



REPUBLIC OF SERBIA
MINISTRY OF FINANCE
- Internal Control and Internal Audit Division -

**CONSOLIDATED REPORT ON THE STATUS OF PUBLIC INTERNAL
FINANCIAL CONTROL IN THE REPUBLIC OF SERBIA IN 2015**

Belgrade, December 2016

TABLE OF CONTENTS:

I.	INTRODUCTION.....	Error! Bookmark not defined.
1.	Purpose and objective	Error! Bookmark not defined.
2.	Legal basis	Error! Bookmark not defined.
3.	Mode of drawing-up Consolidated Annual Report	3
II.	SYSTEM OF PUBLIC INTERNAL FINANCIAL CONTROL.....	4
1.	FINANCIAL MANAGEMENT AND CONTROL	4
1.1.	Concept and definition	4
1.2.	Legal framework and international standards	5
1.3.	Activities necessary for organized establishment of FMC system	5
1.4.	Report results	6
1.4.1.	Organized establishment	7
1.4.2.	Self-evaluation	9
1.4.2.1.	Self-evaluation elements of FMC system	9
1.4.2.2.	Self-evaluation results.....	Error! Bookmark not defined.
1.5.	Training of persons involved in FMC	12
2.	INTERNAL AUDIT	14
2.1.	Concept and definiton	14
2.2.	Legal base and international standards.....	15
2.3.	Status and organization	15
2.4.	Internal audit units and internal auditors	16
2.5.	Planning and performance of works.....	19
2.6.	Training of internal auditors.....	21
3.	CENTRAL HARMONIZATION UNIT.....	21
3.1.	Chapter 32 – financial supervision.....	22
3.2.	CHU – part of public finance reform program.....	22
3.3.	Cooperation with State Audit Institution	24
3.4.	Cooperation with the World Bank	24
3.5.	International Cooperation	25
III.	CONCLUSIONS AND RECOMMENDATIONS	25
1.	Financial management and control	25
2.	Internal audit	26
3.	Central harmonization unit.....	27

I. INTRODUCTION

1. Purpose and Objective

Consolidated Annual Report on the Status of Public Internal Financial Control in the Republic of Serbia for 2015 (hereinafter referred to as: Consolidated Annual Report) was drawn up based on individual annual reports of public funds beneficiaries on adequacy and functioning of the financial management and control and internal control systems in the course of 2015.

The purpose of the reports is the disclosure of the information gathered about the activities implemented by public funds beneficiaries in the process of introduction, development and strengthening of the system of financial management and control and internal audit function. The system of internal financial control represents, in the first place, the support to management responsibility of persons holding managing positions (managers), and the purpose of the reports is to highlight both the good and weak points of the system, but also to provide recommendations for its further development and improvement.

2. Legal Basis

Article 83, paragraph 2, item 7) of the Budget System Law („Official Gazette of the Republic of Serbia”, numbers: 54/09, 73/10, 101/10, 101/11, 93/12, 62/13, 63/13, 108/13, 142/14, 68/15, 103/15 and 99/16 – hereinafter referred to as: Budget System Law), sets out that Central Harmonization Unit in the framework of the Ministry of Finance (hereinafter: CHU) consolidates individual annual reports of public funds beneficiaries on the status of financial management and control and internal audit. Moreover, Article 3 of the mentioned Law envisages that the minister of finance submits the consolidated annual report to the Government for adoption.

The Program of Public Finance Management Reform for the Period 2016 – 2020 was adopted by the Government on 28 November 2015. The purpose of the adoption was to provide a comprehensive and integrated framework for the planning, coordination, implementation and monitoring of the progress in the area of public finance management aimed at improving the macroeconomic stability, providing efficient and appropriate distribution and utilization of public resources, and thus enabling easier achievement of the strategic objectives defined by the Government, raising the quality of services rendered by public administration in the Republic of Serbia, accompanied by simultaneous raising of transparency and overall functionality of public finance management and fulfillment of the requirements necessitated for accession to European Union.

The Government has provided strong support to the introduction and strengthening of the system of internal financial control in public sector by the adoption of the Strategy for Development of Public Internal Financial Control in Public Sector in the Republic of Serbia („Official Gazette of the Republic of Serbia”, numbers: 61/09 and 23/13 – hereinafter referred to as: Strategy). Draft of a new Strategy for the period 2017 – 2020 is also under preparation.

3. Mode of Draw-Up of Consolidated Annual Report

The mode of draw-up of Consolidated Annual Report is stipulated by the Budget System Law and accompanying by-laws.

Article 81, paragraph 5 of the Budget System Law envisages that the head of the public funds beneficiary informs the minister of finance by 31 March of current year for the preceding year about the adequacy and functioning of the system of financial management and control (hereinafter: FMC). Article 13 of the Rulebook on Joint Criteria and Standards for Establishment, Functioning and Reporting on the System of financial system and control in public sector („Official Gazette of the Republic of Serbia”, numbers: 99/11 and 106/13 – hereinafter referred to as: FMC Rulebook), defines that reporting is carried out by providing answers to the questionnaire prepared by CHU.

As to internal audit, Article 82, paragraph 10 of the Budget System Law lays down that head of a public funds beneficiary has a duty to inform the minister of finance by 31 March of the year in course for the preceding year about the functioning of the internal audit system (hereinafter: IA). Also, Article 32, paragraph 1 of the Rulebook on Common Criteria for Organization and Standards and Methodological Instructions for Internal Audit Acting and Reporting in Public Sector („Official Gazette of the Republic of Serbia”, numbers: 99/11 and 106/13 - hereinafter: IA Rulebook), clarifies that internal audit manager draws up the internal report on the internal audit work by using the questionnaire prepared and published by CHU on the website of the Ministry of Finance. Moreover, in conformity with paragraphs 3 and 4 of the same Article, internal audit manager submit the annual report to the head of the public funds beneficiary by 15 March of current year for the preceding year, whereas the head of the public funds beneficiary submits the mentioned report to CHU by no later than 31 March for the preceding year.

CHU has prepared in accordance with the above provisions the questionnaire form for drawing-up annual reports by public funds beneficiaries on FMC system and performed internal audits and activities for 2015, which were posted on the Ministry of Finance website (www.mfin.gov.rs). The questionnaire forms were made based on the questionnaire model used for these purposes in the European Union states.

Consolidated Financial Report for 2015 was prepared by the Internal Control and Internal Audit Division of the Ministry of Finance, which carries out the CHU activities, on the grounds of the annual reports furnished by public funds beneficiaries.

II. SYSTEM OF PUBLIC INTERNAL FINANCIAL CONTROL

The Budget System Law defines the public internal financial control (hereinafter referred as: PIFC) as a comprehensive system of measures for managing and controlling public revenues, expenditures, assets and liabilities established by the Government through public sector organizations in order for the management and control of public funds, including foreign funds, are compliant with the regulations, budget and principles of good financial management, and/or cost effectiveness, efficiency, effectiveness and openness.

