR VI - EXTERNAL SCRUTINY OF PUBLIC FINANCES

In order to secure sound public finances, it is crucial to ensure effective external oversight and monitoring mechanisms, including firm rules on reporting and transparency.

External scrutiny of Public Finances is under the competence of the Parliament and the State Audit Institution (hereinafter: SAI). Parliamentary oversight of the public financial management can be achieved by ensuring adequate administrative and organizational arrangements and establishing clear procedures for the Committee for Finance, State Budget and Control of Public Spending of the National Assembly. They should have full capacity to oversee budget formulation, implementation and outcomes of budget allocations.

SAI is an independent state authority, accountable to the National Assembly of the Republic of Serbia. The Institution performs activities stemming from its competence, ensuring transparent operation, decision-making process and other matters significant for the work of the Institution pursuant to the Law. As such, work of the State Audit Institution is of significant importance for sound public financial management.

In order to ensure effective external scrutiny over public finances, the following set of measures has been defined as to ensure effective external audit and appropriate Parliamentary oversight over public finances in line with the SIGMA Public Financial Management Principles 15 and 16 and Chapter 32 – Financial Control.

Measure 18 – TO STRENGTHEN COVERAGE AND QUALITY OF EXTERNAL AUDITS

Significant improvement was achieved in increasing the number and quality of audit products, number of auditors, and coverage of auditees, through the implementation of the audit guidelines, giving professional assurance to the National Assembly and the citizens of the Republic of Serbia that the public funds are managed and spent appropriately92.

<table>
<thead>
<tr>
<th>Performance indicators</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scope/nature of audit performed (including adherence to auditing standards) (PEFA, score from A to D)</td>
<td>B93</td>
<td>A</td>
<td>A</td>
</tr>
<tr>
<td>Share of SAI audit recommendations implemented by the auditees94</td>
<td>69.66%</td>
<td>75.09%</td>
<td>.70.35%95</td>
</tr>
</tbody>
</table>

93 PEFA assessment was carried out in 2015, based on available data for 2013.
94 Data provided relate to recommendations implemented pursuant to reports from 2014, 2015 and 2016.
95 The given percentage is not final, the preparation of the Annual Report on the work of the Institution for 2017 (deadline is March 31, 2018), which will contain the final data, is underway.
Despite the fact the foreseen activities under Measure 18 should be carried out by 2018 and continuously until 2020, a lot has already been done. In addition to the audit manual adopted in April 2015, during the reporting period, a number of guidelines were adopted by the SAI for the purpose of further implementation of audits (Guidance for Post-Audit Procedure, Guidelines for Assessment of Manner of Violation of Good Business Practice by Auditees, Instruction for Drafting Financial Statements and Compliance Audit Reports, Checklists for Quality Control of Financial Statements and Compliance Audit, New exemplary forms of audit reports (in line with revised International Standard of Audit – ISA 700)). These rules are fully in accordance with the ISSAI standards, domestic legal framework and audit manuals.

Due to delays in its implementation (18.3), the activity switched from the fourth quarter of 2017, to the second quarter of 2018. The twinning light project was started right after the accreditation of the IPA unit in the SAI, which was a prerequisite.

The State Audit Institution has published 220 out of 231 planned audit products in 2017, while the target number of the planned audit products is 253 until the end of 2020. The implementation of the audit in line with the Audit Programme for 2018 (adopted on December 28, 2017) is in its initial stage. List of auditees, after issuing audit conclusions, will be published on the SAI official website.96

96 http://www.dri.rs/ревизије/ревизије-у-току.11.html
In order to further develop the capacity of the SAI staff, internal and international trainings were conducted (nine trainings, with duration ranging from one to three days, with 20 to 213 attendees). Membership in various organizations and working groups (INTOSAI, EUROSAI, EUROSAI Task Force on Audit & Ethics, EUROSAI IT Working Group, EUROSAI Task Force on the Audit of Funds Allocated to Disasters and Catastrophes, EUROSAI Task Force on Municipality Audit, Working Group on Public Procurement) also contributes to employee capacity development.

