



GOVERNMENT OF THE REPUBLIC OF SERBIA

**Negotiation position of the Republic of Serbia for the Intergovernmental  
Conference on the Accession of Serbia to the European Union**

**Chapter 32 „Financial control“**

*Belgrade, 25th July 2014.*

## 1. THE ABSTRACT OF THE NEGOTIATING POSITION

The Republic of Serbia accepts the EU *acquis* and the applicable standards<sup>1</sup> based on international best practices foreseen under Chapter 32 Financial Control as of November 26<sup>th</sup>, 2013 and will ensure the implementation of the EU *acquis* in the framework of this chapter by the time of the accession of the Republic of Serbia to the European Union.

The Republic of Serbia does not request permanent derogations or transitional periods for the implementation of the EU *acquis* and the applicable standards in this Chapter.

## 2. LEGISLATIVE AND INSTITUTIONAL FRAMEWORK

### 2.1. Public Internal Financial Control (PIFC)

#### a) Legislative framework

The legislative framework for Public Internal Financial Control (PIFC) in the Republic of Serbia (RS) is based on the International Organization of Supreme Audit Institutions Internal Control Standards for the Public Sector (INTOSAI Standards) and the Institute of Internal Auditors' International Professional Practices Framework (IPPF) and consists of the following strategic documents, laws and bylaws, namely:

- The Strategy for the Development of Internal Financial Control in the Public Sector (the PIFC Strategy) (“The Official Gazette of the Republic of Serbia”, No. 61/09), adopted in August 2009 and amended in March 2013 (“The Official Gazette of the Republic of Serbia”, No. 23/13).
- The Law on the Budget System (“The Official Gazette of the Republic of Serbia”, No. 54/09, 73/10, 101/10, 101/11, 93/12, 62/13, 63/13 – corr. and 108/13).
- The Rulebook on the joint criteria and standards for the establishment, operation and reporting on financial management and control in the public sector (“The Official Gazette of the Republic of Serbia”, No. 99/11 and No.106/13) (The FMC Rulebook).
- The Rulebook on the joint criteria for organization and standards and methodological guidelines for conducting and reporting of internal audit in the public sector (“The Official Gazette of the Republic of Serbia”, No. 99/11 and 106/13) (The IA Rulebook).
- The Rulebook on the conditions and procedure for taking the exam for certified internal auditor in the public sector (“The Official Gazette of the Republic of Serbia”, No. 9/14).

The PIFC Strategy represents a high level strategic document which sets out the objectives and actions that need to be taken with regards to establishing and implementing a comprehensive system for Financial Management and Control (FMC) and Internal Audit (IA) within the Serbian Public Sector with the ultimate goal of ensuring sound and effective financial management and control of public funds.

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<sup>1</sup> Referenced in the relevant sections of this Negotiation position on PIFC and external audit

The current PIFC Strategy covers the period ending with 2014 and a new PIFC Strategy with the associated Action Plan for the period 2015-2019 is currently under preparation and will be adopted by the end of 2014.

The Law on the Budget System represents the basic legal act in Serbia which defines: 1) PIFC as a comprehensive integrated system for managing, monitoring and auditing the use of public funds in the Republic of Serbia in strict compliance with the applicable national regulations and the principles of sound financial management, 2) Managerial accountability (MA) as a legal obligation of managers of all level in all public fund beneficiary institutions to execute their tasks and responsibilities in a lawful manner observing the principles of efficiency, effectiveness, efficiency and transparency, and to report on actions undertaken by them as well the results achieved to the relevant level of national authority which delegates the associated managerial responsibility upon them, 3) FMC as a system of policies, procedures and activities that are set up, maintained and regularly updated by the managers of all public funds beneficiary institutions, aimed at providing reasonable assurance that the objectives of the beneficiary institutions will be achieved in a proper, economic, efficient and effective manner and 4) IA as an independent function aiming to provide managers of public funds beneficiary institutions an objective opinion on the way operations are carried out and how to improve them so that the organization can achieve its objectives and improve the effectiveness of the risk management procedure, the management and control system within the organization.

The FMC Rulebook contains the common criteria and standards for establishing, managing and reporting on the Financial Management and Control system by public fund beneficiary institutions, whilst the IA Rulebook defines the Internal Audit function and its scope, the common criteria and standards for conducting Internal Audit and Reporting.

The Rulebook on the conditions and procedure for taking the exam for a Certified Internal Auditor in the Public Sector sets out the conditions and procedure for acquiring the title - Certified Internal Auditor in the Public Sector.

Additionally, the Central Harmonisation Unit (CHU) prepared and issued the FMC Manual and the Manual for IA in 2007 which contain methodological guidelines for managers and civil servants in implementing the uniform procedure for establishing the FMC system and IA function.

The Ministry of Finance of the Republic of Serbia signed a Declaration of Intent for Administrative Cooperation with the Directorate-General for Budget of the European Commission (EC) in 2007 which formalised cooperation in the area of strengthening the PIFC system in the Republic of Serbia, with a special focus on the implementation of PIFC and the harmonisation of national strategic documents and regulations with the INTOSAI Standards and the IPPF.

## **b) Institutional framework**

The Law on Ministries (“The Official Gazette of the Republic of Serbia”, No. 44/14) foresees that the Ministry of Finance harmonises and coordinates the system of Financial Management

and Control and Internal Audit in the Public Sector. Additionally, the Law on the Budget System (“The Official Gazette of the Republic of Serbia”, No. 54/09, 73/10, 101/10, 101/11, 93/12, 62/13, 63/13 – corr. and 108/13) stipulates that the harmonization of financial management and control and internal audit is performed by the Central Harmonization Unit within the Ministry of Finance.

The Regulation on the internal organization and job classification at the Ministry of Finance, of October 21<sup>st</sup>, 2013 assigns the function of the CHU for FMC and IA to the Sector for Internal Control and Internal Audit at the Ministry of Finance (hereinafter: the CHU).

The CHU bears the overall responsibility for coordinating the processes of establishing and developing the PIFC system in the Republic of Serbia in line with the Declaration of Intent for Administrative Cooperation, based on the INTOSAI Standards, the IPPF and in compliance with the applicable national legislation stipulating its mandate and scope of responsibilities.

In practical terms, the CHU prepares and proposes laws and bylaws relating to FMC and IA, prepares the methodology and performance standards for FMC and IA and provides instructions and guidelines to public fund beneficiary institutions for establishing FMC and IA, organises and carries out trainings for managers and staff of public fund beneficiary institutions responsible for and involved in FMC and IA and implements the process for the certification of Internal Auditors in the Public Sector, carries out activities related to quality assurance of the established systems for FMC and the IA function within public fund beneficiary institutions, cooperates with the EC and other relevant stakeholders on the further development of FMC and IA according to best international practices, maintains and updates the Register of Certified Internal Auditors and prepares Consolidated Annual Reports on the system of internal financial controls for the Government of the Republic of Serbia.

The Assistant Minister in charge of the CHU reports directly to the Minister of Finance on the development and progress in the field of PIFC.

Organisationally, the CHU is composed of two internal organisational units:

- 1) the Division for the harmonisation of Financial Management and Control, and
- 2) the Division for the harmonisation of Internal Audit.