PIFC system is based principally on the management responsibility (accountability) of managers, defined by the Budget System Law as obligation of managers at all levels with public funds beneficiaries to perform all activities in accordance with law by respecting the principles of cost-efficiency, effectiveness, efficiency and openness to public, and to be accountable for their decisions, acting and results to the person or authority who appointed them or delegated his/its responsibility to them. Article 80 of the said Law stipulates that PIFC comprises the following areas:

- financial management and control with public funds beneficiaries;
- internal audit with public funds beneficiaries;
- harmonization and coordination of financial system and control and internal audit performed by the Ministry of Finance - CHU.

1. FINANCIAL MANAGEMENT AND CONTROL

1.1. Concept and definition

The Budget System Law and FMC Rulebook define the financial management and control as a system of policies, procedures and activities established, maintained and regularly updated by the head of the organization, which on the grounds of risk management provide assurance to a reasonable extent that the organizations' objectives will be achieved in appropriate, cost-effective, efficient and effective manner by way of:

- 1) operation compliant with regulations, internal by-laws and contracts;
- 2) completeness, reality and integrity of financial and business reports;
- 3) cost-effective, efficient and effective utilization of assets;
- 4) protection of assets and data (information).

FMC system includes, in accordance with the above regulations, the following mutually linked elements:

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

FMC system is organized as a system of procedures and responsibilities of all persons in an organization and for its establishment, maintenance and regular updating is responsible the manager of the public funds beneficiary who may delegate his competences onto other persons within the organization he is managing.

1.2. Legal Framework and International Standards

Apart from the Budget System Law and FMC Rulebook, other regulations relevant for establishment of FMC system are:

- The Law on Civil Servants („Official Gazette of the Republic of Serbia“, numbers 79/05, 81/05 – corrigendum, 83/05 – corrigendum, 64/07, 67/07 – corrigendum, 116/08, 104/09, and 99/14);
- The Law on Public Procurements („Official Gazette of the Republic of Serbia“, numbers 124/12, 14/15 and 68/15);
- Decree on Budget Accounting („Official Gazette of the Republic of Serbia“, numbers 125/03 and 12/06);
- Rulebook on Joint Bases, Criteria and Tasks for Financial Service Operation of a Direct Budget Assets Beneficiary („Official Gazette of the Republic of Serbia“, number 123/03);
- Rulebook on Standard Classification Framework and Chart of Accounts for the Budget System („Official Gazette of the Republic of Serbia“, numbers: 103/11, 10/12, 18/12, 95/12, 99/12, 22/13, 48/13, 61/13, 63/13 - corrigendum, 106/13, 120/13, 20/14, 64/14, 81/14, 117/14, 128/14, 131/14, 32/15, 59/15, 63/15, 97/15, and 105/15);
- Rulebook on the Mode of Preparation, Draw-up and Submission of Financial Statements of Public Funds Beneficiaries, Beneficiaries of Assets of Mandatory Social Security Organizations and Budget Funds („Official Gazette of the Republic of Serbia“, number 18/15);
- Rulebook on the Mode of Utilization of Assets from Sub-Accounts and/or Other Accounts of the Consolidated Republic Treasury Account, and on the Mode of Reporting on Investment of Assets of Budget Beneficiaries and Beneficiaries of Mandatory Social Security Organizations („Official Gazette of the Republic of Serbia“, numbers: 3/04, 140/04, 1/06 and 111/09).

The existing legal framework in the Republic of Serbia provides for application of a majority of international internal control standards that are applied by the European Commission’s General Directorates.

1.3. Activities Required for Organizational Establishment of FMC System

As already pointed out, FMC is based on management responsibility of managers at all levels in the framework of public funds beneficiaries, while the manager of a public funds beneficiary is responsible for establishment and appropriate functioning of FMC system in the organization he is managing. On the other hand, this system helps managers in performing their tasks, and/or provides support to the organization to achieve its objectives by doing business in appropriate, cost-effective, efficient, effective and open-to-public manner.

FMC system consists of organizational establishment, implementation and development, and the plan of FMC system implementation and development is rendered by the public funds beneficiary.

Organizational establishment of FMC system involves the following activities:

- appointment of the manager in charge of FMC;

- setting-up of a working group to deal with introduction and development of FMC system.

The plan of FMC system implementation and development includes the following steps:

- determination of the mission, vision and key objectives of public funds beneficiaries;
- making a list of all main processes (sub-processes) and description of the activities contained therein;
- draw-up of the maps of business processes;
- documenting the business processes and draw-up of the flowchart;
- risk establishment at the level of business processes, risk assessment and ranking, decision-making on response to risks, and/or establishment of controls (risk management);
- estimate of internal control elements,
- draw-up of established controls' inspection, by taking into account the most important risks;
- making the list of the most significant processes not defined in written form;
- analyzing the existing control and the one necessary, and decision-making about the previous and subsequent controls;
- adoption of the plan of establishment of necessary controls and removal of the ones not necessary;
- monitoring the plan implementation;
- draw-up of the annual report on established systems for FMC.

1.4. Report Result

Annual Report on FMC System with public funds beneficiaries was drawn up based on the questionnaire drafted by CHU.

The form of FMC system annual report, filled out and submitted by public funds beneficiaries to CHU, consists of the general part and the questionnaire for internal control self-evaluation. General part contains general data about the public funds beneficiary and data relating to organizational establishment of FMC system. The questionnaire for internal control self-evaluation includes a set of questions concerning: functioning of the control environment, risk management, control activities, information and communication system in the organization, and monitoring and assessment of FMC system. The questionnaire provides an assessment of the current status of the system and represents a basis for taking measures for its improvement.

A total of 642 public funds beneficiaries (in the Tables: PFBs) submitted annual reports to CHU for 2015. Of the total number of all received reports, consolidated reports include 591 filled out reports, while the remaining reports that were either incomplete or empty were not included in the analysis. An overview of submitted and analyzed reports by categories is presented in Table 1.

At the republic, and/or central level the reports were furnished by the most important beneficiaries: all 16 ministries, all three mandatory Social Security organizations, as well as the most important republic bodies and republic public enterprises. Republic public enterprises sent 33 reports; in 26 cases FMC has been established. At the level of local self-government units, filled out reports were submitted by the autonomous province and

16 biggest towns in the Republic of Serbia. Twelve (12) towns declared to have



established the financial management and control system.

Table 1

Overview of Analyzed FMC System Reports per PFB Categories		
	PFBs	Number of Reports
Republic level	Ministries	16
	MSIOs*	3
	Other**	104
	Total	123
Other PFBs	Local Self-Government	94
	Other***	374
	Total	468
Total in RS		591

* Republic Fund for Pension and Disability Insurance, Republic Fund for Health Insurance, and National Employment Office

** Republic bodies (agencies, administrations, institutes, courts...) and republic enterprises

*** Indirect beneficiaries (schools, hospitals, institutions ...) and public utility companies

1.4.1. Organizational Establishment

Organizational establishment of FMC system depends on the size, number of employees and other specificities characterizing public funds beneficiaries. At establishing this system, the first thing to be done is to appoint a manager in charge of FMC or set up a working group to deal with all key issues relating to its introduction and development. Establishment of the working group is indispensable for the adjustment of all individual activities, and/or the system introduction into all organizational units, for the harmonization of opinions and views concerning the description of business processes, risk establishment and management, as well as the establishment of controls. Members of the working group need to be members of senior management and experts knowledgeable of, and experienced in, the key areas of operation of public funds beneficiaries, and/or the persons who know well the operation and individual business processes within the organization. The working group is responsible to the manager for the support to introduction and development of FMC system.

