



**REPUBLIC OF SERBIA
MINISTRY OF FINANCE
- Department for internal control and internal audit -**

**CONSOLIDATED ANNUAL REPORT
ON THE STATUS OF PUBLIC INTERNAL FINANCIAL CONTROL
IN THE REPUBLIC OF SERBIA IN 2016**

Belgrade, September 2017

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I. INTRODUCTION

1. Purpose and objective

Consolidated Annual Report on the Status of Public Internal Financial Control in the Republic of Serbia in 2016 (hereinafter referred to as: the Consolidated Annual Report) was prepared based on individual annual reports of public funds beneficiaries regarding the appropriateness and functioning of financial management and internal audit work in the course of 2016.

The purpose of the report is to disclose the information gathered about the activities implemented by public funds beneficiaries in the process of introduction, development and strengthening of the financial management and control system and internal audit function. Internal financial control system represents, in the first place, the support to managerial accountability of managers, and the purpose 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. Legal basis

Article 83, paragraph 2, item 7) of the Budget System Law („Official Gazette of the Republic of Serbia”, 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 and 99/16 – hereinafter referred to as: the Budget System Law), prescribes that the Central Harmonization Unit in the framework of the Ministry of Finance (hereinafter referred to as: the CHU) consolidates individual annual reports of public funds beneficiaries on the status of financial management and control and internal audit. The following paragraph of the same article envisages that the minister of finance submits the consolidated annual report to the Government.

The Government has provided strong support to the introduction and strengthening of the system of public internal financial control by the adoption of the Strategy for Development of Public Internal Financial Control in the Republic of Serbia for the Period 2017-2020¹ („Official Gazette of the Republic of Serbia”, no.: 51/17 – hereinafter referred to as: the PIFC Strategy).

PIFC Strategy relates to Public Finance Management Reform Program for 2016-2020 and constitutes a pivotal topic within pillar IV – effective financial control.

PFM Reform Program for 2016-2020 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.

¹http://ifkj.mfin.gov.rs/user_data/posts/Stategija%20razvoja%20interne%20finansijske%20kontrolle%20u%20javnom%20sektoru%20Republike%20Srbije%20za%20period%202017-2020%20srb.pdf

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

The mode of preparation of the Consolidated Annual Report is prescribed 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 is to inform the minister of finance no later than 31 March of the current year for the preceding year about the appropriateness and functioning of the financial management and control system (hereinafter referred to as: FMC). Article 13 of the Rulebook on joint criteria and standards for establishment, functioning and reporting on the financial management and control system in the public sector („Official Gazette of the Republic of Serbia”, no.: 99/11 and 106/13 – hereinafter referred to as: the FMC Rulebook), specifies that reporting is carried out by providing answers to the questionnaire prepared by the CHU.

With respect to internal audit, Article 82, paragraph 10 of the Budget System Law lays down that the head of a public funds beneficiary is obliged to inform the minister of finance no later than 31 March of the current year for the preceding year about the functioning of the internal audit system (hereinafter referred to as: 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 the public sector („Official Gazette of the Republic of Serbia”, no.: 99/11 and 106/13 – hereinafter referred to as: IA Rulebook), specifies in more detail that the head of internal audit is to prepare the internal report on the internal audit work by using the questionnaire prepared and published by the CHU on the Ministry of Finance web site. Therefore, in conformity with paragraphs 3 and 4 of the same Article, the head of internal audit submits the annual report to the head of the public funds beneficiary no later than 15 March of the current year for the preceding year, while the head of the public funds beneficiary submits this report to the CHU no later than 31 March of the current year for the preceding year.

In line with the provisions referred to above, the CHU developed the questionnaire forms for the preparation of annual reports of public funds beneficiaries on the FMC system and conducted audits and internal audit activities in the course of 2016, all of which were published on the Ministry of Finance web site (www.mfin.gov.rs). The questionnaire forms were developed based on the model questionnaire used in the EU member states for these purposes.

All duly prepared reports of public funds 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 funds beneficiaries were designated in line with the Budget System Law, the List of public funds 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 funds beneficiaries have been classified in the manner referred to in Table 1.

Table 1

Classification of public funds beneficiaries per categories		
Central/ Republic level	Ministries	Ministries of RS
	Mandatory Social Insurance Organizations (MSIO)	Republic pension and disability insurance fund, Republic health insurance fund and National employment service
	Other direct budget beneficiaries	Administrations, agencies, funds, judicial bodies...
	Public fund beneficiaries founded by RS	Public enterprises, companies, limited liability companies, joint-stock companies, institutions founded by RS
Local level	Direct budget beneficiaries	Local self-government bodies and services
	Public fund beneficiaries 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

All indicators for 2016 have been presented following the specified categories. The comparative overview includes the years 2015 and 2016 for the central level, considering that the identical work methodology was applied for these two years.

The Consolidated 2016 Annual Report was prepared by the Department for internal control and internal audit within the Ministry of Finance, which performs the CHU activities, on the basis of individual annual reports submitted by public funds beneficiaries.

II. PUBLIC INTERNAL FINANCIAL CONTROL SYSTEM

The Budget System Law defines the public internal financial control (hereinafter referred to as: 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 organizations 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 is primarily based upon the managerial accountability of managers, defined by the Budget System Law as the obligation of managers at all levels in public funds 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 to them. Article 80 of the above law stipulates that PIFC comprises the following areas:

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

1. FINANCIAL MANAGEMENT AND CONTROL

1.1. Concept and definition

The 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 organization, which on the grounds of risk management provides reasonable assurance that the organization'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 utilization of assets;
- 4) protection 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 and evaluation of the system.

The FMC system is based upon the managerial accountability of managers at all levels, whereby the head of a public funds beneficiary is responsible for the implementation and proper functioning of the FMC system within the organization under his/her management. On the other hand, this system assists managers in performing their tasks and supports the organization in achieving its objectives by operating activities which are lawful, economical, efficient, effective and transparent.

1.2. Legal framework and international standards

In addition to the Budget System Law and the FMC Rulebook, other regulations relevant for the introduction of the FMC system are as follows:

- The Law on Civil Servants („Official Gazette of the Republic of Serbia“, no. 79/05, 81/05 – corrig., 83/05 – corrig., 64/07, 67/07 – corrig., 116/08, 104/09, and 99/14);
- The Labour Law („Official Gazette of the Republic of Serbia“, no. 24/05, 61/05, 54/09, 32/13, 75/14 and 13/17-decision of Constitutional Court);
- Public Procurement Law („Official Gazette of the Republic of Serbia ”, no. 124/12, 14/15 and 68/15);
- The Law on Salaries of Civil Servants and Employees („Official Gazette of the Republic of Serbia”, no. 62/06, 63/06-corrig., 115/06-corrig., 101/07, 99/10, 108/13 and 99/14);
- The Law on Salaries in State Bodies and Public Services („Official Gazette of the Republic of Serbia”, no. 34/01, 62/06-other law, 63/06-corrig. of other law, 116/08-other law, 92/11, 99/11-other law, 10/13, 55/13, 99/14 and 21/16-other law);
- The Law on Public Enterprises („Official Gazette of the Republic of Serbia ”, no. 15/16);
- Regulation on the reimbursement of costs and termination benefits for civil servants and employees („Official Gazette of the Republic of Serbia ”, no. 98/07-consolidated text, 84/14 and 84/15);
- Regulation on budget accounting („Official Gazette of the Republic of Serbia”, no. 125/03 and 12/06);
- Rulebook on common bases, criteria and tasks of financial department in direct budget beneficiaries („Official Gazette of the Republic of Serbia”, no. 123/03);
- Rulebook on the standard classification framework and the Chart of Accounts for the budget system („Official Gazette of the Republic of Serbia“, no. 16/16, 49/16, 107/16 and 46/17);
- Rulebook on the mode of preparation, draw-up and submission of financial statements of public funds beneficiaries, beneficiaries of funds of mandatory social insurance organizations and budget funds („Official Gazette of the Republic of Serbia”, no. 18/15);
- Rulebook on the mode of utilization of funds from sub-accounts and other accounts from the consolidated republic treasury account, and on the mode of reporting on investment of funds of budget beneficiaries and beneficiaries of mandatory social insurance organizations („Official Gazette of the Republic of Serbia”, no. 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. Article 4 of the FMC Rulebook prescribes that the elements of the financial management and control system are defined in accordance with the international internal control standards, in relation to standards harmonized with the Guidelines

for Internal Control Standards for the Public Sector, developed by International Organization of Supreme Audit Institutions (INTOSAI).

1.3. FMC Progress report

The Annual Report on FMC System in public funds beneficiaries was prepared based on the questionnaire developed by the CHU.

The format of the annual report on FMC system, filled-in by public funds beneficiaries and subsequently submitted to the CHU, consists of a general part and a questionnaire for the self-assessment of internal controls.

The General part provides general information on the public funds beneficiary and information relating to implementation of FMC system in the organization. In the section relating to implementation of FMC system, the beneficiaries provide the information on the appointment of a manager responsible for FMC, setting up a work group to address the issues of introduction and development of the system, adopting the action plan, developing a map of business processes, defining key risks, etc.

The Questionnaire for self-assessment of internal controls includes a set of questions about: 1) the functioning of control environment (code of ethics, staff policy, training of employees, protection of assets, reporting on risk management, internal control and internal audit); 2) risk management (defining, measuring and monitoring of realization of operating objectives, identification, monitoring and addressing risks, risk management strategy, risk register); 3) control activities (description of business processes and work procedures, written operational work instructions, segregation of duties, updating work procedures and organizational charts, access to data and records, defining procedures for self-assessment and their utilization); 4) information and communication (the possibility for monitoring the realization of objectives and supervision, well-informed employees on their scope of work, informing the management by the employees on identified control weaknesses, recording errors and complaints, copying of data for protection purposes, data recovery, recording irregularities); 5) monitoring, supervision and evaluation (reporting which ensures impartiality and independence of internal audit, accepting and implementing the recommendations of internal auditors by the management, follow-up on the recommendations of internal and external auditors relating to the improvement of the FMC system, availability of internal audit reports to employees, instructions on actions to be undertaken in case of control weaknesses, the audit committee).

