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To: Members of the Executive Board

From: The Acting Secretary

Subject: **Republic of Serbia—Report on the Observance of Standards and Codes—Fiscal Transparency Module**

Attached for the **information** of the Executive Directors is the fiscal transparency module of the report on the observance of standards and codes for the Republic of Serbia.

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Questions may be referred to Mr. Shields, FAD (ext. 36252).

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REPUBLIC OF SERBIA

Report on the Observance of Standards and Codes (ROSC) Fiscal Transparency Module

Prepared by the Fiscal Affairs Department

Approved by Marek Belka and Carlo Cottarelli

March 11, 2009

EXECUTIVE SUMMARY

This report provides an assessment of fiscal transparency practices in Serbia in relation to the requirements of the IMF *Code of Good Practices on Fiscal Transparency.* It is based on discussions with the authorities and other organizations, the authorities' response to the IMF fiscal transparency questionnaire, and other sources of information. The IMF *Manual on Fiscal Transparency* (http://www.imf.org/external/np/fad/trans/manual/) should be consulted for further explanation of the terms and concepts discussed in this report.

Serbia has made solid advances under all four pillars of the Fiscal Transparency Code. The roles and responsibilities of government are, for the most part, clearly defined. Relationships with the private sector, including the tax system, are governed by comprehensive laws, which protect taxpayer rights. The annual budget process is generally clear, governed by a comprehensive legal framework, which includes a precise budget calendar. Budget documentation records developments and prospects for the whole of general government, as defined, as well as medium-term fiscal policy objectives and debt sustainability. Expenditure and revenue are regularly monitored and reported according to generally clear standards. A Treasury Single Account has been established. Fiscal information, including debt data, is accessible to the public in a timely fashion. Public servants are subject to a well-defined code of behavior, and a state audit institution has been established.

Nevertheless, some major shortcomings in fiscal transparency need to be addressed. To distinguish the general government more clearly from the rest of the public sector, and facilitate measurement of the fiscal stance, well-specified criteria should be defined and observed to mark the boundaries of the Republic and subnational budgets, ideally using GFSM 2001 principles. Responsibilities within the general government should also be demarcated more clearly by clarifying property ownership and the financing of some public services. In the light of their extensive mandates from the general government, the quasi-fiscal activities and finances of state-owned and socially-owned enterprises should be comprehensively reported in budget documentation. Budget projections, which have lacked realism, should be subject to independent scrutiny, and deviations of outturn data from the initial budget projections should be fully explained in the Budget Memorandum. The Budget Memorandum should also include a comprehensive statement of fiscal risks and information on the distribution of privatization receipts. A clear and simple summary guide to the budget and occasional long-term reports on the economy and public finances should be published.

Effective prioritization and execution of the budget process should be strengthened by integrating the National Investment Plan consistently into budget preparation and reporting. Commitment control should be fully enforced so that any expenditure arrears can be comprehensively monitored. Contingency mechanisms in the budget should be rationalized. A legal and institutional framework should be established for managing and accounting for public-private partnerships. To safeguard the integrity of government operations, a program should be initiated for the development of the State Audit Institution, and internal audit and control functions should be strengthened.

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ABBREVIATIONS AND ACRONYMS

BM	Budget Memorandum
BPD	Budget Preparation Department
BSL	Budget Systems Law
COA	Chart of Accounts
CoFoG	Classification of the Functions of Government
DBB	Direct Budget Beneficiary
DFID	U.K. Department for International Development
EAR	European Agency for Reconstruction
EBF	Extrabudgetary Fund
ECB	European Central Bank
EU	European Union
FAD	IMF Fiscal Affairs Department
GAAP	Generally Accepted Accounting Principles
GFSM 1986	Government Finance Statistics Manual 1986
GFSM 2001	Government Finance Statistics Manual 2001
FMAPD	Fiscal and Macroeconomic Analysis and Projections Department of the MoF
FMIS	Financial Management Information System
HIF	Health Insurance Fund
IBB	Indirect Budget Beneficiary
IMF	International Monetary Fund
INTOSAI	International Organization of Supreme Audit Institutions
IPSASB	International Public Sector Accounting Standards Board
MoF	Ministry of Finance
MoERD	Ministry of Economy and Regional Development
MSIO	Mandatory Social Insurance Organization
MTBF	Medium-Term Budget Framework
NIP	National Investment Plan
NBS	National Bank of Serbia
OECD	Organization for Economic Cooperation and Development
PDRS	Property Directorate of the Republic of Serbia
PFM	Public Financial Management
PPA	Public Payments Agency
PPP	Public-Private Partnership
ROSC	Report on Standards and Codes
RSD	Republic of Serbia Dinar
SAI	State Audit Institution
SOE	State-Owned Enterprise
SSOEs	State- and Socially-Owned Enterprises
STA	IMF Statistics Department
TSA	Treasury Single Account

I. Introduction[1]

1. **This report provides an assessment of fiscal transparency practices in Serbia against the requirements of the revised IMF *Code of Good Practices on Fiscal Transparency (2007)*.**[2] It has two parts. The first part is a description of practice, prepared by IMF staff on the basis of discussions with the authorities and their responses to the fiscal transparency questionnaire, and drawing on other available information. The second part is an IMF staff commentary on fiscal transparency in Serbia. Appendixes summarize the staff's assessments and comments on observance of good practices, and document the public availability of information.

II. Detailed Description of Practice

A. Clarity of Roles and Responsibilities

Definition of government activities

2. **General government is defined broadly consistently with the principles of Government Finance Statistics (GFS) 1986, but some entities may be misclassified.** *1.1.1*

The consolidated accounts of the general government in Serbia cover the Republican government, subnational governments, and several extrabudgetary funds (EBFs): the mandatory social insurance organizations (MSIOs) and Republic of Serbia Roads (Box 1).[3] The Republican and subnational governments comprise entities which are either direct budget beneficiaries (DBBs) or indirect budget beneficiaries (IBBs).[4] While DBBs

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[1] Discussions on fiscal transparency were held with the Serbian authorities in August/September 2006, and September/October 2008. The first mission, consisting of Messrs. Marijn Verhoeven (head), Duncan Last, Alejandro Simone, and Mrs. Anna Ivanova (FAD), visited Belgrade from August 31 to September 13, 2006. It met with the then Minister of Finance, Mr. Dinkić, and officials from the Ministry of Finance (MoF), the Central Bank of Serbia, and other agencies. The second mission visited Belgrade from September 24 to October 6, 2008, as part of a joint technical assistance/ROSC team headed by Mr. Thanos Catsambas, with Messrs. Jon Shields, Duncan Last, Abdul Khan, and Brian Olden (all FAD). This team met with the Minister of Finance, Mrs. Diana Dragutinovic; State Secretary, Mr. Janko Guzijan; State Treasurer, Mr. Ivan Mavicic; Deputy Treasurer, Mr. Zivco Nesic; and officials in the Ministry of Finance and the Ministry of Economy and Regional Development. The mission also met with members of the Parliamentary Finance Committee and officials of the Development Fund.

[2] Available at http://www.imf.org/external/np/sec/pr/2007/pr0795.htm

[3] Subnational governments comprise the autonomous province of Vojvodina and local governments. The latter consist of cities and municipalities. Vojvodina has 45 local governments (the city of Novi Sad and 44 municipalities).

[4] The Government Gazette listed a total of 9,228 DBBs and IBBs in 2006. DBBs are institutions which are fully reflected in the Republic budget, such as ministries. IBBs are defined in the Budget System Law as legal entities "founded by the Republic and/or local authority over which the founder, through direct budget beneficiaries, exercises statutory powers in respect of management and financing." IBBs include primary and secondary schools, university faculties, clinics and hospitals, scientific institutes, cultural institutions, and other institutions

(continued...)

Box 1. General Government in Serbia (2006)

	Number of Budget Beneficiaries	Expenditure (in percent of GDP) 1/
Since mid-2006, following the dissolution of the Union of Serbia and Montenegro, the general government in Serbia has comprised the following:		
Central government		
1. Republic budget		15.3
(i) Direct budget beneficiaries (DBBs), including the president's office, government offices, parliament, judiciary, 19 ministries, and other agencies.	173	
(ii) Indirect budget beneficiaries (IBBs), including schools, hospitals, universities, and other institutions.	2772	
2. Central government units with own budgets: Pension and Disability Fund, Health Insurance Fund, Employment Agency, and Republic of Serbia Roads 2/	379	18.2
Subnational governments		6.9
(i) Direct budget beneficiaries (DBBs), including autonomous province of Vojvodina, 4 cities, and 141 local and municipal councils 3/	413	
(ii) Indirect budget beneficiaries (IBBs)	5491	
General government	**9228**	**40.4**

1/ Based on monthly fiscal reports from the MoF to the IMF.
2/ The Pension and Disability, Health Insurance, and Employment Funds comprise the Mandatory Social Insurance Organizations (MSIOs). The Pension and Disability Fund was previously reported in three components: employees, self employed, and farmers. Republic of Serbia Roads was previously the Road Fund.
3/ Excludes 29 Metohija municipalities.

are responsible directly to their respective governments, IBBs are accountable for their activities and budget execution only through DBBs. Both DBBs and IBBs receive finance from the Republic or subnational budgets and many also have own revenues, including fees and charges, donations and privatization receipts, and foreign grants and loans.[5]

In theory, the principles set out in GFSM 1986 for including entities in the general government sector, including that they primarily fulfill a function of government, apply to all

partly financed from the Republican budget. Many of these entities could be classified as extrabudgetary funds or non-market non-profit institutions.

[5] Domestic own revenues include: (i) fees or charges that are determined by national or local legislatures and earmarked for the beneficiary's use; (ii) revenue generated by the beneficiary; (iii) donations from individuals or NGOs; and (iv) sale of financial and nonfinancial assets. Any excess of budgeted own revenues (domestic or foreign) can be spent by the beneficiary within the year or saved for future use, but shortfalls in own revenue cannot be offset by using budget revenues.

budget beneficiaries. However, in practice, it would appear that some IBBs do not currently satisfy these principles; while there are also some entities outside the budget that do. There is no procedure for regularly reviewing the list of IBBs or for ensuring that all EBFs are reported within the general government sector.

The fiscal operations of the central government and MSIOs, as well as of subnational governments, are regulated by the Budget System Law (BSL) of 2002. Their budgets are adopted by their respective legislatures. The budget proposals, and reporting of the Republic and subnational budgets, include most of the own revenues and associated spending of DBBs, but they are less complete in respect of the own revenues and spending of IBBs, particularly the health institutions that report to the Health Insurance Fund (HIF).[6] As a consequence of this, and inadequacies in the coverage and definition of the general government, the consolidated statements and projections for revenues, expenditures, and balances for the general government sector as a whole are not fully comprehensive.[7]

All budget beneficiaries of Republican and subnational governments, together with the MSIOs, are included under the treasury single account (TSA) system of bank accounts maintained by the Treasury. Some IBBs also maintain bank accounts with commercial banks for some of their own revenues. All budget beneficiaries are subject to government accounting and reporting standards.

Government relations with nonfinancial state- and socially-owned enterprises (SSOEs) and the private sector

3. **The relationship between the government and SSOEs is generally defined by law, but lines of responsibility are blurred in practice.** *1.1.4*

The relationship between the state and nonfinancial enterprises that are state-owned or socially-owned is not always clear.[8] In particular, while the Law on Public Enterprises (2000) specifies the nature of the governance arrangements of state-owned enterprises (SOEs), it does not clearly define the limits of government intervention in their management or policy decision making. Socially-owned enterprises are in a similar state, although the last of these are now being subject to the process of privatization or liquidation. The relationship of the government with SSOEs is complicated by the multiple layers of responsibilities for

[6] Only the own revenues of DBBs and IBBs that are spent within the budget year are recorded. No own revenues are recorded for the health institutions reporting to the Health Fund.

[7] The Development Fund, Privatization Agency, Guarantee Fund, Housing Loan Fund, and Export Credit and Insurance Agency carry out sizeable extrabudgetary activities.

[8] Socially-owned enterprises are run by their work forces, which also have a claim on profits. The Constitution (2006) recognizes collective (or social) assets separately from private and public assets, and specifies that collective assets should over time transfer into private hands. Since claims on socially-owned enterprises imply a significant fiscal risk for the government, they are discussed here. There is little regular reporting on socially-owned enterprises.

overseeing and monitoring them, which are shared between the Ministry of Finance (MoF) through the Public Enterprises and State Aid Department and Debt Department, the Ministry of Economy and Regional Development (MoERD) through the Property Office, and the sectoral ministries directly responsible for the area of activity of each public or socially-owned enterprise. There is no published list of SSOEs, although the Solvency Register of the National Bank of Serbia (NBS) publishes summary financial information from the annual reports that are required to be submitted to it. The relationship of the government with state-owned financial institutions has been institutionalized. The task of monitoring ownership and coordinating the activities of state banks and insurance companies has been assigned to the Deposit Insurance Agency.

4. **Reporting of the impact of nonfinancial state-owned enterprises (SOEs) on the budget is inadequate, particularly in the context of their significant quasi-fiscal activities.** *1.1.4*

While privatization has reduced the size of the public sector in recent years, state ownership of the nonfinancial enterprise sector remains significant in key sectors of the economy (Appendix I Table 3). There is, however, no documentation that provides information to the National Assembly or the general public about the overall size of this sector, its impact on the general government sector, or the fiscal risks that it presents. There is also no easily accessible aggregate information on holdings of private equity by the general government.

