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Screening report Serbia

Chapter 32 – Financial control

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I. CHAPTER CONTENT

This chapter contains two main policy areas: (a) public internal financial control (PIFC) and external audit and (b) the protection of the EU's financial interests and the protection of the euro against counterfeiting. In the first policy area there is no EU legislation requiring transposition into national law or directly applicable legislation. Instead, the candidate country is expected to adopt internationally agreed internal control standards and EU good practices across the entire public sector as well as the external audit standards as defined by the International Organisation of Supreme Audit Institutions (INTOSAI).

Public internal financial control (PIFC) is an integral part of national public financial management. It is a comprehensive concept relating to the entire public budget, in particular central government income and expenditure, including foreign funds. The PIFC concept is based on three principles: 1) decentralised managerial accountability underpinned by financial management and control (FMC) systems, 2) functionally independent internal audit and 3) centralised harmonisation of methodologies and standards relating to FMC and internal audit (managed by the Central Harmonisation Unit). The candidate country undertakes to implement PIFC across the entire public sector. The candidate country is expected to adopt and implement a PIFC Policy Paper and action plan and a PIFC legal framework as well as to set up and maintain the necessary national structures and administrative capacity for implementation of PIFC. Regarding **external audit**, the candidate country is expected to comply with the INTOSAI standards, in particular its Lima and Mexico Declarations, which foresee functional, institutional and financial independence of the SAIs as well as implementation of both financial and performance audits in line with the INTOSAI standards.

With regard to the second policy area and **the protection of the EU's financial interests**, Article 325 of the Treaty on the Functioning of the European Union (TFEU) requires Member States to take the same measures to counter fraud affecting the financial interests of the Union as they take to counter fraud affecting national financial interests, including coordination of their actions through close and regular cooperation between the competent authorities and the Commission. The protection of the EU's financial interests covers both the criminal law protection through alignment of national legislation with the Convention on the Protection of the EU's Financial Interests (PFI Convention) and its three protocols and operational cooperation between the competent authorities of the Member States and the Commission. Member States must have the capacity to cooperate effectively with the European Commission and to communicate all suspected cases of irregularities and fraud. Member States are also obliged to assist and co-operate in on-the-spot checks carried out by Commission services. Some of this *acquis* applies directly to Member States and thus does not need to be transposed. In order to facilitate the required cooperation by future Member States, the candidate country is requested to nominate a national anti-fraud coordination service (AFCOS) as a single contact point for the Commission prior to accession.

As concerns **the protection of the euro against counterfeiting**, this Chapter addresses the non-penal aspects, whereas Chapter 24 addresses the penal aspects. The 1929 Geneva Convention for the suppression of counterfeiting currency outlines the general principles, which have been further detailed in the relevant *acquis*. This includes among others the prohibition of metals or tokens similar to euro coins, procedures for gathering, storing and exchange of information on counterfeits, obligation for financial institutions to check authenticity, withdraw counterfeits and transmit them for analysis as well as cooperation at national and international level.

II. COUNTRY ALIGNMENT AND IMPLEMENTATION CAPACITY

This part summarises the information provided by Serbia and the discussion at the screening meetings as well as additional information provided by Serbia upon request of the Commission after the screening meetings. Serbia indicated that it can accept the relevant standards and *acquis* covered by this Chapter.

II.a. Public internal financial control (PIFC) and external audit

With regard to **public internal financial control (PIFC)**, Serbia has a *PIFC strategy* for the period 2009-14 in place. The related action plan was updated in March 2013, covering activities until the end of 2014. Serbia informed that an inter-ministerial working group has been established for preparation of a new PIFC strategy and a related action plan for the period 2015-19. Serbia informed that the new PIFC strategy will be ready before end 2014. Serbia does not have a high-level inter-institutional body that would assess the Central Harmonisation Unit (CHU) annual reports prior to their submission to the government, follow up on the government's recommendations on PIFC and advice on PIFC implementation in the public sector. Serbia informed that the possibility to set up a PIFC Council will be discussed in the context of preparing the new PIFC strategy.