The total number of job positions within the CHU is thirteen. The CHU is currently staffed with twelve civil servants, with one vacant position.

The CHU has organised and held trainings on FMC for 984 participants from 352 public fund beneficiary institutions until the end of 2013.

Trainings for Internal Auditors have been carried out in the form of basic and continual practical trainings and have, up to date, been attended by 501 participants from 267 public fund beneficiary institutions.

The CHU has been implementing the process of certifying Internal Auditors in the Public Sector from the second quarter of 2011 until the present and certified 189 Internal Auditors in 52 public fund beneficiary institutions.

The staff of the CHU regularly participates at regional conferences on PIFC for EU Candidate and Potential Candidate Countries and have also participated at the Second Conference on Public Internal Control for EU Member States. They are also active members of the network of experts of the PEMPAL Community of practice, which includes twenty two countries in Europe and Central Asia.

Cooperation has also been established with the Association of Internal Auditors of the Republic of Serbia – an associate member of the Global Institute of Internal Auditors.

Apart from assigning the CHU function, the Law on the Budget System also stipulates the legal requirement for managers of public fund beneficiary institutions (direct and indirect budget beneficiary institutions, organisations for mandatory social insurance, public enterprises, legal entities over which the Republic of Serbia, and/or local government, has direct or indirect control with over more than 50% of equity, or more than 50% of votes in the Management Board, as well as other legal entities where public funds comprise more than 50% of total revenues) to establish an FMC system and IA function within their respective institutions and to report to the Minister of Finance on their adequacy and effectiveness.

At present, FMC is been implemented at the following levels within public fund beneficiary institutions:

1. the appointment of an FMC Coordinator in 55 public fund beneficiary institutions at the central level,
2. the appointment of an FMC Coordinator and the preparation and endorsement of operational procedures and Risk Management Strategies in 73 public fund beneficiary institutions.

The IA function has been established in 105 public fund beneficiary institutions at all levels, with a total number of 263 Internal Auditors, including 67 public fund beneficiary institutions at the central level (16 ministries, 3 funds of mandatory social insurance and 48 other organization), with 204 Internal Auditors

The main obstacles in implementing FMC and IA by public fund beneficiary institutions in Serbia include lack of understanding of the purpose and benefits of PIFC implementation at the managerial level, lack of strategic and operational planning for the implementation and development of FMC, business processes have not been identified and written procedures have not been prepared/approved. Furthermore, circumstances hampering the establishment of the Internal Audit function include insufficient planning which is rarely based on risk assessment, the complexity of operations and the amount of funds managed by the institutions, as well as a lack in educated staff, low salaries, inadequate systematized positions in relation to the scope and complexity of the work, the lack of practical experience of internal auditors as well as their involvement in activities which fall within the scope of the FMC systems which they are engaged to audit.

According to the Consolidated Annual Report on PIFC in the Republic of Serbia for 2012, 2553 recommendations were given by Internal Auditors aiming to improve business processes and to minimize the operational risks to an acceptable level, out of which 1669 were implemented by the managers of the institutions by the end of 2013.

## **2.2 External Audit**

### **a) Legislative framework**

The legislative framework for external audit/public sector audit in the Republic of Serbia is based on the Lima Declaration of Guidelines on Auditing Precepts, the Mexico Declaration on Independence, the International Standards of Supreme Audit Institutions (ISSAI Framework), the International Organisation of Supreme Audit Institutions Auditing Standards (INTOSAI Standards), the European Implementing Guidelines for INTOSAI Standards and INTOSAI Code of Ethics for Public Sector Auditors and consists of:

- The Law on the State Audit Institution (“The Official Gazette of the Republic of Serbia”, No. 101/2005, 54/2007 and 36/2010).

Apart from reconfirming the status and position of the State Audit Institution (SAI) as the supreme state audit body, in line with the Constitution of the Republic of Serbia, the Law on the State Audit Institution stipulates that it shall exercise audit competence in line with the generally accepted principles and rules of audit and in compliance with internationally recognized audit standards (listed in the paragraph above), and mandates the SAI to perform: 1) Audits of financial statements<sup>2</sup>, 2) Compliance Audits<sup>3</sup>, and 3) Performance Audits<sup>4</sup>.

Furthermore, the Law defines the subject and scope of audit as the investigation, examination, or evaluation of all objective evidence (including financial statements), the adequacy and compliance of operations with established written procedures and the applicable national regulations governing the execution of all public funds as defined in the Law on the Budget System, as well as the effectiveness of the implementation of public funds.

The SAI is legally obliged to conduct annual audits of the State budget, mandatory social insurance organizations, the operations of the National Bank of Serbia (NBS) with regards to the usage of public funds, an appropriate sample of local self-government units, public enterprises and other legal entities, and as of 2015, the SAI will also conduct audits of a sample of parliamentary political parties at the State level in accordance with the Law on Financing Political Activities (“The Official Gazette of the Republic of Serbia”, No. 43/2011).

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<sup>2</sup> review of documents, official papers, reports and other information, with the purpose of obtaining sufficient, adequate and reliable evidence for expressing an opinion as to whether financial statements of the auditee present a true and fair view of its financial position, performance and cash flows, in accordance with the accepted accounting principles and standards.

<sup>3</sup> review of financial transactions and decisions regarding revenues and expenditure, in order to determine whether the respective transactions were executed in compliance with the applicable laws and regulations, given authorization, and for the planned purposes.

<sup>4</sup> review of the budget and other public funds spending, with the aim of obtaining sufficient, adequate and reliable evidence for reporting on whether the funds of the auditee were used in accordance with principles of economy, efficiency and effectiveness, as well as in accordance with the planned objectives.

The Auditees include all public fund beneficiaries<sup>5</sup> in the Republic of Serbia as well as other legal persons associated with the Auditees.

Audits of other legal entities associated with Auditees are limited to their operations and transactions with the Auditees. The SAI is also obliged, by the Law, to prepare and adopt additional regulations which would further detail the manner of conducting audits of these legal entities.

The NBS is subject to SAI audits, for which the SAI is obliged to submit an Annual Compliance Report on operations of the institution, relating to the usage of public funds as the Law on the Budget System foresees that foreign exchange assets of the State budget beneficiaries, mandatory social insurance organizations and local government budgets may be held only with the NBS.

The SAI is also obliged, by the Law, to prepare and adopt additional regulations which would further detail the manner of conducting audits of these legal entities.

## **b) Institutional framework**

As stipulated by the Constitution of the Republic of Serbia (“Official Gazette of the Republic of Serbia”, No. 98/2006), the State Audit Institution is the supreme state body for auditing public finances in the Republic of Serbia, which is independent in its work and subject to supervision by the National Parliament to which it is accountable for its work.

The Law on the State Audit Institution further defines the SAI as the supreme state authority for the audit of public funds in the Republic of Serbia, an independent and autonomous state body, which is accountable to the legislative authority. It provides for the functional and organizational independence of the SAI.

The SAI independently makes decisions on the selection of auditees, subject matter, scope and type of audit, as well as on timing and the manner of conducting an audit.

An assessment carried out by SIGMA in August 2011 stated that the Law on the State Audit Institution is well structured and comprehensive, covering all key issues without any omissions.