Data presented in Table 2 were obtained based on analytical processing of the general part of filled-out questionnaires relating to organizational establishment of FMC system per certain categories of public funds beneficiaries.

Table 2

PFBs ELEMENTS	Republic Level				Other PFBs			Total RS
	Ministries	MSIO*	Other**	Total	Local Self-Government	Other***	Total	
Appointed manager or set-up working group	15	3	57	75	69	194	263	338
Appointed manager and set-up working group	9	3	40	52	56	138	194	246
Neither manager appointed not working group set up	1	0	47	48	25	180	205	253
Making the list of business processes and description thereof commenced	15	3	72	90	66	296	362	452
Map of business processes drawn up	13	3	53	69	42	186	228	297
The most important Business processes not stipulated in written form	0	0	2	2	0	0	0	2
Internal controls established in business processes by taking into account the most important risks	14	3	71	88	64	263	327	415

The best results, by all elements observed, were achieved with the beneficiaries belonging to the category of **Mandatory Social Security Organizations**, which includes: Republic Fund for Pension and Disability Insurance, Republic Fund for Health Insurance, and National Employment Office. Enclosed data show that the mentioned beneficiaries have fully implemented all key activities in the area of organizational establishment of FMC system. Accordingly, they will be able to dedicate more to the raising of quality level in this area.

In the **ministries** category, in 15 out of the total of 16 ministries manager was appointed or a working group was set up, while in 13 organizations was drawn up the map of business processes (81%). In 14 ministries (87%) were established internal controls in business processes by taking into account the most important risks, while there is not a single most important business process not stipulated in writing. In some ministries, more attention needs to be paid in the upcoming period to the draw-up of the maps of business processes and to establishment of internal control based on the most significant risks.

In the case of **other beneficiaries at the republic level**, results are worse per each of the reviewed elements of the organizational establishment of FMC system against two previous categories of beneficiaries. It is also noteworthy that the worst indicators are those showing that with 45% of public funds beneficiaries who have submitted the report neither manager has been appointed nor a working group set up, which is at the

same time the worst result shown in the table, and/or that only one-half of them (51%) has made the map of business processes. Also, only in this category was noted, out of all reviewed categories of beneficiaries at the Republic of Serbia level, that the most significant business processes not stipulated in writing were found in two cases.

In the framework of **local self-government units**, the lowest results were recorded in the area of draw-up of business processes maps, where in 45% of cases this activity was implemented, followed by the segment of internal control establishment in business processes based on risks (68%). Bearing in mind that one of the PIFC Strategy objectives has been that the development of FMC system in local self-government units started since 2014, the results shown were expected to be worse against the republic level. It may be ascertained that certain results have been achieved, which is supported by the fact that average evaluation (grade) for all reviewed elements of the organizational establishment of FMC system at the local self-management is 68%.

As to **indirect beneficiaries (schools, hospitals...)** and **public utility companies** the lowest indicator relates to draw-up of business processes maps (50%), and to appointment of the manager or set-up of the working group (52%), while indicator in the area of established internal controls based on the most significant risks is considerably better (70%).

In the process of organizational establishment of FMC system **at the level of the Republic of Serbia**, the biggest problem for public funds beneficiaries is the elaboration of the maps of business processes, as only 50% of those who have submitted the report noted to have implemented this activity. On the other hand, only two of the total of 591 organizations stated to have in place the most significant business processes not prescribed in writing, which means that for majority of the key business processes the mode of their performance is stipulated by by-laws, internal acts, instructions, directives and procedures.

1.4.2. Self-evaluation

1.4.2.1. Elements of FMC system self-evaluation

An integral part of the annual reports submitted by public funds beneficiaries is the FMC system self-evaluation aimed at assessing current status and taking measures for its improvement.

Elements that are evaluated are:

- control environment;
- risk management;
- control activities;
- information and communication, and
- monitoring (supervision) and assessment.

Control environment establishes the „tone” in the organization and influences on the staff awareness of the controls. It represents a basis for all other components of internal control, ensuring discipline and structure. Control environment factors include integrity, ethical values and expert skills of the employees in the organization, philosophy and work style of the management, the manner in which the management awards powers,

responsibilities, establishes appropriate reporting lines, and organizes and promotes the staff.

A part of the questionnaire relating to control environment includes 12 questions so that each public fund beneficiary could show maximum 60 points. The questions relate to the existence and application of the code of behavior, principles for establishing the efficiency of the staff policy, and the existence of the level of knowledge and skills necessary for each work post, existence of the system of property protection against unauthorized access and use, and the obligations of regular reporting on risk management, internal control and internal audit.

Risk management comprises identification, assessment and control over potential events and situations that may have contrary effect on realization of the public funds beneficiary's objectives. Prerequisite for risk management is the establishment of general and specific goals that an organization has to accomplish. The task of risk management is to offer reasonable assurance that the goals will be achieved. In order to manage the risks, the manager of a public funds beneficiary needs to adopt the Risk Management Strategy that needs to be updated every three years, and also in the case of a major change in the control environment. Reducing the risk to an acceptable level requires that public funds beneficiary obligatorily analyze and update the established controls at least once a year.

Risk assessment is covered by the self-evaluation questionnaire, the questions relating to: definition of long-term operation goals, making the staff familiar with the operation goals, system of monitoring achievement of the targets, and analysis of the causes of possible dissensions, risk identification and assessment, as well as making decisions for the needs of resolving the identified risks.

Control activities include written policies and procedures, established to offer reasonable assurance that the risks to achieving the goals have been brought down to acceptable level defined in the procedures for risk management, including their application. They are carried out across the organization, at all levels and functions by all employees, in accordance with the established operation process and job description. Assessment of control activities is covered by the inquiry if the following has been prepared: detailed descriptions of the operation processes including the documentation flow, detailed descriptions of work procedures, operating instructions, procedures for access to data and records, as well as the rules for distribution of duties, and implementation of self-evaluation of internal controls.

Reliable **information and effective communication** are indispensable for the conduct and control of operation of public funds beneficiaries. The questionnaire includes evaluation of the existing successful and effective internal system of communication and of the system of monitoring the achievement of the goals of public funds beneficiaries, the process of recording the errors or complaints, establishment of the reasons and elimination of problems, the system of data reproduction and keeping, and/or recovery, and the ability of employees to report irregularities and problems.

Monitoring and assessment understand introduction of a system for FMC supervision by assessing adequacy and efficiency of its functioning.