Serbia further informed about other ongoing public financial management (PFM) reforms relevant for PIFC, including reforms in the areas of budgeting (move to programme based budgeting) and accounting in line with the International Public Sector Accounting Standards. Serbia also informed that the new public administration reform strategy, adopted in January 2014, with an action plan under preparation for the period 2014-16 covers also some aspects of PFM, including budgeting, PIFC and public procurement.

The 2009 Budget System Law, last amended in 2013, provides the overall *legal framework for PIFC*. There is no specific PIFC law, but the Budget System Law is complemented by implementing legislation both on Financial Management and Control (FMC) and internal audit. According to Serbia, the Rulebook on joint criteria and standards for the setting up and functioning of the financial management and control in the public sector and the Rulebook on joint criteria for organising, standards and methodological instructions for performing internal audit in the public sector are in place since 2007, and have been last updated in 2011. The related implementing legislation includes a regulation on an internal audit certification programme and a regulation on organising the exams for acquiring the title of a certified internal auditor. A FMC manual and an internal audit manual exist as well. Serbia informed that the Budget System Law was amended in 2012 to better clarify the concept of managerial accountability. However, the existing FMC Rulebook has not been amended so far to further explain practical implications of managerial accountability for heads of budget users.

Serbia informed about the set-up of the *Central Harmonisation Unit (CHU)*, which was formally established as a sector in the Ministry of Finance in March 2010. The CHU has in practice existed since 2008. It is headed by an Assistant Minister and it has two departments, one for FMC (6 posts) and the other for internal audit (5 posts). Out of 13 allocated posts for the CHU, only one post in the FMC department is vacant. In line with the Budget System Law, the CHU is responsible for the central harmonisation and coordination of FMC and internal audit methodology; defining control standards in line with international standards; defining common criteria for internal audit organisation and operation in the

public sector and keeping registry of internal auditors and internal audit charters; defining methodological instructions and manuals for FMC; training and certification of internal auditors; training on FMC; internal audit in certain budget users. The CHU is also responsible for the preparation of an annual consolidated report on implementation of PIFC to the Government. The 2012 annual report was published in May 2013. Since its establishment, the CHU's main focus has been on FMC as well as internal audit training activities and certification of internal auditors.

In line with the Budget System Law and implementing regulation, *FMC implementation* is mandatory within budget users, and includes a number of activities such as: appointment of a manager and/or a working group in charge of FMC; preparing an action plan for FMC development; preparing a vision, mission and objectives for the budget user; inventory of key processes; system documentation and mapping audit trails; risk assessment and risk management; assessment of internal control/self-assessment; analysis of implemented controls; analysis of existing and anticipated controls; preparation of action plans/corrective action; and reporting on internal control, including annual reporting to the CHU on implementation of FMC. Serbia informed that for the purpose of preparing the 2012 annual report, a questionnaire was sent to 183 budget users. 115 replies were received, showing that 47 budget users had appointed a FMC manager or formed a FMC working group. 57 central level budget users and 33 direct budget users had begun to document their operating procedures and to create an audit trail in line with the FMC rulebook.

Centralised budget inspection was fully separated from the CHU function in 2010. It became an independent unit reporting directly to the Minister of Finance in 2012. The unit has currently 11 posts. Out of them 10 are filled. Centralised budget inspection is not yet fully compatible with PIFC requirements, as it acts according to a work plan approved by the Minister. The work plan is based primarily on reports from the State Audit Institution and complaints from the prosecutor's office, the police, the courts, citizens or non-governmental organisations. According to Serbia, the main objective of budget inspection, which focuses on individual transactions, is to ensure compliance with the law by issuing administrative acts and decisions which impose orders to remove irregularities, recover funds during the budget year and file misdemeanour charges against the inspected entities or responsible persons. Despite clearly separate legal bases, in practice there is an overlap between budget inspection and internal audit, as both functions focus on legal compliance. Additionally, the State Audit Institution has been assigned in a State Audit Law a similar task, which is to check whether activities of the audited entities display features of misdemeanour or criminal offences (see below).

