



**REPUBLIC OF SERBIA
MINISTRY OF FINANCE
- Central Harmonisation Unit -**

**CONSOLIDATED ANNUAL REPORT
ON THE STATUS OF PUBLIC INTERNAL FINANCIAL CONTROL
IN THE REPUBLIC OF SERBIA IN 2018**

Belgrade, August 2019

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EXECUTIVE SUMMARY

Consolidated Annual Report on the Status of Public Internal Financial Control in the Republic of Serbia (hereinafter referred to as: PIFC) is each year submitted to the Government by the minister of finance, in accordance with Article 83 of the Budget System Law¹ (hereinafter referred to as: BSL), which prescribes that the Central Harmonisation Unit within the Ministry of Finance (hereinafter referred to as: CHU) consolidates individual annual reports of public fund beneficiaries on the status of financial management and control (hereinafter referred to as: FMC) and internal audit (hereinafter referred to as: IA).

The purpose of the Consolidated Annual Report on the Status of Public Internal Financial Control in the Republic of Serbia in 2018 is to present the information gathered and inform the relevant stakeholders about the progress and results achieved by public fund beneficiaries in the process of introduction, development and strengthening of the financial management and control system and internal audit function, and the objective of the report is to highlight both the strengths and weaknesses of the system, but also to provide recommendations for its further development and improvement.

Through the adoption of the Strategy for Development of Public Internal Financial Control in the Republic of Serbia for the Period 2017-2020 (hereinafter referred to as: PIFC Strategy), the Government has provided strong support to the introduction and strengthening of the public internal financial control system. It is vital to highlight that the PIFC Strategy relates to Public Finance Management Reform Program for 2016-2020, which articulates the Government's unequivocal commitment to implementing a comprehensive set of coordinated and sequenced reforms in the broad field of the PFM, which are aimed at increasing accountability and ensuring sound financial management and good governance by improving the efficiency and effectiveness in managing public resources in the Republic of Serbia. PIFC Strategy prescribes that annual reporting to the Government on implemented activities, achieved results and possible challenges in the realisation of objectives and measures is done by means of Consolidated annual report.

Internal financial control based on international standards and principles was introduced in the public sector in Serbia in 2009 through the provisions of the BSL and at the time, it was considered a novel development in the functioning of the public sector in Serbia. After ten years of implementation, significant results have been achieved: PIFC has been introduced into the legal framework, the CHU was established and produced methodological materials for public fund beneficiaries (hereinafter referred to as: PFBs) to facilitate the implementation of international standards and principles and provided training in the area of FMC for 2,406 employees and managers so far² and more than one thousand representatives of top

¹ („Official Gazette of RS”, no. 54/09, 73/10, 101/10, 101/11, 93/12, 62/13, 63/13-corrig., 108/13, 142/14, 68/15-other law, 103/15, 99/16, 113/2017, 95/2018 and 31/2019)

² Five-day FMC training

management from PFBs. The major and most relevant public sector institutions have largely aligned their respective FMC systems with the international principles (COSO³ framework) and standards (INTOSAI gov) and regularly inform the CHU on the compliance of their FMC systems. The national certification scheme was developed for acquiring the title of certified internal auditor in the public sector, in accordance with international standards for the professional practice of internal auditing (ISPPIA), and to date the title was obtained by 413 internal auditors, 319 of whom are active and additional 84 are in the process of training. According to the number of reports received, internal audit is established in 242 public sector institutions in Serbia.

With respect to **financial management and control system**, as the first of three pillars of PIFC, the key developments in the course of 2018 took place in the area of improving the regulatory and methodological framework. In cooperation with the Twinning partner, the CHU prepared the “*Guidelines on the Managerial Accountability Concept*” and “*Risk Management Guidelines*”, a practical *example/model of the Risk Management Strategy*, and updated the existing “*Manual for financial management and control*” (FMC Manual).

240 employees were trained during five-day basic FMC trainings and 120 top managers attended one-day FMC workshops.

Significant increase was recorded (23%) in the number of submitted FMC reports, the same as last year. Best average scores, for each of the observed parameters, were recorded at the central/Republic level in the category of MSIO, followed by the category of ministries.

In the area of **internal audit**, the second pillar of PIFC, 36 new internal auditors were certified in the course of 2018 and four expert trainings were organised on modern developments in internal auditing (in cooperation with Twinning partner).

The number of PFBs that established the internal audit function in 2018 rose by 10% compared to 2017. In 2018, the number of systematised posts rose by 13%, while the number of filled-in posts rose by 9%, compared to 2017, which all together indicates a positive trend in development of internal audit function in the previous period. All other IA parameters have also recorded a rising tendency.

The work of the **CHU** in the course of 2018, as the third pillar of PIFC, is characterised by a high level of implementation of recommendations by the European Commission (hereinafter referred to as: EC). Out of 21 recommendations provided by the EC within their Progress Reports for 2018⁴ and 2019, 9 recommendations (42.86%) have been implemented so far, 11 recommendations (52.38%) are being implemented, while 1 recommendation (4.76%) is planned to be implemented.

³ Committee of Sponsoring Organizations of the Treadway Commission on Fraudulent Financial Reporting

⁴ All the recommendations from the 2018 EC Progress report are still valid

Significant efforts were undertaken in improving the concept of **managerial accountability** in the public sector of Serbia, as the key pre-requisite for the establishment of PIFC: the Guidelines were produced and previously harmonised with the SIGMA methodology. Also, in 2018 the implementation of “Pilot exercise” was initiated with the main purpose being the improvement of the FMC system and managerial accountability concept in four pilot institutions. The idea behind this exercise is to demonstrate the managerial accountability in practice in the selected institutions that are foreseen to take the lead in the area of managerial accountability in entire public sector of Serbia. Based on the resulting lessons learned and identified weaknesses, the following PIFC policy document should propose measures for their elimination and further improvement of the managerial accountability concept. The pilot exercise is foreseen to last throughout 2019 and will be finalised in the first quarter 2020. The main precondition for its success is full commitment of all stakeholders.

During 2018, the preparations for **conducting FMC quality review** on the spot were underway, a special organisational unit within the CHU was established to address this task, the methodology was being prepared and the initial meeting for the first FMC quality review activity at the National Employment Service was organised in July 2019.

The analysis identified the **most significant weaknesses** in the implementation of PIFC in 2018 and **recommendations** were provided for their elimination. A more detailed overview was provided in *Conclusions and recommendations*, and the *Summary* lists the most important ones.

With respect to **establishing the FMC system in line with the COSO framework**, the conclusion is that although a significant number of major and large institutions tend to report on the FMC system and demonstrate compliance with COSO framework, additional prioritising is needed to ensure the focus on the largest (in terms of budget and/or number of employees) and most significant public sector institutions (direct beneficiaries of RS budget).

It is a priority that the PFBs, **which have never done this before**, and belong to the category of direct budget beneficiaries⁵, including the local self-government units and all other PFBs with more than 250 employees, start reporting on their FMC system to the CHU. Heads of these PFBs should invest effort and allocate appropriate resources, primarily in terms of time available to their employees and overall organisation of work, and with the help of methodological guidelines produced by the CHU, ensure regular reporting and fulfil and demonstrate requirements of the COSO framework being applied in their respective organisations.

Additionally, heads of most of public sector institutions in RS, including the group of PFBs which regularly report on the FMC system, should undertake to improve the functions of *risk management* and *monitoring, supervision and evaluation of the FMC system*, through the use of methodological tools provided by the CHU, all of which will, inter alia, contribute to the

⁵ Ministries and MSIOs do report regularly on the FMC system, so the recommendation does not apply to them.

achievement of goals in the organisation. Indirect beneficiaries and local self-government units (hereinafter referred to as: LSU) are the categories which record the lowest scores in the public sector and therefore require not only higher involvement of their managers in ensuring the development of the FMC system, but also additional support through specialised materials and working with these groups of PFBs, with the cooperation of the CHU, PFBs, relevant ministries and donor community.

The overall conclusion about the establishment of **internal audit** in the public sector in RS is that given the existing circumstances, the level of development of internal audit is satisfactory, however, significant improvements are needed in order to state that the establishment of internal audit function is at an optimal level. Even though the development of internal audit function is visible, the main cause of slow development still remains and this is the lack of capacities, that is, the insufficient number of staff working on internal audit tasks in PFBs.

Significant percentage of established internal audit functions with two or fewer internal auditors raises doubt on whether the internal audit standards can be fully complied with. The CHU should, within the existing regulations, review and consider the changes in criteria for establishing the internal audit functions and internal audit units in PFBs, in order to ensure the optimal number of required auditors, improve the quality of work and compliance with the internal audit standards.

The high-priority categories of PFBs which should immediately fill in their IA units if they have failed to do so by now are as follows: ministries, direct beneficiaries of RS budget whose area of competence covers indirect beneficiaries, cities and all other PFBs with more than 250 employees. Additionally, all heads of PFBs with an IA function in place should continuously ensure the appropriate implementation of IA recommendations, ensure the independence of IA by not having the auditors perform other tasks and duties which may ultimately become subject to audit, and ensure professional development of internal auditors.

The implementation of these recommendations addressed to the heads of PFBs will not only constitute the fulfilment of a legal obligation, but will also contribute to better business operations, taking into account that FMC and IA were originally designed as the main support to managers for achieving good governance.

The analysis has identified the findings and specific weaknesses whose elimination will be incorporated in the operational planning of the CHU. The priority remains further work on improving methodological guidelines and tools, particularly in the areas where weaknesses were identified. As significant training needs were recognised, the transition should be made from the organisation of trainings to the development of e-learning materials in order to make expertise available. This would require significant technical assistance provided through the donor community support.

The CHU should continue its work on shifting its focus from the organisation of trainings to establishing methodological tools and knowledge products, and the priority in the forthcoming

period will be the implementation of the Pilot project on managerial accountability and performing FMC quality review at PFBs.

The overall conclusion suggests that even though PIFC was introduced as an obligation through the regulatory framework, its full implementation is yet to be achieved and further work is still necessary for the improvement of this area.

I INTRODUCTION

1. Purpose and objective

The purpose of the report is to present the information gathered about the progress and results achieved by public fund beneficiaries in the process of introduction, development and strengthening of the financial management and control system and internal audit function, and the objective of the report is to highlight both the strengths and weaknesses of the system, but also to provide recommendations for its further development and improvement.

2. Mode and methodology for the preparation of the Consolidated Annual Report

Consolidated Annual Report on the Status of Public Internal Financial Control in the Republic of Serbia in 2018 was prepared based on individual annual reports of PFBs on the appropriateness and functioning of the financial management and control system and internal audit work in the course of 2018.

Article 83 of the Budget System Law⁶ prescribes that the Central Harmonisation Unit in the framework of the Ministry of Finance consolidates individual annual reports of public fund beneficiaries on the status of financial management and control and internal audit and that the minister of finance submits the consolidated annual report to the Government. By-laws in this area stipulate that reporting is done by means of responding to the questionnaire prepared by the CHU.

In line with the provisions referred to above, the CHU developed the questionnaire forms for the preparation of annual reports of public fund beneficiaries on the FMC system and conducted audits and internal audit activities in the course of 2018, all of which were published on the web site of the Ministry of Finance - CHU – Reporting forms (www.mfin.gov.rs).

The questionnaire forms were developed based on the model questionnaire used in the EU member states for these purposes. The questionnaires for the previous year 2017 underwent major changes compared to previous years, aiming to provide a more comprehensive and insightful overview of the status and the development of internal controls in the public sector in RS. The questionnaire was then amended to include additional 25 questions which constituted a significant shift in focus, which was reflected in the scores obtained. During 2018, 4 new questions were added and one was eliminated. When providing an affirmative response, the beneficiaries need to provide a specific piece of evidence (the document, reference number, date...) to support the respective statement, while in case of a negative response, the explanation is required. Regarding the form of annual IA report for 2018, an additional section

⁶ („Official Gazette of RS”, no. 54/09, 73/10, 101/10, 101/11, 93/12, 62/13, 63/13-corrig., 108/13, 142/14, 68/15-other law, 103/15, 99/16, 113/2017, 95/2018 and 31/2019)

was introduced for internal auditors to provide an opinion on the established level of financial management and control in the reporting period, based on conducted audits.

The CHU will continue its work, with the support of SIGMA experts, on further development of the questionnaires, as the basis for the overall system of reporting on the internal control system, so that the level of achievement of overall EC requirements in the area of PIFC could be better presented through the Consolidated Annual Report.

In addition to being an important tool for collecting data on FMC and IA systems in PFBs, the questionnaire contributes to further development of FMC and IA in public sector organisations, as its questions constitute a genuine roadmap towards a desired status.

Similar to the previous years, all duly prepared and timely submitted reports of public fund beneficiaries have been included in the Consolidated Annual Report, whereas incomplete, unfilled and untimely submitted reports have not been subject to further analysis.

The categories of public fund beneficiaries were designated in line with the BSL, the List of public fund beneficiaries in RS published by the Treasury Administration, and in line with the requirements referred to in Chapter 32 – Financial control, stating that in the area of public internal financial control, Serbia needs to implement the legislation, underlying policies and ensure sufficient administrative capacities at the central and local level, in social insurance funds and state-owned enterprises. The categories of public fund beneficiaries have been classified in the manner referred to in Table 1 below.

Table 1. Overview of public fund beneficiaries per categories

Classification of public fund beneficiaries per categories		
Central/ Republic level	Ministries	Ministries of RS
	Mandatory Social Insurance Organisations (MSIO)	Republic pension and disability insurance fund, Military social insurance fund, Republic health insurance fund and National employment service
	Other direct budget beneficiaries	Administrations, agencies, funds, judicial bodies, offices, services... This group includes Government services and offices and special organisations, as well as independent and autonomous state authorities.
	Public enterprises at the central level	Public enterprises, companies, limited liability companies, joint-stock companies, institutions founded by RS
Local level	Direct budget beneficiaries (LSU)	Local self-government bodies and services
	Public enterprises/public utility companies founded by local self-government	Public enterprises, public utility companies, companies, limited liability companies, joint-stock companies, agencies, funds and institutions founded by local self-government
Indirect budget beneficiaries		Indirect budget beneficiaries at the central and local level (schools, faculties, healthcare institutions, nursery schools, culture institutions, local community centres...)

All indicators for 2018 have been presented following the specified categories. The comparative overviews were provided where feasible, in terms of uniform work methodology and the type of data being compared. Target values were formulated for the analysis of average scores of individual elements of COSO framework. Where appropriate, in the parts of the report referring to the scope of reporting on the FMC system and the establishment of the IA function, as a part relating to the quantitative analysis of open-ended responses, the categories of groups of PFBs were presented in accordance with the requirements of Chapter 32, and also additional in-depth analyses were performed in which the category of *Other direct budget beneficiaries* was further broken down according to the reporting lines and the type of business activity.

In addition to the consolidation of individual PFB reports, the Consolidated Annual Report is further enhanced by the analyses of the State Audit Institution (hereinafter referred to as: SAI) and Budget Inspection (hereinafter referred to as: BI), which test the implementation of the FMC system from their respective viewpoints and contribute to the comprehensive overview of the status of internal financial controls in RS.

Also, the Consolidated Annual Report provides the information about the follow-up on the recommendations from the 2019 EC Progress Report on the process of EU accession, which refers to the results achieved in the course of 2018, and also the follow-up on the recommendations from the previous Consolidated report for 2017. The Report also provides information on the execution of the PIFC Strategy and the latest Action plan for 2019-2020 from the PIFC Development Strategy.

II PUBLIC INTERNAL FINANCIAL CONTROL SYSTEM

PIFC concept⁷ was developed by EC in order to assist the candidate countries in the reform of their internal control systems and management of public funds (national and EU funds), by using the international standards and best EU practices. In accordance with internationally accepted EU standards and recommendations, PIFC implies *a comprehensive system established for the purpose of managing, controlling, auditing and reporting on the use of national and EU funds*. This system encompasses sound financial management, financial and other controls which enable lawful, economical, efficient and effective execution of business processes.

Implementation of PIFC is a benchmark for closing the Negotiation Chapter 32 – Financial control.⁸

Budget System Law defines PIFC as a comprehensive system of measures for management and control of public revenues, expenditures, assets and liabilities established by the Government through public sector organisations in order to ensure that the management and control of public funds, including foreign funds, comply with the regulations, budget and principles of sound financial management, that is, the principles of economy, efficiency, effectiveness and openness.

PIFC system consists of the following interrelated areas:

- financial management and control in public fund beneficiaries, based on managerial accountability;
- decentralised internal audit by the public fund beneficiaries;
- harmonisation and coordination of financial management and control and internal audit performed by the Ministry of Finance – the CHU.

PIFC system is primarily based upon the managerial accountability, defined by the Budget System Law as the obligation of managers at all levels in public fund beneficiaries to perform all operating activities in a lawful manner, by adhering to the principles of economy, effectiveness, efficiency and openness to public, and to be accountable for their decisions, actions and results to the person or authority who appointed them or delegated such responsibility upon them.

The existing legal framework in the Republic of Serbia is based on the international internal control standards. *FMC Rulebook*⁹ states that the elements of the financial management and

⁷ Public Internal Financial Control

⁸ Negotiating chapter 32 – Financial control, covers four main areas: public internal financial control (PIFC), external audit, protection of the EU's financial interests and the protection of the euro against counterfeiting. For more information about chapter 32, see *Annex 2*

⁹ Rulebook on common criteria and standards for establishment, functioning and reporting on the financial management and control system in the public sector

control system are defined in accordance with the international internal control standards, in relation to standards harmonised with the Guidelines for Internal Control Standards for the Public Sector, developed by International Organisation of Supreme Audit Institutions (INTOSAI) and COSO framework.

Also, *IA Rulebook*¹⁰ prescribes the obligation for complying with the international internal audit standards (International Standards for the Professional Practice of Internal Auditing of the Institute of Internal Auditors). The regulations governing the PIFC area are listed in *Annex I*.

1. FINANCIAL MANAGEMENT AND CONTROL

1.1. Concept and definition

Budget System Law and FMC Rulebook define financial management and control as a system of policies, procedures and activities established, maintained and regularly updated by the head of the organisation, which on the grounds of risk management provides reasonable assurance that the organisation's objectives will be achieved in a lawful, economical, efficient and effective manner by:

- 1) operating in line with the regulations, internal by-laws and contracts;
- 2) completeness, reality and integrity of financial and business reports;
- 3) economical, efficient and effective utilisation of assets;
- 4) safeguarding of assets and data (information).

FMC system includes, in accordance with the above regulations, the following interrelated elements, defined in line with the international standards of internal control:

- 1) control environment;
- 2) risk management;
- 3) control activities;
- 4) information and communication;
- 5) monitoring, supervision and evaluation of the system.

Head of a public fund beneficiary is responsible for the implementation and proper functioning of the FMC system within the organisation under his/her management. FMC system is based upon the managerial accountability of managers at all levels. Therefore, this system assists managers in performing their daily tasks and supports the organisation in achieving its objectives by conducting the operating activities which are lawful, economical, efficient, effective and transparent.

¹⁰ Rulebook on common criteria for organisation and standards and methodological instructions for internal audit acting and reporting in the public sector

1.2. FMC Progress report

An integral part of annual reports submitted by public fund beneficiaries is also the questionnaire on self-assessment of the internal control system, aiming to assess the current status and undertake measures for its improvement.

The results of the questionnaire are the basis for the assessment of the FMC system at a specific public fund beneficiary for the year covered by the report and constitute a basis for undertaking measures for its improvement. The questionnaire reflects the desired status and enables PFBs to monitor their progress over time.

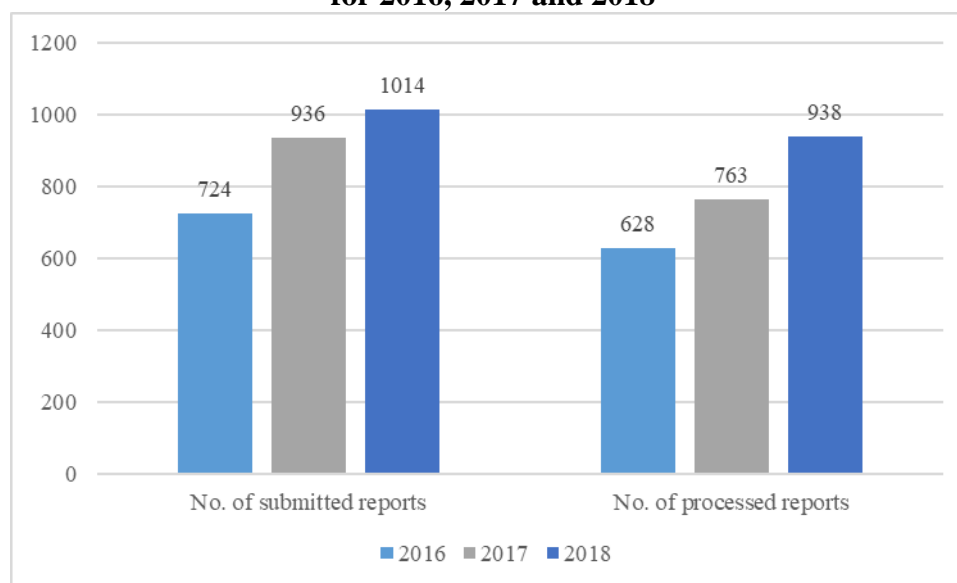
The analysis of FMC progress reports submitted by PFBs starts with the information on the scope of reporting to the CHU.

This is followed by the trend analysis, an in-depth analysis per COSO elements, analysis of issues, comments and suggestions provided by different categories of PFBs, and a brief overview of the managerial accountability concept based on responses provided by PFBs.

1.2.1. Scope of submitted reports

For the year 2018, a total of 1,014 public fund beneficiaries (in tables below referred to as: PFBs) submitted the annual report on the FMC system to the Ministry of Finance - the CHU, which is an **increase** of 8% when compared to 2017, when the number of submitted reports was 936. Of all the submitted reports, the Consolidated report included a total of 938 properly completed reports, which is **19% more** than in the previous year (763), while the remaining reports were either incomplete, unfilled or untimely and as such were not subject to analysis (Graph 1).

Graph 1. Comparative overview of the number of submitted reports on the FMC system for 2016, 2017 and 2018



Total expenditures and outflows of all direct budget beneficiaries (ministries, administrations, judicial bodies, budget funds, directorates, offices, agencies, institutes, services...) included in the Consolidated Annual Report for 2018, account for nearly 86% of total expenditures and outflows of the budget of the Republic of Serbia for 2018¹¹.

Table 2. Overview of the submitted reports per categories of public fund beneficiaries, as required by the Chapter 32.

Categories of PFBs	Percentage of submitted reports	Number of submitted reports
Ministries	100%	18
MSIO	100%	4
Independent and autonomous state authorities	86%	6
Government services and offices and special organisations	74%	26
Judicial bodies (direct budget beneficiaries)	83%	10
Institutions of Autonomous Province Vojvodina	88%	23
Cities¹²	68%	19
Municipalities¹³	55%	65
Public enterprises at the central level	78%	29
PE/PUC at the local level	30%	157

¹¹ The scope of Consolidated annual report was calculated based on the data referred to in Article 8 of the Law on Budget of the Republic of Serbia for 2018 („Official Gazette of RS”, no. 113/17)

¹² Excluding the LSUs from the territory of Kosovo and Metohija. As the LSUs from the territory of Kosovo and Methodija have been operating in difficult conditions and specific circumstances since 1999, their operating methods are regulated with separate provisions and specific organisation methods. Based on this, the LSUs from the territory of Kosovo and Metohija were unable to submit their annual FMC reports.

¹³ *ibid*

High level of reporting in the category of direct budget beneficiaries at the central level of RS (ministries, MSIO, independent and autonomous state authorities, Government services and offices and special organisations, as well as judicial bodies) indicates that the most relevant institutions in RS do report on the improvement of the FMC system.

Cities that submitted the FMC report are responsible for 91% of the total budget for cities¹⁴, while the municipalities that submitted the FMC report are responsible for 55% of the total budget for municipalities. Most authorities and services of local self-governments (LSUs), including the biggest and most relevant ones, do report about the FMC system.

Public enterprises and companies at the central level of RS that submitted the FMC report are responsible for 99% of total revenues in the public enterprise group, while the PEs/PUCs at the local level that submitted the FMC report are responsible for 78% of the total budget of all PEs/PUCs at the local level.

The largest and most important enterprises at both the central and local level in RS are covered by the FMC system and have regular monitoring and reporting on its functioning in place.

484 institutions from the category of **indirect beneficiaries** of public funds submitted the report on the FMC system, which is a half of the total number of submitted reports. However, considering the high number of indirect beneficiaries, the direct beneficiaries have demonstrated significantly broader scope of reporting. Although the category of indirect beneficiaries includes a number of large organisations, majority of them are small organisations with limited budgets and staff, so their contribution to the assessment of the PIFC system in RS is insignificant. In the incoming period, the CHU will reconsider in what ways to approach the FMC development in this category of beneficiaries.

The data suggest that the largest and most important public sector institutions in Serbia do for the most part report on their respective FMC systems, however, the CHU would need to further develop a tailor-made approach to this group, with clear priorities in mind.

1.2.2. Comparative overview per years

Analysis of trends in average scores per COSO framework is made more perplexing due to the changes in the sets of questions each year and the sample of institutions which are subject to statistical processing, as a new group of institutions has emerged. The number of public fund beneficiaries that submit the report on financial management and control is on a constant rise, with indirect budget beneficiaries dominating the rise (63% of the new PFBs in 2018). These beneficiaries, which are just starting out with the process of establishing the financial management and control and internal audit, tend to be quite modest, in terms of their organisational structure and number of employees, and also insufficiently informed and trained.

¹⁴ City of Belgrade that submitted the FMC report covers almost a third of the total budget of local authorities (28,20%)

These beneficiaries have joined with considerable delay the group that already reports to the CHU and this is why the trend analysis within the same group of PFBs is presented in more detail for the last two years, with additional alignment of questions. This method enables drawing conclusions on the progress made in the FMC system in PFBs.

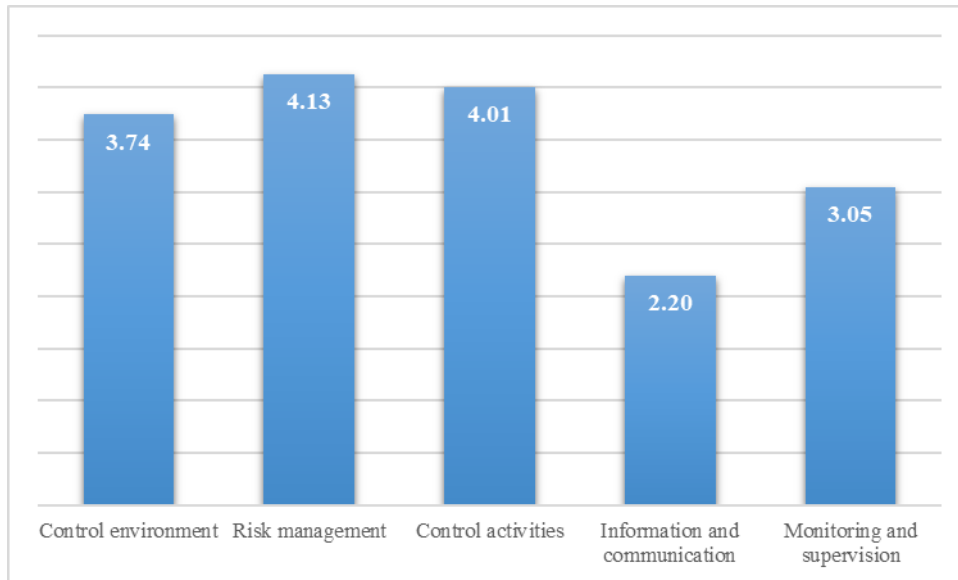
The methodology for analysis of average scores was applied for the same sample of PFBs for 2018 and 2017, with the questions being previously aligned.