In line with the SAI Strategic Plan, SIGMA conducted a functional analysis of the SAI, which will be taken into consideration during the process of planning future SAI activities. One of the recommendations is to change the Law on SAI, in order to enhance precision, remove ambiguities and review management model (for instance, definition of audit terms, contents of the SAI Rules of Procedure, and term of office for public officials). The Strategy for Human Resource Management in the SAI for the period 2017-2020, was prepared with the GIZ support and adopted on April 27, 2017 by the Decision of the SAI Council.

In order to develop and adopt the new Guidelines for quality assurance during 2018, based on ISSAI standards, the SAI will have support of the SAI of Latvia through the Twinning Light project “Audit Quality Control in the State Audit Institution” from IPA 2013. The project was launched in September 2017, and will last eight months. The project will provide support to SAI in introducing quality audit audits in line with international auditing standards and international audit practice. As a result of the project, the SAI is going to introduce a proper quality audit system harmonized with European and international audit standards, as well as standardize its audit practice in accordance with good practice.

In the course of 2017, an Assessment Report was prepared, which includes an overview of the current SAI practice related to quality control and the preparation of a detailed map of the strengths and weaknesses of the system, taking into account compliance with relevant standards. Two workshops were held for over 70 SAI employees on the topic of applying quality control standards.

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The delegation of the Institution went to Latvia for the first study visit envisaged by the project, where they were introduced to the practical processes of quality control and assurance in the quality of audits. During the study visit, the participants had the opportunity to get acquainted with the methods of quality control audit, experience in assuring quality through the practical aspects of strategic planning, communication human resource management, quality management and auditing of resources to support information and communication technologies.

The SAI is continuously working (functioning is analyzed, codebook is updated) to improve systemic follow-up of the implementation of audit recommendations through establishment of public registry of audit recommendations and required database (deadline is the third quarter of 2018).

Illustration 10: Follow-up database

The European Commission’s Progress Report 2016\textsuperscript{98}, as well as SIGMA Report on monitoring the principles of public administration from November 2017\textsuperscript{99}, supports the progress achieved within the measure, stating that “constitutional and legislative framework of the SAI complies with the INTOSAI standards”. The expansion of the audit coverage was also noticed.

**Financing of the measure**

In line with the PFMRF, the planned funds for the implementation of Measure 18 amount to approximately 10.7 million EUR from national budget, and 306,000 EUR from external sources of financing. In 2016, a total of 583,000 EUR was invested from the national budget and 233,200 EUR from donors. In accordance with the Law on the Budget System and Budget Calendar, direct budget beneficiaries have to prepare an annual report by March 31. After the deadline and after the report has been adopted by the Council, the amount of realized funds for 2017 will be available.

**Key challenges**

The biggest implementation problems under the measure are associated with:

- Insufficient workspace capacity that affects the SAI capability to recruit additional staff, which was partially solved during 2016\textsuperscript{100},


\textsuperscript{100} By November 2016, SAI used business premises in Belgrade, Novi Sad, Niš and Kragujevac, (a total area of 2,170.92 m²), and six locations in Belgrade. By the end of 2016, the SAI was provided with workspace. Currently, the area of the commercial premises that SAI uses totals 3,674.55 m² - 3,080.22 m² of which is two locations in Belgrade (which facilitates communication between audit sectors).
Insufficient number of employees (number and structure of employees affect audit coverage) that is directly linked to available funding and availability of the workspace. Possible discontinuity of work at the top management since the terms of office of the SAI Council members are relatively short. If all members of top management were changed at the same time, the SAI could face continuity issues. This is one of the issues that might be addressed alongside other amendments to the SAI law during the next reporting period.

Lack of funds – budget funds and external funds (donors).

Next steps

In the forthcoming period, ending with (and including) the second quarter of 2018, an Action Plan for the introduction and implementation of standards related to audit quality will be developed. Procedures and guidelines for attaining quality of audits will be developed and then tested through selected pilot audits, after which they will be adjusted if necessary and integrated into the methodology of work.