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<sup>5</sup> direct and indirect budget fund beneficiaries, mandatory social insurance organizations (Republic Pension and Disability Insurance Fund, Republic Health Insurance Fund, National Employment Service), public enterprises, business companies and other legal entities founded by a direct, and/or indirect public fund beneficiary, legal entities in which direct, and/or indirect beneficiaries have participation in the capital, and/or participation in the management, along with legal entities founded by legal entities in which the state has participation in the capital, and/or in management, budget funds founded by a separate law or regulations, for the purposes of achieving goal stipulated by separate republic, and/or local regulation or international treaties; non-repayable assets or guarantees, entities dealing with accepting, guarding, issuing and using public reserves, political parties in accordance with the law governing financing of political parties, beneficiaries of the European Union funds, donations and assistance from the international organizations, foreign government and non-governmental organizations and other entities using public funds and assets under control or at the disposal of the Republic, territorial autonomies, local authorities and mandatory social insurance organizations.

A number of internal regulations were adopted by the Council of the SAI defining the decision-making process, manner of work and conduct of activities in the SAI in more detail. These are:

- The Rules of Procedures of the State Audit Institution (“The Official Gazette of the Republic of Serbia”, No. 09/09).
- The Code of Ethics for State Auditors and other employees in the State Audit Institution (“The Official Gazette of the Republic of Serbia”, No. 44/09).

The Rules of Procedures of the State Audit Institution were adopted in February 2009, providing a detailed procedure based on which the SAI exercises its audit competence, provides advice to public funds beneficiaries, as well as reporting manner to the National Parliament, the organization and composition of the SAI, the manner of ensuring transparency of the work of the, the decision-making process and other significant issues related to the operations of the SAI.

The Code of Ethics for State Auditors and other employees in the State Audit Institution is harmonized with the INTOSAI Code of Ethics for auditors in the public sector (ISSAI 30) and provides a definition of as well as the purpose of the Code of Ethics, elaborates ethics principles, generally accepted rules of conduct and professional standards of conduct in the SAI.

The SAI adopted the Rulebook on Internal Job Classification in the State Audit Institution, which includes the Rulebook on Internal Organization and Job Classification in the State Audit Institution, No 110–656/2010-02 as of August 2010 and it’s amendments from 2011, 2012 and last in 2014.

This Rulebook defines the internal organization of the SAI, the management of internal units, the mutual relations between organizational units, as well as the job classification of work positions per organizational unit, number of employees, titles and conditions and employment.

According to this Rulebook, total number of classified job positions in the Institution is 107 with a total of 425 envisaged employees.

The Institution currently employs a total of 210 employees, whereby 5 of them are members of the Council (top management), 172 are employees working on audit activities (out of which 6 are Supreme State Auditors, 17 Certified State Auditors, 9 State Auditors and 140 employees working on audit activities), while there are 33 employees working in audit support activities.

The Rulebook stipulates the establishment of the new Sector for Audit Methodology and Quality Control. This Sector will deal with issues related to the development of audit methodology, quality control in all the audit phases (planning, executing, reporting and follow-up of findings and recommendations), as well as the preparation, publishing and monitoring the implementation of the standards of audit. The staffing of this Sector is already underway.

At present the SAI has premises in Belgrade, Nis, Novi Sad and Kragujevac.

The Institution uses five offices in Belgrade at five locations: 41 Makenzijeve Street (The Council and The Audit Support Sector), Bulevar Mihaila Pupina 2 (the Sector for the Audit of Public Enterprises, Mandatory Social Insurance Organizations and National Bank of Serbia), 16



Gavrila Principa Street (The Performance Audit Sector), 3 Zagrebacka Street (The Sector for Auditing of Budget and Budget Funds) and 24 Resavska Street (The Sector for Auditing of Local Authorities' Budgets).

The allocation of the SAI internal units at multiple locations in Belgrade tends to hamper the efficiency of the work of the Institution, because it creates communication problems and increases the overall operating costs.

The lack of adequate business premises brings the implementability of the Human Resources Plan of the SAI into question.

The newly adopted National Anti-Corruption Strategy highlights the need for ensuring the appropriate business premises, in order to enable an uninterrupted workflow at the SAI so that it can implement its competencies in full capacity.

A Needs Assessment with regards to the minimal requirements of the SAI for office space in Belgrade and in all regional units was prepared and the SAI is working closely with the Government of the Republic of Serbia in ensuring the optimal office space so that the SAI can conduct its regular activities in full capacity.

The financial funds allocated to the SAI from the State budget are sufficient enough for enabling the SAI to execute its regular business activities.

The Council of the SAI adopted the Financial Plan for the period 2014-2016 and submitted it to the Parliament Committee for Finance, the State Budget and Control of Public Funds' Spending for approval.

The SAI is well equipped in technical terms, which have been, in part, financed from international donor assistance, namely by the European Union through IPA and bilateral donor support from the Ministry of Foreign Affairs of the Kingdom of Norway.

The SAI adopted a Strategic Plan of the State Audit Institution for the period 2011-2015 which articulates the following goals: 1) to provide high quality and timely audit services, 2) to increase independence and develop internal governance, 3) to attract and retain professional staff and ensure a well-functioning human resource system, 4) to improve organizational, infrastructural and managerial capacities and 5) to build partnership relations with key stakeholders in order to improve reputation, recognition and impact of the SAI.

The SAI became a fully-fledged member of INTOSAI in November 2008 and a fully-fledged member of EUROSAI in June 2009.

The SAI also became fully-fledged member of the Network of the SAIs of Accessing Candidate and Potential Candidate Countries and the European Court of Auditors in August 2010 and has assumed the role of an active observer in the Contact Committee of the EU SAIs until the date of the accession to the EU when it will become a fully-fledged member.

## 2.3. Protection of the financial interests of the European Union

### a) Legal framework

The protection of the financial interests of the European Union in the Republic of Serbia is ensured by several laws and bylaws, which are harmonised with the Convention on the protection of the European Communities' financial interests<sup>6</sup> and its three protocols,<sup>7 8 9</sup> namely:

- The Law on the Budget System (“The Official Gazette of the Republic of Serbia”, No. 54/09, 73/10, 101/10, 101/11, 93/12, 62/13, 63/13 – corr. and 108/13)
- The Criminal Code (“The Official Gazette of the Republic of Serbia”, No. 85/05, 88/05 – corr., 107/05 - corr., 72/09, 111/09 and 121/12)
- The Criminal Procedure Code (“The Official Gazette of the Republic of Serbia”, No. 72/11, 101/11, 121/12, 32/13 and 45/13)
- The Law on the Liability of Legal Entities for Criminal Offences (“The Official Gazette of the Republic of Serbia”, No. 97/08).
- The Law on the Ratification of the Framework Agreement between the Government of the Republic of Serbia and the Commission of the European Communities on the Rules for Cooperation concerning EC Financial Assistance to the Republic of Serbia in the Framework of the Implementation of the Assistance under the Instrument for Pre-Accession Assistance (IPA) (“The Official Gazette of the RS – International Agreements”, No. 124/07)
- The Decree on the Management of EU Pre-Accession Assistance Programs under IPA Component I of the Instrument for Pre-Accession (IPA) – Transition Assistance and Institution Building for the Period 2007-2013 (“The Official Gazette of the Republic of Serbia”, No. 92/2013)
- The Decree on the Management of EU Pre-Accession Assistance Programs under IPA Component IIb of the Instrument for Pre-Accession (IPA) – Cross Border Cooperation with IPA Beneficiary Countries (“The Official Gazette of the Republic of Serbia”, No. 92/2013)

The Law on the Budget System defines EU financial assistance as public revenue belonging to the national budget, which is used to finance the execution of the constitutional competencies of the Republic of Serbia. As such, it represents the prime legal basis for the protection of the financial interest of the EU in Serbia. All criminal and other relevant regulations sanctioning the misuse of the Budget of the Republic of Serbia are equally applicable to EU financial assistance.