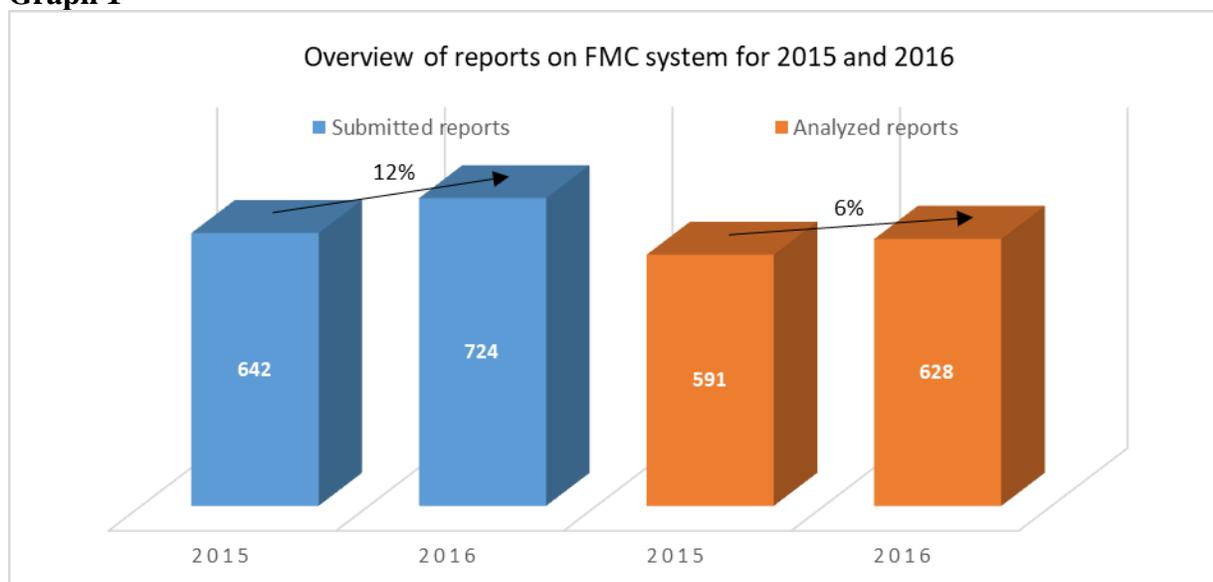
The questionnaire provides an assessment of the current status of the system and represents a basis for taking measures for its improvement.

1.3.1. Submitted reports

For the year 2016, a total of 724 public funds beneficiaries (in tables below referred to as: PFBs) submitted the annual report to the CHU, which is *an increase* when compared to 2015 of **12%**, when the number of submitted reports was 642. Of all the submitted reports, the consolidated

report included a total of 628 duly completed reports, which is **6% more** than in the previous year (591), while the remaining reports were either incomplete, unfilled or untimely and as such were not subject to analysis (Graph 1).

Graph 1



The overview of analyzed reports as per individual categories of public funds beneficiaries, and the explanation behind the defined categories is presented in Table 2.

Table 2

Overview of analyzed reports on FMC system per categories of PFBs for 2016		
	Categories of PFBs ²	Number of reports
Central/Republic level	Ministries	16
	Mandatory soc. insurance organizations	3
	Other direct budget beneficiaries	68
	Public fund beneficiaries founded by RS	36
	Total	123
Local level	Direct budget beneficiaries	111
	Public fund beneficiaries founded by local self-government	105
	Total	216
Indirect budget beneficiaries		289
Total in RS		628

² See the explanation on categories of PFBs on page 5, Table 1

At the central level, the report was submitted by the most relevant beneficiaries: all 16 ministries, all three organizations of mandatory social insurance and 36 major public enterprises and companies founded by RS. At the local self-government level, the complete report was submitted by the autonomous province and 17 towns in RS.

Total expenditures and outflows of all direct budget beneficiaries (ministries, administrations, judicial bodies, budget funds, directorates, offices, agencies, institutes, services...) included in the Consolidated 2016 Annual Report, account for 87% of total expenditures and outflows of the budget of the Republic of Serbia for 2016³.

1.3.2. Establishment of FMC system

FMC system includes the organizational establishment, implementation and development, while the plan for establishment, implementation and development of the system is prepared by the public funds beneficiary.

The organizational establishment of FMC system is an initial step in the process and includes the following activities:

- appointment of a manager responsible for FMC;
- setting up a work group to address the introduction and development of FMC system.

The organizational establishment of FMC system depends on the size, number of employees and other specificities of a public funds beneficiary. When establishing such system, the first task is to appoint a manager responsible for FMC or set up a work group to address all key issues relating to its introduction and development. Setting up a work group is indispensable for the coordination of all individual activities and the introduction of the system into all organizational units, for the agreement on different opinions and views concerning the description of business processes, risk identification and management, as well as the establishment of controls. Members of the work group need to be senior managers and persons with expertise and experience in the key areas of operation of public funds beneficiaries, and the persons who are well-acquainted with the operating activities and individual business processes within the organization. The work group is accountable to the manager for the support to introduction and development of the FMC system.

Further implementation and development of FMC system requires undertaking the following steps:

- drafting of an action plan;
- adopting the risk management strategy;
- formulating the mission, vision and key objectives of a public funds beneficiary;
- listing the main processes (sub-processes) and describing the activities contained therein;
- developing a map of business processes;
- documenting the business processes and drawing-up a flow chart;
- identifying the risks at the level of business processes, risk assessment and ranking, deciding on the response to the risks or establishing the controls (risk management);

³ Republic of Serbia Budget Law for 2016 („Official Gazette of the Republic of Serbia”, no., 103/15)

- evaluation of internal control elements;
- reviewing the controls in place, taking into consideration the most significant risks;
- making a list of most relevant processes not provided for in a written form;
- analyzing the existing and required controls and deciding on necessary prior and subsequent controls;
- adopting the plan for establishing the necessary and elimination of the unnecessary controls;
- monitoring the plan execution;
- drafting the annual report on the establishment of FMC system.

Based on the analytical processing of the general part in completed questionnaires relating to the establishment of the FMC system, the results have been presented in Table 3 for different categories of PFBs.

Table 3

Assessment of elements of FMC system establishment for different categories of PFBs for 2016																			
Parameters		Manager appointed or work group set up		Manager appointed and work group set up		Manager not appointed nor work group set up		Action plan adopted for establishing FMC system		CHU manual in use for FMC		List and description of business processes underway		Map of business processes developed		The most relevant business processes not provided for in written form		Internal controls in place in business processes, taking into consideration the most significant risks	
		Points	%	Points	%	Points	%	Points	%	Points	%	Points	%	Points	%	Points	%	Points	%
Category of PFBs ⁴																			
Central/ Republic level	Ministries	15	93.8	10	62.5	1	6.2	7	43.8	14	87.5	16	100.0	14	87.5	0	0.0	14	87.5
	MSIO*	3	100.0	3	100.0	0	0.0	3	100.0	3	100.0	3	100.0	2	66.7	0	0.0	3	100.0
	Other direct budget beneficiaries	39	57.4	30	44.1	29	42.6	22	32.4	44	64.7	53	77.9	41	60.3	0	0.0	56	82.4
	Public funds beneficiaries founded by RS	24	66.7	17	47.2	12	33.3	16	44.4	24	66.7	30	83.3	18	50.0	0	0.0	31	86.1
	TOTAL	81	65.9	60	48.8	42	34.1	47	38.2	85	69.1	102	82.9	75	61.0	0	0.0	104	84.6
Local level	Direct budget beneficiaries	99	89.2	87	78.4	12	10.8	72	64.9	72	64.9	96	86.5	65	58.6	1	0.9	87	78.4
	Public funds beneficiaries founded by local self-government	85	81.0	74	70.5	20	19.0	54	51.4	60	57.1	78	74.3	51	48.6	0	0.0	62	59.0
	TOTAL	184	85.2	161	74.5	32	14.8	126	58.3	132	61.1	174	80.6	116	53.7	1	0.5	149	69.0
Indirect budget beneficiaries		114	39.4	77	26.6	175	60.6	65	22.5	96	33.2	221	76.5	102	35.3	2	0.7	180	62.3
Total in RS		379	60.4	298	47.5	249	39.6	238	37.9	313	49.8	497	79.1	293	46.7	3	0.5	433	68.9

⁴ See the explanation on categories of PFBs on page 5, Table 1

If we observe the results of individual elements in establishing the FMC system at the level of RS, we can conclude that ***the lowest result has been recorded in relation to adoption of an action plan*** (37.9%). The map of business processes was developed by 46.7% beneficiaries, while only in 0.5% of cases the most relevant business processes are not provided for in written form, all of which implies that for the majority of key business processes, the manner of their conduct was specified in by-laws, internal acts, guidelines, instructions, directives and procedures. With respect to ***establishing the internal controls in business processes, taking into consideration the most significant risks***, the indicator records a ***significantly better result*** (68.9%), while almost 4/5 of beneficiaries have commenced ***making the list and description of business processes*** (79.1%).