Serbia stated that the development of public sector *internal audit* started already several years ago. Training and certification of internal auditors has been the sole responsibility of the CHU. Serbia informed that an internal audit function has been established within 76 budget users (55 at central government level, 21 at local government level). They account for 90% of public funds. In total, those 76 budget users were allocated 319 internal audit posts, with 225 posts filled and 94 posts remaining vacant. Out of 225 existing internal auditors 189 internal auditors (84%) have received certification by the CHU. According to CHU data, out of 76 internal audit units established, 27 units have one internal auditor, 11 units have 2 internal auditors and 38 units have three or more internal auditors. All ministries have set up internal audit units, but in two ministries the positions were vacant. The smaller budget users can either form a joint internal audit unit or enter into an agreement with budget users who have an internal audit function and use their auditors.

According to the 2012 annual report of the CHU, the number of internal audits performed has increased over time. During 2012 the 55 internal audit units established at the central government level (with 194 internal auditors in total) implemented 356 audits out of 401 planned audits. The annual report however further notes that many internal auditors dedicate a large part of their working time to other duties outside the scope of internal audit, which threatens functional independence of internal auditors.

With regard to **external audit**, Serbia's State Audit Institution (SAI) was established with the SAI law in 2005 but it became operational only in September 2007, following election of the five Council members by the parliament. Implementation of audit activities started gradually during 2008. The *independence of the SAI* is anchored in the Constitution since November 2006. The SAI is a member of INTOSAI since 2008, EUROSAI since 2009 and the network of the SAIs of acceding, candidate and potential candidate countries and the European Court of Auditors since 2010.

The *SAI law* of 2005, amended in 2010, has a sufficiently broad mandate for the SAI to perform audits of financial statements, compliance audits and performance audits of state and EU funds. Serbia stated that the SAI law guarantees functional, organisational and financial independence of the SAI, but acknowledged that certain articles of the law could at least in theory adversely affect SAI's independence. According to article 51 of the SAI law, the government is responsible for ensuring appropriate business premises, equipment and funds necessary for the SAI's operations. Also, the hiring of staff could be prevented or postponed, because the SAI is required to acquire consent of the ministry responsible for budget operations for its human resources management plan. According to article 59, the parliament needs to give consent to SAI's internal rules of procedure, and this could affect SAI's organisational independence. Furthermore, article 41 gives the SAI a specific responsibility to check whether activities of the audited entity have displayed features of misdemeanour or criminal offences and in such cases requires the SAI to submit a request for filing misdemeanour and/or criminal charges against individuals to the competent authority. Serbia confirmed that amendments to the SAI law are foreseen to further harmonise the law with the INTOSAI standards.

In line with the SAI law, the SAI is governed by a Council, which has five members. The mandate of the current SAI Council started in 2012. The president of the Council is the president of the SAI and the Auditor General of Serbia. The Council members are elected and dismissed by the parliament's majority vote. The term of the office is five years, and each member can serve a maximum of two terms. The SAI has its main seat in Belgrade and regional offices in Nis, Novi Sad, Kragujevac and Uzice. The SAI has 421 posts according to internal organisation and systematisation, including 5 Council Member posts, 377 audit posts, 35 support posts and 4 posts in the office of the President. By the end of 2013, 209 posts had been filled and 212 posts were still vacant. Concerning audit capacity, out of 377 foreseen audit posts in six different audit sectors 175 had been filled and 202 posts were vacant. Serbia informed that whereas the salary conditions of SAI employees are satisfactory following the 2010 amendments to the SAI law, allowing up to a 30% increase in salary, the key challenge for additional recruitments is the lack of adequate office space. The SAI has premises in five different locations in Belgrade which, according to the SAI, also increases overall operating costs and poses challenges for internal communication.