The Criminal Code contains articles defining fraud, active and passive corruption, money laundering, as well as the conditions for establishing and sanctioning the liability of heads of businesses, the temporal and territorial application of the criminal legislation of the Republic of

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<sup>6</sup> Convention on the protection of the European Communities' financial interests(Official Journal C 316 of 27.11.1995)

<sup>7</sup> Protocol to the Convention on the protection of the European Communities' financial interests (Official Journal C 313 of 23.10.1996)

<sup>8</sup> Protocol on the interpretation, by way of preliminary rulings, by the Court of Justice of the European Communities of the Convention on the protection of the European Communities' financial interests (Official Journal C 151 of 20.5.1997)

<sup>9</sup> Second Protocol of the Convention on the protection of the European Communities' financial interests (Official Journal C 221 of 19.7.1997)

Serbia, as well as the liability of legal persons, whilst the conditions for establishing the liability of legal persons for criminal offences, sanctions and the rules of the procedure for establishing liability and sentencing are regulated by a separate Law on the Liability of Legal Entities for Criminal Offences.

The Criminal Procedure Code stipulates that no one may be prosecuted in connection with a criminal offence for which he has been acquitted or convicted by a final decision of a court, or for which the indictment has been denied by a final decision, or where the proceedings have been discontinued by a final decision as well as the procedure for the confiscation of assets or material gains obtained by a criminal offence.

Serbian legislation encompasses several other laws and regulations in addition to the Criminal Code, the Criminal Procedure Code and the Law on the Liability of Legal Entities for Criminal Offences which further elaborate and define specific acts, the conditions under which they are sanctioned as well as issues related to cooperation in criminal matters.

These are namely: the Law on International Legal Assistance in Criminal Cases („The Official Gazette of the Republic of Serbia”, No. 20/09), the Economic Offences Act (“The Official Gazette of the SFRY”, No. 4/77, 36/77 - correction, 14/85, 10/86 (corrected version), 74/87, 57/89 and 3/90 and “The Official Gazette of the FRY”, No. 27/92, 16/93, 31/93, 41/93, 50/93, 24/94, 28/96, 64/01 and “The Official Gazette of the Republic of Serbia”, No. 101/2005 – other law), the Public Procurement Law (“The Official Gazette of the Republic of Serbia”, no. 124/12), the Law on Accounting (“The Official Gazette of the Republic of Serbia”, No. 62/13), the Law on the Anti- Corruption Agency (“The Official Gazette of the Republic of Serbia”, No. 53/10, 66/11-US and 67/13-US), the Law on Civil Servants (“The Official Gazette of the Republic of Serbia”, No. 79/05, 81/05 - corr., 83/05 - corr., 64/07, 67/07 - corr., 116/08 and 104/09), the Law on the Prevention of Money Laundering and Financing of Terrorism (“The Official Gazette of the Republic of Serbia”, No. 20/09, 72/09 and 91/10) and the Misdemeanour Law (“The Official Gazette of the Republic of Serbia”, No. 101/05, 116/08 and 111/09).

The referenced regulations are harmonized with the relevant articles of the Convention on the Protection of the European Communities' financial interests and its three protocols and ensure the minimum protection of the financial interest of the EU required by the European Commission.

As a candidate country for EU membership, Serbia is a beneficiary of EU financial assistance through the Instrument for Pre-Accession Assistance (IPA) and therefore, the general legal framework for ensuring the protection of the financial interests of the EU is further strengthened by an additional law and bylaws which regulate the rules and conditions for managing EU pre-accession assistance.

The Law on the Ratification of the Framework Agreement between the Government of the Republic of Serbia and the Commission of the European Communities on the Rules for Cooperation concerning EC Financial Assistance to the Republic of Serbia in the Framework of the Implementation of the Assistance under the Instrument for Pre-Accession Assistance (IPA) contains articles specifically related to the prevention of irregularity and fraud, measures against corruption and the recovery of funds in cases of irregularity or fraud, whilst the Decree on the

Management of EU Pre-Accession Assistance Programs under IPA Component I of the Instrument for Pre-Accession (IPA) – Transition Assistance and Institution Building for the Period 2007-2013 and the Decree on the Management of EU Pre-Accession Assistance Programs under IPA Component IIb of the Instrument for Pre-Accession (IPA) – Cross Border Cooperation with IPA Beneficiary Countries further elaborate irregularities in dealing with EU financial assistance and the conditions under which financial recoveries are made.

The Manuals of Procedures for the management of EU Pre-Accession Assistance in Serbia contain obligatory instructions on the procedures for managing irregularities by the responsible persons in the system for the management of EU Pre-Accession Assistance. They prescribe administrative and technical actions that are taken within the system in order to enable efficient irregularity management.

Chapter Q – Irregularities of the Manual of Procedures for the implementation of IPA in Serbia is an operational manual which contains definitions of types of irregularities as well as operational procedures for detecting, submitting, receiving and registering irregularity signals, undertaking investigations of signals as well as the system and frequency of reporting on irregularities to the responsible entities within the European Commission.

## **b) Institutional framework**

As stipulated by the Law on Ministries (“The Official Gazette of the Republic of Serbia”, No. 44/14) the Ministry of Finance proposes regulations in the area of managing available public funds, coordinates the system for managing and implementing EU funded assistance programmes, enforces actions in the area of the prevention of money laundering, executes budget control of the beneficiaries of the national budget, harmonises and coordinates the system of financial management and control and internal audit in the public sector enforces supervision over them.

The same law foresees that the Ministry of Justice proposes regulations in the area of criminal legislation, economic offences and misdemeanour acts and regulates the organisation and supervises the activities of judicial authorities.

The responsibility for enforcing criminal legislation is divided between the judiciary and the government in the Republic of Serbia, that is, the public prosecution and courts, on one side, and the Ministry of Justice and the Ministry of Internal Affairs, on the other.

The Group for Combating Irregularities and Fraud in dealing with EU funds (hereinafter: AFCOS) was established by the Regulation on the internal organization and job classification at the Ministry of Finance, which was confirmed by the Government of the Republic of Serbia on the 21st of October, 2013, as the national coordination body in the field of preventing irregularities and combating fraud in dealing with EU funds.

AFCOS has been set up as a special internal organisational unit within the Ministry of Finance which is accountable to the Minister of Finance to whom it reports directly. This institutional positioning ensures the optimal level of functional independence within the Ministry so that

AFCOS can execute its competencies and operational tasks in full capacity. AFCOS has a total number of three systematised job posts at present. Two positions have been filled while one post remains vacant.

The AFCOS Network has not yet been formally established even though the selection of bodies which will comprise the network has already been made. Preparations for the formal establishment of the AFCOS Network are in progress and initial preparations of draft legislative acts are underway.

