This Project is financed by the European Union

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DISCUSSION PAPER

FINANCIAL MANAGEMENT AND CONTROL

-Can't see forest from the tree-

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.*

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INTRODUCTION AND SUMMARY

Financial management and control (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 smartly and responsibly. Such mechanism is of an even greater importance for Serbia, having in mind the relatively low level of trust within society and towards the public sector, and the relatively high level of (perceived) corruption[1].

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 funds 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

[1] Source: Perceived Corruption Index for 2018 https://www.transparency.org/cpi2018)

as all other relevant organisations, which monitor the level of harmonisation and the level of implementation of FMC.

What is the reason for the poor implementation of the FMC, i.e. how can we influence on a more rapid establishment and implementation? By posing that question, "all eyes are on" the **Central Harmonisation Unit (CHU),** which oversees the introduction and coordination of the financial control in the public sector. Although there is certainly room for improvement in the organisation's work - both through capacity building and better communication with the public, and through a shift in focus from training and licensing towards measuring the quality of FMC and giving the recommendations for 1improving the system, **the causes of the problems are still broader than that institution's capacity and reach.**

The causes are reflected in the lack of basic preconditions for the true implementation of FMC. That is, even if all institutions were to follow manuals, harmonise methodologies, appoint and train coordinators for FMC, thus identifying business processes and adopting the necessary documents for risk assessment and analysis, the question is how much progress would be made in the absence of (1) clear strategic goals, (2) managerial responsibility, and (3) open and meaningful communication with citizens. As the European Commission states in its report, "precondition of preconditions" is stronger political support for the whole process, or "political will" that has not been expressed - at least not enough - in the past 10 years.

The focus of this document is on clarifying and approximating the role and importance of FMC, alongside the degree and characteristics of FMC implementation in Serbia, and shedding light on the structural obstacles to the full implementation of FMC in the public sector of the Republic of Serbia. Within the first section of this paper, the authors point out the importance of FMC for taxpayers. In the second section, they highlight the specifics of public finance management in Serbia and the potential importance of FMC in improving the current system. The third section focuses on the role of the EU and the position of FMC within Chapter 32, whereas the fourth section analyses Serbia's (formal) progress. The fifth section analyses the position and role of the CHU as the body responsible for establishing the FMC. The sixth section reviews the possibility of FMC development in a system characterised by an insufficient level of strategic planning development, which is the case in Serbia. The seventh section reviews the link between FMC and managerial responsibility. The eighth section deals with the involvement and role of the general public in establishing managerial accountability. Finally, the ninth part, summarises the findings of the document and provides concluding recommendations regarding the improvement of the FMC system in Serbia.

I FMC - A “warranty for” smarter and more responsible spending of taxpayers’ money

Financial Management and Control (FMC) is a system of rules and procedures that ensure responsible and smart management of funds, in order to meet the key goals of the organisation. Basically, FMC is an intern control mechanism which was, primarily because of the needs of the private sector, developed by The Committee of Sponsoring Organisations of the Treadway Commission (COSO) in 1992. The goal of such a system was to set a globally recognised standard of responsible (financial) management. The key role of FMC was and remains to be the insurance of "domestic business" - the most productive use of resources and the best possible performance of a company or organisation, by analysing risks, improving the decision-making process, enhancing the accuracy of financial reporting, reducing space for possible frauds and embezzlements and protecting the financial interests of the company or organisation.

FMC is suitable for implementation in the public sector as well and has become an indispensable part of its control mechanism - Internal Financial Control in the Public Sector. In the public sector of EU countries, the FMC is part of a system of Public Internal Financial Control (PIFC), developed by the European Commission which is *operationally* consisted of the function of independent internal audits (IA) in addition to the FMC, while the establishment of the whole system is overseen by the Central Harmonisation Unit (CHU) at the Ministry of Finance. Since the role of FMC is to prescribe *how the organisations (should) function*, the essential role of IA is to determine the *quality of FMC's functioning* and to provide advisory support for its improvement. In other words, the FMC is part of a mechanism whose primary objective is to establish management of public funds which is in the citizens' interest, by establishing public procedures and forming circles of responsibilities and trust.

The FMC has also a role to convince the citizens that the state administration, local self-government, and heads of public enterprises use the citizens' funds in a smart and responsible manner. In a way, FMC plays the role of the owner of a private equity firm – it *insists* on the rationality of decisions. Technically, its purpose is to ensure, within the reasonable likelihood, achievement of the set goals by respecting legal regulations, the principles of efficiency, effectiveness and reliability of reporting, whereas essentially that means protecting the financial interest of organisations, reducing the space for possible fraud and embezzlements, that is, that the citizens and the economy receive proportionately "quality product" for their money. In that way, citizens get a reasonable level of assurance that their funds are used for the purposes they were intended for, and that the country "fights" the corruption in an effective way.