Many nonfinancial SOEs continue to undertake significant social expenditure on behalf of government, including providing essential items (e.g., petroleum products and transport) to consumers at prices that are below cost-recovery levels, using employment and wage policies for social purposes, financing culture and sports activities, and giving dispensations on pricing and collection to some SSOEs in financial difficulty. The costs of some of these activities are recorded in the budget as subsidies (amounting in 2007, for the Republican government, to an estimated 2 ½ percent of GDP, including restructuring costs in anticipation of privatization). Other activities are either supported non-transparently by budget beneficiaries or EBFs or are not compensated at all by the government. In the latter case—which are pure quasi-fiscal activities (QFAs)—severe financial pressure can be put on some individual SSOEs, leading them to negotiate offsets and other opaque arrangements with government and other SSOEs (such as utility companies). These arrangements include non-payment of taxes, social security contributions, and utility bills, and negotiation of loans that will be repaid from uncertain privatization receipts. Similar problems probably also occur in nonfinancial SOEs owned by local governments.

The lack of recognition or costing of QFAs in budget documentation means that important fiscal risks remain unidentified, the scale of the government is underreported, and the true financial positions of both the government and SOE sectors are distorted.

5. **Arrangements regulating profit transfers from public enterprises to the budget are in place, but are not used in practice**. *1.1.4*

According to the Law on Public Enterprises, decisions on the distribution of profits are determined by the enterprises' managing boards, subject to government approval. In most years, the practice has been to transfer about 50 percent of profits to the budget, but there have also been years in which, following Cabinet discussion, no profits have been transferred.

6. **Laws and processes governing government regulation of the nonfinancial private sector are comprehensive but complex, and subject to frequent changes.** *1.1.5*

The laws and regulations defining the regulatory framework are relatively complex and subject to frequent change as laws are adjusted to reflect the ongoing process of transition.[9] Furthermore, the regulatory bodies in charge of implementation of the laws do not always have adequate capacity, and are sometimes not sufficiently independent from the government. The combination of these elements, and a limited dialogue with the private sector, has resulted in substantial compliance costs and inefficiencies. On the latest World Bank's "Ease of Doing Business Index," Serbia was rated at 94 out of 181 countries.[10] Although, overall, Serbia was ranked similarly to other countries in the region, it performed very poorly on dealing with construction permits.

Government relations with the central bank and public financial sector

7. **The National Bank of Serbia (NBS) is operationally independent and has a clearly defined and limited fiscal role.** *1.1.4*

The Law on the NBS (2003) provides considerable autonomy to the NBS. The Governor and Council of the NBS are appointed by the National Assembly. The NBS, through its Monetary Board, is responsible for the determination of monetary policy. The Minister of Finance participates in the meetings of the Monetary Board, but does not have a vote. The Law on the NBS and the BSL prescribe that the government should maintain a TSA at the NBS, and that the NBS should act as fiscal agent and banker for the government. The NBS is also authorized to provide temporary liquidity to the budget.[11] Such loans to the government may be granted within the framework of the determined monetary policy, and may not exceed 5 percent of the average current central government budget revenue over the preceding three years. In addition, the total amount of debt of the fiscal sector incurred on this basis may not exceed three times the minimum capital requirement of the NBS.[12] Loans need to be repaid by the end of the budget year in which they are incurred. Any excess of revenues over

[9] Key laws that regulate private sector activity include the Law on Prices, the Law on Consumer Protection, the Law on Protection of Competition, the Labor Law, the Law on Bankruptcy, and the Law on Accounting and Audit.

[10] "Doing Business 2009," World Bank www.doingbusiness.org

[11] The NBS also holds long-term claims on the government which it uses in open-market operations. These government securities were issued on a one-time basis under the Law on Settlement of the Obligations of the Republic of Serbia to the NBS (2004).

[12] The Law on the NBS (Article 77) specifies that the minimum fixed capital of the NBS needs to amount to SRD 10 billion. In addition, the NBS holds special reserve funds, which cannot exceed the value of its fixed capital, and can be replenished by appropriations of no more than 30 percent of the realized surplus of revenues over expenditures of the NBS.

expenditure must be transferred to the Republic budget.[13] The NBS has been running losses in recent years from the high level of capital inflows and the extensive recourse to sterilization operations for monetary policy purposes (in 2006, NBS losses amounted to 1.4 percent of GDP). Services to the government are provided by the NBS free of charge and no interest is currently (2008) being paid on government deposits.[14]

8. **There is evidence that some state-owned financial enterprises continue to carry out QFAs.** *1.1.4*

Some state-owned financial enterprises hold treasury bills that were purchased at yields considerably below comparable market terms.[15] Explicit and implicit government guarantees have also enabled some state-owned financial enterprises to borrow from the market at relatively low interest rates. However, with government divestment from the sector, QFAs seem to have been declining overall. State ownership of the banking system represented about 21 percent of total bank assets in June 2006, down from 36 percent at end-2004. While government ownership of the insurance sector remains significant at 57 percent of total assets, this sector is rather small: assets are less than 5 percent of banking system assets.

Fiscal management relations among the branches of government

9. **The fiscal roles of the executive, legislative, and judicial branches are clearly defined in the Constitution.** *1.1.2*

The Constitution of the Republic of Serbia (2006) assigns to the executive branch of the government the roles of proposing and executing the annual budget and taxation, while giving the National Assembly the power to enact the budget and tax laws proposed by the executive. The BSL establishes the budget calendar and the roles, responsibilities, and main tasks of the Republican and subnational governments in the budget process. In particular, the BSL provides for a three-month temporary financing arrangement if the budget for the fiscal year has not been adopted before the start of the fiscal year.[16] Cases of fraud and gross

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[13] The NBS Law requires the amount of the surplus of revenues over expenditures (excluding unrealized gains) that remains after allocations to the minimum fixed capital and special reserve funds to be transferred to the Republic budget. In case expenditures exceed revenues, the difference is to be covered out of the special reserves first, and if these funds are inadequate, by transfers from the Republica budget. The government can also place debt securities to cover NBS losses.

[14] Banking services to the government are free of charge, but NBS and the government can enter into a contract under which fees can be charged (Article 61 of the NBS Law). The interest rate on government deposits is determined in a contract between the government and NBS (Article 41 of the NBS Law).

[15] Yields for three-month treasury bills were below 5 percent in July 2008, compared with the NBS policy interest rate of 15 ¾ percent.

[16] Such temporary financing is available in proportion to funds utilized in the same period in the preceding year's budget, up to a maximum of one-fourth of the total revenues allocated in the preceding fiscal year's budget, and cannot be extended beyond three months. The draft revision of the BSL provides for a further extension of interim financing for three months, if the budget is not adopted before March 15 of the budget year.

Table 1. Serbia: Intergovernmental Distribution of Expenditure Responsibilities

	Central Government	Subnational Governments
Economic management	Macroeconomic policy.	
Health	Policy formulation and implementation, and financing (through HIF).	
Education		
Basic 1/	Legislation, financing of wages.	Implementation of legislation, financing of nonwage spending.
Higher	Policy formulation and implementation.	
Social insurance	Policy formulation and implementation, and financing (including pension funds).	
Social assistance	Legislation, financing of benefits.	Implementation of legislation.
Infrastructure	National roads and motorways.	Local roads.
Other		Specific needs of citizens, including communal services, culture, sports, and the environment.

1/ Primary and secondary level of education.

misconduct are referred to the courts, and taxpayers can challenge the legality of taxation by appeal to the courts (¶17).

Fiscal management relations among different levels of government

10. **The responsibilities of different levels of government are clearly defined in various laws, but are numerous and complex.** *1.1.3*

The legal framework defining responsibilities for expenditure and funding for the different levels of government comprises the Constitution, the BSL, the Law on Local Self Government (2002), the Law on Local Self Government Financing (2006), and the Law on Public Debt (2005). Table 1 provides an overview of the distribution of expenditure responsibilities between the central government and subnational governments. As for revenues, the central government controls tax policy and administration, while subnational governments are entitled to collect a limited amount of local taxes and fees, including property tax, lease revenues, and miscellaneous user charges and fees. Local taxes and fees typically account for only 37 percent of total revenues of subnational governments. The system of intergovernmental transfers comprises revenue sharing arrangements, grants, and specific purpose transfers. Restrictions on subnational borrowing have been relaxed to allow borrowing for capital purposes (¶26).

11. **Accountability for some government functions is complicated by divided responsibilities between different levels of government, but discretion in government transfers has been curtailed**. *1.1.3*

The divided responsibilities for certain functions (e.g., education) imply that no level of government ultimately controls all inputs that underlie performance, thereby blurring lines of responsibility. In addition, there was in the past a significant level of discretion in the transfer arrangements between the Republic and subnational budgets. The narrow base for local taxes and fees further limited accountability. However, the Law on Local Self Government Financing reduced discretion in the transfer system by fixing the overall level of non-earmarked grants from central to subnational governments at a level of 1.7 percent of the latest published level of GDP and distributing them according to a formula. Earmarked transfers are also determined transparently in line with explicit criteria. Equalization transfers ensure that per capita tax collections in all municipalities reach at least 90 percent of the national average. Compensational transfers offset losses in revenue from changes in tax regulation. In addition, the Law increased accountability by shifting the responsibility of collecting the property tax to the local level. The Constitution requires that at least 7 percent of the Republic budget should be reserved for Vojvadina.

12. **Subnational governments and local public enterprises do not own the assets they use, complicating their operations and blurring accountability.** *1.1.3, 1.1.4*

The Constitution, and the Law on Property (2005), provide the Republic of Serbia with ownership rights not only for natural resources and property acquired by the Republican government, but also for property used by the subnational governments, local public enterprises, and for property without owner (including property used by socially-owned enterprises). These provisions create obstacles for subnational governments and local public enterprises in managing the assets they use. For example, to sell or rent out the immovable property they use, subnational authorities need to obtain permission from the Property Directorate of the Republic of Serbia (PDRS) at the central government level, which involves a protracted administrative procedure. To reduce the impact of the Law on Property on the operations of the subnational governments, the Law on Planning and Construction (2006) allows them to lease construction land for long periods (typically 99 years) without consulting the PDRS. However, this has not fully resolved the problem, because potential investors remain concerned about the expropriation risk. In addition, subnational governments and local public enterprises have limited incentives for adequately maintaining the assets in their care or engaging in investment and, given the legal problems, cannot be held accountable. A draft law on Public Property, Ownership and other Property Rights (September 18, 2008), which is designed to address these issues, has been issued for public comment.

The legal and administrative framework for budget management

13. **The legal framework for management of public funds is reasonably clear and comprehensive, although it has been subject to frequent changes.** *1.2.1*

The BSL provides a reasonable framework for the management of public finances in Serbia and covers the key elements expected in such a law. Implementation of some aspects of the Law, however, is a challenge for the authorities (e.g., recording of commitments, see ¶30). Since its adoption, the BSL has been subjected to a number of amendments, some of which have brought the original law in line with subsequent reforms, such as the operation of the TSA. The level of detail in some of these amendments, as well as the original text of the BSL, means that they would normally have been addressed under the treasury and financial regulations, but they have instead been legislated to enhance the authority of the Republican government and budget. Further revisions to the BSL are currently under consideration.[17] Article 4 of the BSL lays out the principles of budgetary management of the Republic of Serbia, including macroeconomic stability and minimizing the risks to its financial position. Subnational governments may borrow for investment purposes, subject to the criteria in the Law on Public Debt (¶26). Limits on borrowing and guarantees by the Republican government are set in the annual Budget Law. All guarantees require the approval of the MoF and subsequent confirmation by the National Assembly. The MoF is responsible for monitoring all government debt and guarantees, including borrowing by local governments, as well as managing the servicing of the Republican government debt and called guarantees.

The legal and administrative framework for tax policy and administration

14. **The tax system is fairly comprehensive, with a clear legislative basis, but it is complex and subject to frequent changes.** *1.2.2*

The legislative framework for the tax system comprises the Customs Law (2005) and Law on Tax Procedure and Tax Administration (2005), and various laws covering the different types of taxes, including the Individual Income Tax Law (2001), Company Profit Tax Law (2001), Value Added Tax Law (2004), Excise Law (2006), and Customs Tariff Law (2005). The tax system has become more complex in recent years.[18] It also has been subject to frequent changes, with the expected impact of these changes, including compliance cost, not always adequately assessed. The complexity and instability of the tax system undermine efficient implementation of tax laws and effective self assessment. The tax and customs administrations have tried to address this with a wide range of taxpayer services accessible through revenue administration offices and the Internet, including by providing and publishing instructions for taxpayers and advanced tax rulings on request.

15. **Tax exemptions are numerous, but well defined; and major tax expenditures are calculated, but only partially disclosed.** *1.2.1, 3.1.3*

[17] A revised Budget System Law (BSL) was proposed to the National Assembly in November 2007.

[18] For instance, the Amendment to the Personal Income Tax Law (2006) has introduced exemptions for new labor market entrants, previously unemployed under the age of 30 and over 45, and the disabled, which apply only if the entry into the labor relation with the newly employed person results in an increase in the number of employees of the employer compared to the number of employees as of September 1, 2006. This condition needs to be met for a subsequent period of three years for newly employed under 30, and two years for newly employed over 45 after the expiry of the exemption.

While there are many tax exemptions, they are clearly defined in tax laws and generally do not allow for discretionary decision making. Only the Customs Tariff Law allows for some discretion by the Minister of Finance. However, the criteria to grant exemptions in this case are clearly spelled out in a separate government decision. Information on individual tax exemptions is not disclosed. The tax administration routinely assesses tax expenditures for corporate income tax, excises, and the VAT. Some estimates are published in MoF reports on State Aid, but there is no systematic disclosure of all tax expenditures.[19] Administrative expenses for different types of tax are also not available in the public domain.

16. **There is a clear legal and administrative framework for revenue administration, although some gaps remain in implementation.** *1.2.2*

The Customs Law and the Law on Tax Procedures and Tax Administration provide a clear framework for administering the tax system, including provisions for requesting third-party information, enforcement of collection of arrears, and penalties for taxpayer non-compliance. While the law limits the extent of discretion of tax authorities and provides for mechanisms to ensure accountability, including appeal and reporting procedures, weaknesses in internal audit remain a concern (¶57). Tax fraud cases are widely reported in the media, but enforced collection is impeded by the legal provisions protecting enterprises undergoing restructuring. Websites provide access for the public to laws, regulations, and explanatory material.

