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FINANCIAL MANAGEMENT AND CONTROL

Can't see the forest for the trees

Even though it has been "on paper" for a whole decade, the actual level of implementation (and impact) of Financial Management and Control (FMC) in Serbia remains low. The focus of decision-makers is more on the form - harmonising regulation with the standards and expectations of the European Union, rather than on the essence - implementing, followed by monitoring, and measuring the concrete results of FMC. However, the environment in which FMC is expected to be developed and implemented is, as well, unfavourable, given the lack of strategic planning, managerial responsibility and open and meaningful communication with, above all, citizens, who need to be assured that the money raised from them is spent in a smart and responsible manner. This brief analyses the key achievements, indicates main obstacles in its establishment and implementation and sums up the measures needed to be implemented in order to "move" FMC from strategy on paper towards concrete benefits for the citizens.

Serbia has in recent years succeeded in establishing macroeconomic stability - but not in implementing key structural reforms, that would guarantee the sustainability of such framework. During the fiscal consolidation measures (2015-2017), there was a significant reduction in the fiscal deficit - from almost 6% of GDP on average in the period of 2012-2014 to 1.2% in 2016.[1] In 2017 and 2018, there was even a fiscal surplus. Consequently, public debt was reduced from 71.2% of GDP in 2015 to 52% at the end of 2019. However, regardless of the improved fiscal position, the biggest number of key structural reforms was not carried out - such as planned optimisation of public administration and "deep" reorganisation of key public enterprises. For example, rationalisation of the public sector has been reduced to a *natural outflow* through a hiring ban that has not completely solved the old problems, and has created some new ones (among others, made the recruitment of internal auditors in local government more difficult). The problem of public and state-owned enterprises has been partially solved by restricting warranties and selective privatizations, therefore it still represents fiscal risk. In addition, the realisation of public investments (mostly investments in transport and environmental infrastructure), whose importance for economic growth is pointed out by the expert public points out - remained below the optimum.[2]

In such environment, the development of financial management and control (FMC) must remain a medium-term priority for Serbia – in order to ensure the sustainability of the achieved macroeconomic results, but also to (continue to) develop both the system and the culture of responsibility, control and evaluation. FMC in the public sector is a mechanism that should contribute to the "domestic business" of state institutions and public enterprises, and at the same time to provide assurance to taxpayers that their money is managed in a smart and responsible manner. In the case of Serbia, the development of such a mechanism is even more important, having in mind that the most reviewed and cited international composite indexes point to insufficient management and analytical capacity of the institutions in Serbia, relatively high level of corruption, and low level of predictability and sustainability of the political economy. The analysis of the World Economic Forum (WEF) „Global Competitiveness Index" concludes that Serbia achieves the worst results in topics related to trust in policy consistency and financial management: "Long-term vision of the Government" (rang 80/140), "Political stability of the Government" (92/140), "Accounting and Auditing Standards" (102/140), "Corruption Frequency" (75/140), and "Budget Transparency" (60/140).

1. *Source: Ministry of Finance*
2. *The Fiscal Council estimated for 2018. that the optimal value of public investments would be at least 1p.p. GDP higher than realised one (Petrović, Brčerević, Gligorić, (2019) „Why is the economic growth in Serbia falling behind?", The Fiscal Council)*

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Like most other reform areas, as well as in the case of FMC, the conditions set by the EU - not the conscience of the decision makers - represent the main drivers for change and progress. The implementation of FMC started when Serbia began its way towards European integration. The FMC is a part of the Negotiation of Chapter 32 - Financial Control. Among managers in state administration and public enterprises, there is still no developed awareness of the importance, nor enough knowledge of the basic elements and goals of FMC. According to the IPFC Strategy[3], numerous public fund users have not yet been able to establish basic procedures for the implementation of certain work processes within the FMC. The number of managers who have completed the training in the FMC area is not enough, and therefore there is a clear lack of real knowledge on all the elements of the FMC in the public sector. Managers are not sufficiently familiar with risk management and how such management can help their institution to achieve its goals, because only a limited number of public fund users have risk management plans and risk records.

Therefore, even ten years after the introduction of FMC in Serbia, this mechanism is "nowhere near" functioning in full capacity and truly convincing the citizens of the domestic business of public fund users. The focus of decision-makers is more on harmonising with the acquis of the European Union, that is, passing laws and regulations, rather than performance. In other words, instead of essence, we are dealing with form, which is recognised and noted by the European Commission, in its regular annual reports for Serbia, as well as all other relevant organisations, which monitor the level of harmonisation and the level of implementation of FMC. Even though Serbia is every year "slowly" harmonising with EU standards and requirements, and thus has developed a Strategic Framework for the IPFC, an Action Plan for the IPFC, and manuals for both the FMC and the Internal Audit, full implementation is still missing. Serbia's activities can be described through the "check the box" principle - that is, through the iterative fulfilment of the minimum - and mostly regulatory - expectations, set by the European Union. Thus, for example, it is foreseen that any organisation that is a user of public funds is required to establish an FMC system, which represents the expected regulatory harmonisation. However, the implementation is lacking, among other things, because there is no specific deadline for this obligation, while the Central Harmonisation Unit (CHU) is not even able to track which public funds users[4] have established the FMC, because the official Register of users of public funds that are obliged to implement the FMC does not exist.