The FMC's role is also to increase the level of citizens' trust in the institutions and administration by controlling the spending of funds on a regular, transparent, and objective basis and to report to the citizens about it. The state is raising significant funds from the citizens for the functioning of the institutions - in the case of Serbia, public revenues and expenditures make about 40% of GDP, while the state is also a large employer - employing about 30% of all formally employed citizens in Serbia.[2] FMC, as a warranty of the rational use of these funds, *has a serious task*, a large number of people are involved in its functioning.

II Serbia especially needs that kind of "warranty "tr

Serbia has in recent years succeeded in establishing macroeconomic stability and has improved its fiscal position… 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.[3] 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. Fiscal consolidation was carried out primarily through a ban of employment, a natural outflow of employees, and a reduction in salaries and pensions. These measures were followed by a significant increase in tax revenues and better tax payment, due to the transformation of the Tax Administration and (more) favourable macroeconomic trends. Consolidation was also contributed by some one-off factors - such as public companies payments based on unallocated profits and the amount of wage cuts, or under-performing public investment. The credit for the good results often had the external, usually

[2] Source: Eurostat and BRA, author's calculations
[3] Source: Ministry of Finance

unforeseen factors, rather than planned measures and reforms - the global decline in energy prices, the faster economic recovery of Serbia's major trading partners and the expansionary monetary policy of the European Central Bank (ECB).

…however, the structural reforms were not implemented… Although the fiscal position has improved, the insight into the Memorandum of Economic and Financial Policies (MEFP), which Serbia has signed with the IMF, pointed that many - and significant - structural reforms were not in fact implemented. Rationalisation of the public sector has been reduced to a *natural outflow* by banned hiring that has not completely solved the previous problems, and has created some new ones (among others, it made the recruitment of internal auditors in local self-governments more difficult). The problem of public and state-owned enterprises was partially solved by restricting warranties and selective privatizations, therefore these enterprises still represent a fiscal risk. Also, the realisation of public investments (mostly investments in transport and environmental infrastructure), whose importance for economic growth is pointed out by the expert public - remained below the optimum.[4] Therefore, the sustainability of favourable results is in question, as well as the relations between costs and future results, and the quality of service that the country provides for citizens and the economy.

…the systematic, sustainable, and accountable principles are still lacking. The way in which "rationalisation of the public sector" was implemented is particularly illustrative in this respect. For example, in 2019, a significant portion (an order of 150 million Euros) of savings disappeared consequently to a reduction in the number of employees in the country, by about 35.000, in 2014-2018. However, that reduction is not a consequence of the implementation of functional analysis recommendations implemented by the World Bank, or of a better understanding of the needs of the organisation and the optimal allocation and structure of employees, but rather of the prohibition of employment in the public sector. Not only there is no warranty, in the form of a developed mechanism, that once the ban of employment is lifted, there will be no “boomerang” effect and new, more massive employment, however the ban has also influenced a significant weakening of the capacities of certain institutions - which could not replace retired employees at crucial positions. In addition, the constant extension of the employment ban during the mentioned period also sends a strong message that the Government itself does not believe in the management responsibility of public fund users.

Therefore, the development of FMC, as a mechanism for better governance and objective control, must remain a clear medium-term priority for Serbia. The most observed and quoted international composite indexes indicate insufficient management and analytical capacity of institutions in Serbia, relatively high level of corruption, and low levels of economic predictability and stability. 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). Similar results are shown in the “Global Governance Indicators" by the World Bank and the "Corruption Perceptions Index" (rang 87/180). Therefore, it can be concluded that the citizens and the economy of Serbia cannot be completely sure that their funds are being disposed in a proper manner, and it is additionally worrisome that the measurements do not show any progress compared to the previous years. Having in mind that FMC is essentially a *circle of long-term responsibility and trust*, it becomes clear that in the current environment, in

[4] Fiscal Council for 2018 estimated that the optimal amount of public investments would be at least 1 p.p GDP larger than realised (Petrović, Brčerević, Gligorić, (2019) ,,Zašto rast Srbije zaostaje?“, Fiscal Council)

which there is no tendency to plan and approach problems systematically but spontaneously and at once, FMC exists only formally, *on paper*. Hence, the benefits it brings are lacking as well.