The State Secretary at the Ministry of Finance is the appointed National Authorising Officer, who is responsible for establishing the irregularity management system and reporting to the EC and OLAF on irregularity signals and confirmed cases of irregularities in the management of IPA, as well as notifying the relevant authorities in the RS of cases of suspected fraud in dealing with EU funds in order to initiate judicial action. Also, all IPA beneficiary institutions have appointed Irregularity Officers within their institutions, which are responsible for executing administrative checks of signals in close cooperation with the National Authorising Officer.

## **2.4. Protection of the Euro against Counterfeiting**

### **a) Legislative framework**

This part of the chapter deals with the non-criminal aspects of the protection of the Euro against counterfeiting, the definition of counterfeit money, the obligation of financial institutions to withdraw counterfeit banknotes and coins from circulation, as well as to establish the authority and prescribe the procedures to effectively combat counterfeiting.

The Protection of the Euro against Counterfeiting in the Republic of Serbia is regulated by the following laws and regulations:

- The Law on the National Bank of Serbia (“The Official Gazette of the Republic of Serbia”, No. 72/2003, 55/2004, 85/2005 – state law, 44/2010, 76/2012 and 106/2012),
- The Law on Foreign Exchange Operations (“The Official Gazette of the Republic of Serbia”, No. 62/2006, 31/2011 and 119/2012).
- The Criminal Code of the Republic of Serbia (“The Official Gazette of the Republic of Serbia”, No. 85/2005, 88/2005 – corrigendum, 107/2005 – corrigendum, 72/2009, 111/2009, 121/2012 and 104/2013).
- The Decision on Handling Suspected Counterfeit Money (“The Official Gazette of the Republic of Serbia”, No. 62/2013).
- The Decision on Medals and Tokens Similar to Euro Coins (“The Official Gazette of the RS”, No. 62/2013).
- The Decision on Terms and Manner of Performing Exchange Operations (“The Official Gazette of the Republic of Serbia, No. 93/2011).
- The Decision on Conditions for the Reproduction of Banknotes and Coins (“The Official Gazette of the Republic of Serbia”, No. 18/2011).

The provisions of Article 58 of the Law on the National Bank of Serbia and Article 49a of the Law on Foreign Exchange Operations stipulate that the authenticity of money in the case of suspected counterfeit money shall be established by the National Bank of Serbia (NBS), that the NBS shall prescribe the handling of suspected counterfeit money, and that the counterfeit money shall be delivered to the NBS without any compensation.

The Decision on Handling Suspected Counterfeit Money prescribes the obligation of banks, business entities performing the exchange operations on the basis of the special law (Article 39 of the Law on Foreign Exchange Operations), and authorised exchange offices to verify the authenticity of domestic and foreign currencies (including the Euro) and deliver the suspected counterfeit money to the National Bank of Serbia in order to establish its authenticity.

The counterfeiting of money (this term also relates to foreign banknotes and coins) is a criminal offence as stipulated by Article 223, while obtaining, procuring or providing other parties with counterfeiting equipment is regulated by Article 227 of the Criminal Code. The Law does not distinguish between domestic and foreign money, paper money and coins, nor in describing criminal offences or in determining penalties.

The use of medals and tokens similar to Euro coins is governed by the Decision on Medals and Tokens Similar to Euro Coins, on the basis of Article 49a of the Law on Foreign Exchange Operations.

The Law on Foreign Exchange Operations prescribes the penalties for the production, import, export, circulation and deployment of medals and tokens if non-compliant with the above mentioned Decision.

Article 3 paragraph 2 of the Decision on Terms and Manner of Performing Exchange Operations prescribes that the condition for obtaining the authorisation to perform exchange operations is the possession of UV lamps and advanced devices for detection of forgeries.

The Agreement on Handling Suspected Counterfeit Money between the National Bank of Serbia and the Ministry of Interior more closely defines the cooperation of the two authorities (the technique for delivering suspected counterfeit money, submitting the report on the expertise, reporting, training in the field of identifying counterfeit money, etc.).

## **b) Institutional framework**

The Law on the National Bank of Serbia and the Law on Foreign Exchange Operations stipulate that the authenticity of money in the case of suspected counterfeit money shall be established by the NBS and that counterfeit money shall be delivered to the NBS.

The Regulation on the Internal Organization of the NBS, G. no 53/56, August 8, 2013 and G. no 34/37 June 2, 2014 stipulates that the NBS performs the technical analysis of banknotes and coins, draws up the reports on money expertise, collects and processes the data on counterfeit money.

The National Bank of Serbia has developed a special application for the registration of all the relevant data on asserted forgeries (currency, denomination, plate number, serial number, type of forgery, manner of creating imitations of certain protective elements, etc.) which enables the preparation of various reports according to all the relevant features of the forgeries asserted after the 1<sup>st</sup> of April 2011.

Counterfeit money is kept and destroyed at the NBS. At the request of the state authorities, the counterfeit money may be temporarily given to them (the police, the court, the Prosecutors Office) for the purpose of conducting legal proceedings and returned to the NBS upon the termination of the proceedings. The NBS acts as an expert before the court in the proceedings related to counterfeit money.

The Department of the national centres for combating counterfeiting of money and analysis of banknotes and coins was established in June, 2010, and counts 13 employees.

The Department owns the necessary equipment for the analysis of banknotes (hand-held magnifiers, UV lamps, table lamps and devices for the analysis of banknotes – Projectina Nirvis). It also owns albums containing the copies of certain types of forgeries used in everyday work and for educational purposes.

The Department's employees regularly participate in seminars in the field of forgery (The Pericles Programme and study visits to central banks).

During 2012 and 2013, training in the field of identifying forgeries was conducted for a large number of bank employees (training related to the banknotes of Serbian dinars). Seminars were also organised for the members of the Ministry of Interior, as well as the final year students of the Academy of Criminal and Police Studies.

The Law on Ministries ("The Official Gazette of the Republic of Serbia", No. 44/14) stipulates that the Ministry of Interior performs, among other tasks, activities related to international assistance and other activities with regards to international cooperation in the field of internal affairs.

The Department for the cooperation with Europol at the Ministry of Interior (MoI) deals with issues related to the prevention of counterfeiting. At present, the Department has 8 officers and the Head of the Department. Capacity of this Department will be increased in order to enhance cooperation with Europol regarding suppression of counterfeiting.

The issue of raising the capacities of the Department for improving police cooperation is covered under Chapter 24.

The cooperation between the National Bank of Serbia and the Ministry of Interior in the field of forgeries is regulated by the Agreement on Handling Suspected Counterfeit Money, signed on 31 May 2013.

Other relevant institutions in the Republic of Serbia involved in combating counterfeiting money are the commercial banks, licenced exchange offices, the courts and Public Prosecutors Office.

An Administrative Cooperation Agreement (ACA) between OLAF and the NBS was signed on December 27<sup>th</sup>, 2013, as well as a Cooperation Agreement between the European Central Bank (ECB) and the NBS has been signed, on July 15, 2014, in order to improve cooperation and facilitate the prevention of counterfeiting of Euro banknotes and the detection of counterfeited of Euro banknotes in Serbia.