Adoption of ***an action plan*** is the element with ***the lowest result*** recorded at the level of indirect budget beneficiaries (22.5%), as well as at the central level (38.2%), while the weakest link at the local level is development of ***map of business processes*** (53.7%). On the other hand, similar to the RS level, ***better results*** were recorded in the area of ***establishing internal controls based on most significant risks*** at the central level (84.6%) and with indirect budget beneficiaries (62.3%). At the local level, the best result was recorded in the area of ***organizational establishment of the system***, that is, the appointment of managers or setting up a work group (85.2%).

If we observe the categories of beneficiaries in more detail, ***the best results*** in nearly all assessed elements were recorded with the beneficiaries from the category ***mandatory social insurance organizations***, which include: Republic Pension and Disability Insurance Fund, Republic Health Insurance Fund and National Employment Service. According to the data submitted, these beneficiaries have for the most part realized the key activities in the area of establishing the FMC system, except for the development of map of business processes, with one beneficiary currently being engaged in the process of its development.

In the category of ministries, 15 out of 16 ministries have either appointed the manager or set up a work group, while 10 ministries have appointed the manager and set up a work group simultaneously. The map of business processes has been developed in 14 ministries (87.5%) and the internal controls are in place in business processes, taking into consideration the most significant risks, while there are no most relevant business processes not provided for in written form.

Regarding ***other beneficiaries at the central/Republic level***, some ***mostly lower results*** can be recorded for the assessed elements, when compared to the two categories of beneficiaries above.

At the local level, considering all the assessed elements, significantly ***better results*** were recorded at ***the level of direct budget beneficiaries*** (local self-government bodies and services), compared to other public funds beneficiaries 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...).

Compared to other categories of PFBs, the category of ***indirect budget beneficiaries has recorded the lowest indicators*** for 6 out of 9 assessed elements (organizational establishment, adoption of an action plan, use of FMC manual, development of map of business processes),

while for the remaining 3 elements, this category is ranked second to last (making the list and description of business processes, the most relevant business processes not provided for in written form, establishing the internal controls taking into consideration the most significant risks).

If we compare the elements of FMC system establishment at the level of RS for the last two assessed years (Table 4), we can conclude the following: the area of ***organizational establishment of the system*** has recorded ***the most considerable progress***, particularly in terms of simultaneous appointment of the manager and setting up a work group, of nearly 6%; the second to best progress of 4.3% was recorded in the area of adoption of an action plan, which lessens the severity of the fact that this particular element, the adoption of an action plan, recorded the lowest result in 2016 (37.9%); likewise, the beneficiaries are making more use of the CHU Manual for FMC (3%); the area of ***development of map of business processes*** recorded a ***decline*** of 3.5%, however, it is encouraging to note that the process of making the list and description of business processes is being undertaken in more than 79% of beneficiaries, which is 2.7% more than compared to 2015; the area of establishing the internal control in business processes taking into consideration the most significant risks has recorded a mild decline (-1.3%), whereby it should be noted that this is one of the elements with the highest results in 2016, both at the level of RS and individual categories of beneficiaries (Table 3).

Considering all the assessed elements, the level of RS can be said to have recorded the progress of 2% when compared to the previous year, in the area of establishing the FMC system.

Table 4

Overview of FMC system establishment in RS in 2015 and 2016						
Elements of system establishment	Total in RS in the year		2015		2016	
	Points	%	Points	%	Points	%
Manager appointed or work group set up	338	57.1	379	60.4		
Manager appointed and work group set up	246	41.6	298	47.5		
Manager not appointed nor work group set up	253	42.8	249	39.6		
Action plan adopted for establishing FMC system	199	33.6	238	37.9		
CHU manual in use for FMC	277	46.8	313	49.8		
List and description of business processes underway	452	76.4	497	79.1		
Map of business processes developed	297	50.2	293	46.7		
The most relevant business processes not provided for in written form	2	0.3	3	0.5		
Internal controls in place in business processes, taking into consideration the most significant risks	415	70.2	433	68.9		
AVERAGE IN RS			53.8%		55.8%	

1.3.3. Self-assessment – COSO framework⁵

Elements of COSO framework

An integral part of the annual reports submitted by public funds beneficiaries is the self-assessment of the FMC system with a view to evaluating the current status and undertaking measures for its improvement.

The elements being assessed are:

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

Control environment sets the „tone” in the organization and influences the staff awareness of the controls. It constitutes a basis for all other components of internal control, thus ensuring

⁵ The Committee of Sponsoring Organizations (COSO) of the National Commission on Fraudulent Financial Reporting founded in the United States of America.

discipline and structure. Control environment factors include integrity, ethical values and expertise of employees in the organization, philosophy and work style of the management, the manner in which the management delegates authority, responsibility, establishes appropriate reporting lines, and organizes and promotes the staff.

A part of the questionnaire relating to control environment includes 12 questions and each public funds beneficiary could score a maximum of 60 points. The questions relate to the existence and application of the code of conduct, measures for measuring the efficiency of staff policy, and the existence of the level of knowledge and skills necessary for each workplace, existence of the system of property protection against unauthorized access and use, and the obligations of regular reporting on risk management, internal controls and internal audit.

Risk management comprises identification, assessment and control over potential events and situations that may have an adverse effect on realization of a public funds beneficiary's objectives. A 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 provide 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 event of a major change in the control environment. Reducing the risk to an acceptable level requires that a public funds beneficiary analyze and update the controls in place at least once a year.

Risk assessment is covered by the self-assessment questionnaire, with the questions relating to: definition of long-term operating objectives, informing the staff about the operating objectives, system of monitoring the realization of objectives and analysis of the causes of possible departures, risk identification and assessment, as well as decision-making with a view to addressing the identified risks. The maximum number of points to be achieved is 55.

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 throughout the organization, at all levels and functions by all employees, in accordance with the established business process and a job description.

The assessment of control activities is covered by the questions on whether the following is in place: the detailed descriptions of business processes including the documentation flow, the detailed descriptions of work procedures, operating instructions, procedures for accessing data and records, as well as the rules relating to the segregation of duties, and the implementation of self-assessment of internal controls. The total number of questions is 10, so the maximum number of points is 50.

Reliable **information** and effective **communication** are indispensable for the management and control of operations of a public funds beneficiary. The questionnaire assesses whether there is a successful and effective internal communication system in place and a system for monitoring the achievement of the objectives of a public funds beneficiary, the process of recording the errors or complaints, identification of the reasons and rectification of problems, the system for copying

and protection of data, as well as data recovery in the event of loss, and whether employees are able to report irregularities and problems. The maximum number of points to be achieved is 35.

Monitoring and evaluation implies introduction of a system for FMC supervision through assessing the appropriateness and efficiency of its functioning.

The assessment of this element includes seven questions on the establishment of a reporting structure intended to ensure impartiality and independence of internal audit, cooperation of the head of a public funds beneficiary and internal audit, acting upon the recommendations of external and internal auditors in order to improve the internal control systems, instructions in place for the procedures in case of non-existent controls. The maximum number of points to be achieved is 35.

1.3.4. Assessment of elements of COSO framework

An in-depth overview of the assessment of individual elements of FMC system for 2016, per individual categories of PFBs, is presented in Table 5 below.

Table 5

Assessment of elements of FMC system for 2016, per individual categories of PFBs											
Category of PFBs⁶		Control environment (maximum 60 points)		Risk management (maximum 55 points)		Control activities (maximum 50 points)		Information and communication (maximum 35 points)		Monitoring, supervision and evaluation (maximum 35 points)	
		Points	%	Points	%	Points	%	Points	%	Points	%
Central/ Republic level	Ministries	50.1	83.5	47.1	85.7	38.9	77.8	27.9	79.6	25.9	74.1
	MSIO*	49.7	82.8	51.3	93.3	46.7	93.3	34.7	99.1	31.0	88.6
	Other direct budget beneficiaries	47.9	79.8	42.9	78.1	36.3	72.7	28.7	82.0	20.0	57.0
	Public funds beneficiaries founded by RS	47.2	78.7	46.3	84.2	39.3	78.6	29.3	83.6	23.9	68.2
	AVERAGE	48.0	80.0	44.6	81.2	37.8	75.6	28.9	82.6	22.2	63.3
Local level	Direct budget beneficiaries	44.6	4.3	40.6	73.8	35.0	70.0	26.8	76.6	19.2	54.9
	Public funds beneficiaries founded by local self-government	41.9	69.9	40.9	74.4	32.0	63.9	25.9	73.8	16.8	47.9
	AVERAGE	43.3	72.2	40.8	74.1	33.5	67.0	26.3	75.2	18.0	51.5
Indirect budget beneficiaries		42.7	71.1	40.0	72.8	31.3	62.7	26.2	74.9	13.9	39.8
AVERAGE IN RS		43.9	73.2	41.2	74.9	33.3	66.7	26.8	76.5	16.9	48.4

⁶ See the explanation on categories of PFBs on page 5, Table 1

At the level of RS, the scoring of assessed elements of FMC system is as follows:

1. information and communication (76.5%)
2. risk management (74.9%)
3. control environment (73.2%)
4. control activities (66.7%)
5. monitoring, supervision and evaluation (48.4%)

The identical order of assessed elements is visible as well at the level of each individual category of public funds beneficiaries. The only change when compared to the previous year is that in 2016 risk management reached the top position instead of control environment.

The best average results for each assessed parameter have been achieved at the *central/Republic level*, followed by local level, while the weakest results were recorded with indirect public fund beneficiaries, for each element from COSO framework.

Information and communication is the *leading area* compared to other assessed areas, whereas the weakest link in the system is *monitoring/supervision and evaluation*.

Similarly to the assessment of organizational establishment of FMC system, the *best results* were recorded with the beneficiaries from the category *MSIO*, with the highest average scoring compared to all other categories, for all assessed parameters, except for control environment where ministries are in the leading position.