III The pressure from the EU, and not the real awareness of the managers about the importance of FMC

Like most other reform areas, as well as in the case of FMC, the conditions set by the EU are the main drivers of 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, and therefore the implementation of the FMC is one of the conditions Serbia needs to fulfil within the EU accession process. In fact, Chapter 32 was one of the first chapters opened for negotiation, back in 2015. Serbia did, in the years leading up to the opening of the chapter - and after the signing of the Stabilisation and Association Agreement (SAA), implemented activities related to the establishment of financial control - thus, in 2009, the first strategic framework was adopted, and in 2010, a Central Harmonisation Unit was established, while in the next years the first manuals were adopted, the first trainings held and the certification of coordinators and auditors started in the field of IPFC. For more on Chapter 32, objectives and EU expectations and conditions in this area, see Box 1.

Box 1.0 About Negotiation Chapter 32

The acquis of Chapter 32 is related to the adoption of internationally accepted standards in Internal Public Financial Control (IPFC) and best practices of EU and their implementation to the entire public sector. This negotiation chapter, in addition to FMC, also covers the development of internal and external audit, the protection of the Euro against counterfeiting, and the protection of the EU's financial interests. The concept of Internal Public Financial Control (IPFC) has been developed by the European Commission, with the aim to help candidate countries in reforming their internal control systems, as well as to manage public funds (national and EU funds), by implementing international standards and the best practices of EU. In line with internationally accepted standards and EU recommendations, the term "Internal Public Financial Control" refers to a comprehensive system that is established to manage, control, audit, and report on the use of national and EU funds. This system includes good financial management, financial and other controls, which enable the legal, economical, efficient, and effective running of business processes. The system of internal financial controls in the public sector consists of the following: financial management and control; internal audit and Central Harmonisation Unit for Public Financial Management and Control and Internal Audit.

Among executives in state administration and public enterprises, there is still no developed awareness of the importance, nor enough knowledge on the basic elements and objectives of FMC.

According to the IPFC Strategy[5], many 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 executives who have completed the training in the FMC area is not enough, and thus, there is a clear lack of real knowledge on all the elements of the FMC in the public sector. Managers are insufficiently 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. In risk management, almost all attention is now dedicated to the harmonisation of regulation, and the risks connected to the organisation's goals are not considered, therefore strengthening risk management is a key element of the IPFC Strategy.

Establishing the coordinator for FMC and passing all the prescribed documents in the organisation is the easier half of the job - so the process is often terminated at that point. The Budget System Law and Rulebook[6] prescribe that the head of the organisation is responsible for establishing the system. The rulebook leaves room for the manager to delegate some of the activities to other people, nonetheless he/she remains the responsible person. At the operational level, the process of introducing FMC is managed by the appointed FMC coordinator and the work group formed for that purpose. However, to some extent the "trouble" for the FMC is having the word *financial* in the name - and in practice it is often (unjustifiably) understood as something that is relevant only to the financial department. Thus, the topic of FMC, being understood as financial, becomes irrelevant to other sectors and levels of the organisation. The plan for the FMC introduction and prescribed documents are then uncritically adopted, as they *become a formality*, so managers do not even know that such documents exist.[7] Consequently, the awareness of FMC, which should regulate the behaviour of the entire organisation, remains trapped in a narrow circle of people – the only ones who are truly informed about FMC are FMC coordinators and internal auditors, while the managers of public fund users (PFU) consider it as another *"check- the-box"* obligation.[8]

IV How much progress has Serbia made in the implementation? Form-oriented, but not essence-oriented

It is not easy to make an assessment of the extent to which the FMC was established and developed in Serbia - primarily because of the lack of regular, systematic and objective analysis.[9] The most detailed, systematic and objective analysis of the status of FMC is provided by SIGMA's[10] monitoring reports - however, these do not report on FMC on a regular basis, thus the last available monitoring report covering this topic was published in November 2017, and refers to the period from 2015 to June, 2017. On the other hand, regular European Commission reports on annual basis, monitor the development of FMC, however these reports are generalised, without established indicators and grades, and indicate only the general direction in which FMC's development is going. The CHU's reports are annually regular, and fairly detailed, nonetheless cannot be considered as an objective analysis - but rather a summary of the reports collected by

[5] "Strategy for internal financial control development in the public sector in the Republic of Serbia for the period 2017-2020."

[6] The Rulebook on joint criteria and standards for implementing, functioning, and reporting about the system of financial management and control in the public sector, "Official Gazette" number 99/2011 and 106/2013

[7] "Managerial Accountability in the Western Balkans: A comparative analysis of the barriers and opportunities faced by senior managers in delivering policy objectives", SIGMA Paper No. 58, 2018 (p. 41-42)

[8] Ibid.