The analysis of average scores was done separately for the “new” beneficiaries, that is, the beneficiaries that have submitted the FMC report for the first time, and the scores were compared to the group that regularly reports.

The increase in scores of different aspects of the FMC system in an organisation, in addition to the standards mechanisms from COSO elements monitoring and evaluation (internal and external audit, self-assessment, reporting internal control weaknesses by the employees), is affected by several factors: the base level of the FMC system defines the possibility for further improvement – high base level limits the possibility for further improvement; awareness of staff and managers of the concepts and their thorough understanding of FMC; response trend – increased or lowered criticism; method of implementation and added value that the internal control concept achieves in an organisation; quality and clarity of the questionnaire; familiarity of employees with the questionnaire which leads to better understanding of the underlying idea of the questions; all the way to the factors relating to regulatory changes affecting overall operating activities and changes in management.

Some of these factors contribute to the rise in average scores, and some to their decline. Considering all of the above and the pace of development provided by the CHU, including the scope of external and internal audits so far, minor progress in FMC elements can be expected, followed by occasional lower-scale variations.

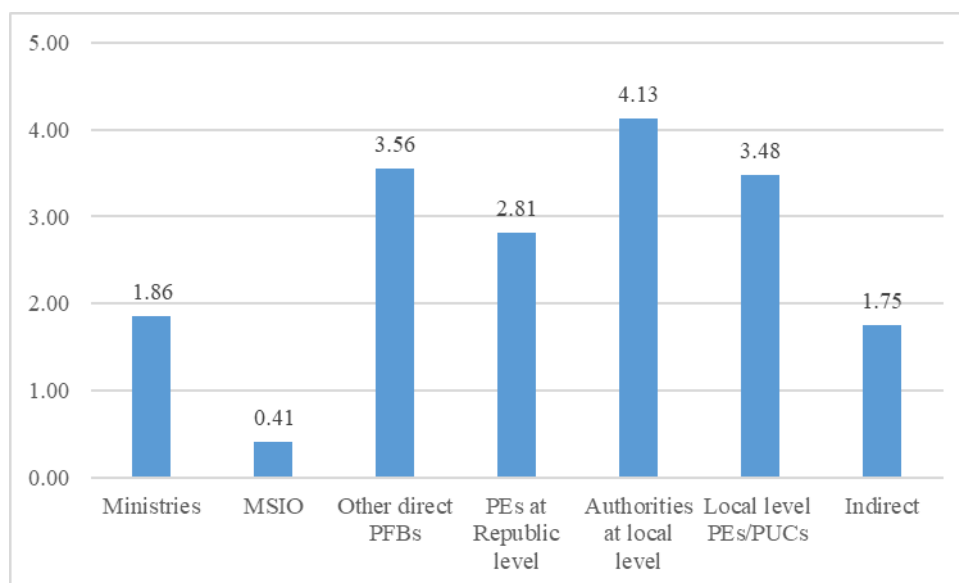
Graph 2. Percentage of average increase in elements of COSO framework for aligned samples of PFBs, per individual COSO elements



If we observe the **elements of COSO framework**, the lowest increase of 2.2% was recorded in the area of information and communication which is the best assessed COSO category, while the highest increase of 4.13% was recorded in the risk management category.

With respect to **categories of PFBs**, limited progress is visible, the highest one of 4.13% in the category of local self-government, while the lowest progress is seen in the category of MSIO (progress of 0.41% compared to 2017, which is understandable due to excellent scores that this group normally records). Graph 3 displays the percentage of average increase per categories of PFBs.

Graph 3. Percentage of average increase in 2018 compared to 2017, per categories of PFBs

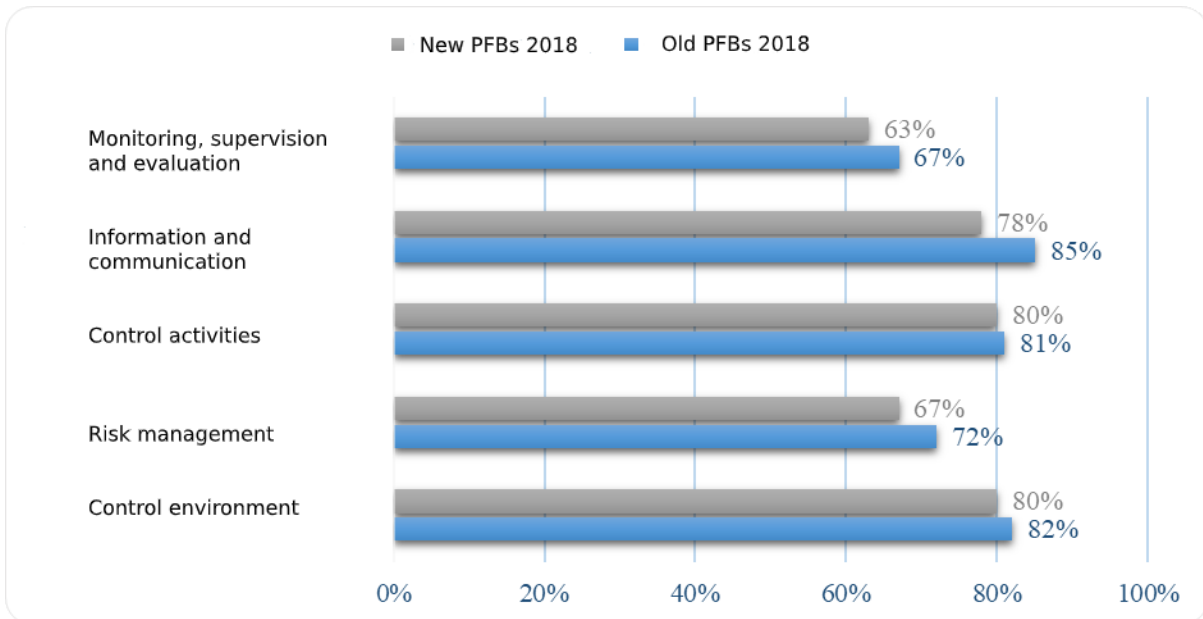


The results suggest that the most important aspect was the existing level of FMC, especially in cases of relatively weak progress in the areas where the existing FMC status is solid. This applies also to the weak progress recorded in MSIO – otherwise considered as the best category of PFBs, and *information and communication* area which is normally the best assessed COSO category.

Relatively insignificant progress in the category of indirect beneficiaries, despite being the weakest group of beneficiaries in the last year report as well, indicates an overall conclusion that this is a weak and neglected category of PFBs.

New beneficiaries (174 of them that have submitted the FMC report for the first time this year) recorded lower average scores by 2% in average, compared to old beneficiaries and based on comparable categories.

Graph 4: Comparison between old and new beneficiaries that submitted the FMC report



From the group of PFBs that submitted the report for the first time in 2018, authorities and services of the local self-governments (LSUs) recorded a considerably lower result than other groups (their average for all elements of COSO was 66%).

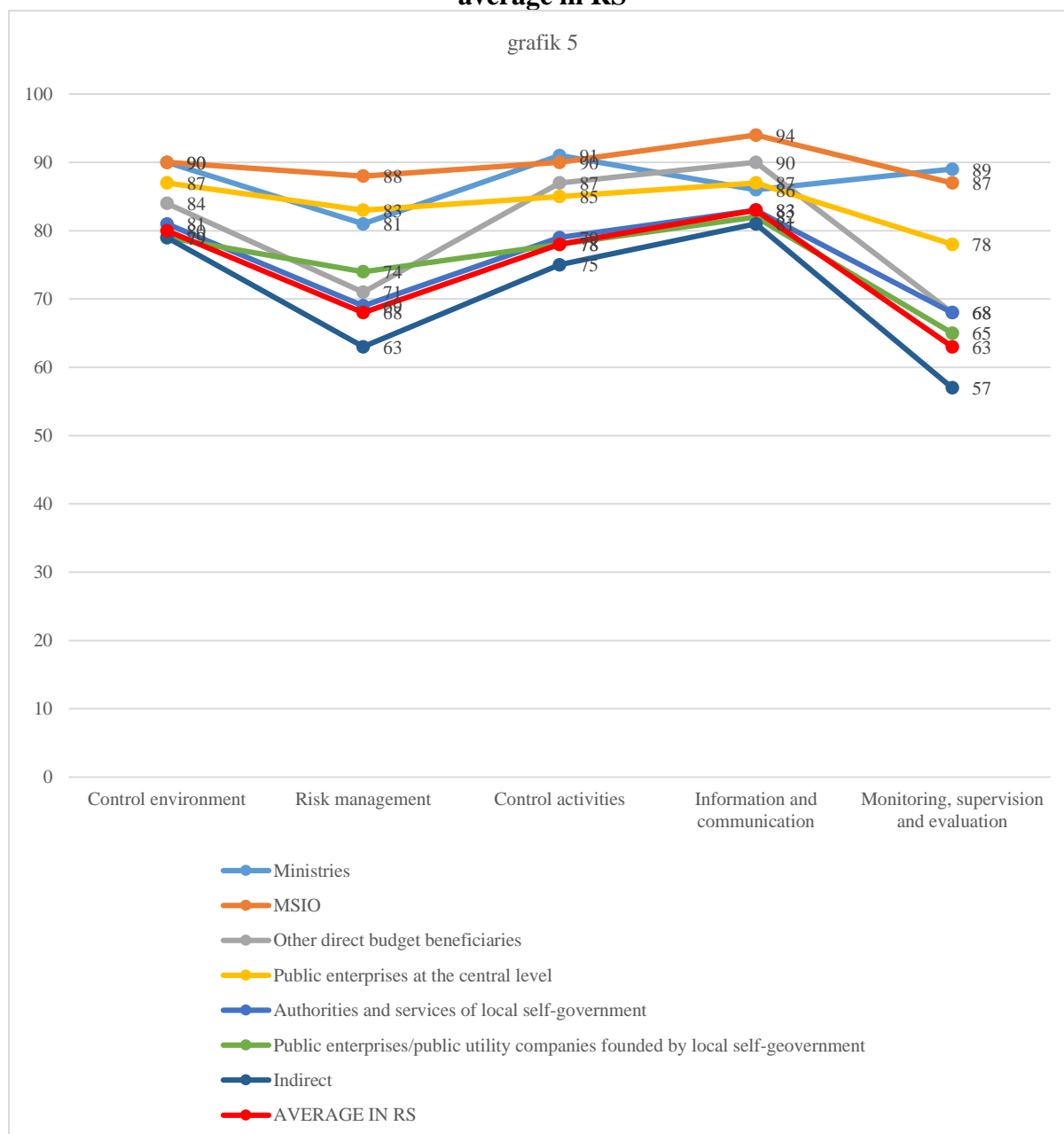
The analysis of average scores for the same group of PFBs for 2017 and 2018, with previously aligned questions, indicated minor variations with a growth tendency, as expected. The most influential factor for the increase of scores in the assessment of the FMC system was the base level of the FMC system: biggest progress was identified in the area which recorded lower scores in the previous year (risk management), and the lowest progress was seen in the area of information and communication, which recorded solid average scores in the previous year.

Similarly, categories of beneficiaries that recorded better average scores in the previous year, made less substantial progress this year (e.g. MSIO). An exception is the group of indirect beneficiaries that demonstrated relatively weak progress in 2018, although they were identified in the 2017 Report as the group of beneficiaries with the lowest average scores. This leads to an overall conclusion that this is a weak and neglected category of PFBs. Beneficiaries that have submitted their reports for the first time recorded the average scores which are 2% lower in average compared to the group of beneficiaries that regularly submit the reports. The group of new beneficiaries also includes the group of authorities and services of local self-governments (LSUs) that have recorded the lowest average scores.

1.2.3. Self-assessment – COSO framework

Graph 5 shows a detailed overview of the assessment of individual elements of the FMC system for 2018, per average scores of individual categories of PFBs, while the comprehensive tables showing the mean values of scores for each COSO element per categories of PFBs are provided in *Annex 3*. Discussion on the results is shown below. The brackets show the average scores for a specific group or groups of PFBs being analysed. In order to facilitate the process of drawing conclusions, each COSO element has a set target value covering the same range as the scores that the PFBs were assigning to the questions (range from 1 to 5).

Graph 5. Assessment of individual FMC elements, percentage of scores compared to the average in RS



1) **Control environment** sets the „tone” in the organisation and influences the staff awareness of the controls. It constitutes a basis for all other components of internal control, thus ensuring discipline and structure. Control environment factors include integrity, ethical values and expertise of employees in the organisation, philosophy and work style of the management, the manner in which the management delegates authority, responsibility, establishes appropriate reporting lines, and organises and promotes the staff. Control environment is a fundamental COSO element and is interrelated to all other elements.

Considering the significance of *control environment*, a high target value was set: **4**.

Compared to other COSO elements, control environment is ranked second in terms of scores obtained, with the least variations in responses of different groups of PFBs.

Set of questions reaching the target value:

- The best result at the level of RS was achieved in the area of *establishing the levels of skills and competencies necessary for each job post* (4.87), the same as the previous year. This is followed by the exceptionally high score (4.82) relating to *detailed description of tasks, responsibilities and authorities for each job post*. A common ground for these questions is that they are both covered by the rulebooks on internal organisation and systematisation of job posts.
- At the level of RS, the key aspects of control environment, such as *defined mission and vision* (4.50), *adopted strategic goals* (4.36), *annual work programmes* (4.62) and their *link with objectives* (4.56) and *regular updating of organisational structure* (4.28), have recorded high average scores. This has been a continuous trend for the last several years.
- Set of questions relating to *integrity and ethical values* recorded high scores in all central government institutions:
 - ✓ Code of conduct at the level of institution (4.59),
 - ✓ Staff awareness of the code of conduct (4.64),
 - ✓ Obligation to act in accordance with the code of conduct (4.75),
 - ✓ Measures undertaken in cases of non-compliance with the code - reached the target value at the central level only (4.68),
 - ✓ Rules in place which define the potential conflicts of interest and the manner of responding – also the question where only central level institutions reached the target value, with the average score of 4.53.

The best scores are recorded in the category MSIO (average score 5.00 for all questions relating to ethical values). Authorities and services of local self-governments also have scores exceeding the target values for the first three questions. Indirect beneficiaries have assessed all the questions from this group, except for the last one relating to the rules in place for conflicts of interest, with the scores exceeding the target value.

- Except for the authorities and services of local self-governments (LSUs), all other groups of beneficiaries do exceed the target value regarding the *adopted annual work*

programmes (4.62). This question also records high scores by PEs from the central (4.93) and local level (4.96).

- Set of questions relating to *human resource management: adopted HR policy* somewhat exceeds the target value among the institutions at the central level (all except for PUCs), and authorities and services of local self-governments (LSUs). In institutions at the central level, *monitoring of HR policy is satisfactory*, and the questions relating to *training and development of employees* (conducting training needs assessment and maintaining record on trainings) also exceed the target value.
- *Managers are convinced that the risk management processes, control activities and internal audits are useful*, that is, *contributing significantly to the achievement of goals* exceeds the target value in all categories of PFBs except for the category of indirect beneficiaries.

Set of questions failing to reach the target value:

- Target value was not reached by some of the questions in the area of human resource management, and specifically the ones about the capacities of employees. The lowest average score at the level of RS relates to *the criteria for establishing the HR policy efficiency* (3.19), which is the same as in the previous period, yet with a mild increase compared to 2017. This question in all categories of PFBs consistently recorded the lower score than the rest – below 4 for each of the categories. The lowest score was seen in PEs/PUCs founded by local self-government (2.66). The result somewhat below the target value was recorded for the question about *the HR policy* (3.88) by PEs/PUCs at the central and local level and among indirect beneficiaries, including the question on *monitoring of HR policy* (3.92) for which all beneficiaries at the local level and indirect beneficiaries failed to reach the target value. For the questions relating to *training and development of employees* (conducting training needs assessment and maintaining record on trainings), both categories of PFBs at the local level and indirect beneficiaries have failed to reach the target value.
- The second lowest score (3.27) was recorded for attendance to *FMC training* by the managers and staff responsible for financial management and control affairs.
- Except for the ministries, not a single group of PFBs is reaching the target value for the questions on conducting an *FMC training needs analysis* and *attendance to FMC training* by the managers and staff responsible for financial management and control affairs. Indirect PFBs have recorded average score of even below 3 for these questions.
- In indirect PFBs, the question relating to the managers being convinced that the risk management processes, control activities and internal audits are useful, that is, *contributing significantly to the achievement of goals*, fails to reach the target value.
- For the question relating to *adopted annual work programme*, the lowest scores were recorded by the authorities and services of local self-governments – the only group with the scores below the target value regarding the annual work programmes and their linkage to the objectives of organisation (3.87).
- Scores of PEs/PUCs at the local level are somewhat below the target value for the whole group of questions relating to *ethics*. Failing to meet the target value is most visible in the category of PFBs founded by local self-government – all the questions relating to

ethics have the average score less than 4. Low scoring is also noted in case of authorities and services of local self-governments in relation to the questions on measures undertaken in cases of non-compliance with the code (3.93) and the rules to prevent the potential conflicts of interest (3.83). This is the only question from the ethics and integrity area where indirect beneficiaries also failed to achieve the target value (3.69).

- The question relating to the obligation of regular reporting on financial management and control and internal audit in an organisation reached the target level only in the category of ministries, MSIO and PEs at the central level, whereas in all other groups of beneficiaries, the question recorded the score which was lower than foreseen by the target value. This question recorded significant progress (by 9.59%) compared to 2017 in the group of beneficiaries that submitted the report for both years.

If we link the question relating to *adoption of strategic objectives* to the question from COSO element *risk management* about the *adoption of operational objectives*, it is visible that somewhat better scores were recorded for the adoption of operational objectives than for the strategic ones, specifically in MSIO and other direct budget beneficiaries at the central level. MSIOs and many institutions that belong to the category of direct budget beneficiaries are focused on operational aspects. Ministries and PEs at the central level have entirely balanced scoring for these two questions – the average score for the question on strategic objectives is the same as for the question on operational objectives. Both groups of PFBs at the local level and a large group of indirect beneficiaries have recorded slightly better scores regarding the strategic objectives, which comes as no surprise – many of these institutions are unable to have strategic objectives in place. This issue can also be linked to the suggestions provided by a number of institutions that are “more operational ones”, yet belong to the group of direct and indirect budget beneficiaries, that the question about the strategic objectives should be tailored to suit their operating environment, as strategic objectives are (normally) defined by the relevant ministry, that is, the respective direct budget beneficiary.

As linking the strategic and operational objectives is important for the organisation, assessing the actual state of play in this respect should be one of the priorities of the new FMC quality review function.

When directly comparing the area of control environment, the central level (4.40) recorded a better overall average score than the local level (4.00) and indirect budget beneficiaries (3.94).

The best scores were recorded in the areas which are regulated in detail through high-level legal acts, which corresponds the tradition of functioning of the public sector. The act on systematisation is a document whose preparation is regulated in detail through high-level legal acts and is subject to approval and review by the expert services/superior organisations.

Good scores of PEs both at the central (4.93) and local level (4.96) relating to the existence of work programmes may be attributed to the obligation of this type of institutions to prepare

work programmes, which has been stipulated by high-level regulations for many years now and applied in practice.

Key aspects of control environment were scored high (mission, vision, objectives, updated organisational structure).

The solid scores for the questions relating to ethics and integrity, with a considerable increase of 7.8% regarding the „most demanding“ question in the area of ethics (rules defining the potential conflicts of interest and the manner of responding) in the same group of organisations that submitted the reports for the previous two years proves that the implementation of anti-corruption regulations in these categories of PFBs, and in particular among ministries and PEs at the central level has intensified.

Responses to the questions relating to the capacities of employees, and especially the question on staff policy and development, can be linked to the findings based on qualitative analysis of open-ended responses: one of the most common responses provided by PFBs was lack of adequate number of staff, or outflow of skilled staff. Insufficient number of adequate staff and inadequate staff policy may be reflected in the achievement of organisational objectives. It was found that this issue needs to be further explored in subsequent versions of the questionnaire, through additional questions.

Low scores for the questions on attending the FMC training by managers and persons responsible for FMC and conducting FMC training needs assessment correlate with the major needs for training and acquiring knowledge in the FMC area, as registered in the qualitative analysis of responses to open-ended questions. The existing trainings have had a considerable effect as 70% of the institutions whose representatives attended the FMC trainings during 2018 have submitted their reports for the first time.

The FMC Manual, which was prepared by the CHU and is the relevant reference material in the area for the public sector in the Republic of Serbia, was used by only 39% of indirect PFBs and managers of these institutions tend to assess the benefits of internal controls, risk management and internal audit for the achievement of objectives less than all other PFBs.

Possible causes may be insufficient awareness, lack of information or interest of the management of these PFBs, however, the capacities of the CHU for organising trainings remain limited, while at the same time faced with the great needs. The successful implementation of COSO principles requires knowledge of these concepts, acquired either at the trainings or by using the FMC Manual. Low scores for these questions immediately raise doubt as to the quality of the FMC system and its compliance with the COSO framework in the institutions which recorded such results. The score on the managers' assurance that the risk management processes, control activities and internal audits are useful, i.e. contributing significantly to the achievement of goals exceeds the target value in all categories of PFBs, except for the category of indirect beneficiaries.

This demonstrates that there exists awareness of the importance of internal controls in organisations that submit the report, which is foreseen, while in the category of indirect beneficiaries, the cause of bad results may be low awareness of the management of the importance of internal controls, but also the inadequate methodology in use.

Table 1, Annex 3 presents an overview of average scores per each question on the quality of control environment in place.

2) Risk management comprises identification, assessment and control over potential events and situations that may have an adverse effect on realisation of a public fund beneficiary's objectives. A prerequisite for risk management is the establishment of general and specific goals that an organisation has to accomplish. The role of risk management is to provide reasonable assurance that the goals will be achieved. In order to manage the risks, the head of a public fund beneficiary needs to adopt the Risk Management Strategy that needs to be updated every three years, and also in the event of a major change in the control environment. Reducing the risk to an acceptable level requires that a public fund beneficiary analyse and update the controls in place. Good functioning of risk management has a preventive effect on the incurrance of irregularities. Inadequate risk procedures may jeopardise the achievement of organisational objectives, normally by only partial achievement of objectives and/or with delay.

Risk management following the COSO model is a relatively new area in the public sector in Serbia, therefore, the questions are categorised into two groups with different target values: target value 3 for the questions relating to the implementation of tools in the area of risk management, as these tools are rather new in the practical operations of the public sector in RS, and target value 4 for the questions relating to objectives, including the questions that should prove whether the management is addressing the issue of risks. The latter group of questions has higher target value assigned, considering its core relevance for the achievement of organisational objectives.

Given the average scores of different groups of PFBs, risk management is the second weakest COSO area, and the differences in average scores between groups of PFBs are significant.

Set of questions reaching the target value:

Average scores at the level of RS which reach the target value are recorded by most of the questions relating to **objectives**:

- defined and adopted operational goals (4.27),
- link between strategic and operational goals is established in all institutions at the central Republic level (except for MSIOs), as well as in PEs and PUCs at the central and local level,
- objectives are SMART in all categories of PFBs (4.28),
- managers are familiar with objectives (4.28),
- the segment with the best scores is about the revenues and expenditures that are projected and planned in accordance with the organisation's set goals (4.75).

In the group of questions relating to the **use of tools** in the area of risk management, the best scores are recorded in relation to:

- strategy in place (3.58),
- risk register in place (3.26),
- risks linked to key business processes (3.58),
- performing risk assessment (3.44).

These four questions reach the target value in all groups of PFBs, excluding the group of indirect PFBs which is the only one failing to reach the target value for these four questions.

- The questions relating to a responsible person assigned and regular assessment of risks are scored above the target value in the category of ministries, MSIOs and PEs at the central level.

The questions that confirm that **the management is actively addressing risks**:

- Risks are to a sufficient extent, that is, above the target value, discussed at management meetings only in the category of MSIOs and PEs founded by RS
- Managers make decisions aimed at resolving the identified risks above the target value level in ministries, MSIOs and PEs founded by the Republic
- For two important questions, the target value is reached only in the category of MSIO: system in place for reporting to the management on the most significant risks (5.0) and the risks which also include the risks of fraud and corruption.

Set of questions failing to reach the target value:

- In the best assessed category of MSIO, and also the category of authorities and services of local self-governments and the category of indirect budget beneficiaries, the target value is not reached for the question on establishing the link between strategic and operational objectives (average score is nearly 3.75 for each category).
- The questions relating to regular updating of risks and assigning responsible persons for this activity are scored below the target value in the category of other direct beneficiaries, in all institutions at the local level and indirect beneficiaries.
- Managers do not make decisions aimed at resolving the identified risks in line with the target value in the category of other direct beneficiaries at the central and local level (authorities and services of local self-governments), in PEs/PUCs founded by local self-government and particularly low result on this question was recorded among indirect beneficiaries – 2.95.
- Except for the category of MSIO, not a single category reached the target value regarding the reporting to the management on most significant risks and the inclusion of risks of fraud and corruption in overall risks.
- Assigning a person responsible for updating the risk register (2.72) as a new question in the questionnaire, that is, regular updating of the risks (2.76) were given the lowest score at the level of RS. Indirect beneficiaries have not reached the target value for any of the questions relating to the use of tools in the area of risk management.

- The questions that recorded the lowest scores in the category of indirect budget beneficiaries were the one on assigning a person responsible for updating the risk register (2.21), and whether the register is updated in accordance with the needs of the organisation (2.27). Also, the risks of fraud and corruption are insufficiently considered (3.16) when assessing the risks.

Link between strategic and operational objectives is consistently and slightly weaker than the level of their establishment. This can be partly explained with the difficulties in elaboration of strategic objectives, especially among the PFBs that are “more operational”, but nonetheless may indicate certain issues in monitoring of achievement of strategic objectives.

The fact that different target values were set for different categories of questions further proves the identified weaker implementation of tools compared to the elaboration of objectives and management’s dealing with risks.

The questions relating to different aspects of objectives whose elaboration is a pre-requisite for risk management are the best assessed questions in this COSO category. The implementation of tools from risk management area has recorded considerably lower scores. Also, the fact that raises concern is that some core aspects of risk management, such as addressing the risks by the management and risk assessment at management meetings also fail to achieve much higher scores.