Therefore, the conclusion may be that the areas of control environment, risk management, control activities and information and communication recorded relatively balanced results, considering that the average scoring at the level of RS ranges from 66.7% to 76.5%, while more significant variation of 48.4% is seen in the area of monitoring/supervision and evaluation.

A comparative review of average scores of FMC system elements for 2015 and 2016 at the level of RS, further confirms the statement that *all individual elements have recorded an increase in percentage, save for monitoring and supervision* which recorded a mild decline of 0.8%. The single highest increase of 5.6% has been recorded in the area of risk management (Table 6).

Table 6

Average results of FMC system elements for all PFBs in RS for 2015 and 2016											
Parameters AVERAGE IN RS	Control environment (maximum 60 points)		Risk management (maximum 55 points)		Control activities (maximum 50 points)		Information and communication (maximum 35 points)		Monitoring, supervision and evaluation (maximum 35 points)		AVERAGE
	Points	%	Points	%	Points	%	Points	%	Points	%	%
YEAR 2015	43.3	72.2	38.1	69.3	33.1	66.3	26.0	74.3	17.2	49.2	67.1
YEAR 2016	44.0	73.2	41.2	74.9	33.4	66.7	26.8	76.5	16.9	48.4	69.1

Overall, we can conclude that regarding the elements of COSO framework, in 2016 the progress of 2% was recorded when compared to the previous year.

For the purpose of an in-depth analysis, each of the five FMC elements above can be further broken down into individual questions that PFBs are obliged to respond to, in order to obtain a more realistic picture on the situation in assessed segments. Each response to the question is scored from 1 to 5, whereby score 1 is assigned for the response NO, whereas score 5 is assigned for the requirements which are fulfilled in entirety.

Below are the average scores per individual questions for each of the elements of COSO framework, at the level of RS and individual categories of PFBs for 2016.

Control environment

Table 7 provides an overview of average scores per individual questions on the quality of established control environment.

The highest score at the level of RS was achieved in the area of *identifying the levels of required knowledge and skills for each workplace* (4.8). On the other hand, the *lowest* average score at the level of RS relates to *establishing the criteria for assessing HR policy effectiveness* (2.9), and the obligation of reporting on risk management, internal control and internal audit within the organization (3.0). These two aspects are among the weakest both at the republic and local level and the level of indirect budget beneficiaries.

Table 7

1. CONTROL ENVIRONMENT										
QUESTIONS	PFBs	Central/Republic level				Local level			Indirect	Total in RS
	Ministries	MSIO	Other direct budget beneficiaries	Public funds beneficiaries founded by RS	TOTAL	Direct budget beneficiaries	Public funds beneficiaries founded by local self-government	TOTAL		
Is there a procedure in place which ensures that all employees are made familiar with the code of conduct?	4.3	5.0	4.1	4.1	4.1	4.0	3.4	3.7	4.1	4.0
Are all employees required to act in compliance with the code of conduct, i.e., the organization's code?	4.6	5.0	4.4	4.4	4.4	4.1	3.7	3.9	4.2	4.1
Have you adopted an HR policy (strategy)?	3.8	3.0	3.9	3.6	3.8	3.4	3.2	3.3	3.3	3.4
Are there criteria in place for assessing HR policy effectiveness?	3.6	3.3	3.7	3.0	3.5	2.6	2.5	2.6	2.9	2.9
Is the HR policy being monitored?	4.4	3.0	4.4	3.9	4.2	3.4	3.3	3.3	3.6	3.6
Are the levels of required knowledge and skills for each workplace specified?	5.0	4.3	5.0	4.9	4.9	4.8	4.7	4.8	4.8	4.8
Do you analyze the needs for training, annually, for each workplace?	4.0	4.0	3.7	3.8	3.8	3.3	3.2	3.2	3.7	3.5
Do you analyze the needs for training in financial management and control?	3.8	3.7	3.4	3.5	3.5	3.4	3.3	3.4	2.9	3.2
Have the managers and employees attended training courses in financial management and control?	3.6	3.7	3.4	3.7	3.5	4.0	3.5	3.7	2.9	3.3
Are the managers assured that risk management, internal control and internal audit processes are useful?	4.6	5.0	4.1	4.4	4.3	4.4	4.1	4.2	3.8	4.1
Are the assets, including intellectual property, protected against unauthorized access and use?	4.5	5.0	4.6	4.4	4.5	4.0	4.1	4.0	3.9	4.0
Is regular reporting on risk management, internal control and internal audit mandatory within the organization?	4.0	4.7	3.2	3.6	3.4	3.2	3.0	3.1	2.7	3.0

Risk management

Table 8 provides an overview of average scores per individual questions on risk management.

If we observe risk management at the level of RS, the segment with the ***highest*** score is ***projecting and planning of incomes and expenses in compliance with the set goals of the organization*** (4.6), immediately followed by regular monitoring of progress in achievement of the set goals (4.5). The highest average scores at the central and local level as well as the level of indirect budget beneficiaries mostly follow the ranking at the level of RS.

Creation of a risk register at the entity level has the lowest score at the level of RS (2.4), and is immediately followed by adoption of the risk management strategy (2.8). These indicators have the lowest score even if observed separately at the central level and at the level of indirect budget beneficiaries, whereas at the local level, in addition to creation of a risk register, decision making for resolving the identified risks has also been identified as weak.

Table 8

2. RISK MANAGEMENT										
QUESTIONS	PFBs	Central/Republic level				Local level			Indirect	Total in RS
	Ministries	MSIO	Other direct budget beneficiaries	Public funds beneficiaries founded by RS	TOTAL	Direct budget beneficiaries	Public funds beneficiaries founded by local self-government	TOTAL		
Does the organization have defined business goals in a written form?	4.5	5.0	4.7	4.8	4.7	4.2	4.6	4.4	4.4	4.4
Do you set goals which are specific, measurable, attainable, realistic and time-bound?	4.6	5.0	4.5	4.7	4.6	4.0	4.4	4.2	4.3	4.3
Are employees made familiar with long and short-term goals of the organization?	4.4	5.0	4.4	3.6	4.4	3.8	4.1	3.9	4.2	4.1
Are incomes and expenses projected and planned in compliance with the set goals of the organization?	4.9	5.0	4.8	4.8	4.8	4.4	4.7	4.5	4.6	4.6
Is the progress in achievement of the set goals regularly monitored?	4.8	5.0	4.7	4.8	4.7	4.0	4.6	4.3	4.5	4.5
Are the causes of possible departures analyzed?	4.3	4.7	4.5	4.6	4.5	3.6	4.1	3.8	4.2	4.1
Have the risks been identified?	4.2	4.3	3.5	5.3	4.2	3.5	3.3	3.4	3.2	3.5
Have the risks been assessed?	4.2	4.0	3.3	3.7	3.6	3.4	3.0	3.2	3.0	3.2
Are decisions made aimed at resolving identified risks?	3.9	4.3	3.5	3.4	3.5	3.1	3.0	3.1	3.2	3.2
Has your organization adopted a risk management strategy?	3.6	5.0	2.6	3.0	2.9	3.8	2.9	3.3	2.4	2.8
Have you created a register of risks for your organization?	3.9	4.0	2.6	2.9	2.9	3.0	2.4	2.7	2.0	2.4

Control activities

Table 9 provides an in-depth overview of average scores per individual questions relating to assessment of control activities, at the level of RS and at the level of individual categories of public funds beneficiaries.

The accessibility of work procedures to all employees and division of duties and responsibilities have recorded the ***highest score*** at the level of RS (3.9), which suggests that it has been largely ensured that the same person does not perform two or more of the following duties: proposing, approving, executing and recording business changes. If we observe separately the central, local and the level of indirect beneficiaries, these questions have also been most positively responded to.

Regarding weak points within the control activity elements, the situation is identical, both at the level of RS and at the level of individual categories of beneficiaries. Therefore, the lowest score was recorded in the ***application of procedures for managers monitoring implementation of internal control (self-assessment)***, with an average score of 2.4 at the level of RS, while the process of defining these procedures recorded a somewhat more positive score (2.5).

Table 9

3. CONTROL ACTIVITIES										
QUESTIONS	PFBs	Central/Republic level				Local level			Indirect	Total in RS
	Ministries	MSIO	Other direct budget beneficiaries	Public funds beneficiaries founded by RS	TOTAL	Direct budget beneficiaries	Public funds beneficiaries founded by local self-government	TOTAL		
Have detailed descriptions been prepared for business processes, including documentation flow, steps in decision-making process, deadlines for job completion and have control mechanisms been put in place?	4.3	5.0	3.9	4.3	4.1	3.8	3.4	3.6	3.6	3.7
Are the work procedures prescribed in detail?	4.3	4.7	3.9	4.1	4.0	3.9	3.4	3.6	3.5	3.7
Are the work procedures accessible to all employees?	4.6	5.0	4.1	4.4	4.3	3.9	3.5	3.7	3.9	3.9
Are the operational instructions for work available in a written form?	3.8	4.7	3.8	4.1	3.9	3.3	3.2	3.2	3.4	3.5
Do these instructions contain descriptions of internal controls?	3.4	4.0	3.3	3.6	3.5	3.0	2.7	2.9	2.5	2.8
Is it ensured that the same person does not perform two or more of the following duties: proposing approving, executing and recording business changes (division of duties)?	4.9	5.0	4.6	4.2	4.5	4.1	4.0	4.0	3.6	3.9
Are work procedures and organizational schemes regularly updated?	3.7	4.7	3.9	4.1	3.9	3.5	3.6	3.6	3.1	3.4
Is the procedure for access to data and records in place?	3.9	5.0	4.1	4.2	4.1	3.7	3.4	3.6	3.4	3.6
Have the procedures for managers monitoring implementation of internal control (self-assessment) been defined?	3.0	4.3	2.4	3.1	2.7	2.9	2.5	2.7	2.2	2.5
Are the procedures for managers monitoring implementation of internal control (self-assessment) in place and applied?	3.0	4.3	2.3	3.1	2.7	2.8	2.3	2.6	2.1	2.4

Information and communication

Table 10 provides the average scores for responses to the questions within the area of information and communication.