Assessment of this component includes seven questions that comprise the establishment of a reporting structure intended to ensure impartiality and independence of internal audit, cooperation of managers of public funds beneficiaries and internal audit, acting according to the recommendations of external and internal auditors for the improvement

of internal control systems, instructions in place for the procedures in the case of lack of controls.

1.4.2.2. Self-Evaluation Results

A detailed overview of the assessment of some elements of the FMC system for 2015 is presented by PFBs categories in Table 3.

Table 3

Average Grade of FMC System Elements per PFB Categories for 2015											
PFB Categories		Control environment (maximum 60 points)		Risk management (maximum 55 points)		Control activities (maximum 50 points)		Information and Communication (maximum 35 points)		Monitoring, supervision and estimate (maximum 35 points)	
		Points	%	Points	%	Points	%	Points	%	Points	%
Central Republic level	Ministries	49	82	43	78	34	68	27	77	24	69
	MSIO*	54	90	51	93	47	94	35	100	31	89
	Other**	47	78	42	76	36	72	28	80	19	54
	Average	47	78	42	76	36	72	28	80	19	54
Local level	Local self-management	39	65	37	67	31	62	24	68	16	46
	Other***	43	72	41	75	33	66	27	77	16	46
	Average	41	68	39	71	32	64	26	74	16	46
AVERAGE IN RS		43	72	38	69	33	66	26	74	17	49

If viewed at the level of the Republic of Serbia, the ranking of evaluation of FMC system elements is as follows:

1. information and communication (74%)
2. control environment (72%)
3. risk management(69%)
4. control activities (66%)
5. monitoring/supervision and assessment (49%)

Identical order is also preserved when the category of public funds beneficiaries is viewed independently at the level of the republic, while in the case of local self-management the only change is that a somewhat better result was achieved in the risk management area than in that of control environment.

All average evaluations (grades) shown at the republic level, per each of the parameters under review, are above the average evaluations shown at the levels of local self-governments and other beneficiaries. As already explained, such results are not surprising in view of the fact that local self-government has been systemically recognized as a priority area only in the course of the previous three years.

In all analyzed categories, information and communication is the area that has the advantage over other assessed areas, with the exception of the ministries where information is on the 3rd place after control environment and risk management.

Contrary to the above, the weakest point in the system is the monitoring/supervision and assessment since average grade (evaluation) of this element is the worst at the level of each category.

Also, control activities can be identified as the second weak point. They are according to average evaluation (grade) in the penultimate place in all categories, except with MSSO.

Based on the presented data and as in the case of assessment of the organizational establishment of FMC system, beneficiaries within the category of MSSOs can be singled out as the best. This category of beneficiaries is recording the highest average grades against all other categories, by all assessed parameters, with the maximum result achieved in this case in the field of information and communication.

Taken as a whole, a conclusion that can be drawn is that in the fields of control environment, risk management, control activities and information and communication uniform results have been achieved, since average grades (evaluations) at the level of RS range from 66 to 74%, while a rather significant dissention of 49% is recorded in the area of monitoring/supervision and assessment.

1.5. Training of Persons Involved in FMC

The Ministry of Finance – CHU has been organizing continuously the trainings for managers and employees in charge of FMC. The purpose of the training is to make the attendees familiar with FMC system and activities that need to be carried out in order for the system to be established, maintained and developed. The task is the work aimed at improving the financial management and decision-making for the purpose of accomplishing the public funds beneficiaries' objectives, and performing operations in a legal, appropriate, ethical, cost-effective, efficient and effective manner that will at the same time be open to the public.

Program of basic training for FMC consists of four areas, namely:

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

In the course of 2015, the training organized in four cycles was attended by 223 participants employed with public funds beneficiaries.

Trainings for managers were carried out *in situ*, on the premises of public funds beneficiaries, and dealt with the basic principles of FMC and IA, methodology for documenting the business processes, draw-up of procedures, register of risks and risk management strategy. The trainings were attended by the highest and medium-level managers, at the following places:

- at the National Employment Office (NEO) training in the area of financial system and control and internal audit was carried out on 27 February 2015, and was attended by NEO director, division directors, members of the Work Group for Introduction and Development of FMC system, in total 33 NEO managing officers;

- At „Železnice Srbije“ (Railways of Serbia) was on 06 March 2015 made a presentation dedicated to the topic „Internal Control in Public Sector“ that was attended by Director General of „Železnice Srbije“, executive directors, assistant directors, and directors of some organizational parts, altogether 34 managing officers of „Železnice Srbije“;
- At the City of Belgrade – City Administration was on 10 March 2015 the host of the event organized for delivering the lecture on „Internal Financial Control in Public Sector“ which was attended by Deputy Mayor of Belgrade and 64 managers of the City Administration;
- At the Ministry of Mining and Energy training was held on 12 February 2015 for the Working group for the conduct of activities relating to establishment of FMC system, i.e. on the manner of preparation of the action plan, including the presentation „Introduction to Business Processes“ for 21 heads of departments, sections and groups;
- On the premises of the City Center for Social Work was on 18 September 2015 held a training in financial system and control for 30 heads of the centers for social work in Belgrade;
- At „Jat-Tehnika“ d.o.o. , on 11 September 2015 was organized the training in the area of financial system and control and internal audit for nine persons holding managing positions;
- At the Ministry of Construction, Transport and Infrastructure training in financial system and control was held on 15.09.2015 for the managing staff members and employees in charge of FMC, more specifically, the issues concerning organization and efficient development of FMC system. It was organized for nine senior officers (state secretaries, secretary of the ministry, and assistant ministers), and 20 heads of departments, sections and groups – members of the task force in charge of FMC;
- At the Ministry of Health training in the field of financial system and control was held on 09.10.2015 for state secretaries, secretary of the ministry, and assistant ministers, heads of departments, sections and groups, 25 participants in total;
- At the Ministry of Trade, Tourism and Telecommunications, by attending the meetings intended for introduction and development of the financial system and control in the area of tourism and tourist inspection at Ministry of Trade, Tourism and Telecommunications and by updating the Strategy for Risk Management for the period 2015 – 2016, technical, expert support was provided by Financial Management and Control Section for ten persons holding managing positions – members of this Ministry’s Working Group in dispelling dilemmas in the process of outing together the documentation: the map of business processes and register of risks, risk ranking and designing corrective activities.