The SAI has adopted the rules of procedure, a code of ethics for auditors and other employees, a rulebook on internal job classification and a staff certification programme in

line with the SAI law. It has also adopted *a strategic development plan* for the institution for the period 2011-15. The strategic goals for this period are to provide high quality and timely audit services; increase independence and develop internal governance; attract and retain professional staff and ensure well-functioning human resource systems; improve organisational, infrastructural and managerial capacities; and to build partnership relations with key stakeholders in order to improve reputation, recognition and impact of the SAI. Serbia informed that in a framework of an EU-funded twinning project the SAI is currently developing the methodology, *manuals and accompanying documents for financial, compliance and performance audits* based on the International Standards of the Supreme Audit Institutions (ISSAI framework). Training of auditors and pilot audits are implemented in parallel while developing the manuals. Serbia also informed about plans to set up a function for methodology and quality control as well as for internal audit during 2014-15. Serbia further stated that during 2014 the SAI will start to prepare a new strategic development plan for the period 2015-19. A peer review on SAI's work is planned for 2016.

Serbia provided statistics regarding the audit work of the SAI. The SAI performs audits according to an annual audit plan, which has certain mandatory elements in line with the SAI law. Otherwise the SAI decides independently on audited entities, subject matter, scope and type of audit as well as on the timing of the start and duration of an audit. By the end of 2013, the SAI published a total of 268 audit reports (audit of financial statements and compliance audit): 1 report in 2009, 13 reports in 2010, 43 reports in 2011, 145 reports in 2012 and 66 reports in 2013. No performance audit reports have been published so far. Implementation of the first performance audit has started in 2013 after setting up the performance audit department in November 2012 and recruitment of staff (9 out of 16 posts filled by the end of 2013). Serbia further informed that since 2009, the SAI has filed 711 requests for initiating proceedings against responsible persons in audited entities in case of illegal operations, including 574 requests for initiating misdemeanour proceedings, 75 requests for initiating proceedings for economic offence, and 62 criminal charges.

As concerns *the SAI's relations with the parliament*, in line with the SAI law, the SAI submits to the parliament the annual activity reports, special reports during the year and the audit report on the annual balance sheet of the state budget, annual balance sheets of the financial plans of mandatory insurance organisations and consolidated financial statements of the state. Serbia informed that the responsible parliamentary committee reviewed the SAI's 2012 annual report and further submitted it to the plenary discussion in June 2013. This was the first time that the SAI's annual report was discussed in the parliament. At the parliamentary committee's request, during 2013 the SAI also submitted to the parliament a report on how the audited institutions had ensured follow-up to SAI audit reports issued in 2011. The SAI concluded that out of 811 recommendations issued requesting the audited institutions to remove detected irregularities and improve operations, 566 recommendations had been implemented, 233 recommendations were in the process of being implemented and 12 recommendations had not been implemented.

II.b. Protection of the EU's financial interests and the protection of the euro against counterfeiting

With regard to **the protection of the EU's financial interests**, the criminal law protection is provided for by the Serbian Criminal Code, the Criminal Procedural Code, the Economic Offences Law, the Law on Liability of Legal Entities for Criminal Offences, the Law on the confiscation of assets gained from criminal offences, the Law on the Prevention of Money

Laundering and Financing of Terrorism and the Misdemeanour Law. Additionally also the Public Procurement Law, the Law on Accounting, the Budget System Law, the Law on Civil Servants and the Law on the Anti-Corruption Agency cover certain aspects of the PFI Convention. The Serbian legislation prescribes penalties for the principle offences of fraud, passive corruption, active corruption and money laundering, including imprisonment in serious cases. It also defines criminal liability of heads of businesses and liability of legal persons as well as defines relevant sanctions. Furthermore, the jurisdiction over criminal offences, *ne bis in idem* – provision (no legal action twice for the same cause of action) and conditions for the confiscation of material gain and proceed from crime are prescribed in the Serbian legislation as well.