17. **Taxpayers' legal rights are well defined, including appeals procedures**. *1.2.2, 4.2.6*

The law provides for key taxpayer rights, such as the right to launch an appeal against tax and customs administrations decisions or to request information from the Tax Administration, and assures the confidentiality of tax information. The taxpayer has access to administrative appeal procedures within the Tax Administration, and can, if these are rejected, submit an appeal through the court system, up to the Supreme Court.

Public consultation

18. **Public opinion is normally sought in advance concerning proposed laws, regulatory changes, and broader policy changes**. *1.2.3*

Government websites provide copies of draft laws.

Contractual arrangements

19. **Contractual arrangements between the government and the private sector, and other parts of the public sector, are generally clear and publicly accessible**. *1.2.4*

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[19] For example: "Report on State Aid Granted in the Republic of Serbia in 2006," Belgrade, September 18, 2008.

In the case of PPPs, however, there is not yet a comprehensive legal and institutional framework that would ensure that the associated risks would be effectively managed and disclosed, that individual PPPs would be fully reported, and that all PPP operations would be reflected consistently in the fiscal accounts.

Legal framework for liability and asset management

20. **Liability management and the granting of rights for mineral extraction are governed by legislation.** *1.2.4*

The BSL requires the Republic budget to specify annual limits on the total amount of debt that may be incurred by the Republic during the budget year. All borrowing and issue of guarantees by the Republic must be approved by the government and signed by the Minister of Finance. Borrowing by subnational governments and the MSIOs is constrained by the limits on outstanding debt and debt servicing provisions set out in the Law on Public Debt (¶26). The Law on Public Debt also regulates the manner and process of debt management by the Republican government, subnational governments, the MSIOs, and other legal entities founded by the Republican government. A public debt agency (currently the Public Debt Department in the treasury) is given responsibility for conducting operations in connection with public debt. The Law on Public Debt identifies the goal of Republican debt management as to decrease borrowing expenses in accordance with a prudent risk level, and requires the Minister of Finance to prepare and publish once a year a public debt management strategy in the BM.

The legal framework for the mineral extraction sector includes the Law on Concessions (2003), Decree on Mineral Resources Compensation Fees (2002), Law on Mining (1995), and Law on Geological Exploration (1995). Regulatory control is shared between the Ministry of Mining and Energy, Ministry of Environment and Science, and the Ministry of Agriculture. The Law on Mining provides for mineral extraction to be subject to royalties, the rates of which are set between 1 percent and 5 percent, depending on the type of mineral.[20] Transparency is limited by the complexity of the regulatory structure, weakness of the overall policy framework, and persistence of discretionary authority.

21. **The legal framework for privatization is clear**. *1.2.5*

Privatization is legislated through various laws, including the Law on Privatization (2001) and accompanying decrees, the Law on the Privatization Agency (2001), and the Law on the Share Fund (2001) and subsequent amendments. Initiation of the privatization process for large enterprises requires the approval of the MoERD. For other entities, privatization can be initiated by a potential buyer, the MoERD (which is responsible for privatization policy), or by the company to be privatized. Implementation of any privatization requires the involvement of the Privatization Agency, which is in charge of decisions on the privatization

[20] For example, the royalty rate is set at 1 percent of total income for coal, 3 percent for oil and gas, and 5 percent for non-metallic raw materials.

mechanism (auction or tender) and restructuring, and enforcing the procedures and sale mechanisms. The MoERD and the National Assembly oversee the privatization process.

22. **Privatization proceeds are not fully reflected in the budget or public reports of the Privatization Agency.** *1.1.5, 4.2.4*

The Privatization Agency collects a commission of 5 percent on privatization receipts. After the deduction of this commission and other costs (such as consultant fees), the Privatization Agency distributes the net funds to creditors and different beneficiary institutions on the basis of percentages established in the Law on Privatization. These payments are reported as revenues in fiscal reports.[21] The Law also provides that up to 30 percent of shares can be given free of charge to employees and other citizens. The remaining funds are transferred to the Republic budget and reported as a financing item. Information on commissions and other privatization costs is not publicly available.

B. Open Budget Preparation, Execution, and Reporting

The budget preparation process: clarity and consistency of process and presentation

23. **The annual budget process is open, and the budget calendar, which allows adequate time for consideration by the National Assembly, is clearly specified in the law**. *2.1.1*

The timetable for the preparation of the Republic budget is defined in the BSL (Box 2). However, it has often not been observed in practice.[22] In the first stage of the Republic budget process, a draft of the BM is prepared by MoF's Fiscal and Macroeconomic Analysis and Projections Department (FMAPD) and submitted to Cabinet. This attempts to reconcile largely unconstrained spending requests by ministries with achievement of a sustainable medium-term macroeconomic scenario that reflects internal model-based macroeconomic forecasts, produced each February, and implementation of an appropriate fiscal policy. However, there is limited analytical capacity in MoF's Budget Preparation Department (BPD) to adjudicate between competing budgetary demands, which are often not fully costed. Cabinet may also add other spending requirements to meet diverse political commitments. As a result, the spending and revenue projections in the BM agreed by Cabinet often lack consistency and realism.

In the second stage of the budget process, once the BM is agreed and published, a circular is issued entitled "Guidelines on Budget Preparation." This provides: (i) indicative ceilings for

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[21] Ten percent is generally allocated to the Employees Pension and Disability Fund, 5 percent to the Restitution Fund, and 5 percent to the subnational government where the company is located. If the company is in the Autonomous Province of Vojvodina, it receives 50 percent of the receipts. These allocations are not considered own revenues of the recipient institutions, and are reported in the same manner as other regular revenues.

[22] For instance, limited time has sometimes been given to the National Assembly to consider the budget, and recourse has sometimes been made to temporary financing procedures. The international financial crisis contributed to delays in presenting the 2009 budget.

each budget user derived from the aggregates established in the BM; (ii) specific instructions related to the calculation of the wage bill with coefficients pre-calculated by the BPD; (iii) instructions on preparing estimates on routine costs, based on previous years' actual indexed by inflation; (iv) instructions on preparing transfers and social welfare entitlements based on the relevant laws; (v) limited guidance on investment spending giving priority to ongoing projects and those financed by external grants; and (vi) any other specific changes arising out of the BM. However, after these estimates have been submitted by budget users, tight fiscal targets and high demands often result in last minute across-the-board cuts, which undermine the reliability of the budget (¶49). The National Investment Plan (which represented over half the capital budget in 2007) is also subject to a different cycle from the rest of the budget: only a single, aggregated line-item appropriation is presented to the National Assembly (not broken down by ministry or economic category) and projects are only determined later in the year.

The final budget proposals presented to the National Assembly are summarized in a revised BM, which outlines the major objectives of the budget in an updated macroeconomic context that is determined by the revised projections made in August. The National Assembly is given 45 days to approve the budget, which is in line with the practice in many emerging markets.[23] The National Assembly's powers to amend the budget are limited by the requirement that the deficit must not exceed that set in the draft budget.

The BSL also prescribes a timetable for subnational budgets (Appendix I Table 4).

The medium-term framework and policy basis for the budget

24. **Broad fiscal aggregates and underlying macroeconomic assumptions over the medium term are presented in the Budget Memorandum.** *2.1.2*

As part of the budget preparation, the FMAPD constructs medium-term projections of the general government aggregates and presents these in summary form in the BM, together with a broad breakdown of revenue and spending by economic category. Indications are also given of trends in the major functions of expenditure. The macroeconomic assumptions underpinning these forecasts are clearly spelled out. Macroeconomic models have been developed to help generate these assumptions, and the NBS and Economics Institute (an independent government-owned entity) are consulted about economic prospects, but no explanations are provided to the public about how the models have been used, how the macroeconomic assumptions compare with alternative projections, or what uncertainties are involved. In addition, the involvement of spending agencies and the BPD in the development of the medium-term framework is limited, and the tables presented in the BM do not include detailed projections of revenue and spending expressed in Republic of Serbia dinars (RSD).

[23] Most developed countries present their budgets at least three months before the start of the fiscal year.

Box 2. The Budget Preparation Process for Republic Budget and Mandatory Social Insurance Organizations

Due Dates	Activities	Legal Basis
The fiscal year is set on a calendar-year basis by the Constitution. The BSL sets out the following main steps in the process:		
April 30	the Minister of Finance, in cooperation with the bodies responsible for economic development, shall prepare the Budget Memorandum, detailing the economic and fiscal policies and outlook for the budget year and two subsequent years.	Budget System Law (BSL)
May 15	the government shall adopt the Budget Memorandum.	BSL
June 1	the Minister shall issue instructions for preparing the draft Republic budget.	BSL
June 1	the Minister shall provide the adopted Budget Memorandum to local authorities and the social insurance organizations.	BSL
August 1 1/	direct budget beneficiaries and social insurance organizations shall submit their proposed financial plans to the Ministry.	BSL
October 1	the Minister shall revise the Budget Memorandum to take into account any updating of macro-economic framework that occurred since April 30.	BSL
October 15	the Minister shall submit the draft Republic budget and financial plans of social insurance organizations to the government.	BSL
November 1	the government shall adopt the proposed Republic budget and submit it with the Budget Memorandum and financial plans of social insurance organizations to the National Assembly.	BSL
December 15	the National Assembly shall pass the Republic budget.	BSL

1/ In practice, DBBs and MSIOs now submit their proposed financial plans by September 1, as specified in the current draft revision of the BSL.

25. **A statement on medium-term fiscal policy objectives is included in the budget documents, and debt sustainability issues are addressed.** *2.1.2, 2.1.4*

The main macroeconomic policy objectives are presented in the BM, which also discusses key fiscal initiatives in broad terms. A comprehensive medium-term budget framework has not yet been developed, and budget documents have not to date contained detailed fiscal projections beyond the budget year. However, starting with the 2009 budget, DBBs will provide detailed presentations of their proposed expenditures by individual strategies and capital projects for a three-year period. A detailed description of the composition and recent dynamics of government and government-guaranteed debt is presented in the BM, and a forward-looking debt sustainability analysis is provided. There is also an account of the sensitivity of this analysis to changes in critical assumptions. The BM does not, however, discuss changes from the previous budget in the medium-term forecasts for broad fiscal aggregates.

26. **No fiscal rules have been specified for the Republic budget.** *2.1.2*

No formal fiscal rules have been established for the general government as a whole or the Republic budget. However, borrowing by subnational governments and MSIOs is limited by provisions in the Law on Public Debt. Subnational government long-term borrowing for capital investment should not exceed 50 percent of the total current revenues collected by the local government in the previous year, and the amount of principal and interest on all outstanding long-term debt falling due in any future year should not exceed 15 percent of the total local government current budget revenues collected in the previous year. Borrowing by MSIOs to finance capital investment or, in the case of the HIF, to finance purchase of medications, should not exceed 20 percent of the total revenues collected in the previous year. The Law on Public Debt specifies penalties for the violation of these provisions, but this part of the legislative framework has yet to be tested. Borrowing by the MSIOs is not normally provided with an explicit government guarantee, but provisions exist in the Law on Public Debt for the Republican government to guarantee borrowing if requested.

27. **Estimates of new initiatives and ongoing costs of government policies are not always adequately calculated and presented in the budget documents.** *2.1.3*

New fiscal initiatives, including any proposals to change tax rates or concessions against tax, are discussed separately in the BM. However, their budgetary implications are in general not adequately calculated or presented.[24] Nor is there any detailed assessment of their expected broader economic or social impact. The budget documents do not clearly distinguish ongoing costs of activities from those of new spending proposals.

28. **The responsiveness of budget estimates to changes in economic variables is discussed in budget documents, but there is no systematic sensitivity analysis or broader disclosure of fiscal risks.** *2.1.4*

Estimates of the broad impact on the fiscal projections (specifically revenue and debt servicing costs) of changes in certain key macroeconomic variables (GDP, exchange rate and interest rates) are provided in the BM. However, no systematic sensitivity analysis of the fiscal projections is undertaken. Similarly, while a helpful description is provided of some other major risks to the fiscal outlook, there is no analysis of their potential quantitative consequences or of possible measures to manage them.

Coordination of budgetary and extrabudgetary activities

29. **The activities and finances of the MSIOs and Republic of Serbia Roads are subject to similar oversight mechanisms to direct budget beneficiaries (DBBs), and their accounts are consolidated within the general government, but some revenues and**

[24] For example, in 2005 pension rules were changed to allow bridging of the gap in pensionable years of service for those employees whose employers did not pay social security contributions during the period 1991–2003. However, the fiscal cost was neither assessed nor presented in the budget documents, since information on the number of qualifying employees and the gap in their years of service was not collected before the rule change.

expenditure of indirect budget beneficiaries (IBBs) are not covered as extensively as DBBs. *2.1.5*

The financial management of the MSIOs is regulated in the BSL, including a requirement that they should have bank accounts with the treasury. Each MSIO is established by its own law. The BSL requires that guidelines for the preparation of the Republic budget should apply equally to the MSIOs and to budget beneficiaries. In particular, when submitting their financial plans to the MoF according to the Republic budget calendar, the MSIOs should use the same economic assumptions as DBBs. The financial plans of the MSIOs should also be presented to the National Assembly at the same time as the Republic budget. Although not covered in the current BSL, a similar process currently applies to Republic of Serbia Roads Company. However, there is no documentation, other than the consolidated financial accounts, that aggregates and assesses the expenditure, activities, and results of these EBFs together with on-budget activities.

Many IBBs also have the characteristics of EBFs or non-market non-profit institutions in that they receive revenues outside the budget process and sell services to the public, without generating profits for their founders. Although the IBBs are subject to close monitoring standards by the DBBs to whom they are responsible, their activities are overseen and reported much less intensively than the DBBs in the Republic and subnational budget processes. As a consequence, provisions in the Republic and subnational budget for the own revenues of IBBs tend to be poorly forecast, and some revenues that are received and not spent are not fully recorded in the fiscal reports (in the case of health institutions reporting to the HIF, own revenues are neither forecast nor recorded). This restricts the ability of the legislatures to ensure effective prioritization or monitoring of general government spending overall. It can also lead to an underestimation of the size of the general government sector, compounding the impact of the exclusion of some activities from the definition of the general government because they are not classified as IBBs.