[9] " Monitoring Report: The Public Administration Principles", Sigma, 2017 (page 127)

[10] SIGMA (Support for Improvement in Governance and Management is a joint EU and OECD iniciative that provides expert support to countries in the development of public administration

the CHU from public fund users, based on self-assessment, and without any obligation - and the capacity of the CHU to verify and validate the reports.[11] Some of the civil society organisations deal with the topic of FMC and publish reports, which mainly rely on the abovementioned sources and independent research ventures of those organisations in the FMC's assessment - “National PAR Monitor“ stands out as the most relevant document, which is published within the “WeBER“ project. However, regarding FMC, the report is mainly focused on issues of transparency, regularity of reporting by institutions and communication of state institutions with the public. The report does not address the degree and effectiveness of FMC implementation and internal control in the public sector, which is a significantly narrower and deeper topic (and requires additional resources, both temporal and research).

However, through careful review of the abovementioned documents, it is possible, with a high level of certainty, to identify two key findings:

1. Serbia is more focused on fulfilling formalities - regulative harmonisation, rather than the essence - implementing financial management and control. This was also noted by the European Commission in a series of regular annual reports and indicates that the primary focus of domestic administration is legal harmonisation, rather than performance in the area of FMC. Therefore, even though Serbia is “slowly” harmonising every year with EU standards and requirements, 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 lacking. 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. Therefore, it was envisaged 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 to be fulfilled within, while the CHU is not even able to track which public fund users[12] have established the FMC, because the official Register of users of public funds that are obliged to implement the FMC does not exist. A concrete deadline and a list of all of those who are obligated to comply with the Law are two basic (but certainly not enough) preconditions for implementation. The focus on regulatory harmonisation is also evident from Sigma's assessments – in which Serbia for the compliance of FMC with the requirements of Chapter 32 was rated as a "solid" three, while the functioning of FMC was rated as with the lowest grade (one).[13]

2. The implementation of FMC is at a relatively low level.[14] The overall level of preparedness in the area of financial supervision is constantly assessed by the European Commission as moderate - and it is exactly 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 evaluates the functioning of the FMC, developed as a 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

[11] “Monitoring Report: The Public Administration Principles”, Sigma, 2017 (page 159)

[12] Users of public funds are direct and indirect users of budgetary funds, users of funds of compulsory social security organisations 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 organizations to which public agency regulations are enforced; (Budget System Law)

[13] “Monitoring Report: The Public Administration Principles”, Sigma, 2017 (page 152)

[14] Ibid. (page 124)

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. “National PAR Monitor “, within the WeBER project, rates Serbia with a score of 1 (on a scale of 0 to 5) when it comes to the public availability of information on the implementation of FMC. Serbia is particularly poorly rated on ministries reporting on its practices within the FMC.[15] Out of the 18 ministries analysed, only three have publicly declared information on who are the managers in charge of FMC. On the other hand, not one (0/18) ministry has a published risk register or business processes map - the basic elements of any developed FMC system.[16]

V The problems are broader than the capacity and scope of the Central Harmonisation Unit

When it comes to improving the FMC system, the highest expectations are, “as a rule”, directed to the CHU. The CHU in Serbia is established within the model of European practice, described in the European Commission Handbook "Welcome to the World of IPFC". The manual states that the CHU is mainly the part of the Ministry of Finance and is responsible for the development and promotion of methodologies of internal control (through FMC) and audits, in accordance with internationally accepted standards and the best practices. It is also stated that the CHU oversees the coordination of implementation of the regulation concerning the FMC system.

The space for improving the capacity of the CHU is significant… There are nine people employed in the CHU (out of only ten systematic jobs), out of which four are “wasted” for the FMC group. Employees who are members of the FMC Group 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.[17] 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 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[18], the scope of organisations that provide the data[19], and the structures and readability of annual reports[20]. 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.

…however, the obstacles to the full implementation of FMC exceed the CHU's capabilities and authorisation, even if that unit were to function in an optimal capacity and role. The obstacles relate

[15] Đinđić, Bajić, “National PAR Monitor, Serbia 2017/2018”, European Policy Centre - CEP, November 2018 (page 124)
[16] Ibid. (page 124)
[17] “Monitoring Report: The Public Administration Principles”, Sigma, 2017 (page 152-153)
[18] “Monitoring Report: The Public Administration Principles”, Sigma, 2017 (page 131)
[19] The CHU reporting coverage has increased in recent years
[20] “Monitoring Report: The Public Administration Principles”, Sigma, 2017 (page 132)

above all to the prerequisites necessary for FMC to have a “chance” to operate in full capacity. Removing these obstacles represents the necessary - but not sufficient - (pre) conditions for the FMC's functioning. These obstacles relate to the following: (1) lack of strategic goals - both at the state (government), ministries’ and local governments’ levels, which would provide the basis for the function / element of "expediency" within the FMC; (2) underdevelopment of managerial responsibility, which would clearly “outline” the rights and obligations of managers on different levels in achieving the strategic and operational goals of the organisation; and (3) the absence of communication with citizens, who are, in most cases, not even aware of the existence of the FMC concept, nor of the potential impact of that mechanism on their well-being and security of managing their funds smartly and responsibly.