Regarding effective assistance and cooperation with the European Commission during on-the-spot checks, Serbia stated that it intends to fully support cooperation with Commission investigators. However, the current legal framework does not have in place specific provisions ensuring that information and evidence produced by Commission's investigators receives an equal treatment in line with requirements of Article 325 of the TFEU. Also, the obligation to safeguard evidence and to actively cooperate and participate in the European Commission's inspection missions (including vis-à-vis economic operators) is not specifically regulated in the national law.

Serbia provided also information on the national legal framework developed for the decentralised management of Instrument for Pre-accession (IPA) funds, where irregularity management and the protection of the EU's financial interest are defined. The Decree on the management of EU pre-accession assistance programmes under Component I, adopted in October 2013, assigns the National Authorising Officer the responsibility to investigate irregularity signals, follow up cases of confirmed irregularities, report on irregularities to the European Commission, ensure proper means of reporting and follow-up with the authorised national bodies on measures taken with regard to cases of suspected fraud as well as to ensure the protection of the EU's financials interests in close cooperation with the Commission. The manner on reporting on irregularities and fraud by the designated IPA structures is further defined in relevant manuals of procedures. Civil servants, employees or third persons, who disclose potential irregularities and fraud, are subject to whistle-blowers protection according to the existing legal framework. Serbia stated that a new comprehensive legal framework on whistleblowing will be finalised in course of 2014.

Serbia informed that on 21 October 2013 the Minister of Finance issued a regulation on the internal organisation and job classification, setting up a national anti-fraud coordination service (AFCOS) within the Ministry of Finance for the cooperation with the European Commission's Anti-Fraud Office (OLAF). AFCOS is established as an independent group (unit) under the direct authority of the Minister of Finance and it has been allocated 3 posts. According to Serbia, no employees have yet been recruited. Besides cooperating with the Commission, AFCOS is tasked to coordinate the work of administrative, investigative and judicial institutions which are part of the AFCOS network. Upon appointment of AFCOS staff, the Commission will provide, through the TAIEX instrument, tailor-made and structured support to Serbian authorities for strengthening anti-fraud coordination and irregularity management. Serbia further informed about the short-term priorities in this area. They include the establishment of the AFCOS network, the preparation of a national anti-fraud strategy and the preparation of a revised legal framework regulating the management of EU funds (IPA II), aiming to better consolidate the management of EU funds and the financial management and control (FMC) system for the management of national funds.

With regard to **the protection of the euro against counterfeiting**, Serbia is not yet a party to the 1929 Geneva International Convention for the suppression of counterfeiting currency. Serbia stated that the Law on the National Bank of Serbia, the Law on Foreign Exchange Operations, the Decision of the National Bank on handling suspected counterfeit money and the Criminal code cover the provisions of Council Regulation (EC) No 1338/2001 (and EC (No) 44/2009) laying down measures necessary for the protection of the euro against counterfeiting. The Serbian legislation defines counterfeiting, competent national authorities, procedures for gathering and storing of suspected counterfeit money and the obligation for banks, economic entities and licensed exchange dealers to verify the authenticity and withdraw from circulation and transmit suspected counterfeits for analysis. The Serbian legislation further defines procedures for the domestic cooperation on counterfeiting and the cooperation with foreign banks and authorities, obliges anyone who comes in contact with counterfeits to report on it to competent authorities and defines the relevant criminal sanctions.

Concerning the authenticity of the euro coins, Serbia informed that its legislation has not been harmonised with Regulation (EU) No 1210/2010 on the authentication of euro coins and handling of euro coins unfit for circulation. Serbia did not provide information regarding the Decision ECB/2010/14 concerning authentication of euro banknotes. Medals and tokens similar to euro coins (Council Regulation (EC) No 2182/2004) are regulated through the Law on Foreign Exchange Operations, the Decision of the National Bank on medals and tokens similar to euro coins and the Criminal Code.