Taking into account the preventive function that risk management has in terms of irregularities, the irregularities identified by SAI and Budget Inspection may also indicate that there is inadequate treatment of risks by auditees, that is, risk review.

Low scores indicate that risk management has not yet become embedded in the public sector in RS, as this is the third year in a row with the low scores in this area.

Risk management constitutes an element of COSO framework and specific expertise and experience are required for it to be properly understood and implemented in practice.

Risk management should be a way of thinking and a way of doing business, and in other words, it should be perceived as a constituent part of good governance. Another aspect to be considered is to what extent risk management should be formalised to meet the needs of different types of organisations. So far, the CHU has worked on the improvement of risk management primarily through trainings and consultations and by providing methodological instructions which underwent considerable improvement during 2018 and its full effect is yet to be seen. In the future, work should be done on improving the coverage of trainings (through e-learning) and fine-tuning of methodological instructions to suit different types of PFBs. However, the primary activity would be to identify the causes of low scores on the basis of FMC quality review.

The overview of average scores per individual questions on risk management area is provided in *Table 2, Annex 3*.

3) Control activities include written policies and procedures, set forth to provide reasonable assurance that the risks to achieving the objectives have been brought down to an acceptable level, as defined in the risk management procedures, including their application. They are carried out across the organisation, at all levels and functions by all employees, in accordance with the established business process and a job description. Control activities assist in defining who does what, who is responsible and accountable, and ensure the uniformity of work throughout the organisation. Control activities also provide continuity of business operations and have a decisive impact on effectiveness, efficiency and economy of the way of doing business.

Majority of public fund beneficiaries that regularly submit the annual reports has already passed the first phase, that is, the cycle of initial establishment of financial management and control, so the target value is set at 4.

Control activities are the second best ranked COSO element, with a relatively low variation among the observed groups of PFBs.

Set of questions reaching the target value:

- *Ensuring that only authorised persons are allowed to access the material, financial and other resources* (4.53) is this year again the best assessed question at the level of RS in the category of control activities.
- Part of the questions relating to business processes and work procedures, such as *detailed descriptions, including documentation flow, steps in decision-making, deadlines for task performance and established control mechanisms* (4.07), *detailed description of work procedures* (4.06) and *awareness of managers and employees of the procedures* (4.29) are scored in average above the target value, particularly in the category of institutions at the central level of RS. Followed by slight deviations and a weaker result of indirect beneficiaries and PFBs founded by local self-governments, this has been a continuous trend for the last several years.
- *Establishing the segregation of duties* recorded a high average score (4.20), except for the PFBs founded by LSUs and indirect beneficiaries that recorded somewhat weaker result.
- *Procedures and rules in place which ensure the security of the IT system* (4.16) is an area which is undergoing systemic development and which shows significant room for improvement, so better results are expected in the upcoming period.

Set of questions failing to reach the target value:

- The lowest average score in this COSO category at the level of RS which recorded certain progress, same as in the previous period, is for *the descriptions of control activities in written procedures* (3.61), which may affect the mitigation of risks, which in turn is the purpose of their establishment, and may ultimately affect the achievement

of organisational objectives. Therefore, the question arises as to how these controls are performed if they are not foreseen in procedures – there is no definition of who, what, when and how controls should be performed and how employees could be informed about them. PEs founded by RS have increased their results in 2018, however, the LSUs and indirect beneficiaries have remained below the target value.

- **Regular updating of work procedures and organizational charts** (3.79) scored below the target value primarily due to bad results achieved by the LSUs and indirect beneficiaries, same as in the previous year. Untimely updating of procedures and organisational charts opens the door for risks in cases of certain organisational, technical or legislative changes.
- **Defining responsibilities, authority, deadlines and control mechanisms for individual activities** (3.91) has achieved the score below the target value at the local level and indirect beneficiaries, including **consideration of the risks relating to specific activities in written procedures** (3.77), noting that other direct beneficiaries at the central level also recorded the result below the target value.
- **Establishing segregation of duties** failed to reach the target value in the category of indirect beneficiaries and the category of PUCs at the local level.

The difference in scores is clearly visible between the “stronger” and “weaker” categories of PFBs. Best average scores for control activities were recorded in the categories of ministries (4.67) and MSIO (4.50). It showed that all PFBs at the central level reach the target value, except for 2 critical questions: existence of control activities in procedures and consideration of risks. These two questions recorded the lowest scores compared to other questions in this group of questions by all categories of PFBs. Given the importance of these questions, in the procedure of FMC quality review particular attention should be given to this segment. Link between risks and control activities is essential and low scores for these questions may indicate certain errors in operations, overlapping and inefficiencies (effectiveness, economy, efficiency).

Small organisations have recorded lower scores for these questions. Lower scores for some of the questions are seen in the category of **direct budget beneficiaries at the local level**, while constantly lower results for almost all the questions are recorded by the **PFBs founded by local self-governments** (3.90), and the entire category of indirect budget beneficiaries (3.76). Some of the questions from this segment, e.g. segregation of duties in small organisations, should be better elaborated in methodology.

The size of an organisation proved critical for the implementation of control activities, and one of the possible reasons (not the only one) is insufficient capacities to draft the procedures in small entities.

As the lowest scored questions in the area of control activities are correlated with the size of an organisation, small PFBs **should get support** to clearly define the authorities, responsibilities, deadlines and control mechanisms for individual activities in their

organisations. These should be linked to risks and control activities should be adequately described in written procedures, and subsequently, the PFBs should update their work procedures and organisational charts in a timely manner. In cases with indirect beneficiaries, this activity would require engagement of line ministries, as well. Regardless of whether this relates to the central or local level, the engagement of donor community would be invaluable as donors are an immensely important partner in this activity.

Table 3, Annex 3 provides a detailed overview of average scores for individual questions which are part of assessment of control activities, at the level of RS and the level of individual categories of PFBs.

4) Information and communication system within an organisation/body should provide key support to the managers at all levels in decision making, both at the strategic and operational levels. Reliable information and effective communication are indispensable for the management and control of operations of a public fund beneficiary, so the review of practical functioning of this segment is vital, including the activities aimed at its development. Communication is not an isolated internal control component, but rather affects all aspects of business operations in an organisation and supports the overall internal control system.

Information and communication system was the best assessed element of COSO framework in the questionnaire in 2018, so the target value was set to 4.

Set of questions reaching the target value:

- Same as in 2017, public fund beneficiaries gave the **highest** score in this category of questions to **reports for management regularly prepared** (4.81), immediately followed by **receiving the information on available funds for the realisation of activities within their scope of competence** (4.75);
- **Ensuring the transparency of information** (4.64) illustrated by uploading of the key documents on the web site, which is considered satisfactory in terms of self-assessment for all categories of PFBs, and making **staff members able to report possible irregularities and problems** (4.7) which also recorded a solid score in institutions at all levels;
- **Monitoring of set goals and the implementation of efficient work supervision by the information and communication system** (4.15) reached the target value in almost all PFBs, except in cases of authorities and services of local self-governments;
- **System in place for communication, enabling the staff to receive the information necessary for accomplishing their tasks** (4.35), as one of pre-conditions for successful functioning of an organisation, is at the threshold of the target value in PFBs founded by local self-government;
- **Support to key business processes (finances, procurement, contracting, asset management, monitoring of capital projects, material records, staff, etc.) by IT systems** (4.36) in all PFBs was scored high, and especially in the category of MSIOs (5.0);
- **Continuity of operations regarding the adequate procedures in place in information and communication system for:**

- *copying data in order to save them, and*
- *procedures of data retrieving in case of loss* (4.05), only for direct budget beneficiaries at the local level and indirect beneficiaries, the target value was not reached.

Set of questions failing to reach the target value:

- *Procedure in place for the staff to keep their managers informed of the weaknesses identified during controls* (3.76) for which the entire category of PFBs at the local level, indirect beneficiaries and PEs founded by RS are failing to reach the target value;
- *Process of recording errors or complaints, so that they can be analysed, their reasons established and problems eliminated* (3.78) recorded the average score below the target value for all groups of PFBs, except for MSIO;
- *Testing the procedures in place for copying data in order to save them and procedures of data retrieving in case of loss* (3.8) failed to reach the target value for all PFBs at the local level and indirect beneficiaries (3.4);
- *Adequate communication with external stakeholders on the issues affecting the functioning of other internal control components* (3.85) reached the target value only in categories of MSIO and other direct budget beneficiaries at the central level;
- regarding *software programmes, supporting certain business processes within the organisation* (3.75) we can conclude that even though key processes are supported by IT systems in a satisfactory manner, the IT systems themselves are not sufficiently interrelated. The lowest score was recorded in ministries (2.69), and the target value was reached by all other central categories of PFBs and authorities and services of local self-governments.

It was identified that all the categories of PFBs recorded the average score above the target value regarding the ability of staff to report irregularities and problems. There is also a relatively modest result on the question: *Are there instructions prescribing the actions to be taken and persons to be informed in case of the lack of controls?* These questions treat the concepts of exceptions, internal control weaknesses, irregularities, errors. Common area for all these questions is that they enable the improvement of the internal control system automatically and from “within” through lessons learned from the problems in functioning and these relate to different life stages of the problem in an organisation (before or after the occurrence). It is unusual that the identified inconsistencies in responses are greater than expected. As the questions were designed differently, the FMC quality review should be undertaken to get the real picture of what the actual situation is in the field.

All categories of PFBs gave a high score for the system in place for communication, enabling the staff to receive the information necessary for accomplishing their tasks. Observing the monitoring of set goals and the implementation of efficient work supervision, it was identified that MSIOs that normally represent the best category of PFBs for almost all questions, actually gave the lowest average score for this question (4.00), at the threshold of the target value. This

unexpected finding may be explained with the integration of the new MSIO in the group, as the old group of MSIOs which constituted this category still has the highest score in this respect. Lower average score was recorded by authorities and services of local self-governments, and very near are the PEs/PUCs founded by local self-governments.

Ministries are one of more advanced groups of PFBs, and somewhat weaker average result on the interrelatedness of IT systems may be explained with the purpose of specialised IT systems for key business processes in ministries. IT systems are introduced in ministries for the so-called side functions: financial unit and accounting, registry office, etc. This probably goes for some other groups of beneficiaries, as well, however, these are not clearly shown in the current classification of institutions.

Adequacy of communication with external stakeholders on the issues affecting the functioning of other internal control components was scored above the target value only in MSIO and direct PFBs at the central level. As this question also refers to the situations when it is necessary to obtain all the relevant consents and approvals by the competent institutions, this finding requires further review.

Ensuring the transparency of information illustrated by uploading of the key documents on the web site is considered satisfactory in terms of self-assessment for all categories of PFBs.

Even though the information and communication system has recorded the highest score among the COSO elements for 2018, and considering the scores given for individual categories of PFBs, it can be concluded that there is room for improvement and that PFBs should focus their activities on the preparation of procedures for establishing the *process of recording errors or complaints*, the procedures for *keeping their managers informed of the weaknesses identified during controls*, and that indirect budget beneficiaries and all PFBs at the local level *start implementing the testing of information systems in practice*, in terms of ensuring the availability, integrity and security of the information in an organisation. It is further necessary to improve the level of adequacy of communication with external parties on the issues affecting the functioning of other internal control components in individual categories of PFBs. These are the findings that the CHU should consider in its future work.

Average scores for responses to individual questions within the area of information and communication are provided in **Table 4, Annex 3**.

5) Monitoring (supervision) and evaluation implies introduction of a system for *FMC supervision* through assessing the appropriateness and efficiency of its functioning. Monitoring is a review of activities and transactions in an organisation for assessing the quality of operations (performance) over a period of time and effectiveness of controls. Monitoring assesses the quality and performance of the system (of relevant key performance indicators) over a period of time.

Considering the importance of this area for the self-regulation of the system and all other COSO elements, the target value for the results achieved in 2018 for the category *monitoring and evaluation* is set to 4.

Monitoring (supervision) and evaluation is based on the questionnaire submitted by PFBs, and is a COSO element with the lowest scores in 2018, with the highest range of average values submitted.

Set of questions reaching the target value:

- The best assessed question at the level of RS, the same as last year, is ***implementation of external audit recommendations*** (4.34) and is above the target values for all categories of PFBs, while the ***implementation of internal audit recommendations*** in relevant groups of PFBs which have largely established this function is also assessed with a high score, e.g. in the group of ministries (4.81) and MSIO (5.0);
- ***Monitoring the implementation of external and internal audit recommendations*** (4.17) is scored a bit lower regarding the implementation of external audit recommendations, but still remains high and in accordance with the target value set;
- ***Availability of internal and external audit reports to the staff*** (4.23) scored well in all the categories of PFBs, except for indirect beneficiaries (3.61);
- ***Reporting structure in place enabling objectivity and independence of internal audit*** in a relevant group of PFBs at the central level is on average assessed with a high score (4.41);
- ***Regular monitoring of the achievement of goals*** (4.21) **and** ***analysis of causes of possible departures from the defined organisational goals*** (4.04) on average scored above the target value, with an insignificant underperformance of authorities and services of local self-governments (LSUs) and indirect beneficiaries – the group that otherwise gives lower scores to the questions relating to objectives.

Set of questions failing to reach the target value:

- Three by far the lowest scored questions in this category at the level of RS are the same as last year:
 - ***establishing audit boards*** (1.32).
 - ***undertaking measures in case of failure to perform the activities referred to in the action plan*** (2.61) for the improvement of the FMC system;
 - ***instructions prescribing the actions to be taken and persons to be informed in case of the lack of controls*** (2.82).
- ***Procedures in place, defined and applied, for managers who monitor the implementation of internal controls (self-assessment)*** (2.90) is one of the three new questions in the questionnaire and is the lowest scored among them at the level of RS. The only category that was at the level of the target value is MSIO, while all others fell far below the target value.
- ***Implementation of the monitoring and information system by the top management which enables them to be regularly informed on the functioning of the financial***

management and control system (3.49) has a relatively weak score (only the ministries and MSIOs recorded the result above 4)

- *Monitoring of the realisation of activities from the action plan for the establishment and development of financial management and control* (2.91) scored a low result by all PFBs except for MSIOs (4.25).

When it comes to implementation of internal audit recommendations, the conclusion about this issue should be drawn from the part about recommendations in the chapter about internal audit, as this is the objective assessment, not self-assessment, while the average score in terms of COSO elements is further lowered by the PFBs with no internal audit function in place. Based on the report prepared by auditors and by observing individual categories, a high level of implementation (90%) is seen in the category of MSIO, which confirms high management awareness of the importance and efficiency of internal audit and the quality of its work. Similarly, high percentage is identified in the category of indirect beneficiaries and PEs at the central level. Lower percentage is seen in the category of ministries and at the local self-government level, which may indicate low management awareness of the need for eliminating the deficiencies in work or even inadequate recommendations of internal auditors. On the other hand, in the self-assessment questionnaire, ministries have assessed the implementation of internal audit recommendations with a high score, above the target value (4.81). Based on the reports by internal auditors, the lowest result is recorded in other direct budget beneficiaries at the Republic level, with only 35% of recommendations implemented.

Major differences in responses between different categories of PFBs prove that there are significant dissimilarities in practice arising out of implementation of this COSO component.

In the previous group of questions, the level of support of IT system was identified to be above the target value, therefore enabling the monitoring of set goals and the implementation of efficient work supervision, regular preparation of reports for the management on revenues generated, execution of financial and other plans, available funds, liabilities, etc., and satisfactory reporting to the management on available funds for the realisation of activities. On the other hand, the procedures of monitoring and informing the top management on the FMC system have not been scored in a satisfactory manner (this type of reporting is usually perceived by the PFBs to be reporting on the execution of the Action plan for establishment and development of the FMC system). The process of reporting to the top management on the functioning of the FMC system needs to be improved *by laying down the procedures and their appropriate implementation in practice*, as the submission of timely and adequate reports affects the realistic evaluation of the system and making high-quality strategic decisions.

The central level of PC (3.91) recorded better results in the area of monitoring and evaluation than the local level (3.31) and indirect beneficiaries (2.86). Although being the category of PFBs with the lowest results, the indirect beneficiaries in 2018 made certain progress in this part of COSO framework compared to the previous year. The average score of MSIO in this

area (4.35) is considerably higher than all other categories of PFBs and was the only one to have the maximum score (5.0) for four questions, while not scoring below the target value for any of the questions.

The questions about different aspects of functioning of internal audit (where it is established) and external audit recorded high scores in self-assessment. An objective indicator from the Annual report of the State Audit Institution for 2018 indicates a high level of implementation of external audit recommendations, while looking into the individual work reports of internal audit, no such confirmation was obtained for internal audit. Implementation of internal audit recommendations varies among different categories of PFBs (as referred to in the section on Internal audit reports) – in MSIOs the recommendations are largely implemented which proves high management awareness of the importance and efficiency of internal audit and the quality of its work, while in the categories of PFBs which recorded the lowest scores in this area, such as ministries and other budget beneficiaries at the central level, poor results prove either low management awareness of the importance of IA or poor efficiency or quality of IA. Based on the self-assessment results, managers are generally interested in whether the recommendations are implemented and ensuring that the persons in charge of their implementation in practice are aware of them.

Managers tend to appreciate more the external audit reports, primarily due to the fact that the management awareness of importance of internal audit remains low and that from the managers' perspective (and this was confirmed in practice), relatively speaking, the level of objectivity and independence of external audit is considerably higher with better quality of recommendations. Such an attitude of the management, however, sets the tone throughout the organisation and sends a bad message, affecting the status of internal audit within the organisation.

Regular monitoring of achievement of goals (4.21) and analysis of causes of possible departures from the defined organisational goals (4.04) recorded solid scores. Considering the importance of this mechanism, it would be necessary to further explore what good practices and tools are being used by the PFBs so that these could be potentially recommended to others as well.

Although scored low, establishing of audit boards has started to roll out, yet insufficiently to impact the statistical measure.

All other questions, however, which could substantially contribute to the achievement of standards in terms of monitoring and supervision, except for the ones relating to audit, recorded the scores below the target value. Considering that ***internal audit*** as self-regulating mechanism is currently insufficiently established in PFBs, that the ***procedure in place for conducting self-assessment*** recorded a relatively low score, including the insufficient scores for the questions on ***mechanisms for informing the management on the status of internal controls***, and the ***lack of procedure which would regulate reporting on the lack of controls***, it **may be concluded** that this area requires further intensive work.

The overview of average score per individual questions in the area of monitoring, supervision and evaluation is provided in *Table 5, Annex 3*.

1.3. Key issues and weaknesses in establishing and development of financial management and control system and proposed activities for systemic improvement of internal controls, per categories of beneficiaries

An integral part of the annual report on the FMC system submitted by PFBs, in addition to the questionnaire for the self-assessment of internal control in accordance with the elements of COSO framework, is also the narrative part of the report with open-ended questions. In order to demonstrate the existing key issues in as much detail as possible, this part of report grew in size over the years.

In this respect, the report for 2017 included the additional narrative part on planned activities by PFBs and proposed topics for training in the area of FMC, while the report for 2018 was made more comprehensive and included the sections for:

- 1) key issues and weaknesses in establishing and development of financial management and control system (according to individual COSO elements, according to individual business processes and activities, etc.);
- 2) proposed activities for systemic improvement of internal controls (e.g. amending regulations, drafting of instructions and tools, changes in reporting arrangements).

Statistical data in itself is not sufficient to provide a clear and realistic overview of the status of the FMC system in the public sector in Serbia. A qualitative analysis of open-ended questions has therefore been conducted this year for over 200 reports from the central and local level, across all categories of PFBs.

The results obtained based on the analysis of open-ended questions were used to further support the conclusions and also provided a useful insight into and proposals of PFBs for future planning of CHU activities towards the improvement of the FMC system. At the same time, this kind of analysis can be seen as the preparatory work for the forthcoming FMC quality review to be done by the CHU.

The analysis first provides the overview of cross-cutting observations recorded in all groups of beneficiaries, followed by an overview per specific categories of PFBs, with a more detailed analysis. If relevant and in order to facilitate the understanding of the context, comments and suggestions provided by PFBs are supported with the results of their self-assessment of COSO elements. The CHU will include some of the suggestions into its work plans, while some of the suggestions will be further elaborated in conclusions and recommendations. The end of this section provides a clarification for the two specific suggestions often raised at different fora relevant for the area of PIFC.

Cross-cutting observations for all groups of PFBs:

1. All the categories of PFBs listed the issue of *insufficient staff capacity* – both in terms of number and competence. While the direct beneficiaries at the central level tend to highlight the issue of outflow of quality and experienced staff, PFBs at the local level typically complain about insufficient number of employees. This is highlighted because the initial establishment of the tools which are the “visible” part of the FMC system (maps of business processes, risks, etc.) and their updating are often perceived from the aspect of additional workload. As the issue with staff capacities may have an impact on operating results (meeting deadlines, quality, overburdened employees and their dissatisfaction with work, which leads to further outflow of high-quality staff, etc.), the effects should be explored in more detail within the next Consolidated PIFC report.

2. In addition to insufficient number of employees, the lack of professional competences and skills in the area of FMC is also mentioned, as well as the need for educating the managers and FMC coordinators about the fundamentals of COSO framework. This issue is primarily caused by frequent **organisational and regulatory changes** which result in delayed implementation of regulations, falling behind the pace of legislative reforms, but also frequent changes in **management** and lack of awareness, skills and commitment of managers and operational staff, especially the newly-employed ones. As changes are imminent, a proposal was frequently raised that for all the managers in the public sector, mandatory and continuous education about the FMC system should be in place.

- Additionally, all groups of beneficiaries listed the lack of experience, practical and formal **skills** for understanding the COSO framework, its review and reporting. FMC coordinators are claimed to be in a far less favourable position than internal auditors, as their work is not recognised or adequately regulated; the need for organising continuous expert seminars and workshops which would include both the practical examples and good practices is highlighted; also, the development of detailed instructions, practical tools and model documents supported with practical examples is recognised as necessary – seen from the PFB point of view, introducing FMC according to COSO model is not an easy task.

- PFBs also listed the need for trainings, methodological materials and tools which would be **tailored to the type of organisation** (e.g. for schools, museums, courts, PEs at the local level, while LSUs even suggested drafting the instructions and tools for practical implementation at the local self-government level, in other words, a sort of universal-general template for all local self-governments, etc.).

- The need for sharing the experiences between similar categories of PFBs is also mentioned.

3. Some PFBs listed a set of specific issues in FMC implementation which confirms that in a number of organisations there exists a serious approach to and thorough consideration of the FMC system: identifying specific relationship between the processes and sub-process activities for risk identification and measuring their materiality; inadequately set objectives of business processes and measurement criteria; inadequate links between individual business activities.

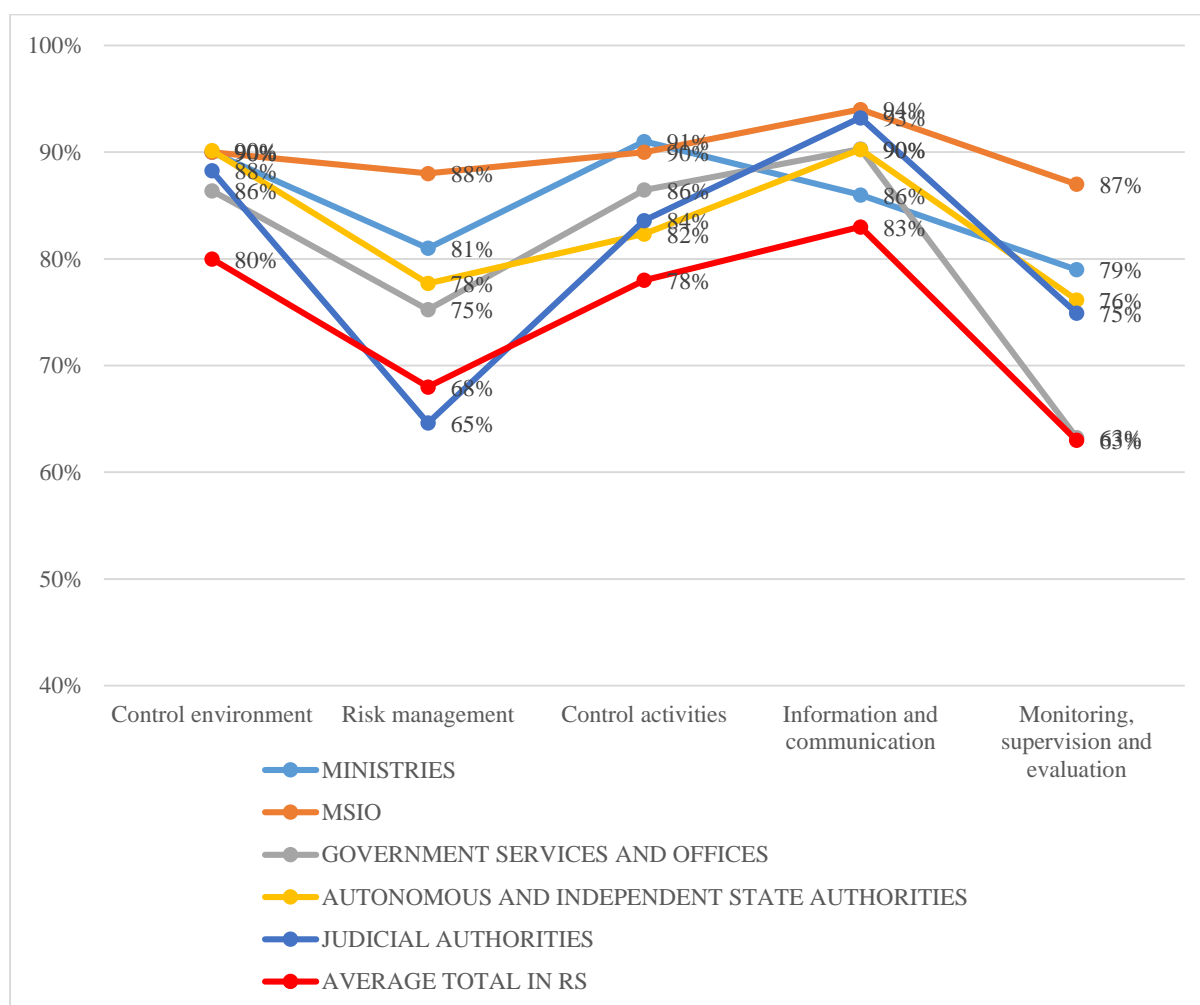
1.3.1. Central/Republic level: ministries, MSIO, other direct PFBS

This group of PFBS constitutes the “elite” group in the FMC area and comprises:

- Ministries
- MSIO
- Government services and offices and special organisations
- Independent and autonomous state authorities
- Judicial bodies (direct beneficiaries of RS budget)

In MSIOs and ministries, internal audit is largely in place, FMC reporting is 100% in this group, however, in all other categories of PFBS from this group, internal audit is established in 21.43% of institutions, while the FMC report is submitted by 73.81% of institutions.