VI Without clear strategic goals, there is no financial control

One of the main goals of the FMC systems, also described in the IPFC Development Strategy, is **strategic planning that connects organisational goals with the overall vision of the Government.** This goal is followed also by a goal of operational planning that connects **organisational goals to resource requirements - primarily budget and staffing.** Based on the abovementioned, it is clear that one of the basic intentions of introducing FMC is the ability and need to make the management of resources at the organisational level as "smart" as possible - that is, to make the management of resources in line with the goals of the organisation itself, which are further in line with the policy and goals of the Government. The mechanism unambiguously entails prioritising 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", 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"[21] 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.

However, the overall vision of Serbia's development does not exist - although it is prescribed by the Constitution and the Law on the Planning System... Namely, the Constitution determines that the National Assembly "adopts a development plan and a space plan". Furthermore, the Law on the Planning System foresees 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. According to the Law, the Development Plan contains a vision, i.e. prioritised goals of development of the Republic of Serbia and the region, as well as guidelines for their realisation. It also emphasizes that the harmonisation of the Development Plan with other development documents, particularly the programmes of economic and financial reform (ERP and Fiscal Strategy), is of great importance. However, such a Development Plan currently does not exist in Serbia, nor do the indications that it will be adopted, although the Law on the Planning System defines the deadline for the submission of the Development Plan Proposal (01. 01. 2020). For example, the adoption of such a development plan in Ireland took a full four years and involved extensive iterative consultations with experts and the public. Given that this process has not even begun in Serbia, the question is whether such a Plan can be adopted in the following years and whether it can, at the same time, be the product of objective analytics and social consensus, harmonised with the EU agenda and the Sustainable Development Goals.

[21] SMART – **S**pecific, **M**easurable, **A**chievable, **R**ealistic, **T**ime-bound

… therefore, it is not possible to harmonise organisational goals and resources with the goals, nor can the full implementation of FMC be achieved. 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 the funds are truly purposefully spent - that is, financial control remains without the "most significant" blade and is reduced to monitoring formalities and procedures. For example, lately, the “hot” topic is subventions to foreign investors, which are annually allocated around € 80-100 million Euros[22]. The key question is whether it is worth to spend so much money on subventions to foreign investors? Subventions promoters point out to the number of jobs created, while the opponents indicate a low level of qualifications in attracted foreign investment and the uncertain sustainability of those jobs when the subventions expire. It also raises the issue of opportunity cost, that is, the effect that these subventions would produce if they were invested in the domestic MSP sector, which annually receive support in about 15-20 million Euros. The answer to who is right or wrong does not exist at this time, because the Government has never set clear goals (in the form of employment, level of economic development, poverty reduction, etc.) that need to be fulfilled with such a policy, nor has it conducted an “ex-ante“ cost-benefit analysis and use of such policy. In the absence of such a strategic framework, the FMC cannot be used as a tool to control the expediency of spending the funds, but solely as a "check the box" mechanism confirming if the subventions were provided in accordance with the regulation, signed by the competent minister, and if this type of state aid is regulatory allowed.

The inability to fully implement FMC, due to the lack of strategic goals, exists in most other sectors and policies - and the most recent and most interesting case is the announced Investment Plan. According to the Law on the Planning System, the Investment Plan is a development planning document, which is adopted for a period of at least 7 years, which further elaborates the prioritised development goals set by the Development Plan, and is the basis for drafting medium-term public investment priorities. According to the information that citizens had the opportunity to receive exclusively through the media and unofficial channels, the announced Investment Plan "overlaps" with all its characteristics with the Law on the Planning System. Namely, the adoption of the Investment Plan for a period of 5 years has been announced, while the Law prescribes a minimum of 7 years. Hereafter, the Investment Plan is defined and adopted before the Development Plan, while according to the Law, the Investment Plan elaborates the goals set out in the Development Plan. Also, the Fiscal Council emphasises the lack of any analytics and details, and states that in the Fiscal Strategy it is impossible to find evidence on increased public investment due to the implementation of the announced Plan.[23] Finally, even in the 2020 Budget it is not possible to recognise what are the activities defined by the Investment Plan, although it was intended to be the basis for the medium-term priorities of public investment. Overall, there is no assurance that the Investment Plan will truly address the key needs of Serbian society and the economy, nor is it clear to what objectives and to what extent it contributes, since the Development Plan and measurements do not exist. In such a situation, FMC will again be reduced to “signature verification” (form), and not to whether the construction of dozens of stadiums is really a priority and in the interest of socio-economic development, previously recognised in the Development Plan (essence).