### **3. ALIGNMENT OF LEGISLATIVE AND INSTITUTIONAL FRAMEWORK WITH THE EU *ACQUIS***

#### **3.1. Public Internal Financial Control (PifC)**

##### **Legal and institutional framework**

The medium and short term priorities in the development of PifC in the Republic of Serbia have been achieved in the broadest sense by the adoption of the PifC Strategy for the period 2009-2014, the inclusion of articles defining Managerial Accountability, PifC, FMC and IA, the legal obligation of managers of all public fund beneficiaries to established the same within their institutions, in the Law on the Budget System, the adoption of FMC and IA Rulebooks as well as the Rulebook prescribing the process of certifying Internal Auditors in the Public Sector. Nevertheless, independent assessment reports on the state of play in the implementation of PifC have stressed the need for further efforts with regards to implementing the PifC principals in line with the established legislative framework in Serbia and to improve harmonisation efforts and reporting to the Government by the CHU on the status of PifC implementation by the public fund beneficiary institutions.

While PifC Reform is perceived as an integral component and important part of the Public Administration Reform (PAR), the links between PifC and other Public Finance Management (PFM) subsystems need to be reinforced as internal control is a horizontal issue and requirement which is applicable across all PFM subsystems.

The new PifC Strategy for the period 2015-2019 will reinforce these links and identify the key objectives and priorities which need to be addressed in order to further PifC implementation under the PAR framework and specifically within the PFM Reform part.

A comprehensive Public Finance Management (PFM) Program is currently under preparation which will be based on outputs of a new PEFA Assessment and complemented by other relevant past assessments, including the Chapter 32 Screening Report, earlier SIGMA Assessments, IMF Assessments on different sub-systems and relevant IPA Project Reports, which is planned to be completed by the end of 2014.

The new PifC Strategy will be completely embedded in the PFM Reform Program which will in hand, be aligned with the PAR Strategy.



The adoption of the Strategy is expected by the end of 2014 while the adoption of the PFM Reform Program is aimed to be achieved by the end of the first quarter of 2015.

As PIfC represents a key element of the overall PFM Reform, the new PIfC Strategy will stipulate measures and actions that will be taken with regards to improving both the legislative framework for PIfC implementation and the actions that need to be taken in order to improve the institutional framework and administrative capacities within the Serbian national administration.

Further coherence of the legislative framework shall be ensured by linking and further detailing the current provisions in the Law on the Budget System in the implementing legislation, namely the FMC Rulebook, the IR Rulebook and the Rulebook on the conditions, manner and procedure of the exam for Certified Internal Auditors in the Public Sector.

Managerial Accountability will be further elaborated as part of the amendments to the FMC Rulebook and FMC Manual in order to clarify and clearly reflect the role of FMC as an instrument of ensuring that operations and transaction executed within a public funds beneficiary under the responsibility of the manager are conducted in a systematic, prescribed and transparent manner, offering the manager assurance that operations and transactions within his institution are conducted according to the principals of sound financial management by the end of 2016.

Furthermore, Irregularity Management (IM) will be incorporated into the FMC framework, in line with the requirements of the Financial Regulation and other applicable EU regulations. This function will be regulated through the Law on the Budget System and closely associated with the relevant provision defining Managerial Accountability. Institutionally, the role of the Irregularity Manager will be allocated to the appointed FMC Coordinators or the heads of public funds beneficiary institutions.

Introducing IM is one of the key priorities in further FMC development and implementation as it represents an important aspect of Managerial Accountability and one of the key components of the internal control system representing the interface of FMC with the inspection services - the next layer in the protection of public funds from misuse. In the context of the present Chapter, IM represents a key element in the ensuring the protection of the financial interests of EU.

The mandate, scope of responsibility and methodology of work of the Budget Inspection will also be revised and redefined in order to provide the appropriate segregation between the internal control, internal audit and inspection functions in order to enable a PIFC compliant centralized Budget Inspection.

It is expected that the amendments to the applicable Law on the Budget System will be adopted by the end of 2014 whilst the legislative framework regulating the function of the Budget Inspection will be completed by the end of 2015.

The revised legislative framework will ensure the coherence and consistency between the Law, the implementing acts and the FMC and IA Manuals, in full compliance with the PIFC requirements by the end of 2016.

The Action Plan of the new PIFC Strategy will foresee the further development of risk management and its systematic application in practice through the provision of seminars and workshops on Risk Management for public funds beneficiaries and monitoring the implementation of Risk Management strategies. It will also encompass an assessment of the institutional and administrative capacities at the Ministry of Finance for executing the CHU function as well as the revision of the Manuals for FMC and IA which will be adjusted to integrate new procedures which will be established in the short term and medium term.

A Gap Assessment of the institutional and human capacities within the Ministry of Finance will be carried in the short term in order to provide basic input so that actions can be taken with regards to enabling the full execution of the CHU function in the Serbian administration

The new PIFC Strategy will stipulate a more active approach of the CHU in promoting the importance of the role of the CHU to managers in creating the culture of the organization, which will enable them to understand FMC in a broader sense, not just through formal drafting of procedures, documenting business processes, preparing Risk Registers and ensuring formal legality. Further efforts will also be invested in raising the expert and technical knowledge of the staff of the CHU as well as fostering a proactive approach toward executing regular activities by the end of 2016.

The CHU will actively provide continuous advisory services on how to address the SAI findings for resolving problem issues and improving the FMC systems within public fund beneficiary institutions by the end of 2016.

The tasks of organizing theoretical trainings on FMC and IA will be transferred to the relevant government bodies who are responsible for human resource management and training of civil servants by the end of 2016 whilst the staff of the CHU will still provide the theoretical training to relevant civil servants. The CHU will also retain the overall role of developing and upgrading the training curricula that will be used for FMC and IA training.

The possibility of introducing a software solution to improve data processing and reporting will also be considered in the short term.

Procedures for collecting information from FMC coordinators and Internal Auditors in public fund beneficiary institutions, conducting regular updates of the FMC and IA Manuals and the preparation/submission of Annual Reports on the status of PIFC implementation to the Government will be prepared, embedded in the FMC and IA Manuals and disseminated to all institutions by the end of second quarter of 2015.

The means for assuring the quality of the Internal Audit function in public funds beneficiaries will be improved through internal and external peer reviews and reporting on associated findings.

The objective of the quality checks is to assess the IA function in public fund beneficiary institutions and to report on its compliance with the definition of Internal Auditing and the Standards and to assess whether Internal Auditors apply the Code of ethics, the efficiency and effectiveness of the internal audit activity and identify opportunities for improvement. The changes will be reflected in the IA Rulebook and associated procedures.

Managers in public funds beneficiaries will be further trained on the importance and role of the Internal Audit function and in particular with regards to the obligations of managers to ensure the independence and objectivity of Internal Auditors.

The possibility of providing the necessary means for enabling international certification for Internal Auditors will also be further discussed with the EC in the medium term.

### **3.2. External Audit**

#### **Legal and institutional framework**

The Law on the State Audit Institution, which regulates the position and defines the scope of work of the SAI was prepared based on the Lima Declaration of Guidelines on Auditing Precepts, the Mexico Declaration on Independence, the International Standards of Supreme Audit Institutions (ISSAI Framework), the International Organisation of Supreme Audit Institutions Auditing Standards (INTOSAI Standards), the European Implementing Guidelines for INTOSAI Standards and INTOSAI Code of Ethics for Public Sector Auditors and provides a high degree of functional, operational and financial independence.