Graph 6. COSO per specific categories



Except for MSIOs and a number of major ministries with large subordinate agencies (subordinate agencies are also considered as direct beneficiaries), most other PFBS in this group are small-sized organisations. Self-assessment results in all the categories are above the

Republic average, except in case of judicial bodies¹⁵ which record somewhat lower results than average at the Republic level in risk management, but however, demonstrate an unexpected surge in the area of information and communication.

PFBs from this category have listed the following **key issues and observations** in the establishment and development of the FMC system:

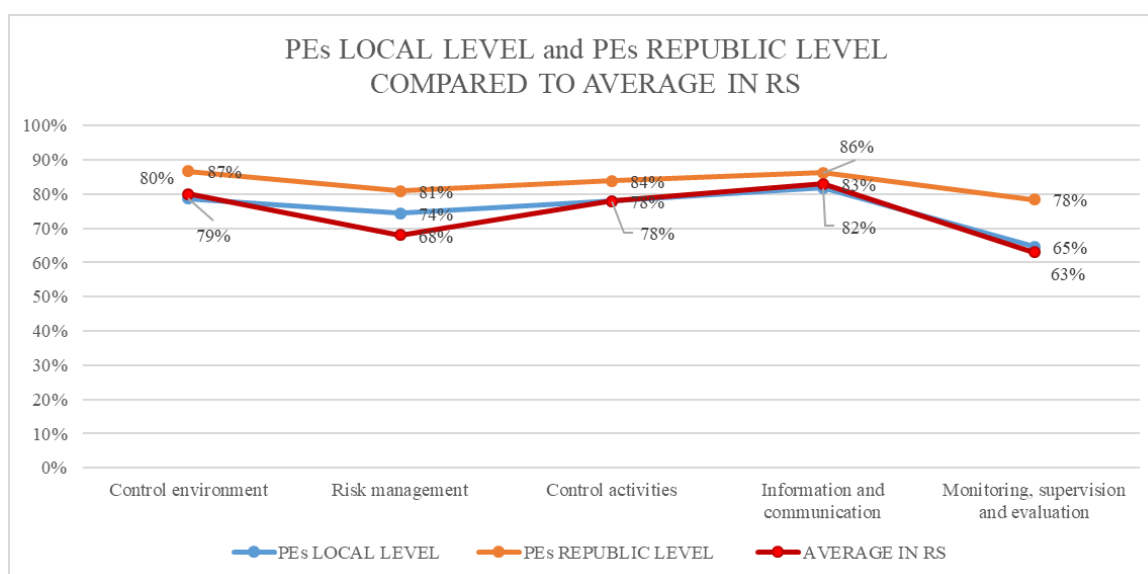
1. the need for strengthening the accountability of managers and employees;
2. the need for drafting the instructions for the development of FMC system in small-sized PFBs, with insufficient staff, to ensure consistent transfer of authority and responsibility;
3. the need for intensifying the activities on cascading the FMC to lower organisational level in **complex organisations**;
4. issues were identified in efficient communication due to complex organisational structure of bodies and their geographic dispersion;
5. the need for practical support to managers and key staff in the process of changing the management method by shifting to the performance and result-based approach.
6. some PFBs with the certified quality management system according to ISO 9001:2015 consider its compliance with the FMC system.

¹⁵ Judiciary is undergoing the transformation process. The institutions from this group have complex organisational structure which hinders the implementation of risk management

1.3.2. Public enterprises

Public enterprises perform the activity of common interest and are subject to the law on public enterprises. The founder of public enterprises at the central level is RS, while the founders at the local level are LSUs. Considering that COSO framework originates from the private sector, its implementation in enterprises is likely to be more straightforward than in public administration institutions. Therefore, it is visible that public enterprises at the central level are taking the lead compared to other group in the areas of risk management and monitoring and supervision, which are considered to be “difficult” for other groups. Public enterprises at the central level belong to a solid group of users both in terms of number of submitted FMC reports and quality of COSO framework, while the level of establishment of internal audit is higher than in most other groups of beneficiaries. When it comes to quality of COSO framework, public enterprises at the local level demonstrate the same level as the Republic average.

Graph 7. PEs at the central level and PEs/PUCs at the local level compared to RS average



Overall observation is that some PEs and PUCs possess the valid, internationally recognised **ISO certificates** (certificate on quality management system ISO 9001, certificate on information security management system ISO 27001, environmental management system ISO 14001), and the **IMS** procedures – integrated management system and controlling function, so in the reports submitted by the beneficiaries from this category whose responses were subject to analysis, it was stated that many requirements were fulfilled specifically through these systems. The PFBs stated the need for defining the method of FMC implementation for the PFBs who possess the certified quality management system in accordance with the requirements of the standard SMK ISO 9001:2015 in order to avoid overlapping.

Public enterprises and companies majority owned by RS

In RS there are **37 public enterprises and companies at the central level of RS** majority owned by RS.

Within this category, the following **specificities** are visible:

1. PFBs with no action plan or a working group have explained that the company already has a functional model of organisation consisting of all segments which cover and constitute the area of FMC. The action plan and the working group are designed to be the support in the initial introduction of FMC tools and in this very case, this requirement is considered as fulfilled.
2. This very group recorded the highest number of audit boards and committees, which are particularly important for monitoring and development of an overall internal control system.
3. Public enterprises have indicated that there are too many requests for reporting by different institutions on similar issues and such requests need to be rationalised and harmonised.

Public utility companies

Serbia has significant number of PEs/PUCs at the local level – around 600 active (no data available for 71 smallest). Their total budget is 683,068,322.00 dinars, however, 80% of this budget is distributed among the top 17 PEs/PUCs from this group.

These are funded by collecting the payments for their services in the market, and by subsidies from the budget of LSUs, that are their founders.

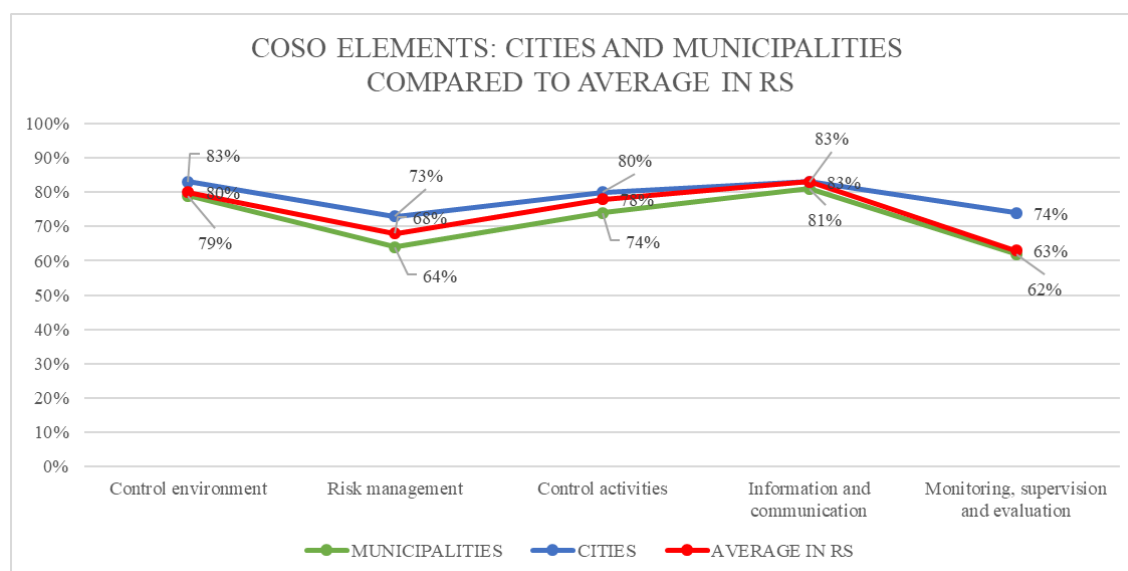
Some of the **issues and specificities** indicated by PFBs from this group are as follows:

1. staff outflow and demotivated high-quality personnel, especially internal auditors;
2. insufficient new staff profiles;
3. changes in management, organisational structure and changes in the status resulted in lower scores made in the area of FMC than in previous years, which cannot be improved until the control environment is made stable;
4. insufficient interlinkage of IT systems and absence of electronic work orders in all major work processes;
5. poor information to managers about weaknesses in internal control system;
6. beneficiaries proposed defining key performance indicators of the FMC system and developing tools for their continuous monitoring, not only annually.

1.3.3. Local self-government: cities and municipalities

Regarding the scope of FMC reporting and IA, cities have demonstrated satisfactory percentage, unlike the municipalities which recorded lower result, especially with respect to IA function. Graph 8 shows that in terms of quality of COSO, cities are above the Republic average, while municipalities are below.

Graph 8. COSO elements: Cities and municipalities compared to average in RS



Issues and suggestions indicated by cities and municipalities are as follows:

1. at the level of cities, it is necessary to consolidate reporting on FMC; extend monitoring and supervision measures in the implementation of the FMC system;
2. in small LSUs overlapping of authority is inevitable as one person is performing several different tasks;
3. it is necessary that each administration body in a city appoints one person to be in charge of FMC, in order to ensure better supervision;
4. there are issues in information and effective communication at all levels;
5. misunderstanding and disagreements occur between individual organisational units;
6. employees are failing to inform the management about identified risks;
7. regarding individual business processes, issues are visible in public procurement area;
8. lack of controls aimed at monitoring the staff performance;
9. an obligation for more frequent reporting on the FMC system and IA within a PFB should be prescribed;

1.3.4. Indirect budget beneficiaries

This group of beneficiaries is the “weakest” group in terms of results of self-assessment of COSO elements, and the largest one at the same time. The average values cannot be used as a benchmark for drawing conclusions on the group, due to significant variations within the group.

Local communities

Local communities are the smallest organisations within LSUs and there are in total 5254 of them (4120 local communities and 1134 local offices). Local communities (LC) normally claim to have no employees, only, for example, the secretary of the local community. Some of the local communities, however, may possess significant assets. 17 local communities submitted the FMC reports, claiming to “have no FMC system in place” (no working group, action plan, defined work objectives, risk register, segregation of duties, internal audit, etc.).

Issues and key observations in establishment and development of the FMC system are as follows:

1. LSUs are expected to introduce an effective FMC system in local communities;
2. local communities propose development of a model general internal act on introducing the FMC system into the local community.

Other indirect PFBs

(healthcare institutions, primary and secondary schools, universities, libraries, culture institutions, archives, nursery schools...)

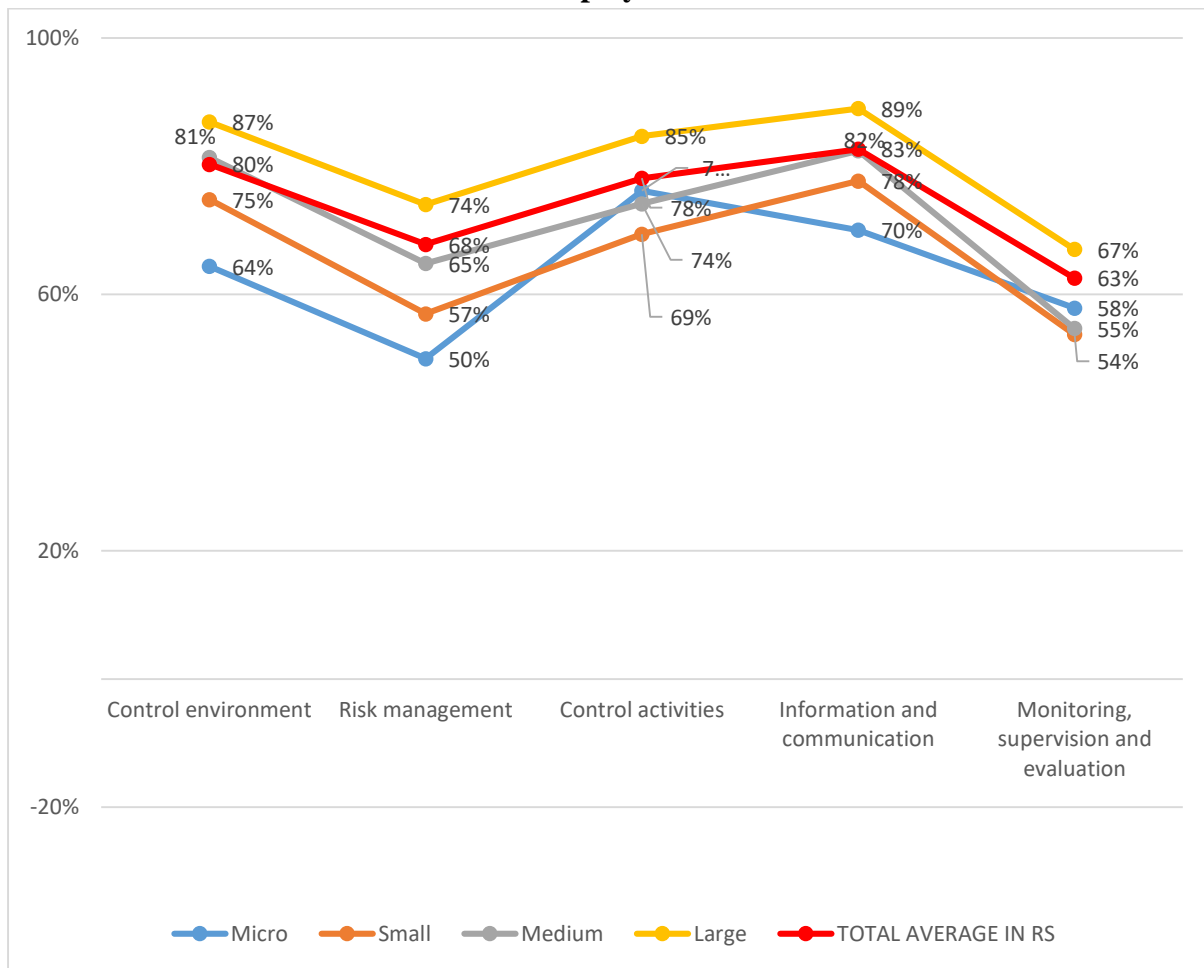
Indirect budget beneficiaries constitute the single largest group in the public sector of RS and are classified per areas and types of activity. They vary in size – there are large systems with several thousand employees, but also a lot of small organisations. Indirect budget beneficiaries fall within the scope of competence of some of direct budget beneficiaries, based on the supervision hierarchy. The category of indirect budget beneficiaries is dominated by the small-sized institutions with a limited number of employees and small budgets, that is, small expenditures and outflows for the reporting period.

Direct beneficiaries influence the objectives of indirect beneficiaries by defining general strategies for the area and operational framework (direct beneficiaries stipulate the actions of relevant indirect beneficiaries), and also set the amount and purpose of funds for the subsequent fiscal year for indirect beneficiaries.

By analysing this group of beneficiaries, it was evident that the size of an organisation has a decisive impact on the quality of COSO perceived by organisations.

Graph 9 shows the results per COSO elements for 4 groups of indirect beneficiaries, classified in terms of their size: micro – up to 10 employees; small – up to 50 employees; medium – up to 250 employees, and large – over 250 employees.

Graph 9. Overview of COSO elements of indirect beneficiaries, classified per number of employees



It is visible that except for large indirect beneficiaries, all other groups of indirect beneficiaries recorded the scores below the Republic average.

Issues and observations by this category of PFBs:

- relationship and communication between direct and indirect PFBs was listed as a particularly significant issue which is reflected onto the FMC system, Indirect PFBs suggest that direct PFBs should support its indirect beneficiaries in the development of necessary procedures and maps of processes, according to the type of organisation;
- indirect PFBs request assistance by direct PFBs in the preparation of written procedures for the development of financial plan, stock taking of assets and liabilities, preparation of the annual financial statements and strengthening of the monitoring and supervision system;
- Additional issue is the excessive number of reports requested by different institutions. The proposal is to change the reporting requirements and adapt them to suit the indirect beneficiaries, especially the ones with limited number of employees and small budget.

All the proposals which were put forward are relevant and some of them should be elaborated as soon as possible. PFBs also listed some of the proposals which are unable to be further elaborated at this moment:

- Some beneficiaries suggest hiring specialised companies to assist in the implementation of the FMC system, while some expect the systematisation of a job post specifically for FMC. FMC is an integral part of all business processes in an organisation. Stipulating the obligation of having one or two employees dealing with FMC within an organisation would entirely miss the point, having in mind that the FMC system is an obligation stretching across entire organisation, all business processes, all managers and employees. On the other hand, it is recommended, particularly in large systems, to professionalise the entire system by having a person delegated to tackle the technical aspects of FMC, who would perform consolidation at the level of institution and who would obtain the necessary expertise that could be further passed on throughout the organisation.
- Some beneficiaries suggest development and adoption of general, mandatory acts relating to the FMC system. PIFC concept is prescribed in the Budget System Law, several rulebooks, manuals and guidelines. Additionally, PIFC concept is based on the implementation of standards (COSO, INTOSAI GOV for FMC and IPPF IA for IA). PIFC concept is based upon managerial accountability and is a novel development for the EU candidate countries. The concept encourages the public sector to make a shift from the traditional and bureaucratic, input-oriented work to the method which is result and performance-based.

1.4. Managerial accountability

Managerial accountability concept is an important pillar in the public administration reform. It is often regarded as a crucial issue in many discussions on public internal financial control (PIFC) and a precondition for all PIFC-related elements.

Managerial accountability concept was introduced in the PIFC system in RS through the provision of the BSL, stating as follows: „Managerial accountability is the accountability of all levels managers with the public fund beneficiaries to carry out all tasks in a legal manner, observing the principles of economy, effectiveness, efficiency and transparency, as well as to be accountable for their decisions, actions and results to those who have appointed them or ‘transferred’ accountability to them“.

European Commission’s *Compendium of the public internal control systems* presents managerial accountability as “a process whereby managers at all levels are responsible for, and may be required to explain, the decisions and actions taken to meet the objectives of the organisation they manage. Managerial accountability implies responsibility for sound financial

management at all levels, i.e. the adequate organisation, procedures and reporting of the results of the organisation.”¹⁶

Each head of public fund beneficiary should be aware that his/her duty is to establish a system of transfer of authority and appropriate lines of reporting, including clear objectives and performance indicators, which would ensure the achievement of goals in a PFB.

In order to gain better insight into managerial accountability in the public sector, separate groups of questions were observed in the FMC reports submitted by PFBs, relating to different aspects of managerial accountability. Similar questions were grouped as follows:

The first group of questions is about **delegation of authority**:

1. mechanism in place for accountability of managers at all levels towards higher levels,
2. hierarchical system of transfer of authority, in accordance with the levels of management,
3. written procedures which clearly define the responsibilities and authority for individual activities.

First two questions recorded satisfactory scores (above 4) except for the group of PEs/PUCs at the local level and the group of indirect beneficiaries (above 3.86), while the lowest score was recorded for the question on written procedures which clearly define the responsibilities, authority and deadlines (average score 3.91 with low value at the local level and among indirect beneficiaries).

The second group of questions was about **objectives**, that is, the elaboration on different aspects of objectives, and these are the fundamental group of questions within the managerial accountability concept:

1. strategic objectives,
2. work programme and its correlation with objectives,
3. operational objectives,
4. links between strategic and operational objectives,
5. use of SMART methodology in formulation of objectives, and
6. management and staff awareness of the objectives in an organisation.

Overall conclusion is that the scores for this comprehensive and important group of questions are generally satisfactory and in almost all categories of PFBs, the average score is above 4. Lower scores are recorded at the local level, typically for the questions on annual work programmes and management and staff awareness of strategic and operational objectives. Link between strategic and operational objectives is insufficiently visible and this is the lowest scored question in each category of PFBs (average 3.95).

¹⁶ Compendium of the public internal control systems in the EU Member States for 2012 provides an overview of definitions and approaches to the managerial accountability issue in the EU member states. *Compendium of the public internal control systems in the EU Member States*. European Commission (2011). Publications Office of the European Union, Luxembourg.

Third important group of questions is about **monitoring of goals**:

1. Is the achievement of goals regularly monitored, and
2. Are the causes of possible departures from the defined organisational goals analysed.

All categories of beneficiaries have recorded a satisfactory score for this group of questions (median values are above 4) except for the local self-governments and indirect beneficiaries which are slightly falling behind (median values above 3.73).

In order to monitor the realisation of objectives, the management needs **analysis and information**. This means there should be:

1. an appropriate ICT system in place which allows monitoring of the realisation of defined objectives, and
2. which informs them about the resources available for their realisation;
3. a monitoring and reporting system in place which allows provision of regular reports on the functioning of the FMC system for which they are responsible.

The first two questions recorded satisfactory scores (above 4) while the last question about the status of FMC had the lowest score in this group of questions (3.49).

Availability of resources is measured as revenues and expenditures which are projected and planned in accordance with the organisation's set goals and was the best assessed question among all groups of questions assessed within the managerial accountability concept.

Inconsistencies among objectives should be identified as soon as possible. This is why another group of questions was introduced and relates to management involvement in risk management. This group of **risks** was introduced as the aspect of risk management where the management is most directly involved:

1. Do managers make decisions aimed at resolving the identified risks,
2. Are strategic and operational risks regularly discussed at management meetings,
3. Is there a system in place for regular reporting (the question with lowest scores in all clusters relating to managerial accountability, except for MSIOs which recorded the average score 5 in this area).

The whole group of questions relating to risks has recorded the lowest scores in the area of managerial accountability. Managers treat risks on a satisfactory level (above 4) only in ministries, MSIO and PEs at the central level. It is an interesting fact that managers tend to resolve risks to a greater extent than discuss them at meetings and all groups of PFBs recorded higher average scores for resolving risks rather than discussing them at meetings, except for MSIOs which recorded the same score. Only in the group of *other direct PFBs* (offices, services, agencies) is visible that they discuss risks at meetings somewhat more than resolving them.

All groups of questions except for risks recorded significantly better scores than the average scores of the overall questionnaire. COSO elements range between 63-94%, while the groups of questions about managerial accountability range between 75-100% (except for risks).

The best assessed question is the one on availability of resources, immediately followed by *delegation, information, objectives*, with relatively similar distribution among the category of PFBs, except for the considerable decline that the local beneficiaries have recorded about *information*. *Monitoring of objectives* also belongs to the category of well-assessed questions, except for greater variation of scores among different categories of PFBs, which confirms there are different practices visible in different types of organisations.

An interesting finding is that in terms of *dissemination of objectives*, ministries and PEs at the central and local level have taken the lead, which can be linked to the existence of public policy documents (strategies, programmes, action planes) prepared by ministries and annual work plans prepared by PEs/PUCs.

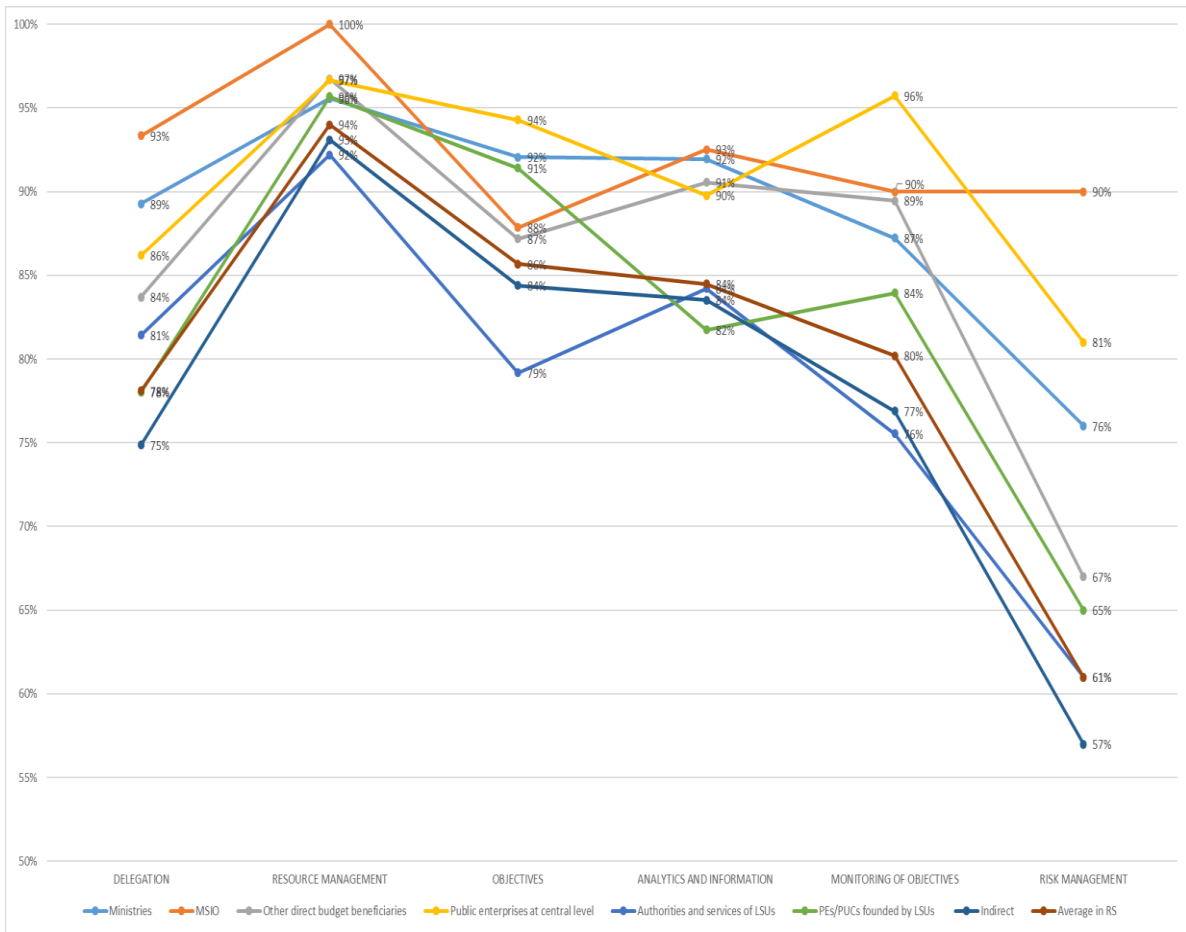
Based on the results of the self-assessment questionnaires, the overall picture of major elements of managerial accountability is positive, although there are risks of managers not making proper decisions on time due to poor linkage between strategic and operational objectives in all categories of PFBs and weak participation of management in risk management.

However, the analysis of open-ended responses provided the information and suggestions which point to a need for improvement of individual elements of managerial accountability. On the other hand, the findings from the study carried out by SIGMA: “ *Managerial Accountability in the Western Balkans - A comparative analysis of the barriers and opportunities faced by senior managers in delivering policy objectives*”¹⁷ suggest that significant improvements are needed within this concept.

Graph 10 displays scores achieved by different categories of PFBs for groups of questions relating to key requirements about the implementation of managerial accountability.