[22] Author's calculations based on the data from Ministry of Finance on given state aid - Database „ Investment projects co-financed with incentives “

[23] Assessment of the Budget Law proposal for 2020 and revised Fiscal strategy for 2020-2022, Fiscal Council, 2019

VII Without clear managerial responsibility, there is no genuine financial control

Managerial responsibility is widely recognised as a precondition for all the reforms and processes connected to FMC.[24] There is no (one) standardised definition of managerial responsibility, but it can be (broadly) explained as an awareness of managers about the obligation for work and the results within the organisations they manage. It assumes responsibility for all aspects of management - from planning to reporting, as well as from delegation to supervision. Managerial responsibility also implies compliance with procedures and rules (harmonisation), as well as a focus on results (performance).

The European Commission, as an absolute priority, recognises the need to establish full managerial responsibility in the administrative culture of the public sector in Serbia. There are weaknesses in systems of responsibility between bodies that are not fully independent and their line ministries and in connecting government's strategic and financial planning. In addition, 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. Managerial responsibility is further limited by the primary focus on compliance rather than performance.

Political will is a necessary precondition to eliminate numerous rooted weaknesses. 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.[25] For similar reasons, middle level of management avoids taking responsibility, and when this happens, the whole process is followed by exaggerated formalisation. Generally, there is a feeling that many formal rules and procedures are simply not being respected[26], and at the same time, it is evident that no one bears any sanctions. For "breaking with tradition" it is not merely enough to change laws (when those who make them will not respect them), but the political will and social consensus are necessary in order for such behaviour to be (politically) punished.

A much different view of the situation is provided by the CHU Consolidated Report, which the most important elements of managerial responsibility evaluates positively. The assessments provided by the report are the result of a self-assessment of the situation of FMC managers within the PFU - and are usually positive and thus contradictory to the assessments of SIGMA and the European Commission. For example, the opportunities for delegation have been assessed satisfactory, with an average grade of around 4 out of a possible 5, while SIGMA and EC have been, for years, seeing weaknesses in this segment. The same goes for deciding and setting goals that were rated between 4 and 4.5. At the same time, SIGMA estimates that

[24] "Managerial Accountability in the Western Balkans: A comparative analysis of the barriers and opportunities faced by senior managers in delivering policy objectives", SIGMA Paper No. 58, 2018 (p. 9)
[25] Sigma, 2018.
[26] Ibid.

planning lacks coherence and prioritisation, and 60in particular, so that in the end, it is often not even possible to compare "achieved with planned". In addition, it has been noted that superiors do not care too much for the set plans and goals.[27] Risk management is the worst rated component of managerial responsibility - generally between 3 and 4 for different PFU. It has also been noted that *at meetings, managers handle risks more than they consider them,* which is also contrary to good practice. The consolidated report admits, though shyly, that the SIGMA' report suggests that *significant improvements are needed*, and that the findings of the SAI indicate that FMC *is not in line with the objectives for most users.*

The reason for these deviations can probably be explained by several factors - (1) self-assessment bias, (2) insufficient knowledge / understanding of the person responsible for completing the questionnaire, (3) the person completing the questionnaire is not independent since the completed questionnaire in the final instance is approved by the head of the organisation.

In its earlier analysis[28], CEVES identified, in addition to politicisation, two reasons for the lack of managerial responsibility:

1. The first reason is that it is often impossible to clearly and unambiguously identify whose responsibility is to complete the tasks / results. Although it seems that public administration follows a reasonable organisational structure, the regulatory framework, and the delegation of responsibilities (and tasks) among them do not attribute clear organisational competence to each organisational unit. Many institutions, both on national and local level, are involved in one way or another in decision-making process, even on non-strategic issues. However often none of these institutions has the authority, competence and autonomy required to take the initiative and take full responsibility for the results. Therefore, no one can be held accountable. The roots of this problem probably lie in the past, when the country was governed by highly participatory self-governing decision-making, although no formal political body was empowered to truly take decisions and take final action - decisions were made by the Communist Party from the background through informal, parallel processes.

2. The second phenomenon is that regulatory practice is very detailed, prescriptive, and formal. As such, it simply prevents the definition and realisation of meaningful results. For example, the manager of an organisational unit is not given the resources to engage staff and achieve results. Instead, the number and profile of the people who can be engaged, as well as most other cost decisions that the manager makes, are set in very detailed rulebooks and by formal criteria. Of course, these types of restrictions are present in every administration, but in Serbia they are extreme. They disable the manager, or relieve him of his duties, to make judgments and decisions that could ensure that results are achieved.

Certain recommendations of the European Commission from last year's report mainly remain valid, such as the need for Serbia to begin drafting a strategic document that defines and explains the national approach to implementing managerial responsibility. It was emphasised 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.

[27] Ibid.