In addition, the SAI will continue to increase the coverage of public funds through auditing. New employees will be hired in accordance with the approved human resource plan and funds, and the number of appointed state auditors will be increased. The professional development of employees and the implementation of the Human Resources Management Strategy will continue. It is planned to develop tailored audit management software, with full functionalities for the implementation of the entire audit process, while integrating the existing document management system.

Measure 19 – TO STRENGTHEN PARLIAMENTARY SUPERVISION OVER PUBLIC FINANCES

As envisaged by the PFM, the Parliamentary oversight function over the public finance has been improved through the establishment of the Subcommittee of the National Assembly for consideration of reports on audits performed by the State Audit Institution (hereinafter: Subcommittee) in February 2015, and appointment of new members of the Subcommittee in July 2016. In the previous period there was a delay in the implementation of activities within Measure 19 (which includes one result and two activities), but in the third quarter of 2017 a significant progress was achieved through the adoption of the Guidelines for the work of the Subcommittee, which finalized preparatory actions for the full implementation of Measure 19.

<table>
<thead>
<tr>
<th>Performance indicator</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of SAI audit reports discussed by the respective parliamentary committees</td>
<td>1</td>
<td>1</td>
<td>7(^{104})</td>
</tr>
</tbody>
</table>

\(^{101}\) Members of the SAI Council are appointed for a period of five years, and can be elected by the Assembly only two times, pursuant to Article 20 of the Law on SAI, Official Gazette of the RS no. 101/2005, 54/2007 and 36/2010.


\(^{103}\) Законом о буџету РС за 2018. годину нису одобрена средства ни за постојећи број запослених.

\(^{104}\) The reports reviewed are: Report on the work of the Sector for Budget and Budget Funds Audit of the Republic of Serbia for 2016 and the recommendations and other effects of the audits carried out in 2016; Report on the work of the Sector for the Audit of Mandatory Social Insurance Organizations for 2016 and the recommendations and other effects of the audits carried out in 2016; Report on the work of the Audit Sector of the National Bank of Serbia, public agencies and other public funds beneficiaries for
In order to promote the principles of accountability, transparency and efficiency of the public funds spending and to define basis of mutual cooperation, the Memorandum of Understanding was signed in June 2015 between the Committee on Finance, State Budget and Control of Public Spending of the National Assembly and State Audit Institution. The Committee and SAI will encourage cooperation and exchange of information regarding the application, adoption and implementation of policies and regulations, as well as projects and other activities and initiatives in the field of financial control and accountability. The SAI will assist members of the Committee in understanding the nature and importance of the audit findings and finding appropriate corrective mechanisms. The Committee will review the activities of the SAI and report to the National Assembly on this, and will also work on identifying and developing mechanisms for monitoring the implementation of recommendations made by the SAI and the National Assembly, based on the SAI report.

Adopting the written rules (guidelines) for reviewing the SAI report is a condition for holding sessions in the form of discussions of reports which would be attended by the SAI representatives and audited entities. Enabling the participation of all relevant stakeholders in reviewing the audit reports of individual audit entities under uniform rules should improve scrutiny of public funds spending.

The Committee on Finance, State Budget and Control of Public Spending of the National Assembly and SAI organized a workshop with presentation of audit reports sector data on September 19, 2016, and agreed on the next steps of mutual cooperation.

At the first sitting of the Subcommittee for the Consideration of Reports on Audits Conducted by the State Audit Institution, held on September 30, 2016, the main topic was role and value of Audit of Expediency. The audit report sector data for expediency were selected because they show the process of using public funds in order to determine whether this was done in accordance with economic principles, efficiently and effectively, and in line with the planned objectives. Namely, Subcommittee meetings increase the level of knowledge of the MPs to train them to review better SAI reports in order to improve scrutiny of public finance.