Public funds beneficiaries have recorded the ***highest*** score (4.4) at the level of RS for the ***ability of employees to report possible irregularities and problems***, and effective and efficient system of internal, electronic and verbal communication in place which enables employees to obtain information necessary for their job performance (4.2). These two questions recorded the highest score even if observed separately at the central, local and the level of indirect budget beneficiaries.

The lowest average score, both at the level of RS (3.4), and the central, local and the level of indirect budget beneficiaries, was recorded in the area of ***establishing the procedure enabling employees to inform the management about observed weaknesses in controls***. The second lowest score at the level of RS (3.5) relates to the question whether the process for recording errors and complaints is in place which ensures the possibility of analyzing them, to identify the reasons and eliminate underlying problems. When analyzing the individual categories of PFBs, the same question also recorded the second lowest score at both the local and the level of RS, whereas at the central level and the level of indirect budget beneficiaries, the second lowest score was recorded on the question: „Have the procedures, already in place within the information and communication system for the purpose of copying data for safekeeping, including the procedure for data recovery in case of loss, been tested? “

Table 10

4. INFORMATION AND COMMUNICATION										
QUESTIONS	PFBs	Central/Republic level				Local level			Indirect	Total in RS
	Ministries	MSIO	Other direct budget beneficiaries	Public funds beneficiaries founded by RS	TOTAL	Direct budget beneficiaries	Public funds beneficiaries founded by local self-government	TOTAL		
Does the information and communication system enable monitoring of realization of set goals and implementation of efficient job monitoring?	4.6	4.7	4.4	4.3	4.4	4.0	3.9	3.9	4.1	4.1
Is an effective and efficient system of internal, electronic and verbal communication in place which enables employees to obtain information necessary for their job performance?	4.4	5.0	4.5	4.3	4.5	4.0	4.0	4.0	4.2	4.2
Is there a procedure in place enabling employees to inform the management about observed weaknesses in controls?	3.6	5.0	3.7	3.8	3.7	3.6	3.1	3.3	3.3	3.4
Is there a process for recording errors and complaints in place which ensures the possibility of analyzing them, to identify the reasons and eliminate underlying problems?	3.6	5.0	3.8	4.0	3.9	3.4	3.4	3.4	3.4	3.5
Are the adequate procedures for copying data put in place for the purpose of safekeeping including the procedure for data recovery in case of loss?	3.9	5.0	4.0	4.3	4.1	3.9	3.8	3.8	3.6	3.8
Have the procedures, already in place within the information and communication system for the purpose of copying data for safekeeping, including the procedure for data recovery in case of loss, been tested?	3.4	5.0	3.8	4.0	3.8	3.7	3.4	3.6	3.3	3.5
Are employees provided with the possibility to report possible irregularities and problems?	4.4	5.0	4.5	4.6	4.6	4.2	4.2	4.2	4.4	4.4

Monitoring, supervision and evaluation

Table 11 provides an overview of average scores per individual questions in the area of monitoring, supervision and evaluation.

Within the area of monitoring and supervision, at the level of RS, the highest result was recorded in the segment ***monitoring of implementation of recommendations provided by external and internal auditors, relating to improvement of the financial management and control system*** (3.3). The second best result (2.8) relates to whether the manager accepts and implements the integrated recommendations issued by internal auditors. The same ranking is visible in individual categories of PFBs, except for the central level, where two highest scores relate to establishing the structure of reporting, ensuring impartiality and independence of internal audit, and the availability of reports of internal audit to persons employed in areas the reports refer to.

Regarding the weakest points in the area of monitoring, supervision and evaluation at the level of RS, the ***lowest score*** was recorded in the question on ***establishing the Audit Board as an advisory body for issues of internal control and internal audit*** (1.2), and establishing the procedures ensuring that the instructions prescribing actions to be taken and persons to be notified in case the controls are missing are updated and their implementation in practice (2.0). Even when observed at the level of individual categories of PFBs, these two weakest segments are the same as at the level of RS.

Table 11

5. MONITORING (SUPERVISION) AND EVALUATION										
QUESTIONS	PFBs	Central/Republic level				Local level			Indirect	Total in RS
	Ministries	MSIO	Other direct budget beneficiaries	Public funds beneficiaries founded by RS	TOTAL	Direct budget beneficiaries	Public funds beneficiaries founded by local self-government	TOTAL		
Has the structure of reporting, ensuring impartiality and independence of internal audit, been put in place?	4.7	5.0	3.3	4.1	3.8	2.9	2.7	2.8	2.1	2.7
Does the manager accept and implement the integrated recommendations issued by internal auditors?	4.5	5.0	3.4	3.9	3.7	3.2	2.7	3.0	2.3	2.8
Is the implementation of recommendations provided by external and internal auditors, relating to improvement of the financial management and control system, being monitored?	4.5	5.0	3.6	4.1	3.9	4.1	3.4	3.7	2.7	3.3
Are reports of internal audit available to persons employed in areas the reports refer to?	4.8	5.0	3.5	3.9	3.8	3.0	2.7	2.8	2.2	2.7
Are instructions available prescribing actions to be taken and persons to be notified in case the controls are missing?	3.4	5.0	2.6	3.2	3.0	2.5	2.2	2.4	1.8	2.2
Are there procedures in place to ensure that the instructions referred to in the question above are updated and implemented in practice?	2.8	5.0	2.4	2.9	2.7	2.3	1.9	2.1	1.7	2.0
Have you formed the Audit Board as an advisory body for issues of internal control and internal audit?	1.3	1.0	1.1	1.7	1.3	1.3	1.2	1.2	1.2	1.2

1.4. Training of persons engaged in FMC

Ministry of Finance – CHU has been continuously organizing training courses for managers and staff responsible for FMC. The purpose of training courses is to make the participants familiar with the FMC system and activities that need to be carried out in order for the system to be established, maintained and developed. The aim is working towards better financial management and decision-making, for the purpose of attaining the objectives of public funds beneficiaries, and performing operations in a lawful, proper, ethical, economical, efficient, effective and transparent manner.

Program of basic 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 the course of 2016, the training was organized in five rounds and included 272 participants from public funds beneficiaries.

Managers attended the on-the-spot training courses, at the premises of public funds beneficiaries, on underlying principles of FMC and IA, methodology for documenting business processes, development of procedures, risk register and risk management strategy. The training courses were attended by senior and mid-level managers in:

- Ministry of Public Administration and Local Self-Government - a one-day workshop on "Managerial accountability", for 26 participants, the heads of organizational units;
- PE „Waterworks and Sewerage" Belgrade - a one-day workshop on "Managerial accountability", for 30 participants.

In the framework of cooperation within the project „Improvement of Public Finance Management“ of the United Nations Development Programme (UNDP), funded by the Swiss Development Cooperation (SDC), a three-day workshop was held from 27-29 June 2016, at the mountain Kopaonik for 40 participants, the heads of organizational units of Internal audit, on "Introduction of guidelines for risk management".

With the support of international PIFC experts, within the framework of PLAC (Policy and Legal Advice Centre) projects providing assistance to Serbia in its preparation for the EU accession, a one-day workshop was held on 26 April 2016 on "Establishing risk management process", by the experts from PLAC project for 32 participants from organizational units and administrations within the Ministry of Finance.

2. INTERNAL AUDIT

2.1. Concept and definition

The Budget System Law and IA Rulebook define internal audit as an activity which provides independent objective assurance and an advisory activity whose purpose is to contribute to improving the operations of an organization, assist an organization in achieving its objectives through systematic and disciplined assessment and evaluation of risk management, control and organization management.

On the basis of objective review of evidence, internal audit provides assurance on the appropriateness and functioning of the risk management processes in place, controls and organization management, and identifies whether these processes function in a manner set by the management and whether they allow for the attainment of an organization's objectives.

Internal audit provides consultancy services, including offering advice, guidance, assistance or any other services whose aim is to increase the value and improve the organization management process, risk management and controls, whereby internal auditors do not assume the managerial responsibility.

Within the PIFC concept laid down by the European Commission, internal audit is perceived as a function performed by an authorized, organizationally and functionally independent internal audit unit, or an internal audit within an organization. Organizational independence implies that internal audit is independent from the activity being audited, is not part of any business process or organizational unit, and is accountable for its work directly to the head of the organization. Functional independence implies that internal audit makes decisions independently, on the basis of risk assessment, on the area, method of conducting and reporting on conducted internal audit.

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

2.2. Legal basis and international standards

Legal framework that regulates the field of internal audit includes the following:

- The Budget System Law;
- 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 certified internal auditor in the public sector ("Official Gazette of the Republic of Serbia", no. 9/2014, hereinafter referred to as: the Certification Rulebook);
- International Internal Audit Standards (International Standards for the Professional Practice of Internal Auditing of the Institute of Internal Audits);
- PIFC Strategy.

Article 82 of the Budget System Law prescribes that a public funds beneficiary is obliged to introduce the internal audit function, as an organizationally independent function which is directly accountable to the manager of such public funds beneficiary for its work.

The manner of introducing, maintaining and developing the IA system is specified in more detail in the following by-laws:

- IA Rulebook prescribes the manner in which an IA unit is organized and set up within the public funds beneficiary, the field of work i.e. the tasks to be done, 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;
- The Certification Rulebook lays down the requirements for taking the exam, the manner and procedure for taking the exam and the record of candidates who have passed the internal auditor exam.