An additional assessment of the Law will be carried out by EU Twinning experts in 2015, in order to identify potential gaps and provide the basis for its further harmonisation with the applicable standards listed above and in line with the appropriate scope and level of competency. The role of the SAI in filing misdemeanour charges will also be assessed and addressed as part of the amendments to the Law on the SAI in parallel with the revision of the role of the centralised Budget Inspection in the medium term.

The SAI is currently carrying out a mid-term review of the implementation of the existing Strategic Plan together with the experts working on the EU Twinning Project supporting the SAI.

The updating, and/or development of the new Strategic Plan for the period 2016-2020 will be conducted during 2015. The associated Human Resources Development Strategy along with the Information Technology Strategy and the Communication Strategy will be prepared and adopted. The Strategic Plan, along with the individual strategies, will be accompanied by Action Plans.

The biannual Action plans will be the key documents for the further improvement of the functioning of the SAI and strengthening the professional skills of audit and support staff. The SAI will be subject to a “peer review” in 2016.

The main areas of further strategic development are the following: increasing the number of State Auditors, increasing the number of audits, increasing total number of audited public funds and expanding the number Auditees, improving the quality of audits and ensuring quality control in the audit process in line with the ISSAI framework, improving the procedure for programming, planning and carrying out audits; providing an efficient system for reporting and monitoring of the implementation of SAI's recommendations and improving internal organization of the Institution.

All relevant stakeholders, including the National Parliament, will be consulted during the preparation of the Strategic Plan.

A framework for enabling a new, efficient and more functional internal organization will be provided by the new Strategic Plan of the Institution.

The Human Resources Plan stipulates the hiring of approximately 100 employees by the end of 2014, out of which approximately 90 employees would work in audit activities. Therefore, it is expected that the SAI will have a total of 311 employees by the end of the year. The remaining staff required to achieve full audit capacity will be employed in the short term.

The provisions of the Law on the Budget System prescribe that the SAI may employ new persons for the purpose of filling vacant job positions until 31<sup>st</sup> December 2015, with the consent of the Committee on Administrative, Budgetary, Mandate and Immunity Issues of the National Assembly.

The hiring of new staff in the newly established Sector for Audit Methodology and Quality Control is initiated and expected to be completed in the medium term.

The SAI is also working closely with the Government of the Republic of Serbia on ensuring the optimal office space so that the SAI can conduct its regular activities in full capacity.

Professional education and certification of auditors will continue, creating the necessary conditions for filling the vacant job positions and increasing the number of auditors significantly. A new training cycle has been initiated, and the organization of exams for acquiring audit titles is underway.

Two Rulebooks are currently being prepared – one defining training, examination and the procedure for acquiring the titles of a state Auditor and Certified State Auditor, and the other stipulating the manner for implementing continuous professional education of employees.

The procedure for acquiring the titles of the State Auditor and Certified State Auditor will be implemented in compliance with the Law on SAI and the internal regulations which define the procedure in more detail will be adopted by the SAI Council. The procedure for implementing continuous profession education will be executed in compliance with the international standards and practices previously stated in the text.

Continuous professional education will be organized and implemented by a separate unit within the SAI, aiming to enhance the knowledge of auditors, which will result in higher quality of work and reporting.

The Institution finalised the first Performance Audit (*The management of company vehicles of direct budget beneficiaries of the Republic of Serbia*), and another audit has already commenced (*The management and usage of property of the Republic of Serbia*).

The Performance Audit function will be further developed in addition to the execution of the Financial and Compliance Audit functions in the coming period.

The development and testing of the Financial and Compliance Audit Manuals is underway with the assistance of EU Twinning Advisors, and they will be adopted in January 2015, along with the Performance Audit Manual, which will be adopted in February 2015. The Audit Manuals are based on the ISSAI Framework.

In addition to the audits of the Budget of the Republic of Serbia; mandatory social insurance organizations; operation of the National Bank of Serbia, in part relating to the usage of public funds; appropriate sample of local self-government units; appropriate sample of public enterprises and other legal entities - as of 2015, audits of an appropriate sample of the Parliamentary parties at the State level will be conducted in accordance with the applicable Law as stated in part 2.1.

As of 2015, the Law on the Budget System stipulates that there will be a transition from the current line-item budgeting to Programme Budgeting at all levels of the government.

All budget beneficiaries will be obligated to define programmes, programme activities and specific projects and, consequently, define clear objectives and indicators for measuring and the implementation of programmes. This will essentially bring about a change in the approach to audit subject matter as well, as performance audit will be carried out at the same time as Financial and Compliance Audits. The SAI is fully prepared for the new approach, and the new internal organization will reflect the new approach.

The SAI also plans to continuously develop its work on financial audit and compliance audit in the period 2016-2020.

At present, the SAI is strengthening its internal control system by introducing a job post for an Internal Auditor. By strengthening its own internal control system, the SAI aims to set a positive example to other public fund beneficiary institutions and to advocate the importance of internal control.

The Reports of the SAI contain detailed information on the status of the internal control systems in Serbia as the functioning of the internal control systems is crucial for the improvement of management and the State level.

The Annual Reports highlight this issue every year. The document is sent to the CHU at the Ministry of Finance in order to assist the relevant body for the coordination of FMC and IA implementation in resolving potential bottlenecks in the implementation of PIfC at all levels. Whilst safeguarding the principle of independence, the SAI will continue to cooperate closely with the CHU on topics of common interest.

Cooperation between the State Audit Institution and the National Parliament is stipulated by the Law.

Contact persons for cooperation have been designated in both, the National Parliament and the SAI, in order to enable more efficient follow-up of recommendations as a result of the completed audits, within which there are also initiatives for amendments to laws and other regulations aimed at improving the public finance system.

The SAI will further strengthen its cooperation with the SAIs that are members of the INTOSAI and the EUROSAI as well as with the European Court of Auditors through bilateral and multilateral cooperation and the implementation of the activities aiming at strengthening the external audit profession.

### **3.3. Protection of the Financial Interests of the EU**

#### **Legal and institutional framework**

The Republic of Serbia plans to implement a variety of measures and undertake actions during the further course of the accession process in order to upgrade the legal framework, the institutional and administrative capacities to further strengthen the protection of the financial interests of the EU.

An Administrative Cooperation Agreement (ACA) between OLAF and Ministry of Finance is planned to be signed by the end of 2014 and will, in addition to the Law on the Ratification of the Framework Agreement between the Government of the Republic of Serbia and the Commission of the European Communities on the Rules for Cooperation concerning EC Financial Assistance to the Republic of Serbia in the Framework of the Implementation of the Assistance under the Instrument for Pre-Accession Assistance (IPA), provide the basis for implementing on the spot checks by OLAF investigators in Serbia.

Furthermore, the relevant national laws regulating the methodology applied to gathering and safeguarding criminal evidence will be analysed and adjusted in the short term in order to ensure the basic legal requirements for securing evidence in cases of potential fraud in dealing with EU funds.