[28] Shadow report for the needs of the „Book of recommendations National Convent European Union", for years 2018/2019 and 2019/2020;Brouchure „Sustainable Development in Serbia: How do we stand?" (page 60)

VIII Without clear communication with citizens, financial control does not have full purpose

The ultimate benefit of FMC (should) receive the taxpayers, who are assured by FMC that the money raised from them is used in a thoughtful and responsible manner. Therefore, the implementation of the FMC mechanism in the public sector is a needed, but not enough, condition for building public confidence in the purposeful and efficient operation of state institutions. It is also necessary for this implementation to be transparent and followed by timely and clear communication towards citizens, in order to build trust. As presented in the previous chapters, FMC is still far from full implementation in Serbia - and this is followed by **insufficient openness of institutions towards citizens** and irregular communication, which results in low levels of citizen trust in financial discipline of institutions. The public faces several objective obstacles:

1. Information, both on FMC and on the public finance management, is often insufficiently available. In other words, the transparency of central and local authorities on this issue is far from optimal. The situation is summed up by the before mentioned "WeBER"reports[29] - they rate Serbia with a score of 2 on a scale of 0 to 5 when it comes to "Transparency and accessibility of budget documents" and, even worse, with 1, "Public availability of information on internal financial control in the public sector". Regarding the information about the progress within Chapter 32 specifically, the Ministry of Finance does not have the space provided for this information on its website. Although an established, special website dedicated to the Central Harmonisation Unit is not updated regularly, it does not offer to the interested public new, often and easily understandable information about financial responsibility in Serbia, nor about the situation within the Chapter 32. It should be noted that there is a systemic problem in public administration communication - information is sometimes not released even when it is 'favourable' because of fear of being misinterpreted or misused.

2. The topic of FMC is insufficiently covered by the media. This obstacle relies heavily on the previous one - media coverage of this topic can largely be conditioned by the availability of information from official sources. The current situation is perhaps best illustrated by the fact that media coverage of this topic is almost non-existent – mostly it is limited to the period when the chapter was just opened - 2015. A simple experiment indicates the extent to which the public is (un) informed about a given chapter - „Google" search for the term "Chapter 32" results in mainly news from 2015 that relate to the opening of the chapter and Serbia's preparedness at that moment. On the other hand, the public is insufficiently aware of the sources that exist - primarily the WeBER and SIGMA reports.

3. 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); most of the information relates to complicated procedures, vague abbreviations, and technical harmonisation with EU requirements. The way Chapter 32 and FMC were written and reported is thus repulsive to citizens, without enough examples and illustrations, and does not attract their attention and interest. Presenting the topic in such a "difficult" and "tiring" way follows from the fact that decision makers in Serbia, when it comes to FMC, are more concerned with form and less with the essence.

[29] Đinđić, Bajić, „National PAR Monitor, Serbia 2017/2018", European Policy Centre - CEP, November 2018

4. Public companies are the least transparent. This segment of financial control for citizens is extremely important - because public companies provide services that directly, on a daily basis, affect the quality of citizens' life (drinking water, public transport, heating, trash removal, landscaping, building maintenance, etc.). However, public companies are institutions with the lowest level of financial responsibility. For example, public utility companies for operating businesses receive subventions bigger than 100 million Euros annually, which is more than it is allocated as state aid to foreign investors, and they report on FMC very poorly.[30]

However, the past period has also been marked by some positive tendencies in the transparency of public finances - primarily, the publication of the Final Statement of Accounts of the State Budget. A positive progress is certainly the publication of the Final Statement of Accounts for the previous 15 years. Although the submission of the Final Statement of Accounts to the National Assembly is an obligation of the Government of the Republic of Serbia under the Law on the Budget System (Article 77 and Article 78), this practice has not taken place since 2002 when the final accounts for 2000 and 2001 had been submitted to the National Assembly. The budget plan for the next year is published in the form of the Budget Law for that year and **essentially represents the plan**, while the Final Statement of Accounts **shows how the funds were actually disposed** - shows revenues and expenditures (together with money flows), their sources and purposes, as well as the status of property. Although they were not available to the public, SAI regularly monitored the Annual Bills - for 2018, as well as for previous years, it expressed an opinion with a reservation, since the consolidated financial reports did not contain complete information from the financial reports of indirect budget users as well as due to the fact that the perennial problem of adequate evidencing of non-financial assets is not resolved. However, except in the part for which an opinion with a reservation was published, SAI assessed that the Final Statement of Accounts is prepared correctly on all materially significant issues.

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.