In the framework of cooperation with the project „Improvement of Public Finance Management“ of the United Nations Development Program (UNDP), funded by the Swiss Agency for Development and Cooperation (SDC), training was conducted for persons managing local self-government units for the area of financial system and control, internal audit and program budget, namely:

- for the territories of the City of Belgrade, Kolubara, Macva, Podunavlje and Branicevo Districts the training was organized for 40 participants on 20 March 2015 at the MPs Club in Belgrade;

- for the territories of the city of Nis, Bor, Zajecar and Toplica Districts training was organized for 39 participants on 17 April 2015 at the City Assembly Meeting Hall of the City of Nis;

With support of international experts in the area of PIFC, in the framework of PLAC (Policy and Legal Advice Centre) projects providing support to Serbia in its preparation for accession to EU, there have been organized and held:

- the workshop on 8 December 2015 for CHU key partners in PIFC implementation, held by experts from PLAC project;
- one-day workshop organized on 15 December 2015 for CHU key partners in implementing integrated approach in the development of Public Internal Financial Control, which was attended by 24 participants from the organizational wholes and administrations falling under the Ministry of Finance;
- one-day workshop held on 21 December 2015 for CHU key partners in implementing integrated approach to the development of PIFC (Public Internal Financial Control). The topic of the workshop was the Role of CHU and public funds beneficiaries, and it was attended by 23 participants from the ministries, mandatory Social Security organizations, and other organizations from the central level;
- one-day workshop held on 22 December 2015 for CHU key partners in implementing integrated approach to the development of PIFC (Public Internal Financial Control). The topic of the workshop was Risk Management, Difficulties in Implementation and measures proposed for improvement. The workshop was attended by 22 participants from the ministries, mandatory organizations of social security and other organizations from the central level.

2. INTERNAL AUDIT

2.1. Definition of the term

Law on the Budget System and the IA Rulebook define the internal audit as an activity that provides independent, objective assurance and as an advisory activity whose purpose is to contribute to the improvement of an organisation's operation, assist the organization in achieving its targets by assessing and evaluating, systematically and with great discipline, the risk management, controls and governance of an organization.

On the basis of objective review of evidence, internal audit provides assurance of the adequacy and functioning of the existing risk management processes, controls and governance of organization, and shows whether these processes function in a manner specified by the management and whether they allow the achievement of an organisation's targets.

Internal audit provides consultancy services that consist of advice, guidelines, training assistance or other services with the aim of increasing value and improving the management of an organization, risk management and controls where internal auditors do not assume managerial responsibility.

As part of the PIFC established by the European Union, internal audit is viewed as a function performed by an authorized, organisationally and functionally independent internal audit unit or an internal auditor within an organization. Organizational

independence means that it is independent of the activity it audits, that it is not part of any business process or organizational unit, that it reports about its work directly to the organization's manager. Functional independence means that it decides independently, on the basis of risk assessment, about the field and method of auditing and on reporting about the performed internal audit.

Internal audit performs independent, professional and systematic assessment of the management and control systems, which means auditing all functions and business processes in an organization.

2.2. Legal Grounds and International Standards

Legal framework that regulates the field of internal audit consists of:

- Law on Budget System;
- Rulebook on Joint Criteria for Organizing and Standards and Methodological Instruction for Acting and Reporting by the Internal Audit in the Public Sector (IA Rulebook);
- Rulebook on Conditions, Manner and Procedure for Taking an Exam and Obtaining a Title of Licensed Internal Auditor in the Public Sector (RS Official Gazette, No. 9/2014, hereinafter: Certification Rulebook);
- International Internal Audit Standards (International Standards for the Professional Practice of Internal Auditing of the Institute of Internal Audits);
- Development Strategy of Internal Financial Control in the Public Sector.

Article 82 of the Law on Budget System prescribes that a public funds beneficiary is obliged to introduce the internal audit function, as an organisationally independent function that reports about its activities directly to the manager of the public funds beneficiary.

The manner of introducing, maintaining and developing the IA system is specified in more detail in the following secondary legislation:

- IA Rulebook that prescribes the manner in which an IA unit is organized and set up in the public funds beneficiary, the field of work i.e. the tasks, standards and methodology of internal audit as a functionally independent organizational unit, rights, duties and responsibilities of IA managers and internal auditors, conditions for performing the work of the IA manager and internal auditors, as well as planning, implementation and reporting on internal audit;
- Certification Rulebook prescribes the conditions for taking the exam, the manner and procedure for taking the exam and the record of the candidates that have passed the internal auditor exam.

2.3. Status and Organization

Development Strategy for Internal Financial Control in the Public Sector, the Law on Budget System and IA Rulebook prescribe that a decentralized internal audit system is established in the Republic of Serbia.

Decentralized internal audit system specifies an obligation that all public funds beneficiaries need to establish an internal audit function. IA Rulebook sets the criteria for establishing the internal audit function that place an obligation on ministries,

autonomous provinces, cities and other public funds beneficiaries with more than 250 employees to establish a separate, functionally independent organizational unit for internal audit. Other public funds beneficiaries may establish internal audit in one of the following manners:

- by establishing an independent internal audit unit;
- by establishing a joint unit for internal audit of several public funds beneficiaries,
- by making an agreement with other public funds beneficiaries on performing the internal audit tasks,
- when there are no conditions for organizing an internal audit unit, tasks of an internal audit unit can be performed also by an internal auditor employed by the public funds beneficiary.

2.4. Internal Audit Units and Internal Auditors

Public funds beneficiaries have prepared their annual reports on performed audits and the internal audit activities on the basis of the questionnaire prepared by the CHU, on the internet website of the Finance Ministry. The purpose of the questionnaire is to gather the information that will enable CHU to prepare a consolidated report about the condition of internal audit in the public sector.

The form of the annual report on performed audits and activities of internal audit is composed of the general and special part.

The general part contains general data about the beneficiaries, data about the IA unit and internal auditors, data about the implementation of the IA standards and methodology, as well as proposals for development of IA systems.

Special part contains an overview of performed audits with the number of issued recommendations by certain types of recommendations.

358 public fund beneficiaries submitted the annual CHU report for 2015. Of all the reports that were received, consolidated reports included 295 completed reports, while the remaining reports, that were either incomplete or empty, were not included in the analysis.

On the basis of the completed reports on performed audits and IA activities in the public funds beneficiaries, a uniform report has been prepared that contains a summary of CHU information and comments.

Table 4 shows the number of established internal audits, as well as the number of classified and filled internal audit positions in public fund beneficiaries.

Table 4

Elements	Number of PFB that established IA with classified and filled in positions in 2015		
	All PFB	National level	Other*
Submitted annual reports	358	105	253

Established audit	180	75	105
Classified positions	478	259	120
Filled in positions	373	211	77

National level: ministries, administrations within ministries, obligatory social security organisations (OSSO) (national health insurance fund, pension and disability fund, national employment agency), government bodies, government-owned companies

***Other:** local self-governance, indirect beneficiaries, public utility companies

According to the received reports, in 180 public funds beneficiaries, where internal audit function is introduced, 478 internal auditor positions were classified and 373 positions were filled. These beneficiaries account for 90% of public funds.

Of the received 105 reports, in 75 beneficiaries on the national level, internal audit was established with 259 classified and 211 filled internal audit positions.

Table 5 shows the number of established internal audits, classified and filled in internal audit positions in public funds beneficiaries on national level.