The accredited system for decentralised management of EU Pre-Accession Assistance programs under IPA Components I and II for the period 2007-2013 represents a good basis and model which will be further revised and improved in order to meet the requirements of the new Instrument for Pre-Accession Assistance (IPA II) for the period 2014-2020.

The legal and institutional framework for managing and implementing IPA II under indirect management will be drafted and adjusted as part of the overall efforts that will be undertaken in the implementation of the comprehensive PFM Reform Program, which will, among other things, aim to ensure the further integration of the national system for financial management and the management and control of EU funds in Serbia under a single system for managing all public funds in Serbia, in line with the relevant EU regulations and requirements for ensuring sound financial management of EU funds.

Irregularity management as one of the components of FMC and elements of Managerial Accountability will be incorporated into the FMC Framework and defined as a component of Managerial Accountability as previously stated in this document, in the section related to PIcC.

The new Law on the Budget System will stipulate the authority of the Ministry of Finance in irregularity management and the coordination of anti-fraud will reinforce the legal basis for the work of the AFCOS, as established by the Regulation on the internal organization and job classification at the Ministry of Finance. Furthermore, it will also provide the legal basis for the management and control of IPA II under indirect management is planned to be adopted by the end of 2014.

The secondary legislative framework including bylaws, additional regulations, as well as manuals of procedures regulating the work of AFCOS are planned to be adopted by mid-2015.

Irregularity Management as an element of Managerial Accountability will be further incorporated through subsequent amendments to the Law on the Budget System and then further detailed in the FMC Rulebook and FMC Manual within the timeframes defined in the section of this document which deals with PIcC.

At present, two out of a total of three job positions have been filled at the AFCOS Office. An increase in the number of job positions at the AFCOS Office by two is planned by the end of 2014 as to provide the necessary conditions for sound and efficient anti-fraud coordination but also for assuming the function of executing administrative checks of irregularity signals and suspected fraud from the accredited horizontal bodies within the system for the management EU Pre-Accession Assistance. It is anticipated that the AFCOS Office will be fully staffed by end of the first quarter of 2015

Capacity building for ensuring the sufficient functional and operational capacities of AFCOS will be ensured through close cooperation with OLAF, the EU funded technical assistance project to the Serbian authorities for the management of pre-accession assistance and the TAIEX program for capacity building for strengthening anti/fraud coordination and irregularity management in Serbia in the medium term.

According to the Action Plan for Strengthening the Anti-Fraud Coordination Function in the Republic of Serbia, which was prepared by the Ministry of Finance in close cooperation with OLAF, the Anti-Fraud Strategy will be prepared during the course of 2015 and it is anticipated that it will be adopted by mid- 2016.

Preparatory activities are also currently being undertaken by the Ministry of Finance with regards to establishing the AFCOS Network. The Network itself will comprise, at a minimum, of representatives from the following institutions: the Ministry of Justice, the Ministry of Internal Affairs, the Public Prosecutors Office, the Ministry of Finance including, the Budget Inspection Department, the National Fund, Tax Administration, the Administration for the Prevention of Money Laundering and Treasury Administration and is planned to be formally established by mid-2015.

### **3.4. Protection of the Euro Against Counterfeiting**

#### **Legal and institutional framework**

The Republic of Serbia has undertaken activities to sign and ratify the Geneva Convention for the suppression of counterfeiting currency. It is expected that the procedure will be finished in a short term.

In terms of establishing the authenticity of euro coins (Regulation (EU) No 1210/2010 on the authentication of euro coins and handling of euro coins unfit for circulation), and euro banknotes (Decision ECB/2010/2014), there is only partial harmonisation of national regulations with the EU regulations.

As stated in the previous section, the Decision on Handling Suspected Counterfeit Money prescribes the obligation of banks, business entities performing the exchange operations and authorised exchange offices to verify the authenticity of domestic and foreign currencies (including the euro) and deliver the suspected counterfeit money to the National Bank of Serbia in order to establish its authenticity. However, there are no national regulations that would establish the procedure for determining authenticity or prescribe the obligation to use the accurately specified devices for determining authenticity, except for Article 3, paragraph 2 of the Decision on Terms and Manner of Performing Exchange Operations (“The Official Gazette of the Republic of Serbia”, No. 93/2011) prescribing that the condition for obtaining the authorisation to perform exchange operations is the possession of UV lamps and advanced devices for detection of forgeries. The mandatory training in identifying the counterfeit foreign money has not yet been provided.

Owing to the fact that national regulations, i.e. the Decision on Cash Flow Management (“The Official Gazette of the Republic of Serbia”, No. 60/2012, 64/2013 and 115/2013) stipulate that manual processing of money (relating to domestic currency - Serbian dinars) may be performed by the employees who underwent training at the National Bank of Serbia, and that machine processing of money (Serbian dinars) may be performed by using only the machines officially approved by the National Bank of Serbia, it is considered unjustifiable to simultaneously impose an obligation on banks to perform the processing of foreign money. The national regulations are expected to be fully applied as of 1 January 2015.

The harmonisation with the EU regulations previously mentioned, in the short term, would impose great costs on banks (training of thousands of bank employees, purchase of a large number of machines to be used to verify the authenticity of Euro coins and banknotes).

With regards to Euro coins, there is an issue of a very low usage. The Euro coins in the Republic of Serbia are used exclusively for paying tolls. Counterfeited Euro coins are very rare and occur every two or three years, in two or three copies. On the other hand, counterfeited Euro banknotes are present in the Republic of Serbia. The data on the presence of counterfeited Euro banknotes indicates that in the five-year period from 2009 to 2013, 8,669 counterfeited Euro banknotes were detected, amounting to 874.795 EUR, which amounts to approximately 1,734 counterfeited Euro banknotes in the amount 174,959 EUR annually when observing this reference period.



For the reasons mentioned above, the Republic of Serbia will transpose the Council Regulation (EC) No 1338/2001 laying down measures necessary for the protection of the euro against counterfeiting, the Regulation (EU) No 1210/2010 of the European Parliament and of the Council concerning authentication of euro coins and handling of euro coins unfit for circulation and Decision ECB/2010/14 on authenticity and fitness checking and recirculation of euro banknotes into a domestic legal system and implement the technical aspects regarding the implementation of the Regulation (EU) No 1210/2010 by December 31, 2018.

Apart from the Administration Cooperation Agreement (ACA) between OLAF and the NBS and the Cooperation Agreement between the European Central Bank (ECB) and the NBS which were signed in 2013 and 2014, the Republic of Serbia signed an Agreement on Operational and Strategic Co-operation with the European Police Office on the 16 January 2014. This Agreement is currently in process of ratification by the National Parliament. It is expected that the procedure will be completed in the short term.

The Republic of Serbia also concluded a Memorandum of Understanding on the Confidentiality and Information Assurance with the European Police Office (MoU), by exchange of notes in February 2014. The MoU will enter into force on the first day of the month following the signature of the last party, but not before the Agreement on Operational and Strategic Co-operation has entered into force.

Representatives of the NBS took a part in the Pericles Training Programme in Montenegro in May 2014. A visit to the Central Bank of Croatia is planned for September 2014 in order to exchange experience in the field of combating counterfeiting money.

The Republic of Serbia plans to continue to participate in the Pericles Programme as well as to further cooperate with the European Commission, the European Central Bank, and a number of EU Member States' central banks.