Implementation of FMC is at a relatively low level.[5] The overall level of preparedness in the area of financial supervision is constantly assessed by the European Commission as moderate - and it is precisely in the area of FMC where harmonisation and implementation are at the lowest level. The low level of implementation of FMC is indicated by all other relevant and available measurements. The indicator that evaluate the functioning of the FMC, developed as part of Sigma's "Monitoring Report", indicates that the largest number of budget users did not implement the FMC or harmonise it with the regulatory framework, so Serbia was rated "one" in the domain of the FMC implementation, at the end of 2017. Within this indicator, out of possible 23 points (full implementation of FMC) Serbia collected "only" 5. Public fund users were rated with zero points for harmonisation between the organisational and budget plan, development and influence of basic managerial responsibilities at the central level, for the mere existence of reporting of irregularities, and for the frequency and wholeness of risk assessments.

What is the reason for poor implementation of FMC, and how is it possible to influence more rapid establishment and implementation of that mechanism?

When that question is asked, "all eyes are on" CHU, in charge of the implementation and coordination of the fiscal control in the public sector. Although it is certain that the space for improving the capacity of the CHU is significant - the causes of the problem are yet wider than the capacities and scope of that institution. Employees who are members of the FMC Group (four of them) are often overwhelmed by "daily" operational activities, such as trainings and certification, design of various materials and presentations, collection and integration of data, and preparation and publication of annual consolidated reports.[6] On the other hand, the FMC Group does not have the time to fully dedicate itself to coordinating the strategic development of FMC, developing methodological guidelines, promoting the concept and communicating with the public. Due to the lack of human capacities, and lack of adequate regulations to authorise them, the CHU does not

3. "Strategy for internal financial control development in the public sector in the Republic of Serbia for the period 2017-2020."
4. Users of public funds are direct and indirect users of budgetary funds, users of funds of compulsory social security organizations and public companies established by the Republic of Serbia or local authorities, legal entities founded by those public enterprises, legal entities over which the Republic of Serbia or local authorities has direct or indirect control over more than 50% of the capital or more than 50% of the votes on the board of directors, other legal entities in which public funds make up more than 50% of the total revenue in the previous business year, as well as public agencies and organisations to which public agency regulations are enforced; (Budget System Law).
5. Ibid. (page 127).
6. "Monitoring Report: The Public Administration Principles", Sigma, 2017 (page 152-153).

analyse individual FMC systems of public fund users, nor monitor the implementation of recommendations for improving FMC in public fund users. In recent years, the CHU has made a significant step forward regarding updating and adapting the strategy and manuals[7], the scope of organisations that provide the data[8], and the structures and readability of annual reports[9]. The European Commission, in its report, also pointed out that the CHU has begun the transformation process from providing IPFC trainings to developing and disseminating methodological guidelines. Nevertheless, that transformation is still at an early stage to produce more significant results, but it is a step forward in the role of the CHU.

Institutional and structural obstacles that prevent FMC to "breathing fully" - and are wider than the "scope" and competence of CHU – refer to the following:

(1) Lack of strategic goals - both at the highest level (of the Government) and at the level of the ministries and local self-governments, which would provide the basis for the function of purposefulness of FMC. The overall vision of Serbia's development does not exist - although it is prescribed by the Constitution and the Law on the Planning System that envisages the existence of the Development Plan, as the hierarchically highest, long-term document of development planning of the Republic of Serbia, which is adopted by the National Assembly for a period of at least 10 years. The Law emphasises that the harmonisation of the Development Plan with other development documents, particularly the programmes of economic and financial reform (ERP and Fiscal Strategy), is important. Since the "supreme" plan does not exist, nor is the harmonisation of other plan documents ensured, it is not possible to harmonise organisational goals and resources with them, nor - thus - achieve the full implementation of FMC. In the absence of clearly argumentative and measurable strategic goals of the Government, it is neither possible to measure the "expediency" of spending the funds, nor to assess to what extent are the funds truly purposefully spent - that is, financial control remains without the "most significant" blade and is reduced to monitoring of formalities and procedures.

(2) Underdevelopment of managerial responsibility, which would clearly "outline" the rights and obligations of managers at various levels in achieving those strategic and operational goals of the organisation. The first reason is that it is often impossible to clearly and unambiguously identify who is responsible for carrying out a task, as well as for achieved results. The management culture is centralised with a small number of delegated decision-making powers at the middle management level. Ministers and senior management are involved in making technical decisions, which distracts them from key strategic functions. The basic impression is that the whole system of state administration works on a day to day basis - without a plan to stick to, relying primarily on the authority of the "people at the top", instead of the established system and formal rules. That illustrates large number of "easily replaceable" officers as acting positions. The consequences are frequent changes in the upper and middle levels in the administration, which occur with almost every change of government that prevents building on continuity. The situation is not eased by the fact that formal rules and procedures are sometimes disproportionately detailed and too large for existing capacities.[10] This further disables the definition and achievement of meaningful results. For example, the manager of some organisation unit is not given resources for engaging the staff and achieving results.