2.3. Status and organization

Public Internal Financial Control Development Strategy, the Budget System Law and the IA Rulebook prescribe that the Republic of Serbia shall have a decentralized internal audit system in place.

Decentralized internal audit system sets forth an obligation that all public funds beneficiaries have the internal audit function in place. IA Rulebook specifies the criteria for establishing the internal audit function, in a manner that all ministries, autonomous provinces, towns and other public funds beneficiaries with more than 250 employees are obliged to have a separate, functionally independent organizational unit for internal audit in place. Other public funds beneficiaries may establish internal audit as follows:

- by establishing an independent internal audit unit;
- by establishing a joint internal audit unit for internal audit of two or more public funds beneficiaries;
- by concluding an agreement with other public funds beneficiaries on performing the internal audit tasks;
- where there are no conditions for organizing an internal audit unit, the tasks of internal audit unit may be discharged 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 and published by the CHU, on the website of the Ministry of Finance. The purpose of the questionnaire 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 format of the annual report on performed audits and internal audit activities consists of a general and a detailed part.

The general part provides general information 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 IA systems.

The detailed part provides an overview of performed audits and the number of recommendations categorized into different types.

For the year 2016, a total of 373 public funds beneficiaries submitted the annual report to the CHU. Of all submitted reports, this consolidated report has included 352 duly completed reports, whereas the remaining reports were incomplete, unfilled or untimely submitted, and as such were not subject to analysis.

Based on the reports on performed audits and IA activities in public funds beneficiaries, a consolidated report was prepared which provides a summary of collected information and the comments by the CHU.

Table 12 presents the number of established internal audit functions and the number of systematized and filled internal auditor positions in public funds beneficiaries.

Table 12

Number of PFBs in RS that established internal audit function with systematized and filled positions in 2016				
PFBs⁷	Submitted reports	Established IA	Systematized positions	Filled positions
Central/Republic level	117	80	281	230
Local level	112	80	182	141
Indirect PFBs	144	35	63	46
Total in RS	373	195	526	417

According to the reports received, 195 public funds beneficiaries have established internal audit function, 190 of which have established an internal audit unit or employed one internal auditor, with 526 positions systematized and 417 internal auditor positions filled. Five public funds beneficiaries have established internal audit function on the basis of agreement concluded with other public funds beneficiary with a functional internal audit unit in place. These beneficiaries account for 90% of public funds.

Based on 117 reports received, 80 beneficiaries on the Republic level have established internal audit with 281 systematized and 230 filled internal auditor positions.

Table 13

Total number of PFBs that established internal audit with systematized and filled positions in 2015 and 2016				
PFBs	Submitted reports	Established IA	Systematized positions	Filled positions
Total in RS in 2015	358	180	478	373
Total in RS in 2016	373	195	526	417

Table 13 presents the total number of established internal audit functions and the number of systematized and filled internal auditor positions in public funds beneficiaries for 2015 and 2016, clearly indicating an increase in all segments in 2016.

Table 14 presents the number of established internal audit functions and the number of systematized and filled internal auditor positions in public funds beneficiaries at the Republic level.

⁷ See the explanation on categories of PFBs on page 5, Table 1

Table 14

Number of PFBs at the Republic level that established internal audit with systematized and filled positions in 2016					
PFBs		Submitted reports	Established IA	Systematized positions	Filled positions
Central/ Republic level	Ministries	16	16	61	41
	MSIO	3	3	34	33
	Other direct budget beneficiaries	63	28	49	48
	Public funds beneficiaries founded by RS	35	33	137	108
	Total	117	80	281	230

Table 14 presents the establishment of internal audit in 16 ministries, 3 mandatory social insurance organizations and 98 public funds beneficiaries at the Republic level. In 16 ministries, the number of systematized positions is 61, while 41 internal auditors perform the internal audit tasks; in 3 MSIO, the number of systematized positions is 34, while 33 internal auditors perform the internal audit tasks; in the remaining 98 public funds beneficiaries, the number of systematized positions is 186, while 156 internal auditors perform the internal audit tasks.

In 2016, the internal audit unit in one ministry remained unfilled and not a single internal auditor position was filled by the end of the reporting period. Three ministries amended the Rulebook on the organization and systematization of positions and each prescribed and filled only one internal auditor position, which is contrary to Article 5, paragraph 2 of the IA Rulebook.

As an underlying explanation in their annual reports, the ministries stated that the current austerity measures in the Republic of Serbia, in terms of limiting the maximum number of employees and reducing the basic wages, resulted in the internal auditors' departure from the public sector and impossibility of recruiting new ones.

Table 15 presents the number of established internal audit functions, systematized and filled internal auditor positions in direct budget beneficiaries of LSG units and public funds beneficiaries founded by local self-government.

Table 15

Number of PFBs at the level of local self-government that established internal audit with systematized and filled positions in 2016					
PFBs		Submitted reports	Established IA	Systematized positions	Filled positions
Local level	Direct budget beneficiaries of LSG units	59	42	113	84
	Public fund beneficiaries founded by LSG	53	38	69	57
	Total	112	80	182	141

Based on 59 reports received from the autonomous province, the city of Belgrade, towns and municipalities, 42 local self-government units established internal audit with 113 systematized and 84 filled internal auditor positions.

Table 16

Number of indirect PFBs at the Republic and local level that established internal audit with systematized and filled positions in 2016				
PFBs	Submitted reports	Established IA	Systematized positions	Filled positions
Indirect PFBs⁸	144	35	63	46

Established IA units and independent internal auditors are directly accountable, in terms of organization and function, to the head of public funds beneficiary.

The percentage of public funds beneficiaries that established the IA function with one internal auditor position filled is 68%, with two internal auditors the percentage is 8%, and with three and more internal auditors the percentage is 24%. 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 most frequently stated reasons for not establishing the IA and not filling the internal auditor positions are legal limitations on the maximum number of employees, insufficient number of highly educated staff, low salaries, inadequately systematized positions compared to the workload and its complexity, insufficient financial assets, 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 organized by the CHU, the reports state that significant portion of time is spent on dealing with other tasks which are not in the scope of internal audit. This is not in

⁸ See the explanation on categories of PFBs on page 5, Table 1

compliance with the internal audit standards and directly affects the functional independence of internal auditors.

2.5. 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. The strategic plan is adopted by the end of the current year for the following three-year period, while the annual internal audit plan is adopted by the end of the current year for the following year. The strategic plan lays down strategic goals of internal audit and is based on long-term objectives of a public funds beneficiary.

The strategic plan of internal audit is prepared by the head of internal audit after the consultations with the management and is approved by the head of a public funds beneficiary.

The annual plan is prepared each year on the basis of the strategic plan. The head of internal audit prepares the annual plan, approved by the head of a public funds beneficiary.

Each individual audit is conducted on the basis of a prepared plan, describing in detail the subject, goals, duration, allocation of resources, audit approach, techniques and the scope of audit. The individual audit plan and related programs describe in detail the audit procedures and are prepared by the internal auditor and approved by the head of internal audit.

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

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

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

External evaluation of work of internal audit units has not been performed.

Department for internal control and internal audit conducted the quality review of internal audit work in ten ministries, covering the period from 1 January 2015 to 30 September 2016. The review included the assessment of fulfillment of prescribed requirements for establishing internal audit units, audit scope, competencies and skills of internal auditors, functional and organizational 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 performed by the staff of the Department for internal control and internal audit within the Ministry of Finance.

2.5.1. Overview of performed audits

Internal audit work in 144 public funds beneficiaries is conducted based on the strategic plan and the annual plan of activities approved by the head of the public funds beneficiary, and the individual audit plan approved by the head of internal audit. At the end of reporting period, in 42 public funds beneficiaries with established internal audit function, the process of adopting the strategic and annual plan was underway.

Table 17 presents a total number of planned, conducted and ongoing audits.

Table 17

PFBs		Number of audits in 2016			
		Planned audits	Conducted audits	Ongoing audits	Not conducted audits
Central/ Republic level	Ministries	92	67	5	20
	MSIO	54	53	1	0
	Other direct budget beneficiaries	89	66	14	9
	Public funds beneficiaries founded by RS	289	263	17	9
	Total	524	449	37	38
Local level	Direct budget beneficiaries of LSG units	171	117	45	9
	Public funds beneficiaries founded by LSG	88	72	10	6
	Total	259	189	55	15
Indirect PFBs		86	71	13	2
Total in RS		869	709	105	55

In 2016, according to the submitted IA activity reports, the number of planned audits was 869, out of which 709 audits were conducted, with 105 ongoing audits and 55 audits not conducted. Most frequently stated reasons for such a departure are reduced number of employees, changes in the organizational structure of public funds beneficiaries, changes in the annual plan of activities and the lack of exchange of practical experiences in the preparation of planning documents.

Table 18

Year	Total number of audits in 2015 and 2016			
	Planned audits	Conducted audits	Ongoing audits	Not conducted audits
Total in 2015	794	620	25	149
Total in 2016	869	709	105	55

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 15% of audits were transferred to the following year and 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.

2.5.2. Issued and implemented recommendations

Internal auditors issued a total of 6,167 recommendations for improvement of operations and reduction of identified risks to an acceptable level (5,055 recommendations from the categorized areas and 1,112 from specific non-categorized areas), 3,407 of which were implemented by the end of 2016, while for the remaining recommendations the implementation deadline has not expired yet.