The Committee on Finance, State Budget and Control of Public Spending held a sitting of the Committee and the 2016 and the recommendations and other effects of audits conducted in 2016; Report on the work of the Sector for Audit Local Government Budget for 2016 and the recommendations and other effects of the audits carried out in 2016; Report on the work of the Sector for the Audit of Public Enterprises, Companies and other Legal Entities that 2016 public funds beneficiaries founded or have a stake in the capital or management, and the recommendations and other effects of audits carried out in 2016; Report on the work of the Sector for Business Intelligence Audit for 2016 and the recommendations and other effects of the audits carried out in 2016; as well as the SAI Report for 2016.

105Link to the sitting: http://www.parlament.gov.rs/Prla_sednica_Podobora_za_razmatranje_izve%C5%A1ta_o_obavljajim_revizijama_Dr%C5% BEvne_revizorske_institucije.29850.941.html
Subcommittee in Novi Sad on August 30, 2017 and adopted Guidelines for the review of State Audit Institution reports on audits performed on public fund beneficiaries. The aim of the sitting held in Novi Sad was to raise awareness at the level of local self-governments on the significance of audit findings and the SAI recommendations, as well as the role of parliamentary oversight of public finances. According to the Committee Chairperson, Novi Sad was chosen to host the sitting as one of four cities with the most stable public finances. In addition to the adoption of the Guidelines, the agenda also included the discussion of the SAI 2016 Activity Report and six sector SAI reports on the performed audits. Based on the ensuing debate and the Subcommittee’s conclusions, the Committee formulated a Conclusion Proposal which would be sent to the National Assembly for consideration and ruling. The Committee suggested that the National Assembly should conclude that the SAI had fully presented its activities in the implementation of the constitutional and legal competences in the audit of public funds. The Committee, among other things, proposed to the National Assembly to take measures within its jurisdiction in order to ensure the smooth implementation of the SAI recommendations and oblige the RS Government to propose to the National Assembly the adoption of laws that would regulate issues not regulated by existing regulations. The Conclusion Proposal contained a request for harmonization of all relevant legal acts with the Law on the Budget System in order to eliminate their mutual incompatibilities, as well as the necessary amendments to certain provisions of the law that could produce negative consequences. It was also proposed that the National Assembly should instruct the Government of the Republic of Serbia on the necessity, in accordance with the SAI recommendations, to amend the by-laws adopted by the Government, as well as those within the competence of the ministries which are specifically indicated in the reports. The Government of the RS, in accordance with the responsibility for enforcing the law, should ensure the consistent implementation of the Budget System Law in the part related to the obligation to establish an adequate system of financial management and control and the introduction of internal audit for all public funds beneficiaries. After they are approved, the conclusions are published in the Official Gazette of the Republic of Serbia.

The sittings of the National Assembly of the Republic of Serbia and sessions of all working bodies, press conferences, public hearings, the activities of the President of the National Parliament and other events, can be followed via live stream, or accessed through the archive on the website by media, interested non-governmental organizations and third parties.

Already at the end of 2015, in order to improve access to data, the National Assembly established the Portal for Monitoring Public Spending, as a software tool for controlling spending of public funds, thus connecting the National Assembly with the existing system in the Ministry of Finance – Treasury Administration. It was planned to enhance the Portal in twelve phases, in order to connect the Portal with other monitoring systems for public funds spending, thus enabling immediate access to information and providing simpler and more efficient monitoring of public funds execution.

106 http://www.parlament.gov.rs/27_%D1%81%D0%B5%D0%B4%D0%BD%D0%B8%D1%86%D0%B0_%D0%9E%D0%B4%D0%B1%D0%BE%D1%80%D0%B0_%D0%B7%D0%B0-%D1%84%D0%B8%D0%BD%D0%B0%D0%BD%D1%81%D0%BA%D0%B8_%D1%98%D0%B5._39054.42.html


108 The introduction of the Portal for Monitoring Public Spending is foreseen in the Action Plan for the Implementation of the National Strategy for the Fight against Corruption of the Republic of Serbia for the period 2013-2018, and the project
The third phase of the development of the Portal was completed on September 16, 2017, by holding one-day training on using the software for the representatives of the Board. Besides facilitating direct work on the Portal, the participants were presented with a way of preparing the budget and the basis of the budget system, as well as the system of internal financial control in the public sector by the relevant representatives of the Ministry of Finance. In the coming period obtaining data of the Treasury Administration will be further improved.