¹⁷ Available at: <http://www.sigmaweb.org/publications/Managerial-accountability-in-the-Western-Balkans-SIGMA-Paper-58-November-2018.pdf>

Graph 10. Scores achieved by different categories of PFBs for groups of questions relating to key requirements about the implementation of managerial accountability



2. INTERNAL AUDIT

2.1. Scope of internal audit

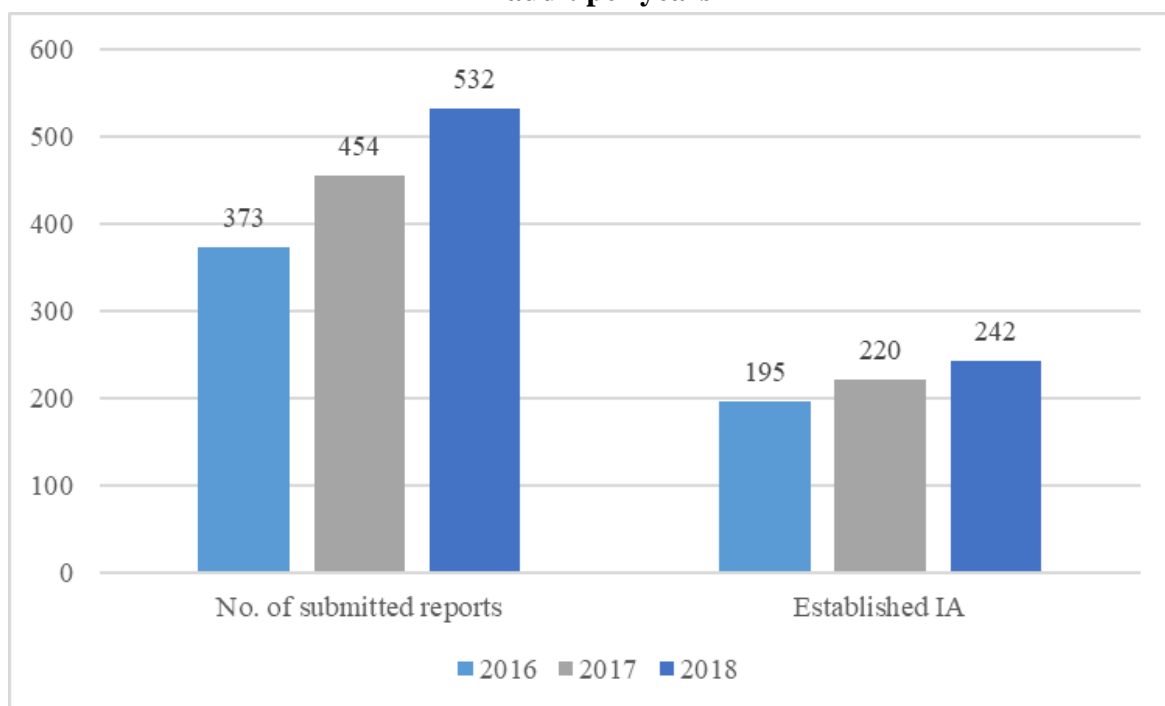
Information presented in this part of the report are based on the submitted Annual reports on performed audits and internal audit activities of public fund beneficiaries. The purpose of annual reports on performed audits and internal audit activities is to collect the information that will enable the CHU to prepare a consolidated report on the status of internal audit in the public sector.

The template of the annual report on performed audits and internal audit activities consists of a general part on the beneficiaries, the IA unit and internal auditors, the information on implemented standards and IA work methodology, as well as proposals for the development of the IA system and an overview of performed audits and the number of recommendations categorised into different types, as well as the number of performed consultancy engagements.

The template of the 2018 annual report was updated to include additional questions, such as the one on using handbooks other than the Manual recommended by the CHU, supported by the reasons for doing so. Another question is on whether all internal auditors signed the IA Code of Ethics. Additional section is included in which internal auditors may give opinion on the established level of financial management and control in the reporting period based on audits performed.

For the year 2018, a total of 532 public fund beneficiaries submitted the annual report to the CHU. 107 of the above reports remained incomplete, while 137 PFBs had no internal audit function established. Internal audit is being established in 46 PFBs, and according to reports submitted, internal audit function has been established in 242 PFBs.

Graph 11. Number of submitted reports and number of PFBs with established internal audit per years



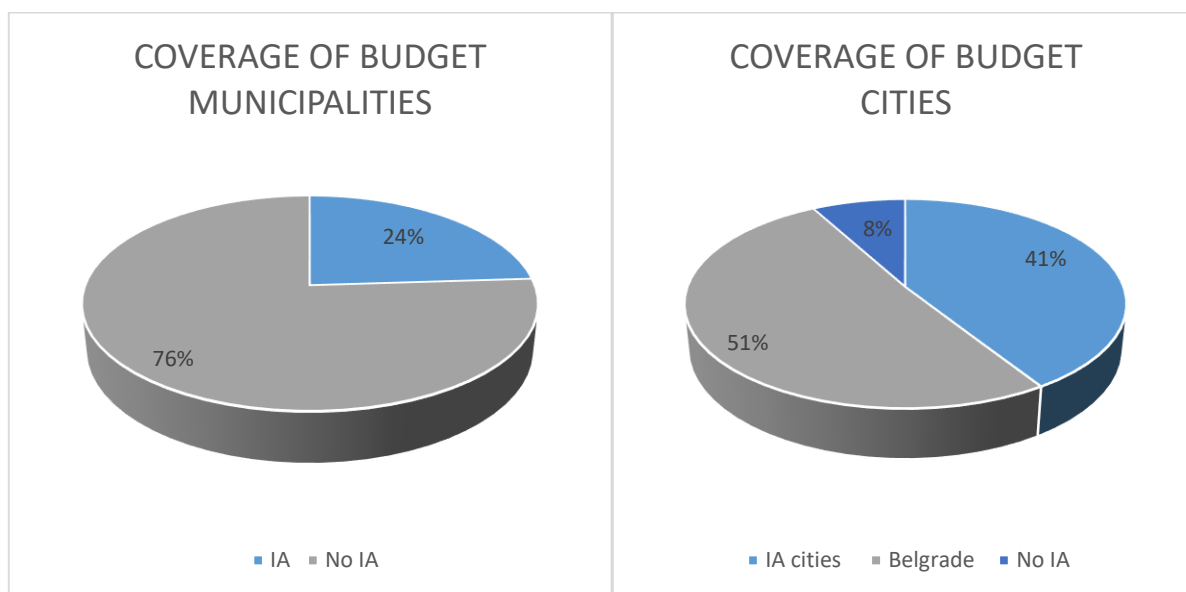
Based on data about revenues of direct budget beneficiaries, which include ministries, MSIOs and other direct PFBs, such as offices, agencies, autonomous and independent state authorities, Government services and offices and special organisations, as well as judicial bodies (direct beneficiaries of RS budget), the IA functions with at least one auditor cover 93% of the revenues from the given category.

With respect to local self-governments, which consist of cities and municipalities, the conclusion is that the situation in cities is considerably better than in municipalities. The analysis showed that the IA function with at least one auditor is in place in as many as 21 out of 28 cities¹⁸, which covers 92% of the budget allocated to this category of PFBs. The situation is worse in municipalities, with IA function in place in only 24 municipalities, covering 24% of the budget allocated to this category of PFBs.

Graphs 12 and 13 show the scope of the local budget covered by internal audit function.

¹⁸ Excluding the LSUs from the territory of Kosovo and Metohija. As the LSUs from the territory of Kosovo and Methodija have been operating in difficult conditions and specific circumstances since 1999, their operating methods are regulated with separate provisions and specific organisation methods. Based on this, the LSUs from the territory of Kosovo and Metohija were unable to submit their annual IA reports.

Graphs 12 and 13. Scope of budgets of cities and municipalities covered by internal audit



Out of total 37 public enterprises and companies at the central level of RS which were subject to analysis and which are performing the activity of public interest and whose work is governed by the law on public enterprises, IA function with at least one employed internal auditor is found in 24 entities, which accounts for 64.9% of the size of this category. These entities are the largest ones in the sample, both in terms of their budgets and the number of employees, so, according to the total number of employees, their coverage is 96%, while budget coverage in this category is 82.5%.

By analysing the group of 288 most relevant¹⁹ PFBs, the table below shows the coverage of IA function in different categories of PFBs, with at least one active internal auditor in an organisation, and additionally and if applicable, the table shows the status of filled-in IA units.

¹⁹ The category of „most relevant“ institutions was defined for the purpose of this report and constitutes a group of direct budget beneficiaries at the central level, MSIOs, LSUs and PEs at the central level

Table 3. Scope of IA function per categories of PFBs analysed within the context of Chapter 32

Scope of IA function	Total number of PFBs per category	Number of PFBs with at least one auditor	Percentage of PFBs with one auditor	Number of PFBs with filled-in IA function with three auditors	Percentage of PFBs with filled-in IA unit
Ministries	18	15	83.33%	7 out of 18 mandatory	39%
MSIO	4	4	100.00%	3 out of 3 mandatory	100%
Offices and other direct beneficiaries	84	18	21.43%	3 out of 10 mandatory	30%
Cities²⁰	28	21	75.00%	6 out of 28 mandatory	21%
Municipalities²¹	117	24	20.51%	0	0
Public enterprises at the central level	37	24	64.86%	7 out of 14 mandatory	50%
Total:	288	106	36.81%	26	

The analysis of the data above leads to the following conclusions:

- Category of MSIO is the only one with the prescribed number of internal auditors.
- In the category of Ministries, which are obliged to have a filled-in internal audit unit²², only a small portion of them, and more specifically, 39% of ministries fulfil this requirement. The number of IA units in this category is stagnating compared to the previous year. Three ministries have no internal auditor employed, as also was the case in 2017.
- 75% of cities have at least one employed auditor, however, in accordance with Article 6, paragraph 1 of IA Rulebook, cities are obliged to have a filled-in IA unit, only 21% of cities actually fulfil this obligation.
- Public enterprises at the Republic level recorded 50% score, as 7 of them have over 250 employees and are obliged to fill-in an IA unit, so the obligation is fulfilled by a half of this category.
- Offices and other direct beneficiaries, including municipalities, do not have a satisfactory level of coverage by internal auditors.

Establishing internal audit functions has been an issue for years now. The major problem in this context is recruitment of internal auditors, which is the responsibility of PFBs. The CHU will further analyse the causes of these problems, as well as the criteria for establishing IA functions and provide proposals for addressing the issues accordingly.

²⁰ Excluding the LSUs from the territory of Kosovo and Metohija. As the LSUs from the territory of Kosovo and Methodija have been operating in difficult conditions and specific circumstances since 1999, their operating methods are regulated with separate provisions and specific organisation methods. Based on this, the LSUs from the territory of Kosovo and Metohija were unable to submit their annual IA reports.

²¹ Ibid

²² In accordance with Article 5, paragraph 2 of IA Rulebook

2.2 IA function

Table 4 presents the number of established internal audit functions, systematised and filled internal auditor positions in PFBs, while *Annex 4* provides an overview of PFBs with established internal audit units per different categories.

Table 4. Number of PFBs in RS that submitted the reports and established internal audit with systematised and filled positions in 2018

PFB	Submitted reports	Established IA	Systematised positions	Filled positions
Central/ Republic level	117	84	311	261
Local level	168	107	203	162
Indirect PFBs	247	51	77	60
Total in RS	532	242	591	483

Table 5 presents the total number of established internal audit functions and the number of systematised and filled internal auditor positions in public fund beneficiaries for 2016, 2017 and 2018. The data shown suggest that 242 PFBs have established IA function, which is a rise of 10% in 2018, compared to 2017 when this number of PFBs was 220.

Also, it can be concluded that the number of systematised posts increased by 13%, and the number of filled-in posts by 9% in 2018, compared to 2017, which all together indicates a recorded positive rising trend in development of IA function in the previous period.

Steady rise is visible in all key indicators for the development of decentralised internal audit function in public sector.

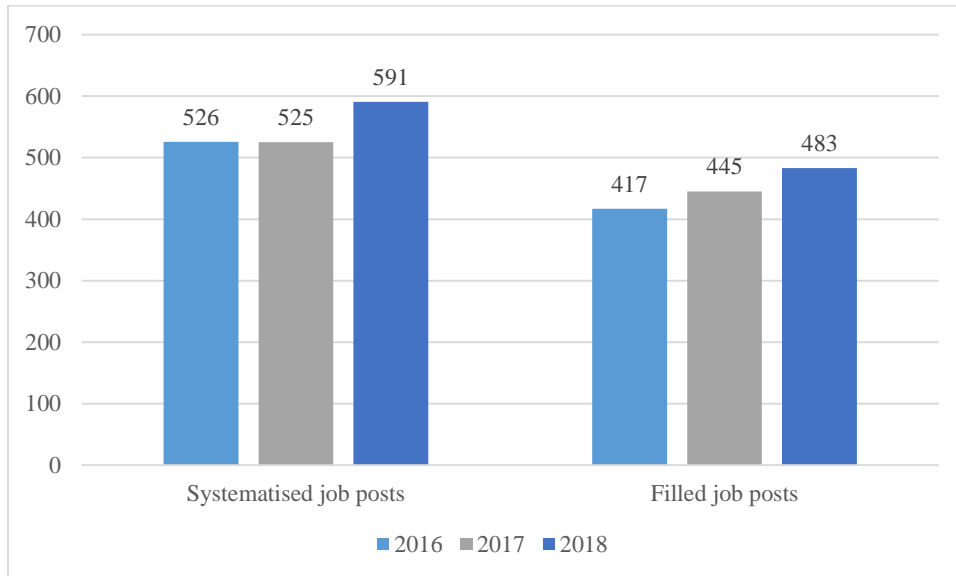
Table 5. Total number of PFBs that established internal audit with systematised and filled positions in 2016, 2017 and 2018

PFB	Established IA	Systematised positions	Filled positions
Total in RS in 2016	195	526	417
Total in RS in 2017	220	525	445
Total in RS in 2018	242	591	483

According to the reports received, in 242 PFBs with IA function established in a regulatory manner, 90 of them have established an internal audit unit, and in 134 of them only one internal auditor was employed. 11 PFBs have established an IA unit on the basis of agreement with another PFB with a functional IA unit in place. In terms of all PFBs, there are 591 systematised and 483 filled-in internal auditor posts.

Direct budget beneficiaries at the central level (ministries, administrations, judicial bodies, budget funds, directorates, offices, services...) with at least one active auditor cover around **83% of the total expenditures and outflows of the RS budget for 2018**²³.

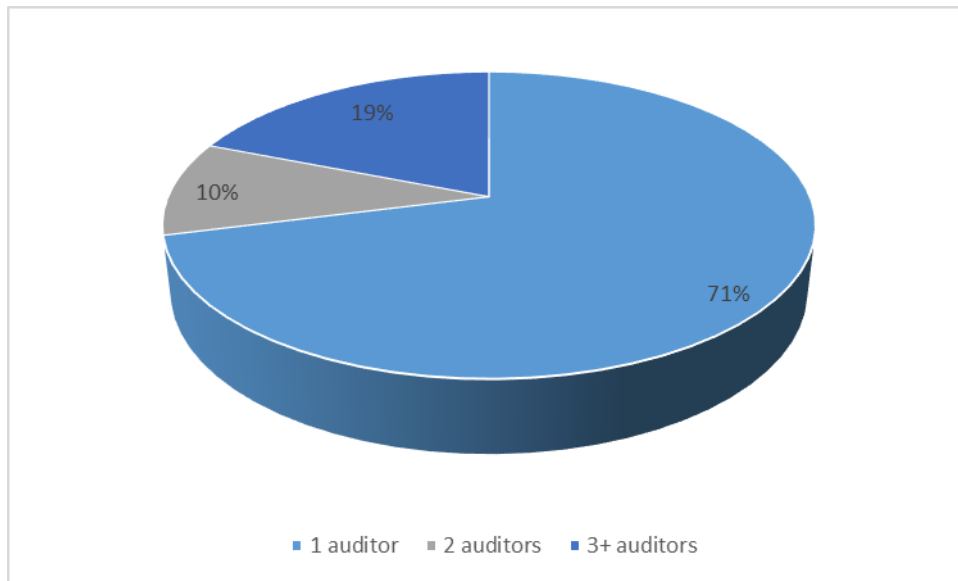
Graph 14. Number of systematised and filled internal auditor job posts in PFBs



Total of 222 PFBs across the entire public sector have established the IA function and have at least one internal auditor post filled-in. Out of this number, the percentage of public fund beneficiaries that established the IA function with one internal auditor position filled is 71%, with two internal auditors the percentage is 10%, and with three and more internal auditors the percentage is 19%. Significant percentage of established internal audit functions with two or fewer internal auditors raises doubt on whether the internal audit standards can be fully complied with.

²³ Percentage of coverage of Consolidated annual report was calculated based on the data referred to in Article 8 of the Law on the Budget of the Republic of Serbia for 2018 („Official Gazette of RS”, no. 113/17)

Graph 15. Number of auditors in PFBs with established IA, in 2018



The most frequently stated reasons for employing only one internal auditor to perform the internal audit work or for not filling the internal auditor positions are legal limitations on the maximum number of employees, insufficient number of highly educated staff, low salaries in the public sector, inadequately systematised positions compared to the workload and its complexity, insufficient funds, lack of formal requirements, competition from the private sector, etc. Regardless of the reasons stated, an obligation to establish internal audit remains in force and the CHU will, within its competence, provide all the necessary assistance.

In newly-established internal audit units, where the internal auditors have not yet been included in the training process organised by the CHU, the reports state that significant amount of time is spent on dealing with other tasks which are not in the scope of internal audit. From the total of 222 PFBs in which an internal auditor post is filled in, 25 internal auditors (13%) also perform other tasks which are not in the scope of internal audit. This is not in compliance with the internal audit standards and directly affects the functional independence of internal auditors. The CHU will in the forthcoming period bring this issue to the attention of internal auditors and heads of PFBs so as to ensure full independence and objectivity of auditors.

By gaining insight into the **salaries of internal auditors** in PFBs, the submitted annual reports have revealed variations in salaries in different categories of PFBs. The lowest average salaries of internal auditors are seen in ministries, MSIOs and direct and indirect beneficiaries at the local level. In order to encourage employment in these PFBs, and particularly in ministries as the most relevant PFBs, it is necessary to achieve a balance between the salaries of internal auditors and the rest of the public sector. Otherwise, there is a risk of delay in the development of the internal audit function due to inability to attract and retain the competent staff for discharging this important function.

Audit board as an advisory body for internal audit tasks was established in 15 PFBs, i.e. in 14 public enterprises and companies at the Republic level and one faculty.

2.3. Planning and evaluation of work

According to the IA Rulebook, internal audit is conducted based on the strategic plan for a three-year period, the annual plan and the plan of individual audit engagement.

An audit report is prepared for each performed audit engagement and contains the summary, objectives and scope of the engagement, conclusions, a detailed report, and may include the findings and recommendations, as well as the comments from the manager of the audited entity.

The head of internal audit approves the individual audit engagement plans and monitors the implementation of each individual audit engagement.

2.3.1. Overview of performed audits

Internal audit work in public fund beneficiaries is conducted based on the strategic plan and the annual plan of activities approved by the head of the public fund beneficiary, and the individual audit plan approved by the head of internal audit. At the end of reporting period, in the public fund beneficiaries with established internal audit function, the process of adopting the strategic and annual plan was underway.

Table 6 presents a total number of planned, conducted and ongoing audits.

Table 6. Number of audits in 2018

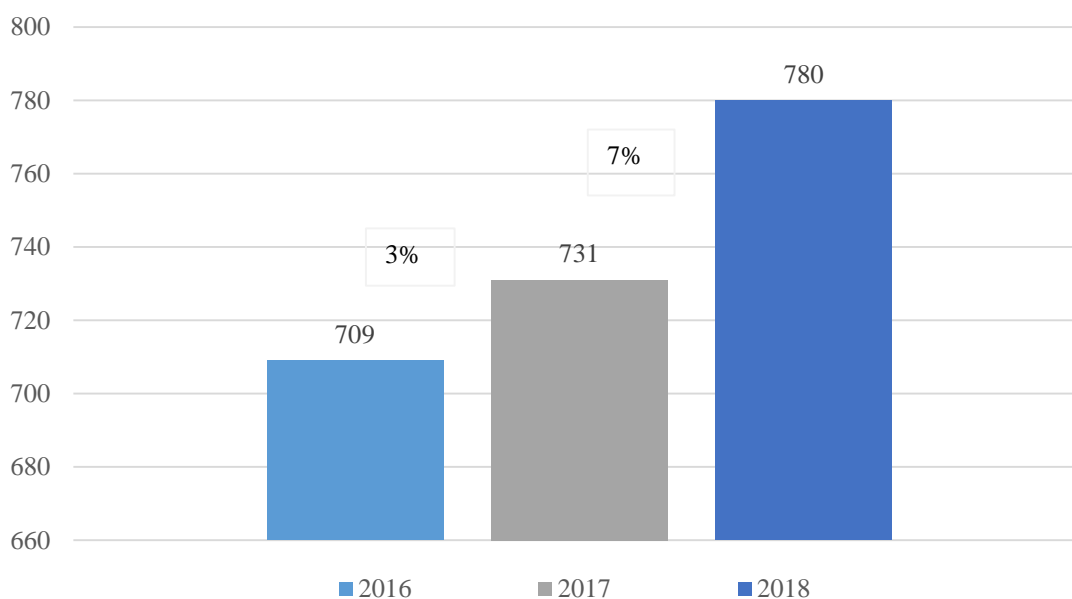
PFBs		Number of audits in 2018			
		Planned audits	Conducted audits	Ongoing audits	Not conducted audits
Central/ Republic level	Ministries	97	67	1	29
	MSIO	51	51	0	0
	Other direct budget beneficiaries	108	58	33	17
	Public enterprises at the central level	261	252	1	8
	Total	517	428	35	54
Local level	Direct beneficiaries of LSU budget	236	182	12	42
	Public enterprises/public utility companies founded by LSUs	131	96	3	32
	Total	367	278	15	74
Indirect PFBs		90	74	7	9
Total in RS		974	780	57	137

In 2018, according to the submitted IA activity reports, the number of planned audits was 974, out of which 780 audits were conducted, with 57 ongoing audits and 137 audits not conducted. Most frequently stated reasons for such a difference are lack of staff in internal audit units, reduced number of auditors due to their departure to more competitive jobs, changes in the organisational structure of public fund beneficiaries, changes in the annual plan of activities and executing non-planned audits requested by management.

Table 7. Overview of the number of audits per years

Total number of audits in 2016, 2017 and 2018				
Year	Planned audits	Conducted audits	Ongoing audits	Not conducted audits
Total in 2016	869	709	105	55
Total in 2017	897	731	17	149
Total in 2018	974	780	57	137

Graph 16. Overview of the number of conducted audits



The increase in the number of established internal audit units and internal auditors resulted in the increase in total number of planned and conducted audits, however, around 14% of audits were not conducted, which indicates certain deficiencies in audit planning and performance, therefore the auditors should be further educated in this area by means of continuous education.

2.3.2. Issued and implemented recommendations

Internal auditors issued a total of 7,322 recommendations for improvement of operations and reduction of identified risks to an acceptable level (5,274 recommendations from the categorised areas and 2,048 from specific non-categorised areas), 4,740 of which were

implemented by the end of 2018, while for the remaining recommendations the implementation deadline has not expired yet. The analysis of data reveals the rise in the number of recommendations issued in 2018 compared to 2017, which demonstrates the positive development and strengthening of IA function in the previous period. The only areas with fewer number of recommendations compared to 2017 are public procurement and contracting and information systems. This can be linked to the increase of percentage of recommendations in these areas that occurred in 2017. The amendments of regulations in the area of public procurement in 2016 resulted in higher degree of utilisation of electronic technologies, so the auditors were focused on the changes that were taking place.

Table 8. Overview of issued recommendations per years

Areas the recommendations refer to		Number of issued recommendations in 2016	Number of issued recommendations in 2017	Number of issued recommendations in 2018
1	Internal rules and procedures	2,492	↓2,214	↑2,587
2	Planning	328	↓310	↑370
3	Revenues and proceeds	184	↓180	↑255
4	Public procurement and contracting	598	↑741	↓595
5	Employees, salaries and allowances	470	↓411	↑460
6	Payments and transfers	202	↓180	↑255
7	Accounting records and financial reporting	622	↓555	↑568
8	Information systems	159	↑215	↓184
TOTAL:		4,778	↑5,055	↑5,274

Table 9 presents the number of issued recommendations in 2018, classified into categorised areas and formulated in the annual report model, as follows:

Table 9. Overview of issued recommendations per categories of PFBs

Areas the recommendations refer to ²⁴		Central/ Republic level	Local level	Indirect PFBs	Total
1	Internal rules and procedures	1,246	1,032	309	2,587
2	Planning	171	165	34	370
3	Revenues and proceeds	78	73	104	255
4	Public procurement and contracting	237	255	103	595
5	Employees, salaries and allowances	230	203	27	460
6	Payments and transfers	114	129	12	255

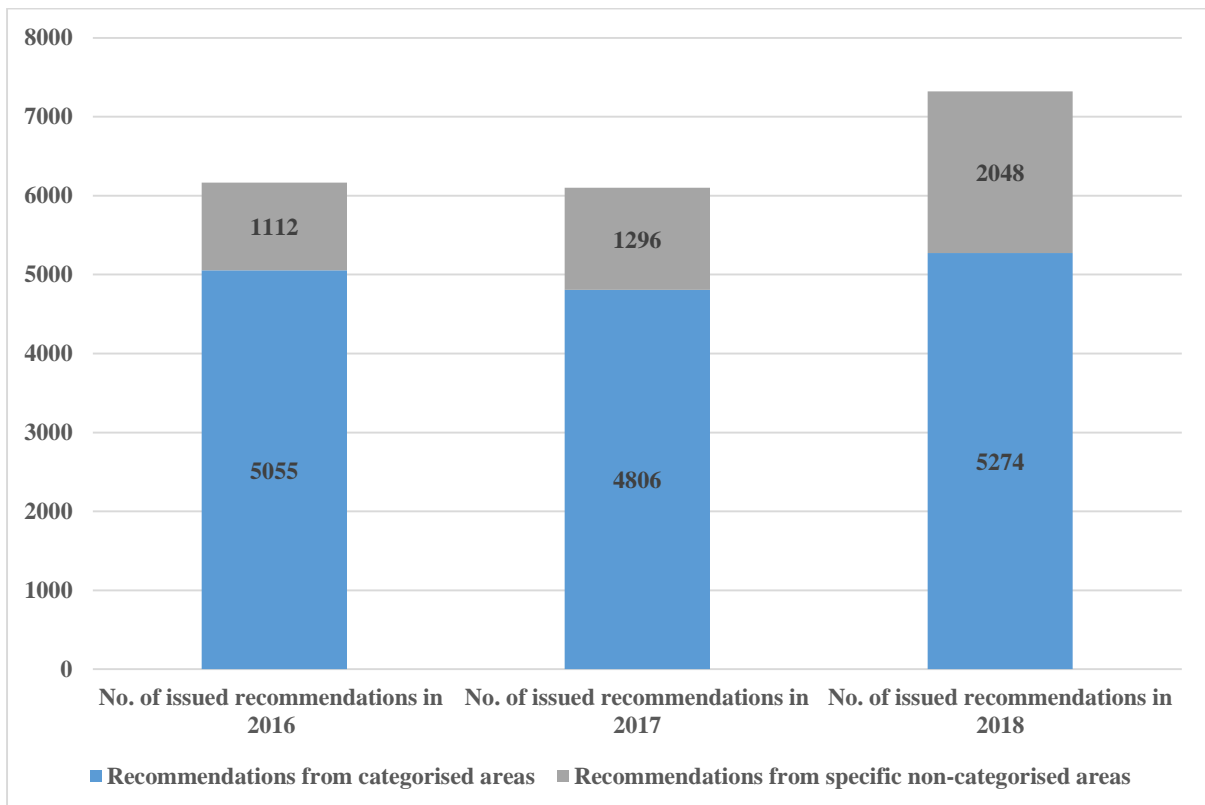
²⁴ The areas and/or types of recommendations are made in accordance with the official Annual report on conducted audits and internal audit activities, submitted by PFBs

7	Accounting records and financial reporting	245	261	62	568
8	Information systems	112	62	10	184
TOTAL:		2,433	2,180	661	5,274

Table 10. Number of recommendations from categorised and specific non-categorised areas

Types of recommendations	Number of issued recommendations in 2016	Number of issued recommendations in 2017	Number of issued recommendations in 2018
Recommendations from categorised areas	5055	↓4806	↑5274
Recommendations from specific non-categorised areas	1112	↑1296	↑2048
TOTAL:	6167	↓6102	↑7322

Graph 17. Number of issued recommendations per years



The percentage of recommendations issued in specific areas, typical for individual PFBs and not classified into the pre-defined areas in the annual report model, has been on rise over the years.