Table 19 presents the number of issued recommendations in 2016, classified into categorized areas and formulated in the annual report model, as follows:

Table 19

Areas the recommendations refer to		Central/ Republic level	Local level	Indirect PFBs	Total
1	Internal rules and procedures	1730	664	98	2492
2	Planning	162	151	15	328
3	Revenues and proceeds	87	75	22	184
4	Public procurement and contracting	341	201	56	598
5	Employees, salaries and allowances	275	154	41	470
6	Payments and transfers	119	77	6	202
7	Accounting records and financial reporting	364	242	16	622
8	Information systems	125	31	3	159
TOTAL:		3203	1595	257	5055

Table 20

Areas the recommendations refer to		Number of issued recommendations in 2015	Number of issued recommendations in 2016
1	Internal rules and procedures	2297	2492
2	Planning	190	328
3	Revenues and proceeds	148	184
4	Public procurement and contracting	667	598
5	Employees, salaries and allowances	508	470
6	Payments and transfers	174	202
7	Accounting records and financial reporting	646	622
8	Information systems	148	159
TOTAL:		4778	5055

Table 21

Types of recommendations	Number of issued recommendations in 2015	Number of issued recommendations in 2016
Recommendations from categorized areas	4778	5055
Recommendations from specific non-categorized areas	1123	1112
TOTAL:	5901	6167

The difference of 1,112 recommendations in 2016 referred to in Table 21 is due to the fact that such recommendations were issued for specific areas characteristic for individual public funds beneficiaries, and could not be classified into the pre-determined areas in the annual report model.

Internal rules and procedures largely reflect the level of quality of financial management and control systems, and despite the fact that the highest number of recommendations was issued in this particular area, this area recorded a decrease in percentage when compared to 2015, which indicates gradual progress.

When compared to 2015, the number of issued recommendations increased, i.e. higher percentage is seen in the planning area, which indicates there are certain deficiencies in the process of planning and setting the objectives of PFBs.

2.6. 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 organizations and the CHU.

The theoretical part of the internal audit training included 84 participants employed in the public funds beneficiaries.

In the period January – December 2015, a practical training was held by means of conducting the internal audit in 34 beneficiaries, for 70 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) the basic training for conducting internal audit, with the duration of 7 work days, i.e. 49 working hours;
- 2) the basic training for financial management and control, with the duration of 5 work days, i.e. 35 working hours;
- 3) the training for practical work on internal audit, by conducting two audits in the beneficiary where the candidate is employed in 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 2016, 52 candidates successfully passed the exam and acquired the title of certified internal auditor in the public sector. By the end of 2016, a total of 330 internal auditors were certified in the public sector.

In the framework of cooperation within the project „Improvement of Public Finance Management“ of the United Nations Development Programme (UNDP), funded by the Swiss Development Cooperation (SDC), training courses were provided for the heads of local self-government units in the areas of financial management and control, internal audit and programme budget:

- a two-day workshop from 19-20 May 2016 at Silver Lake for the heads of internal audit units in ministries, AP Vojvodina and cities (Belgrade, Subotica, Kragujevac, Krusevac, Loznica, Cacak, Valjevo, Uzice and Novi Pazar), titled „Risk Management Guidelines“;
- Department for internal control and internal audit, in cooperation with the Department for managing EU funds within the Ministry of Finance and the State Audit Institution, held a three-day workshop from 12-14 October 2016 dedicated to “EU IPA management system – internal auditor training course” in Vrnjacka banja.

With the support of international PIFC experts, within the framework of PLAC projects providing assistance to Serbia in its preparation for the EU accession, a one-day workshop was organized on 27 April 2016 dedicated to the “Role of internal audit in establishing risk management processes”, delivered by PLAC project experts for 33 participants from ministries, funds, the State Audit Institution, PE “Electric Power Industry” Serbia and the City of Belgrade.

3. CENTRAL HARMONIZATION UNIT

3.1. Organization

The CHU tasks are performed by the Department for internal control and internal audit (hereinafter referred to as: the Department) within the Ministry of Finance. In 2016, the Department had systematization in place for 10 positions and 9 civil servants employed, as follows: the assistant minister, three employees in the FMC Harmonization Group, four employees in the IA Harmonization Group and an administrative officer.

In terms of functional allocation of activities in the previous period, some activities were shared by both Groups, as due to a limited number of staff, the strict specialization and division of functions per groups could not be adhered to without affecting significantly the efficiency and effectiveness of performance of work activities. Furthermore, the situation in practice revealed that nine employees are not sufficient for addressing the extensive and complex tasks within the competence of the Department in a timely and comprehensive manner, particularly considering the growing need for monitoring the progress made in the area of implementation of public internal financial control and providing practical advice to the public funds beneficiaries. The CHU, therefore, undertook the initiative by providing the recommendations for additional employees, which proved fruitful.

In August 2017, the new Rulebook on internal organization and systematization of jobs in the Ministry of Finance⁹ was adopted, according to which 3 new positions were systematized in the Department, as follows: a junior FMC coordinator, a junior IA coordinator and a lead coordinator for FMC and IA. In line with these changes, the Department currently has systematization in place for 13 positions, as follows: the assistant minister, five employees in the FMC Harmonization Section, five employees in the IA Harmonization Section, a lead coordinator for FMC and IA, and an administrative officer. At the moment, the Department still has nine employees; therefore, the process of improving staff capacities in the Department needs to continue in the forthcoming period, primarily by hiring appropriate and qualified staff.

⁹ Government Conclusion 05 No.: 110-7846/2017 as of 17 August 2017, approving Rulebook on internal organization and systematization of jobs in the Ministry of Finance 08 No.: 112-01-1/408 as of 4 August 2017

In addition to raising awareness of financial management as an integral part of the management process and improving the internal audit function, the first strategic goal set forth in the PIFC Strategy was defined as further development of the role of the Ministry of Finance – the CHU, in the area of coordination, monitoring, education and informing of managers and employees engaged in the PIFC process.

Therefore, unlike the previous period when the CHU was more focused on the regulatory framework, the methodology and development of human resources necessary to support the development of the PIFC system, in the forthcoming period, the CHU will need to focus more on providing practical support to the managers and key employees in the public sector who are engaged in developing the internal control systems in their organizations and changing the management culture, by making a transition from the compliance-based approach towards the performance and result-based approach.

3.3. Chapter 32 – Financial control

At the Second Intergovernmental Conference between the Republic of Serbia and the European Union, in Brussels, on 14 December 2015, the Negotiation Chapter 32 – Financial control, was opened.

The Common Position of the European Union – Chapter 32 – Financial control, as of 3 December 2015 (AD 13/15 CONF-RS 2/15), confirms the progress made and notes that the activities and measures undertaken to date in the area of PIFC are in compliance with the requirements of the European Union. Additionally, the benchmarks are specified for provisional closing of the Chapter 32: „Serbia amends its legal framework to ensure coherent PIFC legislation. Serbia implements PIFC legislation and the underlying policies and ensures sufficient administrative capacity at central and local level, in social security funds and in the state-owned companies. Serbia ensures that the centralized budget inspection function is compatible with the PIFC requirements.”

Owing to extensive activities of the Ministry of Finance – the CHU in the previous period, and particularly with the adoption of the PIFC Strategy by the Government, significant progress was made in the area of adjusting and harmonizing the existing internal control systems in the public sector in the Republic of Serbia with the requirements of the Public internal financial control concept, developed by the European Commission with the aim of assisting the accession countries in understanding and implementation of well-developed and effective internal control systems, however, there still remain challenges in terms of full and systematic implementation of financial management and control and internal audit by the public funds beneficiaries.

3.4. Quality review of internal audit work

The CHU conducted the quality review of internal audit work in ten ministries, covering the period from 1 January – 30 December 2016. The report on the quality review of internal audit

work, no.: 401-00-04801/2016-09 as of 30 December 2016 was submitted to the minister of finance and published on the web site of the CHU – Ministry of Finance¹².

The quality review was conducted in the following ministries:

- Ministry of Finance,
- Ministry of Construction, Transport and Infrastructure,
- Ministry of Economy,
- Ministry of Agriculture and Environmental Protection,
- Ministry of Mining and Energy,
- Ministry of Culture and Information,
- Ministry of Health,
- Ministry of Justice,
- Ministry of Education, Science and Technological Development,
- Ministry of Labour, Employment, Veteran and Social Affairs.

The review included the assessment of fulfillment of prescribed requirements for establishing internal audit units, audit scope, competencies and skills of internal auditors, functional and organizational 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 performed by the staff of the CHU in the period November-December 2016.

The review identified the gaps compared to the prescribed requirements on the minimum number of internal auditors in internal audit units, i.e. a trend of reducing the number of systematized and filled internal auditor positions in ministries was identified, as referred to in section “III Conclusions and Recommendations” below. The review also confirmed that internal auditors were implementing the internal audit work methodology, they were familiar with the International Standards for the Professional Practice of Internal Auditing by the Institute of Internal Auditors (IIA) and all 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 organization.

3.5. Improving the public internal financial control

In cooperation with the experts from PLAC project, the Risk Management Guidelines were prepared and published on the web site of Ministry of Finance, Department for internal control and internal audit. With the assistance of PLAC project experts, the Guidelines were presented during two two-day workshops, to the representatives of all ministries and organizations of mandatory social insurance. Printing of the Guidelines was supported by the project “Enhancement of Municipal Audit for Accountability and Efficiency in Public Finance

¹² http://ifkj.mfin.gov.rs/user_data/posts/Pregled%20kvaliteta%20ZBIRNO%2030.12.pdf

Management” conducted by the United Nations Development Programme (UNDP), and funded by the Swiss Development Cooperation (SDC).

The objective of the project „Enhancement of Municipal Audit for Accountability and Efficiency in Public Finance Management is improving the mechanisms of the Ministry of Finance – the CHU, in strengthening and structuring the public internal financial control and accountable public funds management.

The project is being conducted with the aim of improving the FMC system within the units of local self-government and ensuring that the IA function in the local self-government is in place, fully-functional and supports the managerial accountability concept. The broader objective of the project is also achieving better cooperation between internal and external audit, aimed at increasing the efficiency of internal audit and making a shift in focus of external audit to performance audits.