*The role of the National Assembly and the Committee for Finance, State Budget and Control of Public Spending is recognized in the European Commission Progress Report for 2016 “as an important factor and tool available to members of the Parliament and the public for the control of public spending.”*

*Financing of the measure*

The PFMRP does not indicate any additional amount for financing the activities of the Committee for Finance, State Budget and Control of Public Spending of the National Assembly since all activities are implemented within the existing national budget available to the Parliament, SAI and Ministry of Finance.

*Key challenges in implementation*

The biggest implementation challenges under the measure are associated with:

- The lack of mechanism for the follow-up of the implementation of SAI recommendations and conclusions made by the National Assembly related to the discussion of the SAI report that still needs to be developed to improve cooperation between the SAI, Government bodies and the Parliament.

*Next steps*

In its further work, the Committee will endeavour to develop its control function, in particular by holding sessions of the Subcommittee and Committee to review the SAI reports on audits carried out in the presence of representatives of the Institution, audit entities and, if necessary, representatives of other relevant bodies, organizations and institutions. Bearing in mind that the work of the Committee and the Subcommittee is closely connected with the work of the State Audit Institution, and that in the first half of the current year, the appointment of a new President and members of the Council of

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109 The workshop was attended by 18 members and deputy members of the Committee on Finance, State Budget and Control of Public Spending.

the SAI is expected, the mentioned activities will be implemented during the third and fourth quarter of 2018.
CONCLUSIONS AND RECOMMENDATIONS

Significant progress in achieving the results, foreseen by the Program, was achieved during the two-year period of implementation of the reform, which is confirmed by the statistics where about 50% of the planned reform activities have been fully implemented.

The major challenges in most cases are still technical in nature, which are related to delays in the adoption of strategic documents, legal acts and by-laws, due to long internal and interinstitutional consultations on the harmonization of the texts of documents.

Consequently, the conclusion of all relevant parties, that participate in the process of developing and monitoring the implementation of the Program, together with the European Commission, is the necessity of revising the Program and the accompanying Action Plan. Work on the preparation of the new Action Plan for the period 2019-2021 started in May 2018.

The improved Program, which is planned to be prepared by the end of 2018, will contribute to increasing the focus on performance, better prioritization and order of activities, as well as a better assessment of financial effects.

Improvement of the Program is carried out by the Ministry of Finance and relevant line ministries and bodies of the Government of RS, as well as the SAI and the National Assembly of the Republic of Serbia. A significant support in this process, as before, has been provided by the SIGMA project.

In accordance with the Law on Planning System, the civil sector will also participate in the development of the new Program by organizing public consultations, planned to be held in November and December 2018.

These conclusions are also confirmed within the framework of the Program’s coordination structure, the policy dialogue on public finance management reform and the Board of Directors meetings.

At the last meeting of the Program Steering Committee, headed by the Minister of Finance, Dr Sinisa Mali, held on October 29, 2018, a great commitment was dedicated to the realization of the set goals in the area of the reform of the PFM and recommendations for the further work were given. The following conclusions were made at the meeting:

- The Annual Report on the Implementation of the Public Finance Management Reform Program 2016-2020 for the period December 2015 to December 2017 is approved and it is instructed to the Technical Secretariat of the Program to start the procedure for adopting the Report at the Government session;

- Promoting the Program and developing a new Action Plan, as well as improving the performance indicators and assessing the necessary financial resources for the implementation of the Action Plan;
✓ It is suggested to consider the possibility of setting up the Working Group on the Public Finance Reform within the National Convention on the EU;

✓ It is proposed to organize regular, quarterly meetings of the members of the Working Group of the Program;

✓ It is proposed to hold meetings once a year with representatives of the donor community within the mechanism of sectoral working groups in cooperation with the Ministry of European Integration, in order to present priorities in the field of the public finance reform, in accordance with the Multi-Annual Plan for Coordination of International Development Assistance 2019-2020.