In 2016 there were 18% of recommendations issued in specific, non-categorised areas, in 2017 this percentage was 21% and 28% in 2018.

In the course of 2018, further increase in percentage (nearly 28%) of recommendations issued in specific areas characteristic for individual public fund beneficiaries, which proves that the focus of internal audit work has shifted from the support processes to the core business processes in the organisation, that is, the assessment of overall internal control system in place within the organisation is reaching its real purpose.

Table 11. Total number of issued and implemented recommendations to PFBs in 2018

No.	PFBs	Number of issued recommendations	Number of implemented recommendations	Number of implemented recommendations (%)
1	Ministries	667	388	58%
2	MSIO	304	274	90%
3	Other direct budget beneficiaries	396	137	35%
4	Public enterprises at the central level	3019	2221	74%
5	Direct beneficiaries of LSU budget	1483	770	52%
6	Public enterprises/public utility companies founded by LSUs	705	368	52%
7	Indirect PFBs	748	582	78%
Total Central level		4386	3020	69%
Overall total		7322	4740	65%

Table 11 shows the issued and implemented recommendations in the course of 2018. From the total 7,322 recommendations in 2018, all PFBs implemented 4,740 recommendations which constitutes **65%** of issued recommendations. When analysing individual categories, high percentage of implementation is visible in MSIOs (90%) which indicates strong management awareness of importance of internal audit, i.e. efficiency of internal audit and the quality of its work. Similarly, high percentage of implementation is seen in the category of indirect beneficiaries and PFBs founded by the Republic of Serbia.

Lower percentage is recorded in ministries and at the local level, which may suggest there is limited management awareness of the need for eliminating work deficiencies, or that there are even inadequate IA recommendations. The lowest result is seen in other direct budget beneficiaries at the Republic level, with only 35% of implemented recommendations. Some of the main reasons listed by PFBs for the lack of implementation of recommendations issued in 2018 were that the implementation deadlines have not expired yet, that the reports on implementation of recommendations are not submitted on time, including the adequate evidence that such recommendations were actually implemented.

2.3.3. Internal audit consultancy services

The changes in Internal audit standards, in effect since 2017, have particularly highlighted the audit engagements in providing consultancy services.

Table 12. Overview of the number of consultancy services in 2018

PFBs		Number of consultancy services in 2018		
		No. of planned	No. of conducted	Not conducted
Central/ Republic level	Ministries	6	15	0
	MSIO	3	18	0
	Other direct budget beneficiaries	8	11	3
	Public enterprises at the central level	28	49	6
	Total	45	93	9
Local level	Direct beneficiaries of LSU budget	36	45	6
	Public enterprises/public utility companies founded by LSUs	41	14	28
	Total	77	59	34
Indirect PFBs		59	63	7
Total in RS		181	215	50

Based on the reports submitted, the internal audit units in 46 PFBs planned a total of 181 consultancy audit engagements, with 215 engagements performed and 50 not conducted. The difference between planned and implemented audit engagements typically comes as a consequence of insufficient number of internal auditors, which are predominantly hired to provide consultancy services.

Annual report on performed audits and internal audit activities also provides a section in which internal auditors give their opinion on the established level of financial management and control in the reporting period, based on audits performed. Based on the analysis of individual opinions of internal auditors, the overall impression is that the process of establishing the FMC system is underway, however, it has not been finalised yet throughout the public sector. Further effort is still needed for raising awareness of managers in terms of establishment of the FMC system, the need for undertaking risk identification and assessment in an organisation, including the purpose and added value of internal audit. When speaking about individual elements of the FMC system, the submitted annual reports have identified most findings in the area of *risk management* and *control activities*, and fewest in the area of *monitoring and evaluation* of the system.

2.4. Quality review of internal audit work

The CHU conducted the quality review of internal audit work in nine public fund beneficiaries, covering the period from 1 October 2017 – 30 September 2018. The report on the quality review of internal audit work, no.: 401-00-940/2019-09 of 27 February 2019 was submitted to the minister of finance and published on the web site of the Ministry.

The quality review was conducted in the following PFBs:

- City of Belgrade;
- City of Novi Sad;
- Tax Administration – Ministry of Finance;
- Commissariat for Refugees and Migration;
- Public Enterprise for Forest Management “Srbijašume”;
- Joint Stock Company “Elektromreža Srbije”;
- Republic Hydrometeorological Service of Serbia;
- Supreme Court of Cassation;
- Public Enterprise „Zavod za udžbenike (Institute for Textbooks)”.

The review included the assessment of fulfilment of prescribed requirements for establishing internal audit units, audit scope, competencies and skills of internal auditors, functional and organisational independence of internal audit, internal audit charter and code of ethics, familiarity with the internal audit standards, strategic and annual internal audit plans, implementation of internal audit work methodology, internal audit risk management, internal quality controls, needs for future training courses and membership in professional associations.

This report was prepared based on individual reviews at public fund beneficiaries’ premises and was performed by the certified internal auditors for public sector from the Department – Central Harmonisation Unit, Ministry of Finance.

Public fund beneficiaries that were subject to IA quality review have established the IA function by assigning job posts for internal audit in their respective rulebooks on internal organisation and systematisation of job posts, all in accordance with the IA Rulebook. Seven PFBs have systematised IA units with three or more internal auditor posts, while two PFBs have one internal auditor position systematised. Out of total 58 systematised internal auditor positions, 50 was filled and 48 of them with obtained title of certified internal auditor in the public sector, while the remaining two internal auditors are undergoing the practical training for obtaining the title of certified internal auditor in the public sector.

In one PFB, only the executive position in the IA unit was filled, and the reason for not filling-in the relevant posts was that the employees at these posts were assigned to different positions outside internal audit, and the lack of appropriate staff.

In some PFBs, during the quality review, the number of internal auditors was reduced in IA units due to their assignment to other job positions, without recruiting new staff that should fill

in the vacant posts. In PFBs that established the IA unit with only one member of operational staff, compliance with internal audit standards is jeopardised.

Internal auditors in the organisations subject to review were implementing the internal audit work methodology, and were aware of the International Standards for the Professional Practice of Internal Auditing by the Institute of Internal Auditors. All established internal audit units had adopted the main documents required for their work, such as: the charter, code of ethics, strategic and annual work plan, however, these documents were not internally published and disseminated to all managers and employees within the organisation. The internal audit plans also include the audit of the system of decentralised/indirect management of pre-accession IPA funds, within the Operational IPA structure.

The resources for the execution of plans match the reality, with clearly stated limitations in the internal audit units with only one employee. The plans have not fully reflected the consultancy engagements, which are largely present in internal audit work. Some internal audit units planned to perform the follow-up audits, yet to a limited extent. The most commonly stated reason why these audits failed to be conducted was insufficient number of staff in internal audit units, that is, an insufficient number of available man-days compared to the audit scope.

The review identified that the IA Charter and Code of Ethics were not available to all the employees and managers within an organisation.

Also, the review identified that during the preparation of plans each individual step was not documented and that adopted plans were not available to all the managers and employees in an organisation. This is the way to increase the publicity of IA work in an organisation to a higher level and contribute to raising awareness of the need for executing the internal control system by all the managers and employees.

IA units state their training needs within the annual plans, yet in a general manner, without stating the specific areas. In interviews, internal auditors have stated their needs for additional training relating to practical execution of performance audit and audit of electronic information systems and the need for direct exchange of experiences with colleagues from other countries. They also complained about being often prevented to attend certain trainings due to insufficient funds planned for these purposes in budgets of their organisations. They also stated a need for a systemic approach in the organisation of trainings by the CHU and further strengthening of the existing, good informal cooperation with other colleagues and the CHU staff.

In order to assess the progress made in relation to execution of internal audit in IPA bodies, in 2018 the audit of internal audit capacities within IPA II was conducted by *Moore and Stephens*, on behalf of the European Commission. DG NEAR published the final report on the audit on internal audit capacities in the Republic of Serbia in the context of internal control framework for IPA II. Ref. Ares (2019) 2307095 of 1 April 2019. The auditors gave an overall conclusion in the report that internal audit of IPA monies in the Republic of Serbia:

- partially conforms with the Standards and the Code of Ethics of the IIA;

- partially conforms with the requirements of Annex B to the IPA II Framework Agreement.

Most relevant findings from the report are as follows:

- Many IA units only have one auditor, which reduces the number of audits that can be carried out, and makes proper review of audit files impossible;
- IPA audits to date have not been carried out on a risk basis, but with a view to checking compliance with procedures, meaning significant IPA-related risks may go undetected or untreated;
- IPA-specific training does not always take place until several months after staff have joined their IA units, and training calendars are often published late;
- There is no quality assurance and improvement programme in place other than routine supervision of audits;
- Auditors report directly to Ministers, but not to senior management more generally.

Under the coordination of the Department for EU funds management and in cooperation with the CHU within the Ministry of Finance, the preparation of an action plan is underway for addressing the findings referred to above.

In order to improve the quality of internal audit work, the following is needed:

- In line with their HR capacities, PFBs should provide operational staff for internal audit tasks in order to have this function substantially utilised by the management as a tool for organisation management.
- Make IA Charter and Code of Ethics available to all managers and employees in an organisation.
- During the preparation of plans, document each individual action and make adopted plans available to all managers and employees in an organisation. This is the way to increase the publicity of IA work in an organisation to a higher level and contribute to raising awareness of the need for executing the internal control system by all the managers and employees.
- Improve the communication between internal auditors and senior management.
- Prepare the methodology for internal quality development.
- Provide support to continuous professional development of internal auditors.

2.5. PFBs' proposals for development of internal audit

Proposals and suggestions for improving internal audit most commonly referred to in individual Annual reports by internal auditors are as follows:

- Intensifying cooperation and improving communication between the CHU and internal audit for further education and professional development;
- Ensuring adequate status of the profession of internal auditor in the public sector and their financial status, in order to attract the required number of new staff;

- Exchange of experiences and good practices with the colleagues from the region, international institutions in the area of internal audit and organising relevant seminars, workshops and meetings;
- Specialised trainings and drafting the instructions and guidelines for providing consultancy services, performance audit, IA quality assessment, etc.

3. HOW COSO WORKS IN PRACTICE: EXTERNAL REVIEW OF FMC SYSTEM

The information obtained about the status of the FMC system in PFBs is based on self-assessment, and the questions are largely about the design of the FMC system. PFBs report based on their knowledge and the information they own.

It is also necessary to have an analysis of the data obtained from other sources in order to identify how such design works in practice and to what extent the COSO scores assessed by PFBs are accurate. This chapter provides relevant conclusions of the State Audit Institution and Budget Inspection in relation to COSO framework, however, in order to understand them properly, it is important to take into account the limitations of cross-examination of findings from the SAI and BI with the methodology used by the CHU:

- In their work SAI/BI are focused on materiality and weaknesses in transactions, while PFBs in their reports have reflected on the overall functioning of the FMC system and provided their self-assessment within the context of full achievement of COSO framework.
- The sample of institutions covered by inspections and external audit does not match the sample reporting to the CHU.
- This review covers the audit planned and conducted by the SAI in 2018 – *Audit of financial statements and compliance for 2017*, and the measures undertaken in 2018 based on recommendations provided in 2017 and 2018. As the results shown below refer to 2017 and are therefore incomparable, the results cannot be taken into consideration for making conclusion on individual elements of FMC, per categories of PFBs for the purpose of this 2018 Consolidated annual report.

Due to these restrictions, the data provided by SAI and BI are not comparable to the statistical data prepared by the CHU in this report, and the results below can to an extent be used as an illustration and source of additional information.

3.1. Overview of recommendations of State Audit Institution (SAI) in the area of financial management and control and internal audit in public fund beneficiaries based on the 2018 work report

State Audit Institution is the supreme state body for auditing public finances in the Republic of Serbia. SAI is authorised and obliged by the Constitution of the Republic of Serbia to control the execution of all budgets. SAI has an important role in strengthening the accountability of holders of public office through performing audits, reporting, issuing recommendations, initiatives for amending regulations and promoting good practices.

Findings in the area of financial management and control

Regarding the area of financial management and control, based on the analysis of functioning of internal controls in majority of entities, no assurance was obtained that the FMC system is established in a manner which would ensure operations in line with the objectives of such system. In the analysis of establishment and provision of conditions for the appropriate functioning of internal audit, the SAI has identified that from the total number of audit entities (86) that are obliged to establish internal audit, it was actually established by 23% of entities, 6% established it only partially (formally established, but not functional yet), while others failed to establish internal audit.

Largest number of irregularities are identified by the SAI in the area of control activities, which were assessed by the PFBs with a good score. This may indicate that PFBs are either not aware of the fact that they are making errors and/or have eliminated the SAI findings in the course of 2018.

Irregularities per audit entities are shown in Table 13.

Table 13. Irregularities per audit entities, based on SAI findings

Categories of PFBs:	Direct and indirect PFBs at the central level		Beneficiaries of local self-government budget (LSUs and indirect PFBs at the local level)		MSIO/ beneficiaries of funds of RHIF (healthcare institutions)		PEs/companies /institutions		Total cases	
	No.	%	No.	%	No.	%	No.	%	No.	%
Irregularities	No.	%	No.	%	No.	%	No.	%	No.	%
Control environment	7	14.29	278	30.96	28	18.79	11	15.28	324	27.74
Risk management	5	10.20	22	2.45	7	4.70	18	25.00	52	4.45
Control activities	21	42.86	407	45.32	46	30.87	30	41.67	504	43.15
Information and communication	13	26.53	180	20.04	61	40.94	10	13.89	264	22.60
Monitoring and evaluation of the system	3	6.12	11	1.22	7	4.70	3	4.17	24	2.05
Total	49	100	898	100	149	100	72	100	1168	100
Number of beneficiaries	18		68		18		27		140	
Irregularity rate for group of beneficiaries	2.72		13.21		8.28		2.67		8.34	

The lowest irregularity rate is seen in PFBs at the central level (direct and indirect) and public enterprises.

The highest irregularity rate is seen in groups of PFBs at the local level (indirect beneficiaries at the local level) and in beneficiaries of funds of RHIF (indirect beneficiaries in the area of healthcare).

All groups of beneficiaries recorded the highest number of irregularities in the area of control activities (43.15% on average), except for MSIO and healthcare institutions which recorded the highest number of irregularities in the area of information and communication (40.94%). MSIOs and healthcare institutions have considerably lower scores compared to other categories in the area of information and communication.

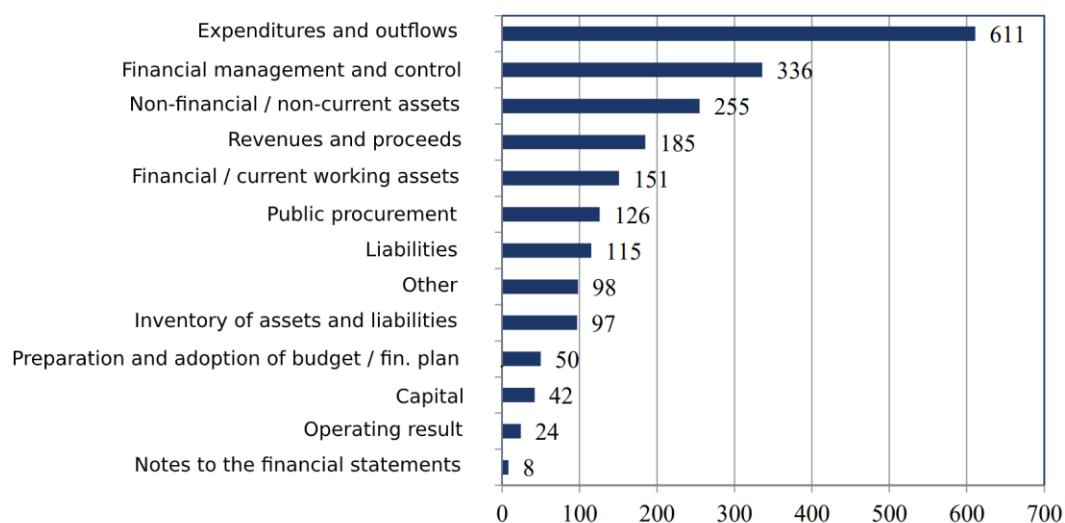
Public enterprises recorded significantly lower scores compared to other categories in the area of risk management.

The overview of most important findings per PFBs in the area of FMC shows the following types of irregularities, listed in order of their frequency (from most frequent to less frequent ones):

- lack of or incomplete internal acts, that is, no regulated procedures or no identified control activities in place, which results in occurrence of irregularity;
- internal acts not compliant with “senior” regulations which is due to inadequate monitoring of regulations and their amendments;
- no identified control activities conducted (e.g. lack of defined supervision, failing to produce minutes, execution of payments without formal and substantial verification of accuracy, no stock taking performed);
- internal acts mutually non-harmonised;
- no appropriate protection from unauthorised access to resources and information in place;
- adoption of acts with no prior consent of the competent authority obtained.

All these irregularities are one of the causes for the occurrence of irregularities in the execution of expenditures and outflows and revenues and proceeds described in audit reports.

Figure 1. Overview of issued recommendations per areas



3.1.1. Measures undertaken in 2018 based on recommendations issued in SAI audits during 2017 and 2018

In the course of 2018, audit entities implemented the recommendations issued during 2017 and 2018 in reports on financial statements and compliance audit for 2016 and 2017.

From the total of 2,518 recommendations in 2017, audit entities implemented or are currently implementing 2,362 recommendations, which constitutes **94%** of all recommendations.

From the total of 2,098 issued recommendations in 2018, audit entities implemented or are currently implementing 242 recommendations, with 1,854 recommendations pending and still within the implementation deadline, while there are only 2 non-implemented recommendations.

Based on the information above, the overall conclusion may be that SAI recommendations are implemented to a significant extent. The data on implementation of SAI recommendations fully correspond to the reports submitted by PFBs. Therefore, it is expected that findings and recommendations in the area of FMC and IA will also be implemented following the same pace, as was the case up to now.

3.2. Overview of inspection controls of Budget Inspection, based on the 2018 work report

Pursuant to provisions of Article 84 of the BSL, Ministry of Finance, Budget Inspection is obliged to undertake the activities on inspection control over direct and indirect budget beneficiaries, mandatory social insurance organisations and other entities listed in items 3), 4) and 5) of the same Article. Therefore, and considering the provision of Article 86 of the BSL which regulates the function of budget inspection, the inspection control assessed the conformity with law in the area of material and financial operations and purposeful and lawful use of funds by the entities undergoing control.

According to the Annual work report of Budget Inspection, in 2018 Budget Inspection performed the inspection control in 15 entities. For the entities that were subject to inspection control in 2018, a total of 66 measures were proposed in the inspection records submitted.

Based on the proposed measures for identified non-compliance and irregularities in the work of entities that underwent control, as listed in the Annual report of Budget Inspection, the conclusion is that most of irregularities were identified within the area of *control activities*:

- Non-compliance of financial plans with the regulations;
- Inadequate utilisation of public revenues contrary to the regulations governing the budget system and special laws regulating utilisation of funds from other sources, as well as by-laws arising from these laws.

- Undertaking commitments without a written contract or any other legal document, which indicates weaknesses in control activities;
- Non-compliance with the provisions of the Law on method of determining the maximum number of employees in the public sector, and non-compliance with the provisions of the Law on the register of employed, elected, nominated, appointed and hired persons in PFBs;
- Failing to pay the profit of public enterprises into the budget;
- Irregularities in payment of salaries, rewards and bonuses;
- Non-compliance with the procedures in the area of public procurement;
- Non-compliance of general and internal acts governing the calculation and payment of salaries with the relevant provisions of the Labour law and other special laws which govern the area of salaries and allowances, including non-compliance with the corresponding by-laws;
- Lack of internal acts which govern the organisation of accounting system, internal accounting control procedures, persons responsible for business changes, flow of accounting documents and deadlines for their submission which are in line with the provisions of the Decree on budget accounting.

By assessing the FMC system in audit entities, SAI has concluded that for **majority of auditees** no assurance was obtained that the FMC system is established in a manner which would ensure operations in line with the objectives of such system, while internal audit was actually established by only in 23% of entities which were subject to audit in the course of 2018.

As the data from the available SAI reports are not relevant for the reporting period addressed in the Consolidated annual report, these could not be used as the benchmark of objective self-assessment but were used predominantly as an illustration and source of additional information.

It would be possible to perform a more thorough analysis and make more relevant conclusions by harmonising the reporting period and agreeing on the samples of auditees covered by SAI and the group of PFBs that report to the CHU, including uniform presentation of findings. This would require strong coordination and partnership between the CHU and SAI. The greatest synergy, however, between the findings of SAI and BI and the FMC self-assessment reports will be seen in the procedure of FMC quality review where the CHU will perform on the spot visits.

Internal auditors in PFBs, through understanding and recording of audit environment, should be regularly aware of the SAI findings and BI measures, monitor their implementation which would lead to better operations and achievement of PFB objectives.

Based on the data referred to above, the conclusion is that SAI recommendations are largely implemented. These data fully correspond to the information in the reports submitted by PFBs. Therefore, it is expected that the implementation of findings and recommendations in the area of FMC and IA will keep up the same pace as was the case so far.

III REPORTING ON PROGRESS

This chapter reports on the progress made in the area of PIFC, based on the three following sources:

1. Action plan of the PIFC Development strategy for 2017-2020
2. Recommendations from the EC Progress report for 2018 and 2019
3. Recommendations from the PIFC report for 2017

Activities of the Ministry of Finance in relation to the three sources above are interrelated. Therefore, the description of activities from the Action plan for the implementation of PIFC Development Strategy for 2017-2020, if appropriate, will refer to the recommendations from the EC Progress report and PIFC report for 2017. The overview of recommendations from these two sources will be presented in tables below.

1. OVERVIEW OF RESULTS ACHIEVED BASED ON THE OBJECTIVES REFERRED TO IN PIFC DEVELOPMENT STRATEGY FOR 2017-2020

Below is the table overview of the most relevant results from the reporting period, achieved on the basis of operational objectives in the PIFC Strategy for 2017-2020, and grouped according to the three defined strategic objectives:

1. Improving the role of the Ministry of Finance – the CHU in the area of coordination, monitoring, education and informing of executives and staff engaged in the PIFC process;
2. Raising awareness on financial management and control as an integral part of the management process with emphasis on managerial accountability, risk management and quality assessment;
3. Further development of internal audit in terms of professionalism and scope of work, more efficient use of available resources and development of the quality assessment system.

This overview also includes the results achieved in the area of international cooperation and implementation of projects supporting the CHU and the Republic of Serbia in the area of PIFC, and which are directly related to the operational objectives. However, the overview of the remaining results and activities in this area is included in the main body of the text covering this topic. The results are shown according to strategic and operational risks, highlighting the recommendations from the EC Progress report and Consolidated annual report for 2017 (in the right-hand column), where appropriate.

Improving the role of the Ministry of Finance – the CHU in the area of coordination, monitoring, education and informing of executives and staff engaged in the PIFC process (Strategic objective 1, the overview is presented according to operational objectives)

Table 14. Table overview of the most relevant results from the reporting period achieved according to operational objectives referred to in PIFC Strategy for 2017-2020

<i>1. Strengthening the coordination of financial management and control and internal audit activities by the CHU</i>	
<ul style="list-style-type: none"> - PIFC Working group for interdepartmental cooperation was established, the composition of members was extended and the meetings were held (January and October 2018); - Seminars and workshops for internal auditors from state bodies were organised to facilitate exchange of experiences, cooperation was established with the Audit Authority Office of EU Funds, internal auditors from the Ministry of Finance, Department for EU funds management and external auditors from the State Audit Institutions. 	
<i>2. Continuous development of methodological manuals and guidelines for internal audit and financial management and control</i>	
<ul style="list-style-type: none"> - The existing methodological manuals and instructions for IA and FMC were updated and improved, and some new were produced and published (during 2018 and early in 2019): <ul style="list-style-type: none"> • “Financial Management and Control Manual” • “Guidelines on the managerial accountability concept – Acting in public interest all the time”, • “Risk Management Guidelines”, • “Risk Management Strategy Model”, • Uploaded Model IA Charter; - A workshop was organised on „Development of model for irregularity management within the financial management and control system in the public sector“; - The methodology for the pilot project on FMC/Managerial accountability was fine-tuned (December 2018) within the project „Support to further development of public internal financial control”, and support was provided to the activities in the implementation of concepts while drafting the methodological materials; - Methodological materials and regulatory framework are being updated and adapted to the national practices by means of open dialogue and consultations with PFBs, meetings with SAI and Treasury Administration as partner institutions. 	<p>EC recommendations</p> <p><i>Adopt or amend the regulations:</i></p> <ul style="list-style-type: none"> - Upgrade the FMC Manual (from 2018); - Develop guidelines for the detection and acting on information about irregularities (from 2019). <p><i>Implement managerial accountability:</i></p> <ul style="list-style-type: none"> - Ensure that managerial accountability is embedded into the administrative culture (from 2019); - implement three pilot projects on managerial accountability (from 2019) <p><i>Further develop Risk management.</i></p> <p>CHU recommendations from the Consolidated annual report for 2018</p> <p><i>Improve the regulatory and methodological internal control framework:</i></p> <ul style="list-style-type: none"> - by upgrading the COSO framework, - by providing better elaboration of the managerial accountability concept, - by developing the area of irregularity management.