Table 5

PFB Elements	Introducing internal audit on the national level in 2015		
	Ministries	OSSO*	Other**
Introduced audit	16	3	56
Classified positions	64	32	163
Filled in positions	60	31	140

* national pension and disability fund, national health insurance fund and the national employment agency

** Government bodies (agencies, administrations, institutes, courts...) and government-owned companies

Table 5 shows the introduction of internal audit in 16 ministries, 3 obligatory social security organisations and in 56 public funds beneficiaries on the national level. In 16 ministries, 64 positions were classified and audit is performed by 60 internal auditors, in 3 OSSE 32 IA positions were classified and internal audit is performed by 31 internal auditors and in the remaining 56 public funds beneficiaries on the national level 163 positions were classified and audit is performed by 140 internal auditors. After an increase in the number of classified and filled in IA positions in OSSO in 2014 (in 2013 31 positions were classified; 30 were filled in, and in 2014 36 was classified and 33 were filled in) and in the remaining PPFBs on the national level (in 2013 172 were classified and 174 filled in, and in 2014 134 were classified and 149 filled in), in 2015 there was a decrease in this number as a result of the current austerity measures in the Republic of

Serbia in the form of limiting the maximum number of employees and reduction in basic salaries, which caused the internal auditors to leave the public sector.

Table 6 shows an overview of the number of introduced audits, classified and filled in IA positions in public funds beneficiaries in local self-governance, indirect beneficiaries and public utility companies.

Table 6

Elements	Introducing IA in local self-governance, public utility companies and in indirect beneficiaries in 2015	
	Local self-governance	Other***
Submitted annual reports	100	153
Introduced audit	33	66
Classified positions	120	115
Filled in positions	77	85

***Indirect beneficiaries of budget funds and public utility companies

On the level of territorial autonomy and local self-governance, out of the received 100 reports, 33 local self-governance units have introduced internal audit with 120 classified and 77 filled in internal auditor positions.

Public funds beneficiaries submitted 153 reports. In 66 beneficiaries, internal audit was introduced with 115 classified and 85 filled in IA positions.

IA units that were introduced and the independent internal auditors report, in organizational and functional terms, to the manager of the public funds beneficiary.

Of the public funds beneficiaries, those that introduced IA with a single internal auditor account for 63%, with two internal auditors for 14% and with three and more internal auditors for 23%. A large percentage of introduced audits with two or fewer auditors raises doubt whether internal audit standards can be fully observed.

The most frequently stated reasons why IA was not introduced and why positions for internal auditors were not filled in are legal limitations on the maximum number of employees, insufficient number of highly educated staff, low salaries, inadequacy of classified positions compared to the volume and complexity of work, insufficient financial assets, nonexistence of formal conditions, competition from the private sector, etc. Regardless of the reasons stated, an obligation to introduce internal audit remains in force and CHU will, within its competence, provide all the necessary assistance.

In the newly introduced internal audits, where the employed internal audits are still not included in the training process organized by CHU, the reports state that a significant portion of time is being spent on other tasks that are not part of the internal audit. This is

not consistent with the internal audit standards and directly jeopardizes the functional independence of internal audits.

2.5. Planning and evaluation of work

On the basis of the IA Rulebook, internal audit is carried out according to the strategic plan for a three-year period, annual plan and the plan of individual audit. Strategic plan is adopted by the end of the current year for the next three-year period, while an annual internal audit plan is adopted by the end of the current year for the next year. Strategic plan, which determines the strategic goals of internal audit, is based on long-term goals of the public funds beneficiary.

IA strategic plan is prepared by the internal audit manager on the basis of the consultations with the management, and is approved by the manager of the public funds beneficiary.

The annual plan is prepared every year on the basis of the strategic plan. IA manager prepares the annual plan that is approved by the manager of the public funds beneficiary.

Each individual audit is carried out on the basis of the prepared plan that describes in detail the subject, goals, duration, allocation of resources, audit approach, techniques and the scope of audit. Plan of individual audit and its related programs, that describe in detail the audit procedures, is prepared by the internal auditor and approved by the manager of internal audit.

An audit report is prepared for each performed audit and contains the summary, targets and scope of audit, findings, conclusions and recommendations, detailed report, as well as the comments from the auditee's manager.

In order to ensure the quality of the internal audit process, a continuous monitoring of each individual audit is performed, which is done by the internal audit team leader.

Internal audit manager approves the plans for performing individual audit and monitors the implementation of the internal audit methodology when performing each individual audit.

The work of the internal audit units was not assessed externally.

2.5.1. Overview of performed audits

The work of internal audit in 161 public funds beneficiaries is carried out on the basis of the strategic plan and the annual plan of activities approved by the manager of the public funds beneficiary, as well as the plan of individual audit approved by the audit manager. In 19 public funds beneficiaries that introduced the function of internal audit at the end of the reporting period, the process of adopting the strategic and annual plan of activities was underway.

Table 7 shows the total number of planned, performed audits and audits that are underway.

Table 7

Audits	Number of audits in 2015
Planned audits	794
Performed audits	620
Audits underway	25
Unperformed audits	149

According to the submitted reports on IA activities, in 2015 there were 794 audits planned, while 620 were completed and 25 are underway i.e. 18% of planned audits were not implemented. Most frequently stated reasons for such a departure are a reduction in the number of employees, changes in the organizational structure of the public funds beneficiaries, changes in the annual plan of activities and the lack of exchange of practical experience in the preparation of planning documents.

2.5.2. Issued and implemented recommendations

Internal auditors issued a total of 5,901 recommendations for improvement of operation and reduction in the identified risks to an acceptable level, 3615 of which were implemented by the end of 2015, while for the other the maturity deadline has still not expired.

Table 8 shows a number of issued recommendations for 2015 that are classified into areas and formulated in the model of an annual report:

Table 8

Area the issued recommendations refer to		Number of issued recommendations in 2015
1	Internal rules and procedures	2297
2	Planning	190
3	Salaries and revenues	148
4	Public procurement and contracting	667
5	Employees, salaries and allowances	508
6	Payments and transfers	174
7	Bookkeeping and financial reporting	646
8	Information systems	148
TOTAL:		4778

The difference of 1123 recommendations in 2015, shown in Table 8, is due to the fact that the recommendations were issued in specific areas typical of certain public funds beneficiaries and could not be classified into the set areas in the annual report model.

Internal rules and procedures show the level of quality of the financial management system and control and, although the greatest number of recommendations was issued in this area, there was a decrease in percentage compared to 2014, which indicates gradual improvement.

On the basis of the submitted reports, CHU did not establish that there were certain conflicts of interest i.e. the conflict of internal auditors and managers of the public funds beneficiaries regarding acceptance and implementation of agreed recommendations.

2.6. Training of Internal Auditors

Continuous professional development of employed internal auditors is carried out by monitoring the local and foreign literature and in direct exchange of experience among the employees in the meetings, with professional organisations and CHU.

Theoretical part of the training for internal audit included 106 trainees employed by the public funds beneficiaries.

In the period January – December 2015 practical training was given on performing internal audit at 29 beneficiaries and 40 candidates for the professional title of a licenced internal auditor in the public sector.

Certification Rulebook sets the conditions for obtaining the title of a licenced internal auditor in the public sector. After the training prescribed in the training program that is an integral part of this Rulebook, the candidates take an exam before an examination board set up by the Finance Minister.