A significant number of donors, including the EU, the World Bank, and the EBRD, provide funding for government projects. The funding is generally reflected in the budget, mostly under the “own revenue” column of individual budget beneficiaries, as prescribed by the BSL for own sources of revenues. Execution of the funding is mostly through separate banking arrangements in commercial banks, because most donors are unwilling at this stage to go through the TSA or to have their funds held in local currencies. The treasury has difficulties in tracking these transactions during the year, since they are outside the TSA, but they are in principle now reported within the revenue aggregates shown in the Monthly Public Finances Bulletin and in the accounts.

Clarity of control of budget execution

30. **Basic accounting and internal control procedures are in place, but expenditure commitments are not tracked centrally in a timely manner, implementation needs strengthening, and the government has considerable discretion in the use of contingency reserve mechanisms**. *2.2.1*

The BSL defines all the main elements for budget execution control and recording, including cash flow plans, quarterly allocations, commitments, and payment processing through the TSA. In each area, the BSL calls for directives by the Minister of Finance (and the subnational finance departments) to further elaborate the specific procedures to be followed by budget users. Since the adoption of the BSL, the efforts of the authorities have concentrated on establishing a system of quarterly (now monthly) allocations ("quotas") and centralizing processing of payments through the TSA, while limited attention has been paid to participative cash flow planning and commitment control.

The payments process for all general government entities has been centralized in the treasury, with very few exceptions, most of which are related to payments in foreign currencies.[25] For IBBs, MSIOs, and subnational governments, controllers at the Treasury perform simple checks on the signatures on payment orders and the availability of balances. For DBBs, additional checks are made to verify the legal basis for the assumption of each obligation and the available budget appropriation and quota for the budget line in question. These transactions are also recorded in the Republic budget's general ledger. Since January 2008, these operations have been supported by information supplied by the FMIS. All DBBs are required at the start of the fiscal year to submit a financial plan and a plan of public procurement to the treasury.

Commitment control is not effectively utilized in the Republic budget. Under current procedures, the treasury cannot monitor commitments made by budget beneficiaries in a timely manner because they can only be entered into the central system (now FMIS) once quotas have been released. In practice, this means that commitments are not entered until the month that payments become due or, at best, the preceding month. Payment arrears have been a significant problem in Serbia since the 1990s.[26] While efforts have been made to clear old arrears related to pensions and the Republic budget, accumulation of new arrears in EBFs has continued.[27] Both the HIF and the Road Fund are known to have accumulated sizeable arrears, although the magnitude of arrears to the HIF is uncertain because the surveys conducted by the treasury do not include payment arrears owed by health institutions. The available information on arrears is not disclosed in the BM or elsewhere.

Rules in the BSL on budget virement limit reduction in appropriations to 5 percent without National Assembly approval, but they do not limit the level of increases. All virements require MoF approval and Cabinet decision. The budget includes two contingency items: (i) the current budget reserve, which may be used for unplanned spending needs, expenditure items for which the initial appropriations prove to be insufficient, or liabilities of subnational

[25] The management of the cash position of the Republica budget rests with the treasury, while subnational governments and EBFs manage the balances on their own sub-accounts in the TSA. The Treasury Department currently has some 1,300 staff, drawn from the restructuring of the Payments Bureau (ZOP) at the end of 2002, providing centralized payment services to direct and indirect budget users, through their headquarters in Belgrade and 140 branch offices around the country.

[26] The treasury's responsibility for monitoring arrears is established in the regulations under the BSL.

[27] Pension arrears were converted to debt at the end of 2005.

government experiencing revenue shortfalls; and (ii) the permanent budget reserve, which may be used by the Republican or subnational governments for emergencies that jeopardize lives or cause large scale property damage.[28] The BSL does not limit the size of the current budget reserve, but the permanent budget reserve may not exceed 1.5 percent of annual budget receipts. Supplementary budgets are common, indicating that original budget estimates are unreliable (¶49).

31. **Financial management practices for the Republic budget are reasonably well coordinated.** *2.2.1*

Annual cash flow plans are prepared and updated quarterly, from which quarterly and monthly allocations (quotas) are issued. Cash flow plans are based on detailed projections for tax revenues, routine spending obligations for wages, transfers (including pensions and other social welfare payments), patterns of spending on regular goods and services items such as utilities, and other information provided in the annual financial plans submitted by DBBs. However, the quality of the projections for revenues is low, and the monthly path for spending relies too heavily on a straight-line allocation of the annual provisions.[29] In addition, short-term liquidity management remains a challenge, given the limited information available on commitments and the short notice (five days) for actual payments.

The recording and monitoring of domestic and external debt is fairly well established in the MoF (¶42). Short-term government borrowing from the domestic market is limited, but the treasury can utilize the TSA surplus, either by drawing directly from cash in the Republic's account or by borrowing from the subaccounts of other TSA users.

Accounting and reporting on budget execution

32. **The treasury accounting system is capable of producing in-year reports on Republic budget users, but elements of the Republic balance sheet are derived from records provided by budget entities rather than the general ledger.** *2.2.1*

The chart of accounts is consistent with the budget classification. Accounts are maintained on a cash basis. The accounting system has been prescribed for use by all general government entities (with a few minor exceptions). The treasury accounting system generates monthly financial reports at the level of the Republic budget. The treasury payment system provides accurate and detailed data on tax revenue collections and its sharing between the different levels of government. It also includes in-year transaction data on the operations of other general government entities, based on codes entered on payment orders, but inconsistencies in coding make these data unreliable and difficult to interpret. The Republic balance sheet includes assets and liabilities on a selective basis only and the reliability of the recorded

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[28] The government determines usage of the current budget reserve, which may be allocated only to DBBs. Usage of the permanent budget reserve is reported to the National Assembly together with the annual financial statement of the budget.

[29] Use of the financial planning application of the budget execution module in the FMIS should facilitate improvements in the monthly profile.

stocks is uncertain. They are derived from records provided by budget entities rather than the general ledger.

33. **The legislature does not receive in-year reports on budget outturns or mid-year reviews, but the regularity of supplementary budget proposals, which are presented to the legislature in a manner consistent with the original budget proposals, means that an update of the fiscal outlook is generally available during the second half of the year.** *2.2.2, 2.2.3*

The BSL does not call for submission of in-year reports on budget outturn to the National Assembly and none is provided. Execution data are summarized in the Monthly Public Finances Bulletin, which the National Assembly can access from the MoF website.

34. **The National Assembly has been unable to approve the final accounts, pending establishment and full operation of the State Audit Institution (SAI).** *2.2.4*

The BSL requires that the annual final accounts of the Republic budget, subnational government budgets, and financial plans of the MSIOs should be submitted to the National Assembly within 10 months of the end of the year. They should include financial statements, an explanation of large discrepancies between the approved funds and execution, and a report on guarantees issued during the fiscal year. The Republican government has provided final accounts to the National Assembly for the years 2002 to 2007, but the legislature has been unable to endorse these accounts because they have not been subject to independent audit, pending the full operation of the SAI. The final accounts have included information on both execution and approved funds (and similar information for revenue projections), but no explanations or analysis of the differences have been provided to the National Assembly.

C. Public Availability of Information

Commitment to timely publication of fiscal data

35. **Although fiscal data are in practice published in a regular and timely fashion, there is no advance release calendar, and no legal commitment to publish fiscal data beyond publication of the final accounts.** *3.3.1, 3.3.2*

MoF publishes a substantial amount of fiscal data on a regular basis in its Monthly Public Finances Bulletin, including detailed monthly execution data for revenue and expenditure on the Republic budget and MSIOs and the main fiscal aggregates for general government. In addition, the customs administration has initiated publication of a quarterly report on its revenue performance (http://www.fcs.yu). However, neither the MoF nor Customs Administration has formally committed to a publication schedule, and the only legal requirement to publish fiscal data is the provision in the BLS (Article 76) to release the final accounts. Serbia does not meet Special Data Dissemination Standards (SDDS) for the dissemination of fiscal data, but it has recently expressed interest in joining the General Data Dissemination Standard (GDDS).[30]

The coverage and quality of budget documents

36. **Budget documents cover central government fiscal activities, including major revenue sources, and provide summary aggregates for the general government, but information is limited on indirect budget beneficiaries and state- and socially-owned enterprises that benefit from budgetary support.** *3.1.1, 3.1.4*

The documents submitted to the National Assembly consist of the BM, the budget summary of revenues and expenditure (including the principal domestic revenue sources) and detailed spending proposals by each budgetary institution (including the usage of foreign assistance) in the format required for voting in the National Assembly, and an explanatory document with brief details for each ministry and government agency.[31] Information provided on IBBs is limited, particularly in respect of own revenues. No detailed breakdown is presented of the projected financing of the projected deficit. The MSIOs and Republic of Serbia Roads also present their financial plans to the National Assembly. Coverage in budget documentation of the impact of the financial position of SSOEs is limited to the aggregated cost of subsidies and net lending to the Republic budget.

The level of detail in the budget consists of organization and sub-organizations, functional classification, and item level economic classification. Projects are also separately identified. The resulting budget consists of over 2,000 lines which form the basis of the vote and in-year appropriation control. The budget documents, including the BM and the explanatory document that accompanies the budget, are published on the government website (http://www.mfin.sr.gov.yu).

37. **Defense expenditures are reported in the budget with the same level of detail as other spending.** *3.1.1*

The defense budget is broken down by economic item, in line with the practice of other budget users. However, the different segments of the armed forces are not separately identified.

Coverage of fiscal reporting and the finances of public corporations

38. **Annual fiscal reporting covers the consolidated general government, as defined, including MSIOs and Serbia Roads; the finances of public corporations are not presented in budget documentation.** *3.1.4, 3.1.6*

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[30] The Serbian authorities informed the IMF Statistics Department (STA) on October 1, 2008, of their interest in joining the GDDS and their appointment of a GDDS country coordinator.

[31] There is no separate identification of the aggregate revenues from mineral extraction, which are currently small and consist of royalty payments and part of any surplus transferred to the treasury by SOEs on account of their extraction activities.

The treasury has published a consolidated final account for the general government since 2005. IBBs prepare financial statements and send them to their respective line ministries, which produce a consolidated statement, including the statement of spending funded by own revenues, and forward it to the treasury. The same applies to the HIF, which prepares consolidated financial statements including health institutions, and the other MSIOs and Republic of Serbia Roads Company. The treasury consolidates these with the annual financial reports of the Republic budget, available from the treasury accounting system, to produce reports for the whole general government sector. No financial information is provided about state- and socially-owned enterprises, many of which rely heavily on government financing and present significant fiscal risks.[32] In the absence of a centralized accounting system and an external audit function (¶60) it is difficult to assess the reliability of data presented in financial statements. There is some inconsistency in the use of the chart of accounts across all general government entities, particularly in respect of the physical assets code (551) (¶46). It is expected that the quality of the data will improve with the full utilization of the new financial management information system (FMIS), which includes accounting.

Past and forecast fiscal data in the budget

39. **The Budget Memorandum discloses the main fiscal aggregates for two years prior to the budget year, and two years beyond the budget year.** *3.1.2*

Highly aggregated estimates are provided in the BM of the expected outturn for the year prior to the budget year, and the outturn for the preceding year, for general government expenditure, revenue, and surplus/deficits. Broad breakdowns by function and economic classification are also shown, expressed as a percentage of GDP. Three-year medium-term forecasts are provided in the BM at a similar, highly aggregated level. More detailed information on the budget year proposals is provided in the main budget document.

Treatment of fiscal risks

40. **Budget documents identify all proposed loan guarantees, and describe other forms of contingent liabilities and fiscal risks, but they do not quantify them.** *3.1.3*

The Republic budget includes a list of debt guarantees that the government plans to issue during the year.[33] Other fiscal risks, such as macroeconomic risks and risks from implicit contingent liabilities (including, for example, possible restitutions for property nationalized after 1945) are also discussed in the BM, but the coverage of fiscal risks is not comprehensive or systematic. For example, fiscal risks arising from extrabudgetary activities (such as borrowing by the Development Fund) and the activities of nonfinancial public corporations are not explored; nor are other quasi-fiscal activities or tax expenditures; and the

[32] There may also be offsetting transactions, such as withholding of royalties on natural resource extraction, which are not reported in the fiscal accounts.

[33] No quantitative assessment of the extent of the actual fiscal risks associated with debt guarantees is published, but data for central government debt include all guaranteed debt at face value.

outstanding stock of loan guarantees is identified only in the report on the debt stock published in the Monthly Public Finances Bulletin. Apart from the impact on debt service liabilities of deviations from forecast of interest rates and the exchange rate, there is no quantification of fiscal risks, such as a systematic sensitivity analysis (¶28). The program of public-private partnerships (PPPs), and hence potential fiscal risks from them, is still small.[34]

41. **Various types of subsidized lending and guarantees are provided for small and medium-size enterprises and housing projects**. *3.1.3*

The Development Fund provides finance for small and medium enterprises at below-market rates; the Housing Loan Fund provides loans for housing projects; and the National Mortgage Insurance Agency provides loan guarantees on housing projects. These extrabudgetary activities, which are funded from market borrowing at fine rates, the funds' current activities, accumulated reserves, and, in the case of the Development Fund, their share in past privatization receipts, are not systematically monitored.