The project supported the software upgrading and the work on a project assignment – development of the information system for electronic communication between the public funds beneficiaries and the CHU, and development of tools for in-depth analysis and storage of collected data. Similarly, the “e-learning” platform is envisaged to enable downloading of risk management models, in order to facilitate the implementation by the public funds beneficiaries.

In the reporting period, advice and instructions were provided to public funds beneficiaries with respect to organization of IA and establishing the FMC system.

By undertaking the activities above, the CHU contributed to better understanding of PIFC throughout the public sector, and particularly with the managers responsible for FMC and mid-level managers, members of work groups for the introduction and development of the FMC system.

Networking with other stakeholders in PIFC process is carried out at meetings, workshops, by using the web site for discussing the issues considered relevant for PIFC, and through direct contacts with the participants at training courses, by providing necessary explanations and advice, and also by encouraging networking among the participants at training courses.

At the level of external networking, the cooperation is maintained with the State Audit Institution, the Serbian Association of Internal Auditors – the associate member of the Global Institute of Internal Auditors, the Serbian Chamber of Certified Auditors and the Association “Internal Auditor”. The contacts with the Central Harmonization Units from other countries are also maintained for sharing experiences related to establishment and development of PIFC.

With respect to international cooperation, several meetings were held 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 Organization for Economic Cooperation and Development (OECD), during which the PIFC-related topics were discussed.

Considering the workload, variety and complexity of tasks performed by the CHU, the system of remunerations, rewards and titles in place remains inadequate, even though addressing these issues has been provided for in the PIFC Strategy.

3.6. International cooperation

The process of selecting the partner for the twinning project “Support to Further Development of Public Internal Financial Control” was concluded. The selected partner is the Ministry of Economy and Finance of the Republic of France. The duration of the project is 24 months, with the total value of two million euros. The project is funded by the EU pre-accession assistance fund (IPA 2013) and co-funded by the Republic of Serbia. The overall objective of the project is establishing modern and efficient public finance management system at all levels of government.

On 23 June 2016, the representatives of the Ministry of Finance, Department for internal control and internal audit, organized a meeting in Ljubljana with the senior representatives of the Center of Excellence in Finance (CEF) aimed at establishing cooperation.

The goal was to gain knowledge of the work and training programs in the area of public internal financial control, conducted by the CEF.

The CEF representatives presented a training program for internal auditors in the public sector, jointly developed with the Chartered Institute of Public Finance and Accountancy (CIPFA) from Great Britain. The meeting also addressed the issue on how the existing training methodologies for internal auditors in the public sector of the Republic of Serbia could be improved, and the level of expertise of internal auditors through obtaining internationally recognized internal audit certificates.

The representatives of the Central Harmonization Unit attended the Regional conference on the public internal financial control system, organized by SIGMA, in cooperation with the Ministry of Finance of Montenegro, in September 2016 in Becici, Montenegro. The main topics of the conference were managerial accountability and quality control of internal audit work in the public sector, while the key message of the conference was that development of internal control concept and strengthening managerial accountability is in fact visible. The conference was supported by the European Commission’s Directorate-General for Budget.

Through its Public Expenditure Management Peer Assisted Learning network (PEMPAL), the World Bank organized a meeting of the Working Group for Relationship of internal audit with financial inspection and external audit (RIFIX) in Moscow in October 2016, with the participation of representatives from the CHU.

In November 2016, the representatives of the Ministry of Finance attended the seminar, jointly organized by the Chartered Institute of Public Finance and Accountancy (CIPFA) and the European Court of Auditors (ECA) in Luxembourg, dedicated to „Discussing good practice and new methods in Public finance management and implementation of the International Public Sector Accounting Standards (IPSAS) ”, applied in majority of the EU member states.

The representatives of the CHU within the Ministry of Finance of the Republic of Serbia attended the first meeting of CHU representatives from Western Balkans countries, organized by Regional School of Public Administration (ReSPA), in December 2016. The purpose of the meeting was setting up a new Working group for PIFC cooperation. The topics of the first meeting were setting up a Working group for PIFC and defining the work guidelines and priority areas for 2017-2018. The objective of the conference was setting up an expert working group and extending regional international cooperation in the area of PIFC, which was recognized by OECD, SIGMA and EC representatives.

Republic of Ireland's Institute of Public Administration organized a seminar in December 2016 for senior managers from the Ministry of Finance, and the representatives from the Department for internal control and internal audit were also present. The seminar focused on audit of EU funds and internal audit. The discussion focused on the topics of recognized principles of financial management and control and internal audit, and the guidelines on the procedures applied in practice which are critical for financial management and control.

III. CONCLUSIONS AND RECOMMENDATIONS

Conclusions and recommendations for further development and improvement of public internal financial control system were drawn both based on the submitted and analyzed reports from the public funds beneficiaries and based on the analysis of the situation in practice.

1. Financial management and control

With respect to *submission of annual reports* on the FMC system, the following has been identified:

- Progress was made in the number of submitted reports (12%) and the number of analyzed reports, that is, the number of reports included in the Consolidated annual report (6%);
- There is a significant portion of unduly submitted reports (13%), which were either untimely submitted, incomplete or incorrect, and as such were not included in the Consolidated annual report;
- Total expenditures and outflows of 76 direct budget beneficiaries that submitted the annual report on the FMC system for 2016 account for 87% of total expenditures and outflows of the RS budget for 2016.

In the area of *establishing the FMC system*, the following has been identified:

- Considering all defined elements of establishing the FMC system at the level of RS, the progress of 2% was achieved when compared to previous year;
- The major problems for public funds beneficiaries is the preparation of an action plan and the map of business processes;
- Public funds beneficiaries from the category of MSIO and Ministries at the central level, as well as direct budget beneficiaries at the local level, achieved significantly better results compared to other beneficiaries;
- The lowest scores are seen at the level of indirect budget beneficiaries.

In assessing the individual elements of the FMC system, that is, five elements of *COSO framework*, the following has been identified:

- Considering all the observed elements, the progress of 2% was achieved at the level of RS when compared to previous year;
- Monitoring, supervision and evaluation still remains the segment with the lowest result, with the lowest ranked indicator within the segment - establishing the audit board;
- The highest average scores were achieved in the category of MSIO beneficiaries;
- Indirect budget beneficiaries are lagging significantly behind when compared to other categories, in all assessed elements.

The following *recommendations* are provided for eliminating the identified weaknesses:

- the CHU needs to update its self-assessment questionnaire, improve its content and format and enable electronic submission of annual reports on the FMC system, in order to improve the quality of submitted and analyzed reports which are the basis for the Consolidated annual report;
- Through amendments to the Budget System Law, it is necessary to define a particular group of public funds beneficiaries that will be obliged to submit the annual report on the FMC system, to be included in the Consolidated annual report;
- Within its training courses and workshops, the CHU should particularly focus on the segments with the lowest scores (preparation of an action plan, monitoring, supervision and evaluation) and by doing so provide practical assistance to beneficiaries;
- Direct and indirect budget beneficiaries need to cooperate more intensively in the area of FMC, at the level of specific fields of work (healthcare, education...), in order to share experiences and pass on the good practices from higher to lower levels;
- Public funds beneficiaries, and particularly large and complex organizations, are recommended to set up an audit board, as an advisory body for internal control and internal audit issues, which will contribute to increasing the quality of PIFC.

2. Internal audit

The most relevant *weaknesses* identified in the internal audit area are as follows:

- Reduced number of systematized and filled internal auditor positions in ministries;
- 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 existing systematized internal auditor positions have not been entirely filled due to legal limitations on the maximum number of employees, insufficient number of highly educated staff, low salaries, inadequately systematized positions compared to the workload and its complexity, competition from the private sector;
- Increased number of non-conducted audits compared to the planned number of audits.

The following *recommendations* are provided for eliminating the identified weaknesses:

- It is necessary to make additional efforts within the current human resources in the ministries to ensure that appropriate staff is selected and recruited as internal auditors;
- Public funds beneficiaries are required to adjust the systematization, number of employees and fill the internal auditor positions, in accordance with the IA Rulebook,

taking into consideration the risks, complexity of operations and the funds under their management;

- Harmonize the remuneration and the reward system of internal auditors with the workload and requirements in terms of competencies necessary for performing the internal audit tasks;
- Provide continuous training for internal auditors which will ensure more appropriate planning and rational utilization of internal audit resources in public funds beneficiaries.

3. Central Harmonization Unit

With regards to work and future development of the CHU, the following has been *identified*:

- The current number of employees is not sufficient for discharging all the tasks within the competence of the CHU in a timely and comprehensive manner;
- Most employees are engaged in providing basic training courses and certification programs for certified internal auditors, while significantly less attention is dedicated to monitoring of the implementation of PIFC system and reviewing its quality;
- The level of awareness of financial management and control, internal audit and particular role of the CHU remains insufficient, whereby the lack of information is more visible at the level of higher management, whereas it is less visible at the level of middle and lower-ranked managers.

The following *recommendations* are provided for eliminating the identified weaknesses:

- Continue with the process of recruiting the appropriate and competent staff;
- Enhance the professional knowledge of the CHU staff by monitoring the international practices in the areas of financial management and control and internal audit (through participation at international conferences organized by SIGMA, PEMPAL, European Commission and by other international and regional institutions);
- Strengthen the coordination role of the CHU through: strengthening cooperation with other sectors within the Ministry of Finance, the State Audit Institution, the Treasury Administration, and other relevant institutions, and cooperate more intensively with internal auditors and managers responsible for financial management and control;
- The CHU should undertake actions in order to promote public internal financial control, by improving its web site, organizing seminars and workshops, particularly for senior managers, cooperating with relevant media channels, etc.