Training program for obtaining a professional title of a licenced internal auditor in the public sector includes the following:

- 1) basic training for internal auditors of seven working days i.e. 49 working hours;
- 2) basic training in financial management and control of five working days i.e. 35 working hours;
- 3) training for practical work on internal audit by performing two audits in beneficiaries where the trainee is employed to perform internal audit assignments with professional assistance from the Ministry of Finance, in the manner specified in the IA Rulebook.

In two examination periods in 2015 an exam was passed by 35 candidates who obtained a title of a licenced internal auditor in the public sector. By the end of 2015 a total of 278 internal auditors were certified in the public sector.

3. CENTRAL HARMONIZATION UNIT (CHU)

Internal Control and Audit Division of the Finance Ministry performs the tasks of the CHU where ten employment positions are classified with eight civil servants, three of which in the IA Harmonization Department and four in the FMC Harmonization Department.

CHU performs the following tasks: connecting all employees who perform IA tasks and internal controls in the public funds beneficiaries, defining the standards for control in accordance with the internationally recognized standards, joint criteria for organization and action of internal audit in the public sector and keeping a registry of internal auditors, model of the internal audit charter, methodological instructions and rulebooks for financial management and control, professional development, certification and supervision over the work of internal auditors and organizing and executing professional training, certification and supervision of the work of internal auditors and organizing and executing the training of the managers and employees in the public sector in the area of financial management and control in accordance with the internationally accepted standards.

3.1. Chapter 32 – Financial Supervision

The Government has adopted the negotiation position for Chapter 32, on financial supervision, on the basis of enclosure for PIFC prepared by CHU.

At the second intergovernmental conference between the Republic of Serbia and the European Union, on 14.12.2015 in Brussels, a negotiation chapter – Chapter 32 on financial supervision was opened.

In the joint position of the European Union, Chapter 32: Financial Supervision, of 3 December, 2015 (AD 13/15 CONF-RS 2/15), it was confirmed that progress had been made and that the activities and measures taken so far in the area of PIFC were compliant with the EU requirements. Also, standards for a temporary closure of the Chapter were stated: “Serbia should change the legal framework in order to ensure coherence of its legislation in the area of PIFC; Serbia should implement the legislation in the area of PIFC, as well as basic policies and secure sufficient administrative capacity on central and local level, in the social security funds and in state-owned enterprises; Serbia should ensure that the function of centralized budget inspection is compliant with the PIFC requirements”.

Draft Strategy of Developing PIFC in the Public Sector has been prepared. The Draft Strategy is in the process of harmonization with the European Commission’s Directorate-General for Budget.

CHU has prepared a Consolidated Annual Report for 2014 about the condition of PIFC in the Republic of Serbia that was approved by the Finance Minister and adopted by the Government with its conclusion 05 No. 400-12520/2015 of 28.11.2015. The report is published on the Finance Ministry’s website.

3.2. CUH – part of the public finance reform program

CHU has prepared an amended Draft Strategy for the Period 2015 – 2019 that included the suggestions made by the members of the working group and the comments from the European Commission’s Directorate-General for Budget. Part of the Draft Strategy for the Period 2015 – 2019 is included in the Program of Public Finance Management Reforms for the Period 2016 – 2020 adopted by the Government on 28 November 2015, with a supplement of 25 December 2015.

Guidelines for Risk Management have been prepared in cooperation with the experts of the PLAC project, the print-out of which has been enabled in the project of “Improving the audit on the local level for more efficient public finance management”, implemented by the United Nations Development Program (UNDP) and financed by the Swiss Agency for Cooperation and Development (SDC).

The aim of the project is to improve the mechanisms of the Finance Ministry, the Central project concerns the Unit (CHU) in strengthening and structuring the internal financial control in public sector (PIFC) and responsible public funds management.

The project is carried out with the aim of improving the FMC system within the local self-governance units and to ensure that the IA function in the local self-governance is introduced, fully functional and supports the concept of managerial responsibility. The wider goal of the project is to improve cooperation between internal and external audit, with the aim of increasing efficiency of internal audit and focusing the external audit on the audit of performance.

Also, this project finalized the test stage and the work on the terms of reference, preparation of information system for electronic communication between the public funds beneficiaries and the CHU, as well as preparation of tools for detailed analysis and storing of the data gathered.

In the reporting period, advice and instructions were given to the public funds beneficiaries on the manner of organizing IA and establishing the FMC system.

With these activities the CHU contributed to increased understanding of PIFC in the whole public sector, especially among the managers in charge of FMC and the managers from the medium level, members of working groups for introduction and development of FMC systems.

Networking with the other participants in PIFC is done by organizing meetings, workshops, using the internet webpage to discuss issues of importance for PIFC and through direct contact with the trainees, by providing the required explanations and advice. Mutual networking of the trainees was also promoted.

On the external networking level, cooperation has been established and maintained with the State Audit institution, Serbian Association of Internal Auditors – an associate member of the Global Institute of Internal Auditors, Serbian Chamber of Licenced Auditors and the Internal Auditors Association. A contact has been established with CHUs from other countries with which experience is shared on establishing and developing PIFC.

As part of the established international cooperation, meetings have been held with the representatives of the European Commission’s Directorate-General for Budget and with SIGMA – an OECD initiative, where topics from the area of PIFC were discussed.

Bearing in mind the volume, diversity and complexity of the tasks performed by CHU, the salary, bonus and title system is inadequate, although these issues are planned to be resolved in the PIFC Strategy.

3.3. Cooperation with the State Audit Institution

Cooperation continued on 14 July 2015 at the conference “Cooperation between the Government Audit Institution and internal auditors in the public sector”, where it was identified that certain government bodies in the local self-governance units have introduced internal financial control and internal audit, but are not functional enough.

The conference “Cooperation between the Government Audit Institution and internal auditors in the public sector” was organized by the State Audit Institution as part of the project of “Improving public finance management”, in the presence of four licenced internal auditors in the public sector from the Internal Control and Audit Division of the Finance Ministry and about 70 internal auditors from the local self-governance units.

The next step in successful long-standing and close cooperation was continued by the second continuous training series for licenced internal auditors in the public sector of the Republic of Serbia on the level of local self-governance, organized by the Finance Ministry, with the support from the Swiss government, as part of the project “Improvement of public finance management”. The training was organized by the Internal Control and Audit Division of the Finance Ministry from 22 to 24 of July 2015, for 61 licenced internal auditors in the public sector and three representatives of the State Audit Institution. Lecturers came from the Internal Control and Audit of the Finance Ministry and the Office for audit of the EU funds management system, as well as guest lecturers from the Central unit for harmonization of financial management and control in the Finance Ministry and the Agency for auditing the EU program implementation system from the Republic of Croatia. Topics for this training were the role and importance of internal audit in the local self-governance units in auditing and assessing the adequacy of management and control systems for implementation of programs and projects financed from the preaccession funds of the EU and which includes the processes of programming, implementing, monitoring, valuation and reporting on implementing such processes, as well as exchanging practical experience from work with the colleagues from the Republic of Croatia, who have many years of experience in implementing and auditing the instruments of EU pre-accession assistance in the accession stage.