Publication of data on debt, other liabilities, and financial assets

42. **Information on the gross public debt of the Republic is largely complete and published, but it is not reconciled with data on income and expenditure.** *3.1.5*

The definition of public debt used in Republic budget documents is the sum of direct and government guaranteed debt of the central government, both of which are broken down into internally and externally held components.[35] The inclusion of government guaranteed debt in the definition of public debt, and the exclusion of some debt arising from extrabudgetary activities, does not conform to GFSM 2001 and ESA 95 standards.[36] Foreign debt is distinguished by lender, and domestic debt is classified by instrument and maturity. This information is published in summary form in MoF's Monthly Public Finances Bulletin. Projections of future debt service are included in the annual BM. There is no regular reconciliation of debt information with deficit data and no information is disclosed on debt swaps, netting out operations, and any debt arrears. There is no consolidated debt report for the general government.

43. **Information on general government financial assets is compiled but not published.** *3.1.5*

The treasury consolidates information on financial and nonfinancial assets from annual reports provided by DBBs, IBBs, MSIOs, and local governments. As part of the final accounts of the Republican government, a balance sheet for the Republic is prepared, but the

[34] PPPs include concessions for several geological exploration projects in the mining sector, and for bus services in the City of Belgrade.

[35] Other forms of public debt are also monitored but are not published, including commercial liabilities of state-owned enterprises, commercial liabilities of municipalities, and liabilities in dispute related to the former Yugoslav state.

[36] Outstanding payment arrears (non-debt liabilities) are also not reported.

lack of an auditing agency since 2002 has delayed the auditing of the accounts and no data on the assets of either the Republic or other parts of the general government have been published.

Analysis of the long-term outlook for public finances

44. **Analysis of the long-term outlook for public finances is neither undertaken nor published**. *3.1.7*

The BM contains a forward-looking debt sustainability analysis, including an account of its sensitivity to changes in critical assumptions, but no detailed medium- or long-term fiscal projections are made available.

Guide to the budget

45. **There is no clear and simple guide to the budget made accessible to the general public**. *3.2.1*

Although the full text of the BM is published on the MoF website, it is not supported by material in plain language and charts that would clarify the context and objectives of the budget to the average citizen. In some countries, a separate "citizen's guide" is published at the time the budget is presented to the legislature to explain the economic outlook and present the budget proposals and likely impact in a non-partisan manner.

Budget classification

46. **With the exception of the National Investment Plan, the classifications for revenue, expenditure, and financing used in the annual budget presentation are broadly consistent with international standards**. *3.2.2*

GFSM 2001 compatible functional and economic classifications have been introduced for all of the general government. Although the classifications are generally well designed, there is limited control and discipline over their application during both the budget preparation and the accounting phase. As a result, problems have arisen with the economic classification, including the use of salaries codes for transfers earmarked for salary payments to indirect budget users, instead of the appropriate transfers codes. Another key issue is that all project spending under the National Investment Plan (NIP)—which covers about half of the capital budget—is classified under a special NIP tracking code (551) rather than under the relevant current, capital or lending items, for which codes already exist. Administrative classifications exist at two levels: in the budget; and as a structured list for all entities of the general government, grouped according to sectors.

A pilot project was launched in 2005 to develop program budgets in five line ministries (Health, Education, Religion, Public Administration and Local Government, and Trade and Services). These were utilized in the 2008 budget, but the methodology was applied differently across different pilot ministries and NIP projects were not included.

General government balance

47. **The overall balance of general government, which is the main indicator of the fiscal position, is monitored on a monthly basis during the year, together with gross public debt.** *3.2.3*

The main focus of fiscal policy formulation is the overall balance of the general government. The BM now defines this in a manner similar to the cash-based overall deficit/surplus of the general government described in GFSM 1986. A recent change has been to treat items designated as "net acquisition of financial assets for policy purposes" as expenditure (i.e., above the line). MoF's Monthly Public Finances Bulletin monitors the cumulative consolidated overall balance of the general government through the year. No other indicators of the fiscal position are routinely assessed although, for consistency over time, the MoF also continues to publish overall balance figures on a formal basis.

This definition of the overall balance is not specified in the BSL (2002) or in recent draft revisions of the BSL. The BSL (2002) does, however, require that the "budget balance" for the Republic budget in the annual financial statements should be presented according to a different definition. The confusion is amplified by some internal inconsistencies in the definitions of individual components utilized in the BSL.

Figures for gross public debt are published in the Monthly Public Finances Bulletin. While the definition of gross public debt does not correspond with accepted international practice, and no data are produced for net debt, the series for gross public debt provides useful information to assess and monitor the sustainability of the government's fiscal position.

Results-oriented budgeting and reporting

48. **Budget documents discuss the objectives and expected results from government activities in general terms, but do not systematically evaluate outcomes**. *3.2.4*

The BM describes key policy objectives and identifies related budget allocations, and the explanatory part of the budget provides some descriptive information on recent developments and on policy directions being taken by each sector or line ministry, with objectives and targets for the budget year. However, there is not yet an agreed, consistent classification of the whole budget by program, or identification of intended outcomes, which are necessary steps towards establishing clear links between spending, activities, outputs, and outcomes. The pilot project on program budgets marks an important movement in this direction, but the five ministries involved have so far used different approaches in defining their programs. Other necessary prerequisites for implementing a performance-based budget, including greater responsibilities and accountability of implementing agencies for results, and a well-developed internal auditing system, are also still being developed. They may take some time to be established. Furthermore, the ability to evaluate performance through external audit is still some way off, because the SAI is not yet fully operational.

D. Assurances of Integrity

Integrity of budget and accounting processes

49. **Republic budget estimates are not yet fully reliable, and no analysis of differences between planned and actual outturns is made available to the public.** *2.1.2, 4.1.1*

Available data for the Republic budget and MSIOs for 2003-06 indicate that, in all years, there were substantial deviations between budget and outturn figures for the major components of expenditure and revenue. Deviations were particularly pronounced in respect of the initial budget proposals: most budgets were subject to mid-year revisions and the revised budget estimates were closer to the final outturns. Performance in 2007 (Appendix I Table 5) was generally better, but expenditure outlays (particularly on capital projects and interest payments) were well below the budget projections, and non-tax revenues were much higher than expected. The only document that regularly presents both planned and actual outturns on revenues and expenditures is a summary table in the annual financial statement of the Republic budget (¶34). The table does not include any analysis. The authorities do not publish any summary tables comparing projections and estimated outturns for general government as a whole.

50. **Statements on accounting policy are not included in the budget**. *4.1.2*

The budget documents do not include specific statements on accounting policy other than that a cash basis is used throughout.[37] However, indications of some of the definitions and practices used are publicized through regulations printed in the Government Gazette, supplemented by some notes in the BM .

Reconciliation practices

51. **The process of accounts reconciliation is not always effective, and debt and deficit data are not reconciled.** *4.1.3*

The accounts of the Republican government entities are reconciled with budget appropriations and bank accounts on a regular basis. However, for the consolidated accounts, neither monetary and fiscal data, nor debt and deficit data, are reconciled on a regular basis, and there is no publicly available report on any level of reconciliation. Discrepancies have been noted in the fiscal accounts.[38]

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[37] The authorities indicated that, although Serbia has not yet adhered to the application of IPSAS provisions, the accounts procedures are in large part consistent with the practical application of these standards.

[38] Consolidated monthly reports of the general government, based on estimates provided to the IMF, deviate significantly from the preliminary final accounts produced for 2005 by 2.8 percent of GDP for spending, and by 2.4 percent of GDP for revenue.

52. **Major revisions to historical fiscal data and any changes to data classification are explained**. *4.1.3*

It is now regular practice to provide full explanations of changes in coverage or classification, revise historical fiscal data to current definitions, and continue to provide information according to former definitions where this is necessary to monitor previous policy commitments.

Internal oversight

53. **Public servants are subject to a well-defined code of behavior, and corruption is perceived to have declined in recent years, but it remains a matter of concern.** *4.2.1*

The Law on Prevention of Conflicts in the Discharge of Public Office (2004) establishes the framework for ethical conduct of officials appointed or elected within the public sector. It prohibits public officials from maintaining relationships which could affect impartiality, the use of public office for personal benefits or privileges, and abuse of authority. The law is implemented by the independent Republican Committee for Resolving Conflicts of Interests, which maintains a register of public officials' property, arbitrates cases brought against public officials under the Law, and issues reports on its activities and decisions.[39] The Law on Civil Service of 2005 sets out a code of conduct for civil servants employed by the Republican government, and separate codes have been adopted for customs and tax officers. At present there is no code of conduct for other public service employees in subnational governments, indirect budget users, or EBFs. In 2005, the National Assembly adopted a National Anti-Corruption Strategy and the government has established an advisory Anti-Corruption Council. In 2008, a the National Assembly approved the formation of an Anti-Corruption Agency and amendments to the law on financing political parties.

Despite improvements in recent years, perceptions of high levels of corruption persist. Serbia improved its ranking in Transparency International's "Corruption Perception Index" from 106 out of 133 surveyed countries in 2003 (at a par with Sudan and Zimbabwe) to 85 out of 180 countries in 2008 (level with Albania and Montenegro), but it still ranks below most of its other neighbors.[40] Serbia also improved its standing in the World Bank's "Control of Corruption" indicator league tables, where it went up from the 30th percentile of the surveyed countries in 2002 to the 46th percentile in 2006.

54. **Civil service employment rules are well established for the Republican government, and plans have been made to establish similar arrangements for the rest of the general government.** *4.2.2*

The rules for civil servants employed by the Republican government have been strengthened under the Law on the Civil Service (2005). It will, however, take some time before these

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[39] Annual and monthly reports as well as decisions on individual cases can be found on the Committee's website at http://www.sukobinteresa.sr.gov.yu.

[40] The 2003 survey covered Serbia and Montenegro.

rules become fully established. It is expected that a similar law will be adopted for employment in the public service, which will cover subnational governments, EBFs, and indirect budget users. Salary structures are well defined and salaries are set according to a well established system of coefficients and annual increments, and supplemented by clearly identified allowances linked to specific positions. Centralized payroll is in place for direct budget users of the Republican government. Control of the payroll, however, is only gradually being addressed at the subnational government and indirect budget user level.

55. **Procurement procedures are being improved, but much remains to be done.** *4.2.3*

The Public Procurement Law (2002, amended 2004) and regulations set thresholds which require an open tender process. In general these rules are followed for large tenders, but there is a widespread preference to use restricted tenders procedures for medium-size procurements, even in circumstances where there is no justification. A complaints procedure is prescribed in the regulations, but it is slow and does not work effectively. The absence for many years of an external audit function, and deficiencies in internal audit, have diminished capacity to ensure that standards are maintained. The 2007 Sigma report noted that the legal framework promotes transparency in procedure for prospective suppliers, but that it requires extensive modernization and simplification to be consistent with EU directives, and that institutions and training activities need to be strengthened.[41]

56. **Sales of public assets are subject to well-defined processes, including the reporting of all major transactions, but bids are not always subject to competition**. *4.2.4*

The Privatization Agency submits a monthly privatization progress report to the MoERD and the National Assembly, and also informs the public. It maintains a website (http://www.priv.yu) with a database of all companies in the process of restructuring and privatization, including information on their status and financial condition, and the manner in which they will be sold. The results of each sale are also recorded. However, neither gross receipts, nor commissions or other payments from privatization receipts, are reported in the budget documents. Although competition in bids is sought, it is not always achieved: a tender sale or auction may continue even if only one buyer presents itself as long as the buyer meets the conditions for bidding.[42] Sales of government assets by the Government Property Directorate are also not adequately reported.

[41] Sigma Report (OECD, EU) “Serbia: Public Procurement System Assessment” (June 2007).

[42] Ordinance on the Sale of Capital and Assets by Public Tendering (2001), and the Ordinance on the Sale of Capital by Public Auction (2005).

57. **Internal audit is not well established.** *4.2.5*

Recent efforts have been made to develop a system of internal audit in line with the requirements of the BSL and international best practice.[43] However, staff capacities remain very limited because the government faces strong competition from the private sector. Some training of trainers has been undertaken, but internal auditors have not been deployed to budget users. The internal audit function is centralized in the MoF's Budget Inspection and Audit Department, which has focused so far on ex-post controls on budget users.[44] Inspectors have broad autonomy in how they conduct their work. Inspection reports are sent to the budget user and the Minister of Finance. Twice yearly, the MoF reports to the National Assembly on the inspections, and the MoF also publishes an annual report on the inspection findings. Systems control is not yet being implemented. Budget controllers are deployed to budget users, but their duties are limited to ex-ante verification of payment order accounting documentation (¶30).

Clarity of internal control and independence of tax and customs administrations

58. **Internal monitoring and control mechanisms in tax and customs administrations are still being strengthened**. *4.2.6*

Efforts have been made to limit the room for discretion of tax and customs officials and ensure the appropriate application of tax laws. Measures include organizing the administrations along functional lines, which has established an arms-length relationship between officials and taxpayers. In addition, taxpayers have access to administrative appeal procedures and telephone hotlines for complaints and reporting of corruption and fraud. The tax and customs administrations have internal control and audit units, but their activities are not well defined and lack coordination with the MoF's Budget Inspection and Audit Department. Corruption in tax and customs administration remains of concern to businesses, and there is mixed evidence on whether the situation is improving in practice.[45]

59. **The tax and customs administrations are not given legal protection from political interference.** *4.2.6*

The heads of the revenue administration agencies have no legal protection against being removed from office, and the law does not provide for a fixed term of appointment. While

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[43] The concept of internal control used in the BSL is broadly in line with the definition used by the Committee of the Sponsoring Organizations of the Treadway Commission.

[44] In 2006, there were 10 staff in the Internal Audit Unit and 5 inspectors in the traditional Inspection Unit.

[45] EBRD-World Bank BEEPS (Business Environment and Enterprise Performance) surveys record a drop in the number of firms who report that tax administration is a problem for doing business from about 60 percent in 2002 to under 50 percent in 2005. However, during the same time period, the number of firms reporting paying bribes to tax and customs officials rose substantially, as did those reporting other categories of bribes. In the World Bank's 2009 "Doing Business" survey, Serbia ranked 127 out of 181 countries in respect of the ease of paying taxes.

both administrations get some revenues from retention and fees, the bulk of their financing comes from the budget and they are, therefore, not financially independent.