Serbia stated that the National Bank of Serbia performs technical analysis with respect to counterfeit banknotes and coins. The Division of National Centres for Combating Counterfeiting and the Analysis of Banknotes and Coins was established in June 2010 and it has 13 employees. It is responsible for the analysis of the authenticity of money (domestic and foreign banknotes or coins) suspected to be counterfeit; the central collection and processing of information on counterfeit money; money expertise in court proceedings; the creation of albums with representative samples of each type of counterfeit; the storing, keeping and destroying of counterfeits; and training on the recognition of counterfeits for banks, licensed exchange offices and other entities, including employees of the Ministry of Interior.

Serbia informed that at national level the cooperation between the National Bank and the Ministry of Interior has been formalised in a cooperation agreement on handling of suspected counterfeit money. The Ministry of Interior receives data from the National Bank regarding counterfeits, keeps data in internal databases and coordinates the work of 27 police administrations on cases of counterfeit money. Concerning international cooperation, the National Bank of Serbia already cooperates with the European Central Bank by sending counterfeit specimens and by asking opinions in specific situation. The procedure for entering into a more formal cooperation agreement on euro banknotes is under way. In the meantime the National Bank has signed an administrative cooperation arrangement with the European Technical and Scientific Centre of the European Commission regarding euro coins. Concerning international police cooperation, Serbia informed that the Ministry of Interior cooperates with Europol and Interpol and exchanges information on counterfeit money, including monthly reports on counterfeit money to Europol. Serbia also participates in the Pericles programme.

III. ASSESSMENT OF THE DEGREE OF ALIGNMENT AND IMPLEMENTING CAPACITY

As regards the relevant international standards and the *acquis* under this chapter, Serbia's level of legal alignment is broadly satisfactory. Serbia still needs to take additional steps in order to complete legislative alignment, improve implementation and guarantee sufficient administrative capacity in all the areas covered by this chapter.

III.a. Public internal financial control (PIFC) and external audit

In the area of **PIFC**, Serbia has a strategic framework in place. However, the PIFC strategy is a rather technical, stand-alone strategy, which is not sufficiently placed in the overall public administration and public financial management (PFM) reform context. The updated action plan is also too general for a meaningful monitoring of implementation.

A new PIFC strategy for the period 2015-19 is currently being developed and is expected to be presented before end 2014. Ongoing reform actions in the areas of public administration and PFM, especially the budgeting reform with the aim of introducing programme-based budgeting, require that the PIFC reform needs to be increasingly understood as a management reform, whereby the focus is placed on managers' responsibility within each budget user to ensure a proper financial management and control (FMC) system, supported by an internal audit function. Only a robust PIFC system can contribute to a more stable economic environment, support managers to move from input to output and results-based (economic, efficient and effective) policy-making and public spending. The new PAR strategy covers only some specific areas of PFM, including budgeting, PIFC and public procurement. Serbia is therefore encouraged to prepare a more comprehensive PFM action plan to complement the PAR strategy, and place the new PIFC strategy and its specific action plan also in that framework in order to ensure appropriate sequencing and linking of various PFM reform actions. Serbia is requested to provide the European Commission with updates of relevant action plans on a regular basis.

The legal framework for PIFC is largely in place with the Budget System Law and implementing regulations. The PIFC legal framework could be made more coherent by linking better the provisions of the Budget System Law with implementing legislation, as well as by regularly updating the FMC and internal audit manuals. The managerial accountability principle was introduced in the Budget System Law more comprehensively in 2012, but still needs to be translated into implementing legislation. Also, irregularity management (as a responsibility of the head of budget user) is not yet effectively regulated. The centralised budget inspection function will also need to be developed and regulated in line with the PIFC requirements.