This round of training sessions was finalized with the workshop “Cooperation between the State Audit Institution and internal auditors”, organized by the State Audit Institution and held between 29 and 31 July 2015 for 55 internal auditors from the local self-governance units, attended also by two CHU managers in the capacity of lecturers, who shared their experience with the other participants in the area of cooperation between internal and external audit. Internal auditors from the local self-governance units took an opportunity at this workshop to point to the problems they meet with in practical work, focused on improving public finance on the local level.

3.4. Cooperation with the World Bank

At the request of the Finance Minister of the Republic of Serbia, a mission for technical assistance from the IMF fiscal department (FAD) visited Belgrade between 14 and 25 September 2015 in order to assist in amending the Law on Budget System. The mission was financed with the support of the European Commission, Directorate-General for

Neighbourhood and Enlargement Negotiations, as part of the project for strengthening the economic governance and governing public finance. The mission has held several working meetings with the members of the working group set up by the Finance Ministry for the purpose of preparing the amendments to the Law on Budget System.

3.5. International Cooperation

European commission has organized the Conference on public internal control (Paris PIC Conference) attended by a three-member delegation of Serbia in the capacity of representatives of a candidate country for the purpose of familiarizing themselves with the latest good practice in EU member countries in the area of PIC principles, internal control environment, function of the Central Harmonization Unit and assessment of reasonable assurance of the achieved level of PIC. The conference was attended by the representatives of all member countries and representatives of the candidate countries from Albania, Macedonia, Turkey, Serbia and Montenegro.

In May 2015, Sigma prepared, in cooperation with the Finance Ministry – CHU, a report on comprehensive ground for measuring the principles of public administration and continued to monitor the progress of public administration reforms in Serbia. This report covers four principles for public services in the area of HR management and four principles in the area of public finance management. The chapter on public finance management analyses the operational framework for FMC and IA and implementation of FMC and IA within certain budget organisations. The chapter on public finance management is important because the negotiations on chapter 32 (financial control) started in December 2015 and the Strategy for developing public internal financial control 2016 – 2020 is underway.

Representatives of the Division participated in the work of the Internal Audit Community of Practice organized by the World bank (WB) PEM PAL, in the workshop – theme meeting: Challenges in implementation of modern internal audit and financial management and control in Bishkek, Kyrgyzstan in the working group on the topic of a relation between internal audit and financial inspection and external audit (RIFIX) in the working group for quality assurance in Erevan, Armenia.

III. CONCLUSIONS AND RECOMMENDATIONS

Conclusions and recommendations for further development and improvement of the internal financial control system in the public sector were drawn both on the basis of the submitted and processed reports from the public funds beneficiaries and on the basis of analysing the situation in practice.

1. Financial Management and Control

In the area of organizational establishment of the FMC system, the following key weaknesses can be emphasized:

- preparing a map of business processes is an activity that received the poorest mark in all observed categories of public funds beneficiaries, with the lowest result being at the level of local self-governance;

- one third of the public funds beneficiaries on the national level have not appointed a manager nor have they set up a working group for FMC;

When assessing certain elements of FMC system, the following key weaknesses were identified:

- on the level of the RS the poorest result was identified in the elements of monitoring/supervision and assessment, with the lowest average marks being recorded in this segment in each individual category and with the local self-governance having the lowest ranking;
- the second identified weak point was the control activities, with the poorest result being achieved among the beneficiaries on the local self-governance level;
- unlike all other categories of public funds beneficiaries where the best results were achieved in the area of information and communication, this self-assessment element is ranked only third in ministries;
- all average marks for certain self-assessment elements are the lowest in the local self-governance category.

The following recommendations are issued for the purpose of eliminating these weaknesses:

- CHU will provide practical assistance to the public funds beneficiaries in mapping business processes;
- CHU will provide advisory support to the public funds beneficiaries in appointing managers and setting up a working group for FMC, and will place particular emphasis on these activities in the training sessions and workshops;
- CHU will organize special workshops and seminars with the key topic of introducing the system for monitoring and supervision of FMC system and introduction of control activities and written policies and procedures;
- when implementing the above stated activities, the CHU will pay special attention to the specific features of the beneficiaries on the level of local self-governance.

2. Internal Audit

The most important weaknesses in the area of internal audit are:

- all budget beneficiaries on the national level have not introduced the internal audit function;
- a large percentage of introduced internal audits with two or fewer employees raises doubt about whether internal audit standards can be fully observed;
- the existing classified positions for internal auditors are not fully filled due to legal limitations on the maximum number of employees, the shortage of highly educated staff, low salaries, inadequately classified titles given the volume and complexity of the work, competition from the private sector;
- increased percentage of unimplemented audits compared to the planned number;
- the work of internal audit units has not been evaluated externally.

The following recommendations are issued for the purpose of eliminating the identified weaknesses:

- public funds beneficiaries which have not introduced the internal audit function should address CHU for assistance in preparation of internal by-laws for setting up and starting the work of internal audit (charter, classification with job

- description, IA Rulebook, IA Manual, strategic and annual plan, instruction for risk assessment, etc.) the models of which have been prepared by the CHU;
- public funds beneficiaries should adjust the classification, the number of employees and fill in the positions of internal auditors, in accordance with the provisions of the IA Rulebook, depending on the risks, complexity of operation and the volume of funds they manage;
 - adjust the salaries and the bonus system for internal auditors to the salaries and the bonus system for audits in the State Audit Institution, as set in the Strategy;
 - secure continuous training of internal auditors that will enable more adequate planning and more rational use of internal audit resources in public funds beneficiaries;
 - establish, on the basis of the CHU guidelines, the external evaluation of the work of the internal audit units in public funds beneficiaries.

3. Central Harmonisation Unit

When it comes to the work and future development of the CHU, the following has been identified:

- eight employed servants are not enough to timely and comprehensively perform the tasks that constitute essential competence of the CHU;
- inadequate salary, bonus and title system compared to the volume and complexity of work results in employee attrition, causes problems in recruitment, employment and retention of the adequate staff in the CHU;
- insufficient funds for organizing conferences, seminars and workshops in order to raise awareness of the importance of the FMC and IA systems by the managers in the public sector;
- lack of funds and other resources for developing a data processing and networking program (computer application) and organization regular meetings and workshops in order to consider the issues of importance for PIFC that would enable the participants in the PIFC process to network.

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

- start the process of hiring adequate staff;
- adjust the salaries and the bonus system for employees in the CHU with the salaries and the bonus system in the State Audit Institution, as set in the Strategy;
- secure the necessary funds and other resources that would enable the CHU to organize conferences, seminars and workshops for the purpose of raising the level of understanding and acceptance of the PIFC system by the managers;
- secure the necessary funds and other resources that would enable the CHU to connect with other participants in the PIFC, by obtaining a data processing and networking program and for organisation of regular meetings and workshops with the aim of considering the issues of importance for PIFC.