(3) Complete absence of meaningful and clear communication with citizens, which are in most cases not even aware of the existence of FMC, nor the potential impact of that system on the quality and financial control of the services they are offered. The situation is summed up by the aforementioned WeBER[11] reports[12] - which rate Serbia with a score of 1 on a scale of 0 to 5 when it comes to "Public availability of information on internal financial control in the public sector". The topic of FMC is insufficiently covered by the media, and the current situation best illustrates the fact that the news in this area are mainly related to the period when the Chapter was just opened - year 2015. The language used to report FMC often has a too technical character and is difficult for citizens to understand. Citizens rarely have the opportunity to read and truly understand what benefits they can receive from the implementation of FMC (or better yet - what benefits they already had received).

7. Monitoring Report: The Public Administration Principles", Sigma, 2017 (page 131)
8. The CHU reporting coverage has increased in recent years
9. "Monitoring Report: The Public Administration Principles", Sigma, 2017 (page 132)
10. Sigma, 2018.
11. WeBER project ("Western Balkans Enabling Project for Civil Society Monitoring of Public Administration Reform") is a three year initiative that aims to prompt and enhance the relevance, participation and capacity of the civil society organisations and the media in the Western Balkan, so they could be able to advocate the implementation of the public administration reform for the citizens.
12. Đinđić, Bajić, „National PAR Monitor, Serbia 2017/2018", European Policy Centre - CEP, November 2018

In the future period, in parallel with already started transformation of the CHU and the more intensive implementation of the FMC mechanisms at central and local level institutions, it is necessary to:

(1) Define the strategic framework within which the FMC is implemented - to answer the question: "whether the funds are used in a meaningful and responsible way"? Therefore, it would be endured that the resources are spent in line with the goals of the organization itself, which are in line with the policy and goals of the Government. In this manner, the mechanism unambiguously entails prioritizing and investing resources in key goals, in order to ensure the concept of the expediency (effectiveness) of resource management. Of course, the goals are expected to be "SMART",[13] meaning precise, measurable, achievable, realistic, and have a time dimension, or a deadline for implementation. For example, achieving a decent employment rate of 75% by 2030 could be considered a "SMART" goal, with which the competent institutions would have to align their programmes, and the FMC mechanism would be checking and ensuring that resources are indeed used to achieve that prioritised goal.

(2) Introduce genuine managerial responsibility (to answer the question: "who is (was) responsible for planning and spending the funds meaningfully and responsibly?" Certain recommendations of the European Commission, as well as from the organisations that follow the development of the managerial responsibility, stay similar from year to year - one of the key recommendations is that Serbia needs to begin drafting a strategic document that defines and explains the national approach to implementing managerial responsibility. The European Commission emphasizes that in the future Serbia should implement at least three pilot projects on managerial accountability in key institutions, and to start implementing the quality review of the internal control system. Serbia is also expected to take the necessary measures to ensure that the system for irregularity detection works in practice, both for EU funds and for the state budget.

(3) Ensure clear and regular communication with the citizens - in order to insure them that their funds are also being “taken care of “. An important contribution to the transparency of public finances may represent the publication of state and city manuals for citizens through budgets. However, in case of Serbia, these manuals are still halfway there - they do not provide enough information for public expert analysis on the one hand and may still not be sufficiently clear to the non-professional public. Because they represent guides through the budgets of the republic, not the state, they show what happens to only 55-60% of total consolidated expenditures. In addition, it is necessary to work on the skill of presenting data - sometimes it is not clear what level of government is analysed, or on what, and with which part certain categories of expenditures refer to. Particularly, it is necessary to ensure bigger consistency in communication; the names and levels of government in methodological explanations are not always consistent through the whole report. Also, reporting should include the cross-section analysis, which means the presentation of expenditures by economic (what the funds are spent on - expenditures for employees, subventions ...) and functional classification (which sector - defence, environment, or health). This would open the door for analysing, not only to which sector the money goes (for example, health or education), but also what part of that money is used to pay out wages or investments within that sector. Of course, needed requirement for such analysis would be that the mentioned data are open, or at least - for starters - available for downloading in the machine-readable format.

Finally, it should be mentioned, that the potential role of civil society in strengthening the FMC mechanism is significant, given that civil society organisations - led by NCEU - should and can establish regular monitoring, both of formal (regulatory harmonisation) and essence implementation of FMC ("is there really a responsible control of budget spending?"). It is also desirable that civil society organisations follow the aforementioned preconditions, in the form of a strategic framework, managerial responsibility, and transparent and regular communication.

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13. SMART – *Specific, Measurable, Achievable, Realistic, Time-bound*