The Central Harmonisation Unit (CHU) has existed for a number of years and it has contributed to an increased understanding of PIFC especially among technical FMC and internal audit staff. Due to a strong emphasis on training activities, some of the CHU core functions have not received sufficient attention. The CHU core tasks related to developing PIFC strategies and policies need to be strengthened, especially regarding the improvement of PIFC methodology, facilitating networking of FMC officials and internal audit managers, the monitoring and reporting on systemic shortcomings in FMC and internal audit implementation as well as on good practices in FMC and internal audit. There is also a need to ensure a more effective reporting to the government on the implementation of PIFC,

including concrete proposals for corrective measures. With the ongoing update of the PIFC strategy, this is an opportune moment to re-focus the CHU's role, by reducing the specific task of organising theoretical training to financial officers and internal auditors and adopting a more proactive approach to PIFC coordination and implementation in general. While the CHU will need to maintain a key role in developing training curricula, the training could be organised differently, for example through institutions responsible for civil service training (both at central and local level).

Implementation of FMC in line with the Budget System Law and FMC Rulebook is still at an early stage, as evidenced by the CHU 2012 annual report and the State Audit Institution's audit reports, which point out infringements of existing procurement, accounting and financial control rules by many budget users. Despite managerial accountability being better defined in the Budget System Law since 2012, FMC is still in practice at the basic fiscal control stage, whereby the focus is on the legality and regularity of financial transactions. Many managers still perceive FMC as a technical issue rather than as a management issue. Procedures, controls, audit trails and risk registers are developed as a formality in compliance with the Budget System Law requirements, but they are not perceived as necessary building blocks for a solid internal control environment, assisting managers to reach objectives and results in a cost-effective manner. Risk management is not applied yet systematically in practice and will need to be further developed. More awareness-raising among senior public-sector managers is needed to increase understanding of their specific role and responsibilities in setting up FMC and of the role of an internal auditor within their organisation.

The internal audit function has been progressively set on a decentralised basis. The number of internal auditors and performed audits has increased over time. 84% of current internal auditors have received training and certification by the CHU. An effective and functioning internal audit system however still remains to be established in line with the Budget System Law requirements in many budget users. Also, many internal auditors still continue to implement other tasks beside internal audit, which indicates that the top management in many budget users is not utilising the internal audit function accordingly. More awareness-raising among senior public-sector managers is therefore needed also in this respect.

Overall, at this stage of development of PIFC in Serbia, the internal control focus is on *ex post* checking of compliance with laws and detecting potential irregularities, as evidenced by the work performed by internal auditors, centralised budget inspectors and also the State Audit Institution. In line with the managerial accountability principle, however, the focus should gradually move towards making managers responsible for setting up and implementing appropriate FMC structures, supported by an internal audit function, to prevent irregularities from happening in the first place.

As concerns **external audit**, the SAI's independence is broadly anchored in the Constitution. The SAI law is to a large extent in line with the INTOSAI standards, but the envisaged amendments to the SAI law should further contribute to full functional, operational and financial independence of the SAI. In this context the responsibility prescribed in the law for the SAI to file with competent authorities misdemeanour, economic offense and criminal charges against individuals requires special attention. Whereas this additional task is understandable due to FMC being at an early stage of implementation in many budget users, especially at local level, there is at the same time a risk that with the SAI being allocated the responsibility for detecting individual errors and

ensuring that persons responsible for irregularities and mismanagement are prosecuted, the heads of budget users are not held sufficiently accountable for ensuring appropriate FMC structures and procedures (internal control standards) in their respective institutions in line with the managerial accountability principle. The SAI's task of filing misdemeanour, economic offense and criminal charges takes up some of the SAI's limited audit resources that could be instead used for actual audit work. With future development of centralised budget inspection in line with the PIFC requirements, this task could ideally become a budget inspection task and therefore the responsibility of the executive.

The SAI has a strategic development plan for the period 2011-15 in place, and a new strategy for the period 2015-19 is being developed during 2014. The institutional capacity needs further considerable strengthening. Currently 202 audit posts out of 377 (foreseen audit posts) remain to be filled. The lack of appropriate business premises has been among the main stated reasons for delays in recruitment. This will require also the government's attention, especially since according to the SAI law it is the government's responsibility to ensure adequate premises for the SAI.