Independent oversight

60. **External audit, as defined in the Law on the State Audit Institution, is independent of the executive branch and its mandate covers all public sector activities**. *4.3.1, 4.3.2*

The Law on the SAI (adopted in 2005) meets INTOSAI standards. Under its provisions, five members, approved by the National Assembly, were appointed in September 2007 to the Supreme Audit Council of the SAI for terms of six years each. The Law provides for the financial and operational independence of the SAI; the Council reports directly to the National Assembly, and dismissal of council members must be approved by the National Assembly. The Law empowers the SAI to audit all entities that are considered users of government funds. The SAI is required to submit an annual report and special reports. Auditees will be given a fixed time by the SAI to indicate remedial actions taken regarding audit findings.

61. **The Supreme Audit Council of the State Audit Institution (SAI) is not yet fully operational, and it has not presented any reports to the legislature.** *4.3.2*

Following appointment of the members of the Supreme Audit Council, the SAI has focused on finding accommodation and recruiting and training staff. It will still take some time before it can become fully operational and the necessary audit capacity is built. In the absence of an external audit function, public accounts for the years 2002 to 2007 were submitted to parliament without being independently audited. They have not been formally published.

62. **Government bodies with independent status (including the NBS) are consulted about macroeconomic models and assumptions, but they do not scrutinize material in advance of publication.** *4.3.3*

The MoF (FMAPD) consults with the NBS and the Economics Institute (an independent government-owned entity) on the macro-economic assumptions to be used in the BM. For the last three BMs, FMAPD has used a macroeconomic and forecasting model that was developed with external financial and technical assistance.

63. **The Serbia Statistical Office (SSO) does not verify fiscal data, and does not have legal assurance of independence.** *4.3.4*

The institutional arrangements for the statistical system are in transition. A new law is currently being drafted. At present, the SSO, which is responsible for national accounts, trade and prices data, does not have a role in producing or disseminating fiscal data, or in verifying its methodological basis or quality. It does not have statutory independence.

III. IMF Staff Commentary

64. **Serbia has made solid advances in fiscal transparency in recent years, but there are still some major shortcomings.** Important milestones were the adoption of a legal framework for fiscal financial management, the successful creation of a treasury single account (TSA), the disclosure of fiscal information on a routine basis, and the establishment of an independent state audit institution. However, improvement in these areas has, at times, been piecemeal. As a result, key issues and challenges remain in (i) the assignment of some of the roles and responsibilities of government; (ii) the relationship between the Republic budget and the rest of the general government, as well as the public sector as a whole; (iii) the quality, coverage, and comprehensiveness of fiscal data; and (iv) internal and external audit and control. Further progress in these areas would be greatly enhanced by the development of a consistent and widely accepted strategy for addressing fiscal transparency problems within the context of the overall program of fiscal reforms in Serbia. Based on the diagnosis of current practices, this ROSC attempts to identify a number of important elements for such a strategy, including some measures which could yield substantial transparency gains in the short term.

In recent years, fiscal transparency has improved due to:

The establishment of a comprehensive fiscal legal framework for budgetary management and governance.

65. **The Budget System Law (BSL) of 2002, along with its more recent amendments, has introduced a modern legal framework for the key aspects of the budgetary management system.** The Law, while focusing on the Republic budget, sets out the basis for public finance management across all general government entities in Serbia. It defines responsibilities and sets dates for key points in the budget cycle, prescribes a budgetary and accounting classification, raises the standard of budget documentation submitted to the National Assembly, establishes a common payment system for the general government based around the principles of a TSA, and establishes the legal basis to introduce modern accounting standards as well as internal controls and audit. This has been supplemented by specialized laws covering debt, procurement, and external audit.

66. **In addition, Serbia is in the process of putting in place a modern legislative and administrative framework for improving governance and combating corruption.** Legislation has set ethical standards for the behavior of civil servants (direct Republic budget users) and there are plans to extend these requirements to cover all of the general government. In addition, anti-corruption institutions and codes of conduct in the tax and customs administrations have been set in place; and the National Assembly has approved the establishment of an Anti-Corruption Agency.

Strengthening of the treasury system and improvement of the accounting of government transactions

67. A **comprehensive system of treasury subaccounts under a TSA has been established.** The public payments function of the Payments Bureau, which was closed at the

end of 2002, was moved to the treasury, to handle all transactions of the general government. For the management of the Republic budget, the treasury introduced a centralized accounting system capable of generating monthly accounts, and is now making use of the reporting modules of the financial management information system (FMIS) that were rolled out in January 2008. The FMIS aims to capture all stages of budget execution in the government as well as providing facilities for cash and debt management.

Disclosure of more fiscal information

68. **The extent, regularity, and accessibility of information to the public has improved markedly.** Updated laws and relevant decrees are generally readily available from government websites. The MoF has expanded the BM to include medium-term projections, a list of proposed loan guarantees, a more comprehensive discussion of the objectives and the macroeconomic context of the budget, debt sustainability analysis, and a discussion of fiscal risks. The BM and budget are published on the MoF website. The MoF routinely publishes monthly reports on the execution of the Republic budget in its Monthly Public Finances Bulletin (http://www.mfin.sr.gov.yu). Other government agencies also make extensive use of the internet to keep the public informed: the Privatization Agency, for instance, uses its website to publish information on the enterprises being offered (www.priv.yu).

***However, in a number of critical areas, Serbia falls short of the standards of good practices in fiscal transparency*:**

Budget estimates are not yet fully reliable; and fiscal operations, sensitivity analysis and other fiscal risks are not adequately reflected in budget documentation.

69. **Coverage of the fiscal activities of the government and fiscal risks is incomplete.** The definition of general government is not fully observed and is not in line with GFSM 2001. Budget documentation on the outturn and prospects for the Republican and general government sectors is limited in detail, with inadequate information on the finances, performance and objectives of indirect budget beneficiaries (IBBs). There is no comprehensive assessment of the financial position of state- and socially-owned enterprises (SSOEs) or associated fiscal risks.

70. **Although budget outcomes have been closer to initial budget projections in recent years, there are still substantial deviations in some major components of both expenditure and revenue.** No analysis is presented of the reliability of the budget projections or why deviations occurred.

71. **Quasi-fiscal activities (QFAs) are significant, but are not routinely identified, quantified, or disclosed.** SSOEs continue to perform functions on behalf of government, at both Republican and subnational levels, for which they are only partly compensated through budget subsidies. The impact of these QFAs on the financial position of SSOEs is often obscured by non-transparent arrangements such as offsets against tax or payments to other SSOEs, such as public utilities. These arrangements obscure the extent of the social spending carried out by SSOEs, encumber the use of future one-off privatization receipts and, because the National Assembly does not vote on them, reduce accountability.

72. **Discussion of other fiscal risks, including sensitivity analysis of the budget projections, is limited.** There is very little quantification of the potential impact of deviations in economic assumptions on the fiscal outlook. Tax expenditures are not reported. There is no comprehensive assessment of the impact of PPPs or other innovative financing arrangements.

Monitoring of the execution of the budget is incomplete.

73. **The budget execution and accounting systems do not fully capture commitments and arrears in a timely fashion**. Reporting to the treasury of commitments made by budget beneficiaries is impaired by the requirement that they can only be entered against the current or following month's payment quota. Although known payment arrears of direct Republic budget users are not very substantial at present (compared to the late 1990s), the lack of a reliable system for monitoring and verification of arrears entails risks for the future. While efforts are being made to redress this situation with regard to direct budget beneficiaries (DBBs) through separate reporting mechanisms, this is not being done in the case of IBBs. Arrears may still be accumulating in both IBBs and EBFs, including self-managed health care institutions funded through the Health Insurance Fund (HIF), which are known to have accumulated significant payment arrears. Finally, the disclosure of collection arrears on taxes and social contributions is inadequate.

The management of investment spending is not adequate.

74. **The advent of the National Investment Plan (NIP) has obscured budgeting and recording of capital expenditure.** The different budgetary cycle followed by the NIP, and the lack of a transparent economic classification for identifying project inputs, has complicated expenditure tracking and distorted overall fiscal analysis. MoF does not have a comprehensive view of capital projects, nor criteria to prioritize them transparently, and insufficient information is included in budget appropriations to permit adequate scrutiny or monitoring by the National Assembly.

The legal framework that determines relations between different levels of government and other areas critical to fiscal management, is still evolving, leading to blurred lines of responsibility and accountability.

75. **Frequent amendments to the BSL reflect numerous changes that have been made to the relationships between different levels of government.** Dual financing (from the Republic and local government budgets) still remains the practice for many indirect budget users (e.g., schools and hospitals). In addition, many entities collect and use own revenue, for which the management is inadequately defined in the BSL.

76. **Complexities in the definition of property ownership further obscure the division of responsibilities between different levels of government**. The Republican government controls decisions related to the ownership of state and former socially-owned assets. This includes property in use by local governments and subordinated bodies.

77. **Implementation of some revised laws and regulations is often incomplete and deficiencies remain in their coverage.** Certain key elements of the regulatory framework for fiscal management remain to be implemented. In other areas (including procurement, tax and customs administration, and governance) the implementation of revised laws and regulations is still at an early stage or not yet complete, and much remains to be done to reform actual practices. While fiscal reporting has become more comprehensive and systematic, the disclosure of fiscal information, including advance release calendars, is not underpinned by appropriate legislation and regulations.

78. **Although recent practice has been to keep its size at modest levels, the lack of any specification of a formal ceiling for the current budget reserve in the BSL, and the existence also of a separate permanent budget reserve, could potentially permit considerable discretion to the executive to determine both the size and composition of in-year spending.** Inclusion in the initial budget of a large appropriation for the current budget reserve would loosen the effectiveness of parliament's control over the fiscal target and the allocation of expenditure; and, hence, reduce the transparency and realism of the budget.

The limited use of reconciliation procedures and systematic independent external scrutiny undermines the credibility of fiscal information.

79. **Aggregate reconciliation of fiscal and monetary data is not conducted on a regular basis**. The system of accounting, due to its close relationship with the comprehensive TSA, should be able to produce accurate fiscal data. However, the government does not routinely undertake reconciliations with monetary data.

80. **External independent assessment of the budget projections is limited**. The government provides opportunities for independent experts to examine the macroeconomic assumptions and policies underlying the budget only on an informal basis. No formal procedures for independent external scrutiny have yet been established.

The internal and external audit functions need to be strengthened.

81. **Although an external audit function has now been put in place, it is not yet fully operational.** Final accounts are still not being subject to audit. The absence of an external audit institution has severely limited the government's ability to address many of the issues identified above, and the National Assembly's ability to exercise its oversight function.

82. **The internal audit function is still being developed**. While internal control functions are in place in most institutions, they remain focused on ex-ante verification of documentation and compliance with regulations. Budget inspection continues to be used as the ex-post investigative function of government. Plans to introduce internal audit focused on providing advice on improving systems are underway, but capacity remains limited and centralized in the MoF, and insufficient attention is being paid to this critical element of financial management.

Further improvements in fiscal transparency should be undertaken. These should be based on a clear strategy that is set within the context of an overall framework for public finance management reform.

Measures to improve fiscal transparency

Action should be initiated in the near future in a number of key areas:

- **Refine the list of entities that comprise the general government**. The current list of over 9,000 government entities should be reviewed, on the basis of GFSM 2001 and Systems of National Accounts (SNA) criteria, to determine which fully meet the criteria for classification as part of the general government. The review could also enable consideration of consistency with ESA 95. Those entities that do not meet the agreed criteria for general government entities should be taken off the list, government entities that are currently not in the list should be added, and a procedure should be determined to keep the list fully up to date and publicly available.

- **Agree on a program for the development of the State Audit Institution (SAI)**. A priority is to clear the backlog of unaudited financial statements. Now that the SAI council members and some staff have been appointed, attention should be focused on making the SAI fully effective. International experts might have a transitional role. External support for SAI capacity building should be carefully managed in order to get the maximum learning value for the new auditors. The SAI should develop mechanisms for monitoring responses to the reports that it is required to present to the legislature.

- **Further develop the internal audit function.** In the short term, a training program should be introduced, drawing on donors, internal audit staff from other countries, and the Institute of Internal Auditors. A key subsequent step will be to operationalize the envisaged Central Harmonization Unit in the MoF with responsibility of oversight of financial management, inspection, and internal audit. Additional measures for strengthening audit would include collaboration with neighboring and EU countries through experience sharing and professional attachment. The establishment of a professional association of auditors would also be important. Strengthening of internal control and audit would strengthen safeguards for the correct use of the economic classification in accounting, particularly in local governments and indirect budget entities.

- **Integrate the NIP into the budget process.** All capital projects should be discussed and approved within the main budget cycle. NIP projects should be classified under the normal economic classification codes for budget and reporting rather than the 551 code. Oversight for the planning of investment should be placed with the MoF so that it can be fully coordinated with the rest of the budget, including recurrent spending.

- **Further develop budget analysis capacity**. This will include improving capacities in the MoF Budget Preparation Department to challenge effectively the bids of spending departments and NIP projects, and to develop and introduce a comprehensive medium-term budgetary framework. Before completing the roll-out of the program budgeting initiative, attention should be focused on strengthening its methodology, improving the consistency and comprehensiveness of program design (including the NIP) across ministries, and introducing a budget review process. These steps would also lay the foundation for introducing coherent performance-oriented budgeting over time.

- **Expand the discussion of fiscal risks in the BM into a comprehensive "fiscal risks" statement.** This would include systematic analysis of the impact on the fiscal projections of alternative economic assumptions and the quantification, where possible, of other fiscal risks, including the likely costs of meeting contingent liabilities, restitutions and other compensation claims on government, and the potential fiscal impact of extrabudgetary activities and SSOEs. The fiscal risks associated with PPPs should be carefully assessed, fully disclosed, and integrated into the budget.