SAI has also announced that, during 2019, it will carry out 12 expediency audits. The SAI states that the topics of these audits will relate to the prices of different services, determining the degree of poverty, whether repairs to medical devices take too long, whether waiting lists for medical interventions are justified, as well as what kind of air we inhale, what kind of water we drink, whether the land is polluted, whether less is being invested in something useful, where should be invested more. Thus, in the case of the audit of the

[30] Author's calculations based on data from Ministry of Finance and Comission for control of the state aid

purposefulness of "Incentives Effectiveness in Livestock", SAI emphasised that the Ministry of Agriculture, Forestry and Water Economy should, among other things, provide planning documents, determine written procedures (as this is one of the important reasons for regular delays and uncertainty in incentives payment deadlines) and conduct analysis of (un) successfulness of the incentives.[31] In other words, an official step is made in insisting not only on the fulfilment and satisfaction of the form of the financial control, but also in insisting on the essence and analysis of performance.

The National Convention on the EU (NCEU), as a potent network of over 700 members from the civil sector, can contribute to a more clear, objective, and regular communication to the public. NCEU can significantly improve its role as analyst, reporter, and adviser in EU negotiations in the area of Chapter 32 (and consequently FMC) by developing instruments for regular and objective monitoring, followed by illustrations and examples that can intrigue and interest citizens. It would be desirable for such an instrument to be just about the essence - that is, measuring the benefits to citizens of the implementation and functioning of FMC, as well as an analysis of the causes why FMC is not operating at full capacity. Also, such a tool could take into account the preconditions, mentioned in this document, for the successful functioning of FMC and monitor the extent to which the environment itself (strategic planning, managerial responsibility, openness of data and information) is improved.

IX Implementation of FMC is not possible without transformation of CHU, or without fulfilling basic institutional preconditions

Financial Management and Control (FMC) in the public sector is an arranged "network" of interconnected rules and procedures that ensure responsible and smart spending of financial funds raised from taxpayers, with the aim to meet key organisational goals and provide quality services to citizens and the economy. The role of such a system is to assure the public that the public sector executives use funds raised by citizens and businesses in a lawful, thoughtful, and productive way.

However, despite the evident importance for the success of an organisation's business and the strengthening of trust between the public sector and citizens, the FMC in Serbia has not yet been established in full capacity. Like other reform areas, in the case of FMC, the conditions set by the EU are the main drivers of change and progress. The introduction of the FMC began only when Serbia set foot on the path of European integration, given that the FMC is part of Negotiation Chapter 32 (Financial Supervision), and therefore the implementation of the FMC is one of the conditions Serbia needs to fulfil in the EU accession process. Executives still do not have developed awareness of the importance of FMC and the benefits of implementing it into the functioning of the public sector (even if it were not one of the EU requirements in the accession process).

With detailed review of key analysis of the situation in the area of FMC, it is possible to conclude, with a high level of security, that the implementation of FMC is at a low level, and that Serbia has so far been more focused on completing the formalities ("check the box" approach). The European Commission states in its report that the level of preparedness in the area of financial supervision is moderate - and FMC is precisely the area where compliance and implementation are at the lowest level. It is also

[31] „Report on the audit of business purposefulness: Efficiancy podsticaj u stočarstvu", DRI, December 2019.

stated that, year after year, Serbia tends to lean more towards regulatory harmonisation, than essence - implementing financial management and control.

Clearly, the expectations regarding the progress in the area of FMC are directed primarily to the CHU, but that organisation cannot (and should not) make the necessary changes on its own. Although there are significant opportunities, as well as recommendations from the European Commission, for improving the capacity of the CHU - primarily in the field of analysing the individual FMC systems of public fund users, monitoring the implementation of recommendations for improving FMC in public fund users, and starting the transformation process from providing IPFC training towards development and dissemination of methodological guidelines... obstacles to the full implementation of the FMC are beyond the scope and authority of the CHU, even if that organisation were to operate in a desirable capacity.

The institutional and structural obstacles that prevent FMC from "breathing fully" relate primarily to: **(1)** lack of **strategic goals** - both at the highest level (of the Government) and at the level of ministries and local self-governments, which would provide the basis for the function of purposefulness of FMC; **(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; and **(3)** the complete absence of meaningful and clear **communication with citizens**, who are most often not aware of the existence of the FMC, nor of the potential impact of that system on the quality and financial control of the services provided to them.

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 define, as soon as possible, the strategic framework within which the FMC is implemented (to answer the question: "whether the funds are used in a meaningful and responsible way"?), to introduce genuine managerial responsibility (to answer the question: "who is (was) responsible for planning and spending the funds meaningfully and responsibly"), and to ensure clear and regular communication with citizens (in order to insure them that their funds are also being "taken care of"). **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 formal (regulatory harmonisation) and substantive 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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This Project is financed by the European Union

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The publication was published within the project "Prepare to participate", which is jointly implemented by CEP, NALED and CSP / EWB.