	<p><i>Improve and develop specific guidelines, practical tools and PIFC models for:</i></p> <ul style="list-style-type: none"> - risk management, - managerial accountability.
3. Coordination of continuous professional development	
<ul style="list-style-type: none"> - For the purpose of improving the professional capacities, in the course of 2018, the employees in the Department – the CHU: <ul style="list-style-type: none"> • attended the AiP WG meetings and IC WG meeting in Brussels (Belgium) in March and Armenia (Tsaghkadzor) in June, and also in Tbilisi (Georgia), through the Public Expenditure Management Peer Assisted Learning network (PEMPAL) organised by the World Bank in November 2018, • attended the study visit to the Ministry of Finance of the Slovak Republic (March 2018) within the Twinning project „Support to further development of public internal financial control“, • attended the „Workshop on collaboration of internal and external audit and roles of key institutions: ministry of finance, supreme audit institutions and central harmonisation units” (October 2018) organised by the Regional School of Public Administration – ReSPA in cooperation with the Center of Excellence in Finance (CEF), • attended the two-day seminar on managerial accountability of senior civil servants in comparative practice in Western Balkan countries, in Danilovgrad (Montenegro), organised by the Regional School of Public Administration – ReSPA, • attended the study visit to the Ministry of Finance of the Republic of Croatia (November 2018), for exchange of experiences within the Public finance management reform programme 2016-2020, - Produced Gap assessment report and road map for the transition from the current system for the certification of internal auditors in the public sector in Serbia to the preferred model, within the project „Enhancement of Municipal Audit for Accountability and Efficiency in Public Finance Management” (UNDP, SDC), - The implementation of the project was launched „Enhancement of Municipal Audit for Accountability and Efficiency in Public Finance Management” towards better 	<p>CHU recommendations from the Consolidated annual report for 2018</p> <p><i>Enhance the professional knowledge of the CHU staff by monitoring the international practices in the areas of financial management and control and internal audit in order to facilitate the implementation of international standards and EC recommendations, all with a view to successful realisation of requirements relating to Chapter 32.</i></p>

certification process (UNDP, SECO).	
4. Development and implementation of IT support to PIFC	
<ul style="list-style-type: none"> - The web site of the CHU was redesigned and improved, and the elimination of technical shortcomings is currently underway; - A new deadline was defined (Q4 2020) for the implementation of activity <i>Improvement of e-learning platform for the exchange of knowledge in the area of FMC and IA</i>, through Twinning, UNDP and RELOF projects, focusing on knowledge products; - Executed test phase and defined new deadline (Q2 2020) to realise the improvement of the existing software for accessing and electronic submission of annual reports to the CHU, in cooperation with the project “Enhancement of Municipal Audit for Accountability and Efficiency in Public Finance Management” (UNDP /SDC), due to elimination of technical shortcomings. 	<p>CHU recommendations from the Consolidated annual report for 2018</p> <p><i>Improve the reporting system to the CHU:</i></p> <ul style="list-style-type: none"> - by upgrading the questionnaire, - by upgrading the consolidated report, - by full implementation of electronic reporting via the PIFC software, <p><i>Develop e-learning platform of the CHU:</i></p> <ul style="list-style-type: none"> - by uploading new documents and practical tools, - ensure availability of materials.
5. Monitoring and quality control of the Consolidated annual report	
<ul style="list-style-type: none"> - A new deadline was defined (Q2 2020) for improving the content and quality of the consolidated annual report and the system for monitoring of identified weaknesses in the consolidated annual report, that the CHU is implementing in cooperation with SIGMA experts. 	<p>EC recommendations</p> <p><i>In the Annual PIFC Report:</i></p> <ul style="list-style-type: none"> - Assess progress made regarding the PIFC Strategy (2018) - Assess the implementation of recommendations from the previous year’s report (2018) - Better identified weaknesses and proposed corrective measures (identified systemic weaknesses) (2019) <p>CHU recommendations from the Consolidated annual report for 2018</p> <p><i>Improve the reporting system to the CHU:</i></p> <ul style="list-style-type: none"> - by upgrading the questionnaire, - by upgrading the consolidated report, - by full implementation of electronic reporting via the PIFC software.
6. Coordination with other ministries and other key institutions	
<ul style="list-style-type: none"> - Working group which was established within the PAR Council was extended with additional members based on the Decision of the Council, of 20 December 2018, no.:02-02-12743/2018. 	<p>EC recommendations</p> <p><i>Political support and coordination mechanism:</i></p> <ul style="list-style-type: none"> - Establish coordination, monitoring and reporting of

	<p>the PAR, PFM and PIFC reforms. (2018)</p> <ul style="list-style-type: none"> - A more comprehensive policy approach needs to be developed to improve and further guide the implementation of PIFC (from 2019) - WG within PAR Council has to meet (from 2019).
<p>7. Promoting the significance of the internal financial control reform</p>	
<ul style="list-style-type: none"> - A conference was organised for promoting the PIFC Development Strategy (October 2017); - Promotion is ensured by means of continuous coordination activities, through organising different workshops, trainings, seminars and providing direct consultancy to PFBs on the issue of PIFC, through relevant media channels – the CHU web site, by uploading the training material and other relevant documents on the web site and by distributing different promotional materials. 	<p>CHU recommendations from the Consolidated annual report for 2018</p> <p><i>Continue with promoting the importance of public internal financial control, by organising seminars and specialised workshops for senior managers, and by cooperating with relevant media channels.</i></p>

Raising awareness of financial management and control as an integral part of the management process with emphasis on managerial accountability, risk management and quality assessment (Strategic objective 2, the overview is presented according to operational objectives)

<p>8. Providing support to all managers of public fund beneficiaries for substantial understanding of the significance of financial management and control activities as an integral part of strategic and operational processes with emphasis on managerial accountability</p>	
<ul style="list-style-type: none"> - The IC self-assessment questionnaire was amended in cooperation with SIGMA experts; - “Guidelines on the Managerial Accountability Concept” was produced and published within the Twinning project, in line with the document on managerial accountability of managers, drafted by SIGMA experts²⁵ and DG Budget for the Western Balkans; - A two-day workshop was organised „General FMC concept and new COSO framework” by the CHU in cooperation with the Twinning project, and a number of one-day workshops for the education of managers and on the role and importance of managerial accountability and implementation of internal controls in the public sector, as follows: 	<p>EC recommendations</p> <p><i>Adopt or amend the regulations:</i></p> <ul style="list-style-type: none"> - Provide a mandate for the Central Harmonisation Unit to implement quality reviews of internal control systems (from 2018) - Upgrade the FMC Manual (from 2018) - Establish internal control quality review (from 2019) <p><i>Implement managerial accountability:</i></p> <ul style="list-style-type: none"> - Ensure that managerial

²⁵ “Managerial Accountability in the Western Balkans - A comparative analysis of the barriers and opportunities faced by senior managers in delivering policy objectives“ , available at: <http://www.sigmaweb.org/publications/Managerial-accountability-in-the-Western-Balkans-SIGMA-Paper-58-November-2018.pdf>

<ul style="list-style-type: none"> • Air Traffic Services LLC – SMATSA, • Srbijacargo AD, • Security information agency, • Ministry of Economy, in the area of Risk management, • Municipality Novi Becej; <ul style="list-style-type: none"> - The new Rulebook on internal organisation and systematisation of jobs in the Ministry of Finance (December 2018) has established the Group for FMC quality review; - “FMC Manual” was updated in December 2018 and published in early 2019; - The activity <i>Conducting an analysis of implementation of the standards of internal control in a specified number of PFBI with reference to adopted policy documents on financial management and control</i> was launched in 2018 and will continue in cooperation with Twinning project and RELOF, with a new deadline for its implementation defined (Q4 2020); - A new deadline was defined (Q2 2020) for the <i>model for practical application of the financial management and control</i>, to be done after the implementation of pilot project that will be available to PFBs on „e-learning“ platform. The delay was due to additional coordination of RELOF and Twinning activities; - A new deadline was defined (Q2 2019) for <i>further amendments to the FMC Rulebook</i>, in order to have it harmonised with the general guidelines from the SIGMA document „<i>Managerial Accountability in the Western Balkans</i>“, drafted at the request of the European Commission²⁶; - A new deadline was defined for <i>Updating and redesign of all training materials for financial management and control in line with amended regulations</i> (Q4 2019). 	<p>accountability is embedded into the administrative culture (from 2019);</p> <p>CHU recommendations from the Consolidated annual report for 2018</p> <p><i>Improve and develop specific guidelines, practical tools and PIFC models for:</i></p> <ul style="list-style-type: none"> - risk management, - managerial accountability. <p><i>Improve the reporting system to the CHU:</i></p> <ul style="list-style-type: none"> - by upgrading the questionnaire, - by upgrading the consolidated report, - by full implementation of electronic reporting via the PIFC software. <p><i>Raise awareness of the role and importance of PIFC in PFBs:</i></p> <ul style="list-style-type: none"> - by organising basic and specialised workshops for top management, particularly addressing the following aspects: action plan, monitoring, evaluation and supervision, risk management, self-assessment and reporting, irregularity management, managerial accountability. <p><i>Develop e-learning platform of the CHU:</i></p> <ul style="list-style-type: none"> - by uploading new documents and practical tools, - ensure availability of materials.
<p>9. Strategic planning that links organisational objectives to the Government’s overall vision</p>	
<ul style="list-style-type: none"> - Law on Planning System of the Republic of Serbia was 	<p>EC recommendations <i>Implement managerial</i></p>

²⁶ “Managerial Accountability in the Western Balkans - A comparative analysis of the barriers and opportunities faced by senior managers in delivering policy objectives“, available at: <http://www.sigmaxweb.org/publications/Managerial-accountability-in-the-Western-Balkans-SIGMA-Paper-58-November-2018.pdf>

<p>adopted („Official Gazette of RS”, no. 30/18) which governs methodology of public finance management, analysis of effects of public policies and regulations and the contents of individual public policy documents;</p> <ul style="list-style-type: none"> - A new deadline was defined (Q1 2019) for the <i>adoption of the regulation governing the methodology for developing the medium-term (strategic) plans</i>, due to consultations with a large number of stakeholders and harmonising the Decree on the methodology for developing the medium-term plans, with comments and suggestions for the amendment of the act. 	<p><i>accountability:</i></p> <ul style="list-style-type: none"> - Ensure that managerial accountability is embedded into the administrative culture (from 2019);
<p>10. Operational planning that links operational objectives to resource requirements (budgetary, personnel and other assets)</p>	
<ul style="list-style-type: none"> - A new version of the Regulation on the principles for the internal organisation of jobs in ministries, special organisations and Government services was prepared and is being harmonised to facilitate the implementation of the Law on Planning System and PIFC Development strategy in RS for 2017-2020, and a new deadline was defined (Q3 2019). 	<p>EC recommendations <i>Implement managerial accountability:</i></p> <ul style="list-style-type: none"> - Ensure that managerial accountability is embedded into the administrative culture (from 2019);
<p>11. Monitoring and reporting progress towards objectives linked to resource utilization</p>	
<ul style="list-style-type: none"> - A new deadline was defined (Q3 2019) for <i>amending the existing regulations governing this area</i>. 	<p>EC recommendations <i>Implement managerial accountability:</i></p> <ul style="list-style-type: none"> - Ensure that managerial accountability is embedded into the administrative culture (from 2019);
<p>12. Development of risk management process</p>	
<ul style="list-style-type: none"> - “<i>Risk Management Guidelines</i>” (November 2018) and “<i>Risk management strategy model</i>” were drafted and published 	<p>EC recommendations <i>Further develop Risk management (from 2018 and 2019).</i></p> <p><i>Implement managerial accountability:</i></p> <ul style="list-style-type: none"> - Ensure that managerial accountability is embedded into the administrative culture (from 2019); <p>CHU recommendations from the Consolidated annual report for 2018</p> <p><i>Improve and develop specific guidelines,</i></p>

	<i>practical tools and PIFC models for:</i> - risk management, -managerial accountability.
13. Development of a model for evaluating the quality of financial management and control	
- A new deadline was defined (Q2 2019) for introducing the <i>Annual statement on internal controls by the head of PFB</i> , due to the need for further harmonisation of the annual statement on internal controls with the amendments to the FMC Rulebook and managerial accountability function and introduction of irregularity management function.	EC recommendations <i>Implement managerial accountability:</i> - Ensure that managerial accountability is embedded into the administrative culture (from 2019), CHU recommendations from the Consolidated annual report for 2018 <i>Improve and develop specific guidelines, practical tools and PIFC models for:</i> -managerial accountability.
14. Communication of accurate, relevant and timely information in relation to financial and operational performance to be published inside and outside the organisation	
- A new deadline was defined (Q3 2019) for amending the existing regulation governing this area.	EC recommendations <i>Implement managerial accountability:</i> - Ensure that managerial accountability is embedded into the administrative culture (from 2019),

Further development of internal audit in terms of professionalism and scope of work, more efficient use of available resources and development of the quality assessment system (Strategic objective 3, the overview is presented according to operational objectives)

15. Development of professional skills of internal auditors	
- A meeting was held for exchange of experiences of internal auditors from IPA beneficiaries, EU Audit Authority Office of EU Funds and the CHU (October 2018) for reviewing and agreeing on IPA Decree in the part relating to submission of audit reports, with announced further cooperation in 2019 on preparation of documents and checklists for IPA audit through the Twinning project;	CHU recommendations from the Consolidated annual report for 2018 <i>PFBs should provide continuous training for internal auditors (which will ensure more appropriate planning</i>

<ul style="list-style-type: none"> - Rulebook on professional development of certified internal auditors in the public sector was prepared in late 2018 and adopted in March 2019; - Update and redesign of the training materials necessary for the implementation of the updated manual for internal audit is planned to be done within 30 days after updating manuals for internal audit. 	<p><i>and rational utilisation of internal audit resources in public fund beneficiaries)</i></p>
16. Development of a model for evaluating quality of work of internal auditors	
<ul style="list-style-type: none"> - A new deadline was defined (Q4 2019) for <i>stipulating external evaluation of quality of work of internal audits in PFBs by a regulation, development of a model for internal assessment of the quality of internal audit, and development of guidelines for quality assurance of internal audits for heads of internal audit units</i>, due to additional coordination with the Twinning partner and existing administrative barriers arising from Addendum to the Twinning contract. 	<p>EC recommendations</p> <p><i>Improve internal audit:</i></p> <ul style="list-style-type: none"> - Improve the IA quality assurance system.
17. Establishing minimum criteria for organising a joint internal audit of two or more PFBs (from a designated territory, for the same-type or similar activities, of a small size)	
<ul style="list-style-type: none"> - A new deadline was defined (Q1 2020) for <i>Development of Guidelines for the establishment of the internal audit functions within small PFBs, in relation to establishing the joint internal audit unit</i>, which is being implemented in cooperation with the Twinning partner, PFBs and RELOF. 	<p>EC recommendations</p> <p><i>Improve internal audit</i></p> <ul style="list-style-type: none"> a) Define the criteria for establishing the IA function (from 2018)

Monitoring of the strategy implementation

18. Monitoring and reporting on the implementation of PIFC Strategy and Action plan	
<ul style="list-style-type: none"> - A PIFC Working group was established the its composition was updated on the basis of the new Decision of the minister of finance of August 2018. - Meeting of PIFC Working group was held in October 2018 discussing the activities from the Action plan which were implemented in the course of 2017 and 2018, and those planned to be implemented in the upcoming period; - Annual reporting to the Government on the implemented activities, achieved results and possible difficulties in the implementation of the objectives and measures is implemented within the Consolidated annual report on PIFC for 2018, which is adopted by the Government. 	<p>EC recommendations</p> <p><i>Political support and coordination mechanism:</i></p> <ul style="list-style-type: none"> - Establish coordination, monitoring and reporting of the PAR, PFM and PIFC reforms. (2018) - A more comprehensive policy approach needs to be developed to improve and further guide the implementation of PIFC (from 2019)

2. RECOMMENDATIONS FROM THE EC PROGRESS REPORTS FOR 2018 AND 2019

Out of 21 recommendations provided by the EC within their Progress Reports for 2018 and 2019, 9 recommendations (42.86%) have been implemented so far, 11 recommendations (52.38%) are being implemented, while 1 recommendation (4.76%) is planned to be implemented. The table below presents the recommendations from the EC Progress Reports for 2018 and 2019. The results achieved in relation to the objectives of PIFC Strategy have also been listed above.

Table 15 – Overview of recommendations from the EC Progress Reports for 2018 and 2019

Recommendations	Implementation		
	Recommendation implemented	Implementation underway	Implementation is to start
<p>1. Adopt or amend the regulations</p> <p>a. Amendments to the Budget System Law in the part relating to managerial accountability (from 2018)</p> <p>b. Review and amend the laws in public administration to provide a coherent basis for the implementation of delegated managerial accountability (from 2019)</p> <p>c. Provide a mandate for the Central Harmonisation Unit to implement quality reviews of internal control systems (from 2018)</p> <p>d. Upgrade the FMC Manual (from 2018)</p> <p>e. Develop guidelines for the detection and acting on information about irregularities (from 2019)</p>	<p>a) implemented in amendments of BSL in 2018</p> <p>c) mandate was regulated in BSL since 2009</p> <p>d) prepared in late 2018, published at the CHU web site in February 2019: implemented COSO 2013, further elaborated MA concept, presented COSO 2017 – Risk management framework and included tools for implementation</p> <p>e) initial workshop organised in October 2018</p>	<p>e) within the Twinning project. expected finalisation in 2019</p>	<p>b) Following the finalisation of Pilot project</p> <p>d) continuous activities</p>

<p>2. Develop a policy approach on PIFC in the public sector, focusing on managerial accountability (from 2018)</p>	<p>Within the existing PIFC Strategy, the main objective is increasing the accountability of managers. Operational objectives 8, 9, 10, 11, but also 12, 13 and 14 are dedicated to managerial accountability.</p>	<p>Pilot project is underway, as a starting basis</p>	<p>New policy document will cover the period from 2021, and the beginning is planned for Q1 2020</p>
<p>3. Implement managerial accountability</p> <p>a. Ensure that managerial accountability is embedded into the administrative culture (from 2019)</p> <p>b. implement at least three pilot projects on managerial accountability (from 2019)</p>	<p>Guidelines on the managerial accountability concept, August 2018</p> <p>In June 2018, a training was organised on the FMC tools, practice and implementation of managerial accountability in France</p>	<p>Pilot exercise is implemented in the following institutions: MoF, MPALSG, RPPS, NES. Expected results are implementation of tools in the area of delegation, performance management, procedures of financial units; identification of weaknesses in the legal framework and drafting guidelines and methodological instructions based on lessons learned from the Pilot activity</p>	
<p>4. Political support and coordination mechanism:</p> <p>a) Establish coordination, monitoring and reporting of the PAR, PFM and PIFC reforms. (2018)</p> <p>b) A more comprehensive policy approach needs to be developed to improve and further guide the implementation of PIFC (from 2019)</p> <p>c) WG within PAR Council has to meet (from 2019)</p>	<p>PIFC Strategy envisages a working group for monitoring of PIFC Strategy, and it has been in place since June 2017</p> <p>A working group which should focus on coordination of activities in the area of PIFC was set up in December 2018. The initial meeting was held in May 2019.</p>	<p>An extension of the WG within PAR council is foreseen to include the members relevant for managerial accountability area</p>	
<p>4. Further develop Risk management (from 2018 and 2019)</p>	<p>Published “<i>Risk management guidelines</i>” and “<i>Risk management strategy model</i>” in November 2018</p>		
<p>5. Establish internal control quality review (from 2019)</p>	<p>In December 2018 a special organisational unit was established within the CHU: Group for quality</p>	<p>First quality review mission was planned</p>	

	<p>review of the FMC system, with 3 systematised job posts</p> <p>Preparatory activities are underway (preparation of procedures, checklists), the documents are submitted and analysed</p>	<p>to take place in summer 2019</p>	
<p>6. Establish and implement in practice the system for detection of irregularities (from 2018 and 2019)</p>	<p>In October 2018, a workshop was organised with the representatives of relevant institutions: <i>„Development of irregularity management model in the FMC system in the public sector “</i></p> <p>Definition of irregularities was included in the latest version of the BSL in December 2018</p>	<p>More detailed reporting was elaborated in the draft FMC Rulebook which is in its final stage of development.</p> <p>In relation to item 1e, Guidelines are being produced at the moment</p>	
<p>7. Improve internal audit</p> <p>a) Define the criteria for establishing the IA function (from 2018)</p> <p>b) Raise awareness of senior management of internal audit (from 2018)</p> <p>c) Improve the IA quality assurance system (from 2018)</p> <p>d) Improve timely implementation of IA recommendations (from 2019)</p>	<p>b) 120 managers attended the training during 2018; FMC trainings included in the Programme of professional development of managers (mandatory programme, in accordance with the Law on Civil Servants);</p> <p>c) Formulated methodology for quality review by the CHU, with two cycles performed so far</p> <p>d) need for this request is also highlighted in the Consolidated annual report also by the SAI. In the categories of MSIO, PEs at the central level and indirect PFBs, over 70% of recommendations is implemented.</p>	<p>a) expected finalisation date for the Guidelines on joint IA units is 2020 (ways for improving the current criteria are further considered)</p> <p>c) Preparation of draft rulebook for IA quality review based on peer review model is underway, with the deadline end of 2019</p> <p>d) the part of the IA Manual: monitoring the implementation of recommendations will further clarify</p>	<p>b) continuous activity</p>

		and help to understand the need for more efficient implementation of recommendations. This need should also be addressed to managers of PFBs.	
<p>8. In the PIFC Annual Report</p> <p>a) Assess progress made regarding the PIFC Strategy (2018)</p> <p>b) Assess the implementation of recommendations from the previous year's report (2018)</p> <p>c) Better identified weaknesses and proposed corrective measures (identified systemic weaknesses) (2019)</p>	<p>a, b) implemented in the PIFC report for 2017</p> <p>c) in PIFC Report for 2018 (improved recommendations, statistical data and questionnaire, new possibility for PFBs to highlight key issues and weaknesses and propose ways of improvement; there is also a section on SAI and BI conclusions)</p>		
<p>9. The CHU should gradually shift its focus from training activities to methodological guidance (2018)</p>	<p>In 2018, a large number of methodological guidelines was produced: <i>"Guidelines on the managerial accountability concept"</i> prepared and published on the CHU web site in August 2018 (in line with the measure no. 8.2 from the Action plan of PIFC Strategy);</p> <p>The existing <i>"Financial management and control manual" (FMC Manual)</i> was updated²⁷ in the course of 2018, and published in February 2019</p> <p><i>"Risk management guidelines"</i> were updated²⁸ and published on the CHU web site in November 2018, as well as the practical example/model of <i>Risk management strategy</i></p>	<p>The project for improving the certification scheme for IAs is underway</p> <p>The transition of training organisation is underway</p> <p>Drafting the new version of IA Manual is underway in cooperation with the Twinning partner</p> <p>Guidelines are being produced within the Pilot project</p>	<p>A plan is to prepare a number of case studies for self-learning of internal auditors</p> <p>Guidelines on FMC in LSUs are planned</p>
<p>10. The CHU – filling in capacities (2018)</p>	<p>Two persons hired through an internal recruitment procedure in April 2019</p>		<p>Public competition planned by the end of 2019</p>

²⁷ in accordance with the measure 8.6 from the PIFC Strategy Action Plan

²⁸ in accordance with the measure 12.1 from the PIFC Strategy Action Plan

3. RECOMMENDATIONS FROM THE 2017 PIFC ANNUAL REPORT

Overall, the implementation of most recommendations can be said to be underway, due to their long-term and continuous nature, while for many others, implementation will take some additional time. For the three recommendations, the implementation was delayed and they were redefined or repeated. The results achieved regarding the recommendations from the 2017 PIFC Annual report are listed in the table below, with a summary overview of recommendations.