- **Provide more detailed information in the budget documentation about the past and proposed activities of IBBs, and any EBFs not currently classified as IBBs or MSIOs, and about the finances of state-owned financial and nonfinancial enterprises.** In particular, budget documentation should provide comprehensive outturn data and realistic projections for the own revenues of all IBBs. The presentations currently used for the MSIOs should be extended to cover IBBs. Key financial information should be provided for all SSOEs that present fiscal risks.

- **Ensure consistency between the legal basis for reporting fiscal outturns and actual practice.** At present, the overall balance of the general government, which is reported monthly on a cash basis, is the main indicator used by the authorities to assess the fiscal position. However, there is no mention of this indicator in the BLS. The accounting and reporting framework of the budget needs to be clarified and a strategy should be agreed, including appropriate changes to the requirements in the BLS and in methodology, to develop the form and content of financial statements to ensure consistency with the appropriate elements of the legislation. Debt and deficit data for the general government should be reconciled, at least on an annual basis.

- **Widen the scope of fiscal data collected by the authorities, and disclosed to the public and National Assembly**. The reporting on arrears could be strengthened and broadened by improving the monitoring of commitments by DBBs and including health institutions in the coverage of the treasury surveys, as well as by more rigorous monitoring of IBBs and local governments. Tax arrears and tax expenditures should also be reported.

- **Publish more detail and analysis in the budget documentation on expenditure and revenue prospects and debt management policy, and past performance, and work to improve the realism of budget projections.** To reduce the likelihood of persistent errors in budget projections, analysis of the current and previous years' outcomes compared with the original budget proposals should be prepared, subject to independent scrutiny, and published in the BM. Aggregate projections and forecasting models should also be subject to independent scrutiny. Budget appropriations and aggregate expenditure and revenue projections should be comprehensively explained and justified in the BM. Proposals for new measures should be supported by projections of their fiscal, economic and social impact; and the results and broader economic and social impact of past measures should also be evaluated. On debt management, there is scope to extend the strategies that have been presented to date to elucidate more fully the government's objectives, including for the domestic debt market, and to propose specific options for funding the expected borrowing requirement.

- **Establish an overall legal and institutional framework for managing PPPs.** This will require, among other things, the development of a robust methodology for accounting for PPPs and for comprehensively reporting on PPPs and their fiscal risks.

- **Improve the specification of fiscal public reporting obligations by (i) including explicit fiscal data publication requirements in the BSL; and (ii) publishing an advance release calendar on the MoF website.** The BSL should include a requirement for a mid-year report on the budget to be presented to the National Assembly.

- **Ensure comprehensive and consistent coverage of privatization receipts.** Payments made directly out of privatization receipts to the Privatization Agency (other than to cover direct expenditure), Employees Pension and Disability Fund, Restitution Fund, and subnational governments should be treated in the same way as payments made directly to the treasury, which are now recorded as financing items rather than revenues.

- **Publish a clear and simple summary guide to the budget.**

Looking further forward, additional action should be taken in the following important areas:

- **Reconsider the roles and size of the current and permanent budgetary reserves.** Most countries that appropriate expenditure in case of emergencies or unanticipated events have only a single reserve, which is subject to a cap in the relevant legislation.

- **Clarify responsibilities for monitoring and reporting on state-owned financial and nonfinancial enterprises.** Overlapping responsibilities within and between the treasury and other parts of the MoF, NBS, the Ministry of Economy and Regional Development, and line ministries should be resolved. Oversight for monitoring and policy advice with respect to state-owned financial and nonfinancial enterprises should include QFAs, guarantees, implicit and explicit subsidies, and monitoring of financial statements. Regulations should be prepared on publication of this information to ensure that budget documentation includes comprehensive reports on their financial outturns and prospects.

- **Extend the FMIS to IBBs and subnational governments, and introduce general ledgers for DBBs and IBBs**. This would follow confirmation that current phases of the FMIS roll out are performing effectively.

- **Publish occasional reports on prospects for public finances over the long term.** These would provide an analytical and practical framework to address crucial issues like the impact of pension commitments and the costs of financing health care in the context of alternative demographic and macroeconomic projections.

Institutional reform would include measures to:

- **Reform intergovernmental fiscal relations and strengthen public financial management at the subnational level**. This should include clear assignment of responsibilities and the apportioning of state-owned assets. Improvements in public financial management at the subnational level should be aimed at full implementation of the provisions of the BSL, as well as development of appropriate PFM regulations and procedures in subnational governments.

- **Strengthen the integrity of fiscal data and tax administration.** The mandate of the Serbia Statistical Office should be extended to cover the quality and methodology of fiscal data, and it should be given institutional independence. Consideration should be given to mechanisms for subjecting fiscal projections to independent scrutiny before finalization. The tax and customs administrations should be legally protected from political direction.

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APPENDIX I Table 1. Serbia: A Summary Assessment of Practices

Code	Principles and Practices	Summary Assessments	Comments
1.1	**The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles should be clear and publicly disclosed.**	***Largely Observed***	
1.1.1	The structure and functions of the government should be clear.	**The general government is defined broadly consistently with the principles of Government Finance Statistics (GFS) 1986, but some entities may be misclassified.**	Using the principles of GFSM 2001, and the criteria of the Systems of National Accounts (SNA), the current list of over 9,000 government entities should be reviewed to determine which entities fully meet the criteria for classification as part of the general government. At present, while the principles of GFSM 1986 are applied in theory, in practice there is no procedure for regularly reviewing the list of IBBs or for ensuring that all EBFs are reported within the general government sector.
1.1.2	The fiscal powers of the executive, legislative, and judicial branches of the government should be well defined.	**The fiscal roles of the executive, legislative, and judicial branches are clearly defined in the Constitution.**	
1.1.3	The responsibilities of different levels of the government, and the relationships between them, should be clearly specified.	**The responsibilities of different levels of government are clearly defined in various laws, but are numerous and complex. Accountability for some government functions is complicated by divided responsibilities between different levels of government, but the scope for discretion in government transfers has been curbed.**	Intergovernmental fiscal relations should be reformed, particularly in the assignment of responsibilities and apportioning of state-owned assets. Public financial management (PFM) at the subnational level should be strengthened to fully implement provisions in the BSL, and appropriate PFM regulations and procedures should be developed.

Code	Principles and Practices	Summary Assessments	Comments
1.1.4	Relationships between the government and public corporations should be based on clear arrangements.	**Relationships between government and state- and socially-owned enterprises are generally defined by law, but lines of responsibility are blurred in practice. Reporting of the impact of nonfinancial state-owned enterprises on the budget is inadequate, particularly in the context of their significant quasi-fiscal activities. There is also evidence that some state-owned financial enterprises continue to carry out QFAs. Arrangements regulating profit transfers from public enterprises to the budget are in place, but are not used in practice. The National Bank of Serbia is operationally independent and has a clearly defined and limited fiscal role. Local public enterprises do not own the assets they use, complicating their operations and blurring accountability.**	Responsibilities for monitoring and reporting on state-owned financial and nonfinancial enterprises should be clarified. Oversight for monitoring and policy advice with respect to state-owned financial and nonfinancial enterprises should include QFAs, guarantees, implicit and explicit subsidies, and monitoring of financial statements.
1.1.5	Government relationships with the private sector should be conducted in an open manner, following clear rules and procedures.	**Laws and processes governing government regulation of the nonfinancial private sector are comprehensive, but complex and subject to frequent change.**	
1.2	**There should be a clear and open legal, regulatory, and administrative framework for fiscal management.**	***Largely Observed***	
1.2.1	The collection, commitment, and use of public funds should be governed by comprehensive budget, tax, and other public finance laws, regulations, and administrative procedures.	**The legal framework for management of public funds is reasonably clear and comprehensive, although it has been subject to frequent changes.**	
1.2.2	Laws and regulations related to the collection of tax and non-tax revenues, and the criteria guiding administrative discretion in their application, should be accessible, clear, and understandable. Appeals of tax or non-tax obligations should be considered in a timely manner.	**The tax system is fairly comprehensive, with a clear legislative basis, but it is complex and subject to frequent changes. There is a clear legal and administrative framework for revenue administration, although some gaps remain in implementation. Taxpayers' legal rights are well defined, including appeals procedures.**	
1.2.3	There should be sufficient time for consultation about proposed laws and regulatory changes and, where feasible, broader policy changes.	**Public opinion is normally sought in advance concerning proposed laws, regulatory changes, and broader policy changes.**	

Code	Principles and Practices	Summary Assessments	Comments
1.2.4	Contractual arrangements between the government and public or private entities, including resource companies and operators of government concessions, should be clear and publicly accessible.	**Contractual arrangements between the government and the private sector, and other parts of the public sector, are generally clear and publicly accessible.**	An overall legal and institutional framework should be established for managing and accounting for PPPs.
1.2.5	Government liability and asset management, including the granting of rights to use or exploit public assets, should have an explicit legal basis.	**Liability management and the granting of rights for mineral extraction are governed by legislation. The legal framework for privatization is clear.**	
2.1	**Budget preparation should follow an established timetable, and be guided by well-defined macroeconomic and fiscal policy objectives.**	***Largely Observed***	
2.1.1	A budget calendar should be specified and adhered to. Adequate time should be allowed for the draft budget to be considered by the legislature.	**The annual budget process is open and the budget calendar, which allows adequate time for consideration by the National Assembly, is clearly specified in the Law.**	The National Investment Plan (NIP) should be fully integrated into the budget process.
2.1.2	The annual budget should be realistic, and should be prepared and presented within a comprehensive medium-term macroeconomic and fiscal policy framework. Fiscal targets and any fiscal rules should be clearly stated and explained.	**Broad fiscal aggregates and underlying macroeconomic assumptions for the medium term are presented in the Budget Memorandum. Republic budget estimates are not yet fully reliable. No fiscal rules have been specified for the Republic budget.**	Budget appropriations and aggregate expenditure and revenue projections should be comprehensively explained and justified. Capacity for budget analysis should be further developed, including improving the ability of the MoF Budget Preparation Department to challenge effectively the bids of spending departments and NIP projects, rationalize the program budgeting approach, and develop and introduce a comprehensive medium-term budgetary framework.
2.1.3	A description of major expenditure and revenue measures, and their contribution to policy objectives, should be provided. Estimates should also be provided of their current and future budgetary impact and their broader economic implications.	**Estimates of new initiatives and ongoing costs of government policies are not always adequately calculated and presented in the budget documents.**	Proposals for new measures should be supported by projections of their fiscal, economic, and social impact.
2.1.4	The budget documentation should include an assessment of fiscal sustainability. The main assumptions about economic developments and policies should be realistic and clearly specified, and sensitivity analysis should be presented.	**A statement on medium-term fiscal policy objectives is included in the budget documentation and debt sustainability issues are addressed. The responsiveness of budget estimates to changes in economic variables is discussed in budget documents, but there is no systematic sensitivity analysis or broader disclosure of fiscal risks.**	The sensitivity of the fiscal projections to deviations in the macroeconomic assumptions should be systematically analyzed and disclosed.

Code	Principles and Practices	Summary Assessments	Comments
2.1.5	There should be clear mechanisms for the coordination and management of budgetary and extrabudgetary activities within the overall fiscal policy framework.	**The oversight mechanisms for the activities, finances, and reporting of the Mandatory Social Insurance Organizations (MSIOs) are similar to those applied to direct budget beneficiaries, and their accounts are consolidated within the general government, but reporting of the activities, revenues and expenditure of some indirect budget beneficiaries is not comprehensive.**	
2.2	**There should be clear procedures for budget execution, monitoring, and reporting**	***Largely Not Observed***	
2.2.1	The accounting system should provide a reliable basis for tracking revenues, commitments, payments, arrears, liabilities, and assets.	**Basic accounting and internal control procedures are in place, but expenditure commitments are not tracked centrally, implementation needs strengthening, and the government has considerable discretion in the use of contingency reserve mechanisms. The treasury accounting system is capable of producing in-year reports of revenues and expenditure for the Republic budget, but elements of the annual balance sheet are derived from records provided by budget entities rather than the general ledger. Financial management practices for the Republic budget are reasonably well coordinated.**	The reporting on arrears could be strengthened and broadened by improving the monitoring of commitments by DBBs and including health institutions in the coverage of the treasury surveys, as well as by more rigorous monitoring of IBBs and local governments. Consideration could be given to extending the FMIS to indirect budget users and subnational governments once there is confirmation that all of the initial phases of the FMIS are performing effectively. The roles of the current and permanent budgetary reserves should be reconsidered.
2.2.2	A timely midyear report on budget developments should be presented to the legislature. More frequent updates, which should be at least quarterly, should be published.	**The National Assembly does not receive in-year reports on budget outturns or mid-year reviews, but the regularity of supplementary budget proposals means that an update of the fiscal outlook is generally available during the second half of the year.**	The BSL should include a requirement to present a mid-year report on the budget to the National Assembly.
2.2.3	Supplementary revenue and expenditure proposals during the fiscal year should be presented to the legislature in a manner consistent with the original budget presentation.	**Supplementary budget proposals are presented to the National Assembly in a manner consistent with the original budget proposals.**	
2.2.4	Audited final accounts and audit reports, including reconciliation with the approved budget, should be presented to the legislature and published within a year.	**The National Assembly has been unable to approve the final accounts, pending establishment and full operation of the State Audit Institution (SAI).**	A priority for the State Audit Institution is to clear the backlog of unaudited financial statements.