The SAI does not yet have the required audit manuals in line with the INTOSAI standards in place, but they are being developed in the framework of an EU-funded twinning project. The SAI will need to continue with the certification and systematic training of its audit staff. In view of the state of play as regards the development of the overall public internal financial control system in Serbia, there is still a considerable need for financial audits focusing on compliance and legality. Performance audit work has started on a pilot basis and will need to be developed in the coming years. As the SAI itself has noted in the 2012 annual activity report to the parliament, development of performance audit work is not only dependent on the SAI. Serbia needs to ensure parallel improvements in the overall public financial management system for the SAI to assess performance in a meaningful manner.

The SAI has proactively contributed to the improvement of the public sector internal control standards in Serbia over the past few years. While safeguarding its independence the SAI cooperates closely with the Central Harmonisation Unit of the Ministry of Finance on topics of common interest. Furthermore, the plans to set up an internal audit function within the SAI are welcomed, because the SAI can by its own example also demonstrate the importance of internal control standards to other budget users.

The responsible parliamentary committee has started to take an active interest in the SAI's audit reports, including a follow-up to SAI's audit findings. The parliament discussed the SAI's 2012 annual activity report for the first time in June 2013. The SAI is encouraged to continue its proactive approach towards the parliament and the parliament is encouraged to continue to ensure a formal mechanism for review and reaction to SAI's audit reports in order to strengthen the accountability of the executive in their use of budgetary funds.

III.b. Protection of the EU's financial interests and the protection of the euro against counterfeiting

With regard to **the protection of the EU's financial interests**, Serbia's legal framework is already harmonised with the relevant parts of the PFI Convention and its three protocols. It therefore provides for a sufficient criminal law protection in this area. As concerns cooperation and on-the-spot checks with the European Commission investigators, Serbia

will need to include in its national legislation provisions on the safeguarding of evidence and on efficient cooperation with the Commission's investigators.

Even though an AFCOS has been formally set up by an internal regulation of the Ministry of Finance, Serbia will need to ensure a more comprehensive legal basis, which defines tasks and responsibilities of AFCOS and cooperation arrangements with the European Commission. After recruitment of staff, Serbia will also need to ensure training and sufficient operational capacity for AFCOS so that it can efficiently coordinate all relevant actors in the future AFCOS network. Serbia has further committed to preparing a national anti-fraud strategy and improving the legal basis for the management of EU funds (IPA II). In this context, and in view of improving Serbia's overall public financial management system, Serbia's plans to manage irregularities and prevent and detect fraud both in the EU funds and national funds in a more harmonised manner are welcomed.

With regard to the non-penal aspects of **the protection of the euro against counterfeiting**, Serbia will need to sign and ratify the Geneva Convention for the suppression of counterfeiting currency. Serbia's legal framework is already harmonised with parts of the *acquis*, except for the authentication of euro coins and the handling of euro coins unfit for circulation. Serbia needs to provide information to the Commission on the harmonisation of its legislation with decision ECB/2010/14 concerning the authentication of euro banknotes. Serbia needs to further provide information to the Commission on whether the legal provisions in the Serbian legislation regarding the obligation for banks, economic entities and licensed exchange dealers to verify the authenticity and withdraw from circulation and transmit suspected counterfeits for analysis covers also the exchange offices, transporters of funds and other economic agents such as traders and casinos in line with Article 6 of the Regulation (EU) No 1338/2011.

Serbia has set up the necessary administrative structures for technical analysis and classification of counterfeit money, including euro banknotes and coins, in the National Bank of Serbia. There is a formalised cooperation in place at national level between the National Bank and the Ministry of Interior. With regard to international cooperation, a formalised agreement with the European Central Bank on euro banknotes will need to be concluded. Furthermore, the Ministry of Interior is expected to sign an operational agreement with Europol. Serbia needs to ensure sufficient implementation capacity and cooperation at international level.