Table 16 - Overview of recommendations from the 2017 PIFC Annual report

Recommendations	Implementation		
	Recommendation implemented	Implementation underway	Implementation is to start
<i>FMC:</i>			
<p>1. Improve the regulatory and methodological internal control framework (CHU):</p> <p>a) by defining the selection of PFBs for the Consolidated annual report, based upon the largest PFBs,</p> <p>b) by upgrading the COSO framework,</p> <p>c) by providing better elaboration of the managerial accountability concept,</p> <p>d) by developing the area of irregularity management</p>	<p>b) The existing “<i>Financial management and control manual</i>” was updated in late 2018 and published at the CHU web site in February 2019, implementing COSO 2013, further elaborating MA concept, presenting COSO 2017 – Risk management framework and included tools for implementation;</p> <p>c) “<i>Guidelines on the managerial accountability concept</i>” were prepared and published on the CHU web site in August 2018;</p>	<p>a) Analysis of PFBs was done, cooperation with SIGMA is underway for defining a selection of most relevant institutions</p> <p>d) link with item 6 of the Overview of recommendations from the EC Progress Report for 2018.</p>	

Recommendations	Implementation		
	Recommendation implemented	Implementation underway	Implementation is to start
<p>2. Improve and develop specific guidelines, practical tools and PIFC models (CHU) for:</p> <p>a) risk management</p> <p>b) managerial accountability</p>	<p>a) “<i>Risk management guidelines</i>” were updated and published in the CHU web site in November 2018; Risk management strategy model was prepared and published in the CHU web site in November 2018; The existing “<i>Financial management and control manual</i>” was updated (in accordance with the measure 8.6 from the PIFC Strategy Action Plan)²⁹, including the tools for risk management.</p> <p>b) “<i>Guidelines on the managerial accountability concept</i>” were prepared and published on the CHU web site in August 2018;</p>		
<p>3. Improve the reporting system to the CHU:</p> <p>a) through further upgrading of the questionnaire</p> <p>b) through further upgrading of the consolidated report</p> <p>c) through full implementation of electronic reporting via the PIFC software</p>	<p>a) Further activities are undertaken in improving the reporting system by expanding the self-assessment questionnaire to include the section in which PFBs can indicate the key issues and weaknesses in the practical implementation of FMC and indicate measures for improving the internal control system;</p> <p>b) link with item 8 of the Overview of recommendations from the EC Progress Report for 2018.</p> <p>c) the software was developed, tested and uploaded, however it is not functional due to technical issues</p>	<p>c) Software servicing was initiated by UNDP partners, and is expected to be functional in 2019</p>	

²⁹ Although the Manual was published on the CHU web site in February 2019, it was prepared in entirety in 2018

Recommendations	Implementation		
	Recommendation implemented	Implementation underway	Implementation is to start
<p>4. Raise awareness of the role and importance of PIFC (CHU) in PFBs</p> <p>- through organising basic and specialised workshops for top management, in the area of: action plan, monitoring, evaluation and supervision, risk management, self-assessment and reporting, irregularity management, managerial accountability</p>	<p>In addition to organising basic FMC trainings, further work was done on organising specialised FMC trainings for the executives in PFBs, particularly focused on: managerial accountability, risk management, monitoring and reporting, etc. (described in more detail in the section on training of persons involved in FMC). In the course of 2018, 120 executives attended the training</p>	<p>Within the Programme of professional development of managers (NAPA) for 2018, a mandatory training was planned in the basics of FMC. The actual implementation was delayed due to preparatory activities of the training, however, it will be included in the following programme for 2019. Based on the new version of the Law on Civil Servants³⁰ this training programme is mandatory for all appointed persons.</p>	
<p>5. Develop e-learning platform (CHU):</p> <p>a) by uploading new documents and practical tools</p> <p>b) ensure availability of materials</p>	<p>All the materials produced by the CHU in 2018 are uploaded to the e-learning platform</p>		
<p>6. Direct and indirect budget beneficiaries should establish and develop cooperation and share experiences in the area of FMC at the level of specific fields</p>			<p>Planned for the new strategic period with support of donor community</p>
<p>7. “Large” PFBs should set up audit boards, as advisory bodies for PIFC</p>	<p>There are 15 audit boards in PFBs</p>	<p>This will be further worked on</p>	
Internal audit			
<p>1. Ministries should recruit or select within the existing human resources the appropriate staff for the internal auditor positions</p>			<p>The recommendation was repeated in the</p>

³⁰ Law on Civil Servants

Recommendations	Implementation		
	Recommendation implemented	Implementation underway	Implementation is to start
			Consolidated report for 2018
<p>2. PFBs should:</p> <p>a) adjust the systematisation, number of employees and fill the internal auditor positions, in accordance with the IA Rulebook</p> <p>b) harmonise the remuneration and the reward system of internal auditors to match the workload and required competencies</p>		Although there was a rise in the total number of systematised and filled internal auditor job posts in PFBS in 2018 compared to the previous one, the recommendation is still not entirely implemented.	The recommendation was repeated in the Consolidated report for 2018
<p>3. PFBS should provide continuous training for internal auditors (in order to ensure more appropriate planning and rational utilisation of internal audit resources)</p>	In accordance with the Rulebook on professional development of internal auditors in the public sector, adopted in March 2019, professional development is mandatory for all certified internal auditors in the public sector.		
<i>CHU</i>			
<p>1. The CHU should fill-in the remaining job posts which would enable the CHU to focus more on aspects of methodology, monitoring, analysis and reviewing the quality of PIFC system.</p>	<p>A separate group was established for the activities of FMC quality review</p> <p>Two persons were hired through an internal recruitment procedure in April 2019 and during the previous year, significant amount of methodological materials was produced (see item 9 from the Overview of recommendations from the EC Progress Report for 2018 and 2019)</p>	<p>Project for improvement of IA certification scheme is underway</p> <p>Transition of training organisation is underway</p> <p>Several guidelines are being drafted</p>	Public competition planned by the end of 2019
<p>2. Continue with uploading the new material onto the e-learning platform (practical exercises, tests, IA training material, etc.)</p>	All the materials produced are uploaded to the e-learning platform	Drafting the new version of IA Manual is underway in cooperation with the Twinning partner Guidelines are being drafted within the Pilot project on managerial accountability	A plan is to prepare a number of case studies for self-learning of internal auditors

Recommendations	Implementation		
	Recommendation implemented	Implementation underway	Implementation is to start
3. Improving the system of monitoring and reporting on internal controls in an electronic format, via the CHU software	The software was developed, tested and uploaded, however it is not functional due to technical issues	Software servicing was initiated by UNDP/SDC partners, and is expected to be functional in 2019	
4. Enhance the professional knowledge of the CHU staff by monitoring the international practices in the areas of financial management and control and internal audit, in order to facilitate the implementation of international standards, recommendations of the European Commission, and successful realisation of requirements relating to Chapter 32	Link with the implementation of the strategic objective 3 from the PIFC Development Strategy for 2017-2020		
5. Continue with promoting the importance of public internal financial control , by organising seminars and specialised workshops for senior managers, and by cooperating with relevant media channels	<i>For a total of 120 top and mid-level managers, specialised one-day trainings were organised focusing on the specific requests of PFBs, such as: establishing and implementation of FMC, managerial accountability, establishing the risk management process.</i>		

4. ACTIVITIES OF THE CHU

4.1. Main results and international cooperation

In the course of 2018, the Central Harmonisation Unit had considerable support from the following donor projects in the area of PIFC:

1) **Twinning project „Support to Further Development of Public Internal Financial Control”** (June 2017) in cooperation with the Ministry of Economy and Finance of the Republic of France, funded by the EU pre-accession funds (IPA 2013), whose overall objective is establishing modern and efficient public finance management system at all government levels, while the specific objective is focused on internal financial control and rollout of consolidated PIFC methodologies and procedures in public sector, in line with applicable international standards and best EU practices.

The CHU achieved some of the most relevant results in cooperation with this project in 2018:

- 1) **“Guidelines on the managerial accountability concept”** prepared and published at the web site of the CHU in August 2018 (in accordance with the measure 8.2 from the PIFC Strategy Action Plan);
- 2) The existing **“Financial management and control manual” (FMC Manual)** was amended (updated) (in accordance with the measure 8.6 from the PIFC Strategy Action Plan). **The Manual was published at the CHU web site in February 2019, although being entirely prepared in 2018.**
- 3) **“Risk management guidelines”** were updated (in accordance with the measure 12.1 from the PIFC Strategy Action) and published at the CHU web site in November 2018.
- 4) **practical example/model of the Risk management strategy**, published at the CHU web site in November 2018.

Pilot activity is focused on improving the managerial accountability and was launched at the end of 2018 with an envisaged finalisation date in Q1 2020. Pilot activity should provide support in implementation of concepts and should produce the following methodological materials:

- Guidelines on delegation,
- Guidelines on performance management,
- Guidelines of management of irregularities and handling of exceptions,
- Guidelines for financial units,
- Guidelines on quality review of internal control system,
- Guidelines on the FMC system in small PFBs.

An important output of the Pilot activity should be a clear picture of required changes in the regulations, which would improve the implementation of the managerial accountability concept and which would be implemented in the next strategic period.

Pilot activity is being performed in cooperation with the National Employment Service, Ministry of Finance, Ministry of Public Administration and Local Self-Government, Republic Public Policy Secretariat.

Trainings provided by the Twinning project are listed in the section about trainings. Other outputs and activities of this and other projects are listed in the overview of results achieved based on the objectives referred to in PIFC Development Strategy for 2017-2020.

2) The project „**Enhancement of Municipal Audit for Accountability and Efficiency in Public Finance Management**” conducted by the United Nations Development Programme (UNDP), and funded by the Swiss Development Cooperation (SDC), is focused on improving the mechanisms of the Ministry of Finance – the CHU, in strengthening and structuring the public internal financial control and accountable public funds management, improving the FMC system and ensuring that the IA function in local self-governments is in place, fully-functional and supporting the managerial accountability concept.

In cooperation with the CHU, the project has contributed to further implementation of PIFC according to international standards at the local self-government level.

A number of activities were implemented in the project relating to further improvement of the system of electronic reporting by the public fund beneficiaries, which should reduce the time necessary for entering and processing of data, the time for completing the questionnaire, as well as the possibility of errors in reports and data processing, and the paper work will be reduced to minimum.

3) „The project „Enhancement of Municipal Audit for Accountability and Efficiency in Public Finance Management” conducted by the United Nations Development Programme (UNDP), and funded by the Swiss Development Cooperation in the Ministry for economic affairs (SECO) (launched in June 2018) is about development and testing the new internal auditor certification model in the public sector and enabling greater inflow of skilled internal auditors in the system, through setting-up a separate module in the area of internal audit and lifting the “barrier” between the private and public sector, by providing possibilities for the recognition of other certificates.

4) The project „Local Finance Reform “(launched in 2016) conducted by the Swiss Development Cooperation in the Ministry for economic affairs (SECO), provides support in local self-government units (Vranje, Knjazevac, Osecina, Sremska Mitrovica and Uzice) by enhancing the local finance management and providing consultancies for:

1. Introducing adequate FMC system in municipal/city administrations,
2. Introducing or improving IA in municipal/city administrations,
3. Introducing the FMC system in public enterprises at the local level.

5) The project „Public Finance Reform – Agenda 2030“ for 2018-2020, funded by the Government of the Federal Republic of Germany and implemented by German Development Agency (GIZ), supports the public finance reform in the Ministry of Finance – Customs Administration, Tax Administration, Public Debt Directorate, Treasury Administration, Central Harmonisation Unit, AFCOS, Department for international cooperation and European integration, Budget Inspection and Budget Department.

The initial workshop was held in October 2018 in Subotica and was attended by representatives of the relevant state authorities, in order to conceptualise the irregularity management in PFBs.

The CHU is maintaining active cooperation with the representatives of the European Commission’s Directorate-General for Budget and Support for Improvement in Governance and Management (SIGMA) – an initiative of the Organisation for Economic Co-operation and Development (OECD). Most of the work in 2018 was focused on developing the future model for reviewing the quality of the FMC system and other PIFC-related topics.

4.2. Trainings organised by the CHU

Training of persons engaged in FMC

Ministry of Finance – the CHU has been continuously organising training courses for managers and other employees responsible for the establishment and development of the FMC system. The purpose of training courses is to make the participants familiar with the main concepts, role and importance of the internal control system, and with all the specific activities that need to be carried out in order for the system to be properly established, maintained and developed. The main goal of these training sessions is improvement of the internal control systems and managerial accountability in practice, for the purpose of efficient achievement of strategic and operational objectives of public fund beneficiaries, by executing all the operations and transactions in a lawful, ethical, economical, efficient, effective and transparent manner.

The programme of basic, five-day training for FMC consists of four areas, including:

- introduction to public internal financial control;
- integrated internal control framework - COSO model;
- risk management system;
- management control system.

In addition to the theoretical part, the training courses also include the practical part (exercises, case studies, tests...), so that the participants could master the methodology of establishment and development of the FMC system and be entirely equipped to implement the lessons learned within their respective entities/organisations.

In the course of 2018, ***the basic FMC training*** was organised in three rounds and ***included a total of 208 participants*** from different public sector institutions.

In order to contribute to comprehensive development of public internal financial control, the CHU continued to conduct the basic training courses at the local level. A five-day basic training in financial management and control was organised in Krusevac, for the representatives of the City of Krusevac and the municipalities Aleksandrovac, Cicevac, Varvarin, Trstenik and Brus. The training was aimed to gather as many participants as possible from Rasina administrative district. These trainings at the local level were organised in cooperation with the UNDP/SDC project.

Senior and mid-level managers, 120 of them in total, attended the one-day training courses, particularly addressing the specific topics, tailor-made to respond to the beneficiaries' requests, such as: establishing and implementation of FMC, managerial accountability, establishing the risk management processes, etc. The training courses were held at the following institutions:

- Joint Stock Company for Freight Railway Transport "Srbija Kargo" Belgrade, on the topic „Establishing and implementation of FMC” for 46 participants;
- Air Traffic Services LLC – SMATSA, on the topic „Basic training on financial management and control“ for 10 participants;
- Security Information Agency, on the following topics: „Financial management and control system“, „Risk and risk management system“ and „Presentation of Risk register“ for 25 participants;
- Ministry of Economy, on the topic “Establishing the risk management process” for 15 participants;
- Municipality of Becej, on the topic „Managerial accountability“ for 20 participants.

Internal auditor training

Continuous professional development of internal auditors is done by means of keeping up with the local and foreign literature and through direct sharing of experiences among the employees during the meetings, with professional organisations and the CHU.

The theoretical part of the internal audit training included 56 participants employed in public fund beneficiaries. In the period January – December 2018, a practical training on conducting the internal audit was held in 24 beneficiaries, for 58 candidates for acquiring the professional title of a certified internal auditor in the public sector.

The Certification Rulebook lays down the conditions for acquiring the title of a certified internal auditor in the public sector. After completing the training course envisaged by the Training program, which is an integral part of the Rulebook, the candidates sit for an exam before an examination board formed by the minister of finance.

The Training program for acquiring a professional title of a certified internal auditor in the public sector includes the following:

- 1) basic training for conducting internal audit, with the duration of 7 work days, i.e. 49 working hours;

- 2) basic training for financial management and control, with the duration of 5 work days, i.e. 35 working hours;
- 3) training for practical work on internal audit, by conducting two audits in the beneficiary where the candidate is employed at to perform internal audit tasks, with expert support of the Ministry of Finance, in the manner specified in the IA Rulebook.

During two examination periods in 2018, 36 candidates successfully passed the exam and acquired the title of a certified internal auditor in the public sector. By the end of 2018, a total of 413 internal auditors were certified in the public sector.

The certification scheme which includes mentoring, that is, the practical training of candidates by the CHU in conducting two audits prior to taking an exam is demanding considering the capacity aspect – not only does it take significant number of days, but it also requires considerable expertise of a mentor. In order to reduce the need for direct involvement of the CHU staff, the existing certification scheme should be made more efficient by making the trainings more available and by opening up opportunities for obtaining the title of certified internal auditor.

In cooperation with the PIFC Twinning project experts, the CHU organised the following training courses:

- “*Effective audit reports*”, four one-day trainings held from 6-9 February 2018 (total 76 participants);
- “*Performance audit*”, four one-day trainings held on 29th and 30th May, 6th and 7th November 2018 (total 58 participants);
- “*Audit of FMC system*”, two one and a half-day trainings, held on 5th and 6th June 2018 (total 35 participants);
- “*Audit of EU funds*”, a one and a half-day training held on 5th and 6th December 2018 (15 participants).
- In January 2018, a two-day workshop was held „*General FMC concept and new COSO framework*“ (total 17 participants).
- In June 2018, a workshop was held „*FMC tools, practices and managerial accountability implementation in France*“, for pilot institution representatives (Ministry of Finance, Ministry of Public Administration and Local Self-Government and National Employment Service). The workshop was attended by 19 participants.

IV CONCLUSIONS AND RECOMMENDATIONS

Before listing all conclusions and recommendations about the three pillars of the PIFC system: FMC, IA and CHU, it is necessary to state that based on results of self-assessment questionnaire, the image of the most important elements of **managerial accountability** is a positive one, while the responses to open-ended questions suggest there is a need for further improvement of this concept.

The findings from the SIGMA study: “ *Managerial Accountability in the Western Balkans - A comparative analysis of the barriers and opportunities faced by senior managers in delivering policy objectives* ”³¹ and EC recommendations suggest that the managerial accountability concept requires further improvement. Managerial accountability concept is a complex one and may be approached from different aspects, whereby it is necessary to have full consideration of the RS organisation and importance of PIFC. The Pilot project implemented by the Twinning partner together with the CHU should provide answers to a number of specific questions about the managerial accountability concept in RS.

1. Financial management and control

The most important *results* achieved in the field of FMC are as follows:

- During 2018, a significant increase (23%) in the number of submitted FMC reports was identified. Reporting institutions come from all categories of the RS public sector. The institutions that report most and whose FMC systems have the highest scores are the most important institutions of the Republic of Serbia, direct budget beneficiaries from the central level: ministries, mandatory social insurance organisations, independent and autonomous state authorities, Government services and offices and special organizations, institutions of the Autonomous Province of Vojvodina, the judicial authorities as well as public enterprises founded by the Republic of Serbia. Submission of the report demonstrates the level of compliance with the COSO framework in PFBs and the level of awareness within the PFBs of the importance of PIFC.
- The best average scores, according to each of the observed parameters, were achieved at the central / Republic level in the category of MSIO, followed by the category of ministries.
- Considering the COSO framework, the best results were achieved in the areas of information and communication (83%) and control environment (80%).

In the area of FMC, the following *weaknesses* were identified, mainly due to the lack of awareness of managers about the importance of internal controls:

- Fewer reports come from the **local government** level, and even fewer from the

³¹ Available at: <http://www.sigmaweb.org/publications/Managerial-accountability-in-the-Western-Balkans-SIGMA-Paper-58-November-2018.pdf>

category of **indirect budget beneficiaries**. These categories also have lower average scores. Average scores of the beneficiaries who submitted their reports for the first time are 2% lower than the group that reports on a continuous basis, and within them the lowest average scores were recorded in the **local self-government** group. The lowest indicators are seen at the level of **indirect PFBs**, by all observed parameters, just as in the previous year. Many findings point to the overall observation that this is a weak and neglected category of PFBs. Indirect PFBs constitute the single largest group of the RS public sector, but at the same time are the weakest group in terms of average COSO scores.

- The **quality of procedures** and their relationship to risks are questionable, especially in the categories of PFBs from the local level, indirect PFBs, and partly from other direct beneficiaries at the central level. One of the causes (not the only one) is the lack of capacities for preparing the quality procedures in individual PFBs.
- Low scores indicate that **risk management** is not yet fully implemented in the RS public sector and for three years in a row, the scores have been low. In particular, it is visible that the questions from the self-assessment questionnaire about substantial risk management done by the senior management have also recorded low scores, which leads to the conclusion that demanding methodology is not the only issue.
- The area of **monitoring, supervision and evaluation of the FMC system** is the **lowest-rated COSO component**. Low scores are recorded on questions that address the existence of self-regulatory mechanisms (existence of internal audit, self-assessment procedures, reporting of lack of controls by employees) that would serve for improving the system of internal controls.
- PFBs are different in size, organizational structures, type of activity, etc. The approach of the CHU so far has been to produce materials that are general and applicable to all public sector institutions. Staff capacities were identified as an issue in certain categories of PFBs (indirect beneficiaries, LSUs), in situations when they attempted to apply the existing CHU methodologies in specific categories and/or aspects of functioning of individual beneficiaries.

The following **recommendations** are issued for elimination of identified weaknesses:

- Further activities should be pursued towards improving the **regulatory internal control framework** in the public sector, through: defining the **selection of PFBs** which should cover the most important public sector institution and also the largest institutions, in terms of number of employees and/or budget. These would be covered by the Consolidated annual report, so that the development and monitoring of internal control systems could be based upon the largest PFBs. This was also one of the recommendations from the previous Consolidated annual report whose implementation is underway.
- In the coming years, there is a need for direct beneficiaries to become more involved in the process of improving the FMC system of indirect beneficiaries within their competence. In addition to the support they can provide, this would strengthen the overall management and achievement of objectives of direct budget beneficiaries, in which indirect beneficiaries within their competence are also accounted for (*redefined recommendation from the Consolidated Annual Report for 2018*).

- Further work remains to be done towards improving risk management. Guidelines and tools were prepared and improved during 2018 and their implementation should be monitored. Risk management is a mandatory topic for all trainings organised by the CHU, and should be further emphasized within the mandatory trainings for managers. On-the-spot visits within FMC quality review of FMC should identify in more detail the problems related to the implementation of risk management (*redefined recommendation from the Consolidated Annual Report for 2018*).
- In the context of improvement of the FMC system, it is necessary to work on the introduction of irregularity management in public sector institutions, first by preparing the regulatory and methodological framework by the CHU with Twinning partner and then ensuring its implementation by the heads of PFBs.
- The CHU should, through an open dialogue with the local level of government, take into account their specificities in the forthcoming improvements of regulation and the development of methodological guidelines. The methodological support that is now being provided through donor projects, targeting the local PFBs level (RELOF and UNDP / SDC), should be further pursued.
- The CHU, with the support of the Twinning project and the donor community, should work on improving and developing specific guidelines, practical tools and models in the field of internal controls, in order to provide additional support to beneficiaries, especially in the area of implementation of managerial accountability, monitoring, supervision and evaluation components, irregularity management as well as specific tools for particular types of users (*redefined recommendation from the previous Consolidated Annual Report*)
- **Heads of PFBs are a key point** in setting up the FMC system under the COSO framework and it is necessary to engage and allocate adequate resources, particularly in terms of availability of their employees and work organization, and with the help of methodological guidelines prepared by the CHU through regular reporting reach and demonstrate COSO standards that are in place in their organizations. This recommendation applies **primarily** to PFBs that do not yet report on the FMC system, and which fall into one of the following categories of PFBs: direct beneficiaries of the RS budget, local self-government units, and all other PFBs with over 250 employees.

2. Internal audit

The most significant *results* in the field of internal audit are:

- A 10% increase in the total number of PFBs with an internal audit function established in 2018 compared to 2017. The number of systematised job posts increased by 13% as well as the number of filled posts by 9% in 2018 compared to the previous 2017, which all suggests a positive trend in the development of the internal audit function in the previous period.
- An increase in the number of internal audit functions established and the number of internal auditors employed has led to an increase in the total number of audits planned and conducted.

- The increase in the total number of recommendations made in 2018 compared to 2017 indicates a positive development and strengthening of the internal audit function in the previous period. In the course of 2018, there was a further increase in percentage of recommendations issued in specific areas characteristic for individual public fund beneficiaries, which proves that the focus of internal audit work has shifted from the support processes to the core business processes in the organisation, that is, the assessment of overall internal control system in place within the organisation is reaching its real purpose.

Although the internal audit function has been established and is functioning in an increasing number of PFBs, the following *weaknesses* have still been identified:

- The number of internal auditors in the RS public sector is still insufficient for optimal coverage of the internal audit function in PFBs. Development of internal audit function in the category of ministries is stagnating; Ministry of Youth and Sports, Ministry of Environment and Ministry of Foreign Affairs do not have any filled internal auditor positions. In 11 out of 18 ministries, internal audit units do not have a minimum of three internal auditors employed. In accordance with Article 6, paragraph 1 of the IA Rulebook, cities are legally obliged to have a filled internal audit unit, while only 21% of cities fulfil this obligation.
- Significant percentage of established internal audit functions with two or fewer internal auditors raises doubt on whether the internal audit standards can be fully complied with.
- Although efforts have been made to recruit a number of new internal auditors, the inability to attract and retain quality staff due to low public sector earnings relative to the private sector remains evident. It is concluded that, in addition to low salaries, there are additional causes that lead to an inadequate number of internal auditors. (*Redefined recommendation from the previous Consolidated Annual Report*)
- The current certification scheme is demanding in view of the high workload and insufficient capacities of the CHU.
- In the area of methodology, it is visible that there are no quality assurance and quality improvement programs, except for regular oversight by the head of internal audit and that IPA audits were not conducted on the basis of risk assessment, but more in terms of monitoring compliance with internal procedures.
- In the area of internal audit implementation, a need was identified for internal auditors to communicate more with mid-level management.
- Insufficient support from PFBs senior management is one of the causes of several weaknesses in the following identified areas: filling in internal auditor positions, implementing internal audit recommendations, performing other non-internal audit related tasks by internal auditors, facilitating the professional development of internal auditors.

The following **recommendations** are issued for elimination of identified weaknesses:

- Recommendations about **filling-in IA job posts** and improving the **professional status of internal auditors**:
 - All PFBs should harmonise the systematisation, number of staff and fill in the internal auditor positions in accordance with the regulations, risks, complexity of operations and the amount of resources they manage;
 - Ministries, direct beneficiaries of RS budget funds with indirect beneficiaries within their competence, and cities that have not filled in the number of posts in internal audit units should, as soon as possible and as a priority, select or recruit appropriate internal audit staff within the existing human resources;
 - All the factors affecting filling in of internal auditor posts, as well as the adequacy of the existing recruitment and retention policy should be systematically considered (*repeated and redefined recommendation from the previous Consolidated Annual Report*).
- The CHU should **improve the certification scheme** in order to reduce the need for direct involvement of the CHU employees. It is necessary to expand the availability of training and provide an opportunity for private sector auditors to obtain certification (certified internal auditor in public sector), as well as to establish cooperation with the academic community.
- Based on the identified weaknesses, the CHU should further **improve the regulatory and methodological framework**, as follows:
 - The CHU should analyse and consider some changes in terms of the criteria for setting up the internal audit function and internal audit units in PFBs in the existing regulations, in order to optimise the number of auditors required, improve the quality of work and comply with internal audit standards;
 - improve, through a methodological framework, an internal assessment of the quality of internal audit to be used by internal audit units as well as guidelines for quality assurance of internal audit for heads of internal audit units;
 - develop risk assessment methodology for audits of IPA funds; develop guidelines for the establishment of internal audit functions within the small PFBs, regarding the establishment of a joint internal audit unit that will be piloted and tested previously with the support of the donor community.
- The **role of senior management in PFBs is crucial** for the adequate establishment of internal audit function. Therefore, the managers who have not adequately established an internal audit function at their institution should engage in the following tasks: in addition to filling in of internal auditor posts, they need to ensure adequate implementation of internal audit recommendations, to ensure independence of internal audit function by preventing auditors from performing other tasks that may become subject to audit, as well as facilitating the professional development of internal auditors (*redefined and expanded recommendation from the previous Consolidated Annual Report*)

Many of these activities have been foreseen by the PIFC Strategy Action Plan and some of them require additional support from donor projects.

3. Central Harmonisation Unit

Most important results of the CHU

The CHU has implemented a significant number of recommendations. From 21 recommendations made by the EC within their Progress reports for 2018³² and 2019 in the field of PIFC, 9 (42.86%) have been implemented so far, 11 (52.38%) are being implemented, and the implementation of 1 (4.76%) recommendation is planned. Recommendations from 2018 Consolidated Annual Report are of a longer-term nature and are already being largely implemented. The best results have been achieved in improving the regulatory and methodological framework, in raising awareness among senior and middle management and in organizing and providing workshops and trainings, which highlighted the importance of PIFC and emphasized issues of risk management and managerial accountability in particular. The effects of the trainings organised by the CHU are significant, with 70% of the institutions whose representatives attended trainings in 2018, submitted a report on the FMC system for the first time.

Major *weaknesses*:

- Significant needs for knowledge and training in all PIFC areas have been identified. The CHU has been very involved in this field so far, but the reality is that the training needs are far greater than the capacities of the CHU for organising them. In order for the CHU to devote more attention to developing methodological guidelines in the future, it is necessary to break away from the organisation of training;
- It is necessary to promote the importance of PIFC for different target groups;
- The scope of the current affairs done by the CHU requires recruitment of more staff than the existing number.

Based on the weaknesses identified, the following *recommendations* are made:

The first set of recommendations relates to **better dissemination of knowledge** in the PIFC area:

- With the support of the UNDP (SDC) project, the CHU has been provided with an e-learning platform that has been used to publish educational materials produced by the CHU so far. In order to increase the availability of training, in the next few years the CHU should enable the production of comprehensive and advanced high quality e-learning materials (*which will include deductive materials, videos, exercises, tests, e-portfolios, simulation software, etc.*) in different PIFC areas which requires more extensive technical assistance with the support of the donor community.
- In 2018, the CHU initiated the process of transferring of training in the field of PIFC in cooperation with the National Academy of Public Administration, however, this is a

³² All the recommendations from the 2018 EC Progress report are still valid

complex process and requires a systematic approach and it is necessary to develop a Roadmap to guide this process in more detail;

- In addition to the transferring of basic training, the mandatory module for managers (managerial accountability, risk management) needs to be improved;
- **Promoting** the importance of PIFC (CHU) for various target groups through relevant media channels and resources should be continued. (*redefined recommendation from 2018 Consolidated Annual Report*)

The recommendations from the 2018 Consolidated Annual Report, which should be addressed on a continuous basis in the future, were repeated:

- Improve the monitoring and reporting system (CHU) of internal controls electronically through the CHU software, by further improving the Questionnaire, and by further improving the Report;
- enhance the professional knowledge of the CHU staff by monitoring the international practices in the areas of financial management and control and internal audit, in order to facilitate the implementation of international standards, recommendations of the European Commission, and successful realisation of requirements relating to Chapter 32.

The CHU priorities for the coming period are working on improving the concept of managerial accountability through the Pilot Project and performing FMC system quality review.