Code	Principles and Practices	Summary Assessments	Comments
3.1	**The public should be provided with comprehensive information on past, current, and projected fiscal activity and on major fiscal risks.**	***Largely Not Observed***	
3.1.1	Budget documentation, including the final accounts and other published fiscal reports, should cover all budgetary and extrabudgetary activities of the central government.	**Budget documents cover central government fiscal activities and provide summary aggregates for the general government, but information is limited on indirect budget beneficiaries and SSOEs that benefit from budgetary support. Defense expenditures are reported in the budget with the same level of detail as other spending.**	More detailed information should be provided in the budget documentation about the past and proposed activities of IBBs.
3.1.2	Information comparable to that in the annual budget should be provided for the outturns of at least the two preceding fiscal years, together with forecasts and sensitivity analysis for the main budget aggregates for at least two years following the budget.	**The Budget Memorandum discloses the main fiscal aggregates for two years prior to the budget year and two years beyond the budget year.**	More detail and analysis should be published in the budget documentation on expenditure and revenue prospects of the general government, and past performance, including analysis of previous years' outcomes compared with the original budget proposals.
3.1.3	Statements describing the nature and fiscal significance of central government tax expenditures, contingent liabilities, and quasi-fiscal activities should be part of the budget documentation, together with an assessment of all other major fiscal risks.	**Budget documents identify all proposed loan guarantees, and describe other forms of contingent liabilities and fiscal risks, but they do not quantify them. Although QFAs are significant, budget documents do not identify them or provide estimates of their cost. Various types of subsidized lending and guarantees are provided for small- and medium-size enterprises and housing projects. Statements on tax expenditures are not included in the budget documents.**	Additional information should be provided on tax arrears, tax expenditure, and estimates of contingent liabilities. Key financial information should be provided for all SSOEs that present fiscal risks. The statement on fiscal risks should be expanded into a comprehensive "fiscal risks" statement, including some quantification of the major risks.
3.1.4	Receipts from all major revenue sources, including resource-related activities and foreign assistance, should be separately identified in the annual budget presentation.	**Budget documents cover central government fiscal activities, including major revenue sources.**	Budget documentation should provide comprehensive outturn data and realistic projections for the own revenues of all IBBs.
3.1.5	The central government should publish information on the level and composition of its debt and financial assets, significant nondebt liabilities (including pension rights, guarantee exposure, and other contractual obligations), and natural resource assets.	**Information on the gross public debt of the Republic is largely complete and published. Information on general government financial assets is compiled but not published.**	

Code	Principles and Practices	Summary Assessments	Comments
3.1.6	The budget documentation should report the fiscal position of subnational governments and the finances of public corporations.	**Annual fiscal reporting covers the consolidated general government, as defined, including MSIOs and Serbia Roads; the finances of public corporations are not presented in the budget documentation.**	Regulations should be prepared on publication of detailed information about the finances of state-owned financial and nonfinancial enterprises to ensure that budget documentation includes comprehensive reports on their financial outturns and prospects.
3.1.7	The government should publish a periodic report on long-term public finances.	**Analysis of the long-term outlook for public finances is neither undertaken nor published**.	Occasional reports on prospects for public finances over the long term would provide an analytical and practical framework to address crucial fiscal issues under alternative assumptions.
3.2	**Fiscal information should be presented in a way that facilitates policy analysis and promotes accountability.**	***Largely Not Observed***	
3.2.1	A clear and simple summary guide to the budget should be widely distributed at the time of the annual budget.	**There is no clear and simple guide to the budget made accessible to the general public**.	A "citizen's guide" to the budget should be published.
3.2.2	Fiscal data should be reported on a gross basis, distinguishing revenue, expenditure, and financing, with expenditure classified by economic, functional, and administrative category.	**With the exception of the National Investment Plan, the classifications for revenue, expenditure, and financing used in the annual budget presentation are broadly consistent with international standards.**	To safeguard the correct use of economic classifications in accounting, particularly in local governments and indirect budget entities, and in respect of the 551 code for the NIP, internal control and audit should be strengthened.
3.2.3	The overall balance and gross debt of the general government, or their accrual equivalents, should be standard summary indicators of the government fiscal position. They should be supplemented, where appropriate, by other fiscal indicators, such as the primary balance, the public sector balance, and net debt.	**The overall balance of the general government, which is the main indicator of the fiscal position, is monitored on a monthly basis during the year, together with gross public debt.**	There should be consistency between the legal basis for reporting fiscal outturns and actual practice. The accounting and reporting framework of the budget needs to be clarified.
3.2.4	Results achieved relative to the objectives of major budget programs should be presented to the legislature annually.	**Budget documents discuss the objectives and expected results from government activities in general terms, but do not systematically evaluate outcomes.**	The results and broader economic and social impact of past measures should be evaluated and published in the Budget Memorandum.

Code	Principles and Practices	Summary Assessments	Comments
3.3	**A commitment should be made to the timely publication of fiscal information.**	***Not Observed***	
3.3.1	The timely publication of fiscal information should be a legal obligation of the government.	**There is no legal commitment to publish fiscal outturn information beyond publication of the final accounts.**	The BSL should include explicit requirements for the main fiscal data (annual, quarterly, and monthly) to be published in a regular and timely fashion.
3.3.2	Advance release calendars for fiscal information should be announced and adhered to.	**Although fiscal data are, in practice, published in a regular and timely fashion, there is no advance release calendar.**	An advance release calendar should be published on the MoF website.
4.1	**Fiscal data should meet accepted data quality standards.**	***Largely Not Observed***	
4.1.1	Budget forecasts and updates should reflect recent revenue and expenditure trends, underlying macroeconomic developments, and well-defined policy commitments.	**Republic budget estimates are not yet fully reliable, and no analysis of differences between planned and actual outturns is made available to the public.**	Analysis should be provided of previous years' outcomes compared with the original budget proposals.
4.1.2	The annual budget and final accounts should indicate the accounting basis used in the compilation and presentation of fiscal data. Generally accepted accounting standards should be followed.	**Statements on accounting policy are not included in the budget.**	The accounting and reporting framework of the budget needs to be clarified and clearly described in budget documents and reports.
4.1.3	Data in fiscal reports should be internally consistent and reconciled with relevant data from other sources. Major revisions to historical fiscal data and any changes to data classification should be explained.	**The process of accounts reconciliation is not always effective, and debt and deficit data are not reconciled. Major revisions to historical fiscal data and any changes to data classification are explained.**	Debt and deficit data for the general government should be reconciled, at least on an annual basis.
4.2	**Fiscal activities should be subject to effective internal oversight and safeguards.**	***Largely Not Observed***	
4.2.1	Ethical standards of behavior for public servants should be clear and well publicized.	**Public servants are subject to a well-defined code of behavior, and corruption is perceived to have declined in recent years, but it remains a matter of concern.**	
4.2.2	Public sector employment procedures and conditions should be documented and accessible to interested parties.	**Civil service employment rules are well established for the Republican government, and plans have been made to establish similar arrangements for the rest of the general government.**	

Code	Principles and Practices	Summary Assessments	Comments
4.2.3	Procurement regulations, meeting international standards, should be accessible and observed in practice.	**Procurement procedures are being improved, but much remains to be done.**	
4.2.4	Purchases and sales of public assets should be undertaken in an open manner, and major transactions should be separately identified.	**Sales of public assets are subject to well-defined processes, including the reporting of all major transactions, but bids are not always subject to competition**.	There should be comprehensive coverage in budget documentation of privatization receipts, including information on how all the proceeds are distributed, and they should be treated consistently in the financial accounts.
4.2.5	Government activities and finances should be internally audited, and audit procedures should be open to review.	**Internal audit is not well established.**	The internal audit function should be further developed. A training program should be introduced, drawing on donors, internal audit staff from other countries, and the Institute of Internal Auditors. Additional measures for strengthening audit would include collaboration with neighboring and EU countries through experience sharing and professional attachment, and establishing a professional association of auditors.
4.2.6	The national revenue administration should be legally protected from political direction, ensure taxpayers' rights, and report regularly to the public on its activities.	**The tax and customs administrations are not given legal protection from political interference. Internal monitoring and control mechanisms in tax and customs administrations are still being strengthened**.	The tax and customs administrations should be legally protected from political direction.
4.3	**Fiscal information should be externally scrutinized.**	***Not Observed***	
4.3.1	Public finances and policies should be subject to scrutiny by a national audit body or an equivalent organization that is independent of the executive.	**External audit, as defined in the Law on the State Audit Institution, is independent of the executive branch and its mandate covers all public sector activities, but the SAI is not yet fully operational.**	A program should be initiated for the development of the State Audit Institution. International experts might have a transitional role. External support for SAI capacity building should be carefully managed in order to get the maximum learning value for the new auditors.
4.3.2	The national audit body or equivalent organization should submit all reports, including its annual report, to the legislature and publish them. Mechanisms should be in place to monitor follow-up actions.	**The Supreme Audit Council of the State Audit Institution(SAI) is not yet fully operational, and it has not presented any reports to the legislature.**	The State Audit Institution should develop mechanisms for monitoring responses to the reports that it is required to present to the legislature.

Code	Principles and Practices	Summary Assessments	Comments
4.3.3	Independent experts should be invited to assess fiscal forecasts, the macroeconomic forecasts on which they are based, and their underlying assumptions.	**Government bodies with independent status (including the National Bank of Serbia) are consulted about macroeconomic models and assumptions, but they do not scrutinize material in advance of publication.**	Consideration should be given to mechanisms for subjecting fiscal projections to independent scrutiny before finalization.
4.3.4	A national statistical body should be provided with the institutional independence to verify the quality of fiscal data.	**The Serbia Statistical Office does not verify fiscal data, and does not have legal assurance of independence.**	The mandate of the Serbia Statistical Office should be extended to cover the quality and methodology of fiscal data, and it should be given institutional independence.

APPENDIX I Table 2. Serbia: Public Availability of Information—A Summary

	Budget and Fiscal Report Element	Included in Budget/ Report Documents	Available to the Public	Code Reference
1.	Central government (CG) budget estimates	Yes.	Yes	2.1.1
2.	CG defense expenditures	Yes.	Yes	2.1.1
3.	Extrabudgetary funds	Only the MSIOs and Road Fund.	Yes	2.1.1
4.	CG budget outturns	Yes. These appear in the Monthly Public Finances Bulletin.	Yes	2.1.2
5.	CG budget forecasts	Yes. These are in the Budget Memorandum at an aggregate level for three years.	Yes	2.1.2
6.	CG contingent liabilities	List provided of guaranteed loans.	Yes	2.1.3
7.	CG tax expenditures	No.	No	2.1.3
8.	CG QFAs	No.	No	2.1.3
9.	Macroeconomic assumptions	Yes. These are presented in the Budget Memorandum.	Yes	3.1.3
10.	Fiscal risk/sensitivity analysis	No substantive analysis.	No	3.1.5
11.	CG debt	Yes. Public debt data appear in the Monthly Public Finances Bulletin.	Yes	2.1.4
12.	CG financial assets	No.	No	2.1.4
13.	Sustainability analysis	No.	No	3.1.1
14.	General government budget estimates	Yes.	Yes	2.1.5
15.	CG monthly/quarterly reports on fiscal outturn	Yes. These appear in the Monthly Public Finances Bulletin. There is no mid-term review document.	Yes	3.4.1
16.	General government monthly/quarterly reports on fiscal outturn	Yes. These appear in the Monthly Public Finances Bulletin.	Yes	3.4.1
17.	CG final accounts	Provisional (unaudited) accounts only.		3.4.2
18.	Consolidated general government final accounts	Provisional (unaudited) accounts only.		3.4.2

Appendix I Table 3. Serbia: State-Owned Enterprises and the Nonfinancial Sectors of the Economy (2005)

Sectors of Economic Activity	Percentage of total assets in sector
Agriculture, hunting, and forestry, and water management	35.6
Construction	9.6
Generation and supply of electric power	57.1
Wholesale and retail trade; repair	29.3
Manufacturing industry	0.3
Activities related to real estate; renting	4.7
Government administration and defense; mandatory social insurance	8.0
Health and social care	3.3
Other utilities; social and personal service activities	66.0
Ore and stone extraction	22.6
Hotels and restaurants	0.1
Transport, warehousing and communications	60.1
Weighted Average	**26.2**

Source: Solvency Agency (2006), and IMF staff calculations.

Appendix I Table 4. Serbia: The Budget Preparation Process for Subnational Governments

Due Dates	Activities	Legal Basis
The fiscal year is set on a calendar-year basis by the Constitution. The BSL sets out the following main steps in the process:		
June 15	the local government body responsible for finance shall issue instructions for preparing their proposed budgets.	Budget System Law
July 15	direct beneficiaries of local budget funds shall submit financial plans to the local body responsible for finance.	Budget System Law
October 15	the local government body responsible for finance shall submit the proposed budget to the executive local government body.	Budget System Law
November 1	the executive local government body shall submit the proposed budget to the local assembly and to the Ministry.	Budget System Law
December 20	the local assembly shall enact local budget.	Budget System Law
December 25	the local government body responsible for finance shall submit the approved local government budget to Minister.	Budget System Law

Appendix I Table 5. Serbia: Republic Budget—Comparison Between Budget and Execution, 2007

	Budget	Execution	Deviation (percentage)
Budget receipts	581.8	580.4	-0.2
Income tax	88.7	89.9	1.4
Value-added tax	270.4	265.4	-1.8
Customs excise and other taxes	158.2	155.7	-1.6
Non-tax revenues	64.5	69.4	7.6
Budget outlays	595.5	567.2	-4.8
Employment expenditures	152.9	147.7	-3.4
Goods and services	42.9	39.2	-8.6
Interest payments	17.4	14.7	-15.5
Subsidies	35.5	35.3	-0.6
Transfers to MSIOs	147.4	145.1	-1.6
Grants and other transfers	56.2	56.6	0.7
Social protection	72.4	69.4	-4.1
Capital outlays (including NIP)	70.7	59.1	-16.4
Budget surplus/deficit 1/	-13.7	+13.2	

Source: Draft Law on the Closing Balance of the Republic of Serbia Budget for 2007, and IMF staff calculations.

1/ Defined according to BSL as “current revenues plus proceeds from sale of nonfinancial assets” less “current expenditures plus outflows for the acquisition of nonfinancial assets.”