



PUBLIC FINANCIAL SYSTEM IN MACEDONIA

Center for Economic Analyses (CEA)

Skopje

November, 2010

Disclaimer: Opinions expressed in this report are those of the Center for Economic Analyses – CEA and do not represent the opinion of the USAID or any other concerned institutions.

It is the responsibility of other authors to cite this report when it has informed their research and publications.

Table of contents

BACKGROUND	4
PROCESS OF BUDGETING.....	5
INTERNAL FINANCIAL SYSTEM	11
PUBLIC PROCUREMENT	12
EUROPEAN FUNDS	14
EXTERNAL FINANCIAL AUDIT	15
LITERATURE AND REFERENCES	20

General information about CEA

Logo:



Address:

CENTER FOR ECONOMIC ANALYSES (CEA)
Bul. Jane Sandanski 63/3,
1000 Skopje Macedonia

Tel: + 389 (0)2 24 44 766
Mob: + 389 70 834 636

TIN: 4030003479278
Reg. 5763061

Account number:

Stopanska Banka AD Skopje
Account number: 200000856268559

Web page and e-mail:

www.cea.org.mk

www.lsg-data.org.mk

info@cea.org.mk

BACKGROUND

This report was prepared under the contract provisions signed between CEA and USAID for nonexclusive services to USAID as part of a grant agreement. This report provides research findings on the public financial system-PFS in Macedonia. This report should be regarded as an initial study that sets the basis for a more thorough and systematic analysis of the PFS in Macedonia, and its findings should be regarded in that light.

The report comprises:

- Current state of affairs.
- Identification of main achievements and weaknesses in terms of legal framework, institutional setting and
- Track records for the:
 - Process of budgeting,
 - Internal financial system,
 - Public procurement,
 - European funds,
 - External financial audit.

Source of data used were obtained from the State Audit Office, Ministry of finance, interviews with state administration, Public Procurement Bureau and are as of June 2010.

PROCESS OF BUDGETING

The budgeting process will be evaluated by using the Fiscal transparency manual of the IMF where the basic requirements and the best practices are based on four pillars that we will use to assess the Macedonian case¹.

The **first pillar of fiscal transparency** is the clarity of roles and responsibilities and comprises of two core practices on the clear distinction between government and commercial activities and on a clear legal framework governing fiscal administration.

First pillar evaluation for Macedonia:

1. The scope of the central and local governments are clearly separated by the legislation, also the financial and non-financial public entities, but it is not very clear to the general public,
2. By the Constitution, the fiscal powers of the executive, legislative, and judicial branches of government are well defined, Parliamentary Commission for financing and budgeting exists and is operational but its role needs to be strengthened, awareness is missing for the taxpayers, pensioners, social categories of citizens to practice their right to appeal to courts in order to exercise their rights,
3. There is a space for higher consistency in the fiscal decentralization, calculation of fiscal needs is missing, there is need for more transparent distribution of central government transfers and to crowd out the discretionary rights for fiscal distribution, there is space for improving public finance data and information dissemination and to improve accountability toward citizens, there is space to improve local government statistical system especially for the local government's contingent liabilities, there is need for more active and efficient Commission for monitoring the development of the system for financing local government, there is need for more efficient Law on the City of Skopje,
4. There is need for presenting the quasi fiscal activities to downsize the fiscal risks (example is the high pressure for the current account of the BoP from the electricity importation in 2008 as in the power market and there was a social price for the electricity for the households and the small businesses),
5. There is space to assess the compliance costs (for example the costs for the implementation of the gross salary system for the first time in Macedonia in January 2009 where the government practically was testing the new system during the implementation period and salaries were late for the employees or the example of the so-called patriotic fiscal receipts with the "buy Macedonian" label was cancelled by the Constitution Court, the example with the fire extinguishers and the proper by law and law, and thus, created significant compliance costs to the businesses to adjust, the example with the resigning of the health fund spokesman when he announced that the

¹ The first review was done back in 2008 under same methodology. See: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1443394. In this report the text was updated with recent developments but not much progress was identified anyway.

government invested a lot in the 3-children campaign and now the fund is empty to pay the maternity leave compensation etc).

The **second pillar of fiscal transparency** is the open budget process and it relates to the transparent budget process in the budget preparation, execution and monitoring. It is an important pillar more because the budget is the main government instrument to conduct its fiscal policy.

Second pillar evaluation for Macedonia:

1. The budget calendar is prescribed by the budget law but in practice doesn't provide enough time (OECD good practices show that even three months before the fiscal-year-start the budget can be submitted to the Parliament), positive for the Macedonia budget is that the PIP, macroeconomic policy and fiscal strategy are being prepared before the budget,
2. Macroeconomic policy should be consistent with a set of assumptions that are not biased, the Ministry of finance prepares the Pre-Accession Economic Program – PEP which already includes the macroeconomic policy within thus, it should consider being more efficient and actually cancel the double work by preparing twice similar documents, the revenue forecasts should take into account the current trends and more scenarios should be considered, the fiscal strategy (which is actually fiscal outlook) should be developed into mid-term fiscal framework by introducing performance measurement indicators and to be connected with other strategic documents (for example poverty reduction strategy, decades of the Roma population and similar), the mid-term fiscal framework could further in future be developed into mid-term budget framework where revenues and expenditures can be presented together with the strategic goals of the budget users, the government could also consider introducing fiscal responsibility legislation (budget deficit fiscal rules, borrowing, debt ceilings etc) and possible could consider for a new law on public finances,
3. Budget discipline asks for clear description and calculation of the expenditures of the government programs and the newly proposed policies and thus, providing better accountability, such a budget discipline can provide better information for the local governments about the costs of the services for their transferred competencies as well,
4. In the fiscal strategy there is a need for the fiscal sustainability assessment, it is good that the total public debt is presented but information are missing about the scope, exactness and the impact, information are missing about the contingent liabilities (guaranties, insurance, risks, local government hidden debt), interesting is that there is a presentation of the programs with outputs (it is not clear why in accordance with the budget circular it is explicitly stated that the budget users must present the output indicators but are not obliged to use the outcome and performance indicators even though proper definitions for them are presented in the circular), it is too early to talk about performance budgeting in Macedonia because of the still weak administrative and institutional capacity and here we recommend small steps, to provide the administrative merit system to take over, to make proper needs assessments, proper training plans to enhance capacity etc,

5. The contingent liabilities can lead to unrealistic budget deficit information thus, they should be provided transparently with a proper narrative, and the final financial statements should be inclusive of proper performance reports

The **third pillar of fiscal transparency** is about public availability of information. The information should be presented in a way to provide proper analysis of the government policies and will promote responsibility and accountability.

Third pillar evaluation for Macedonia:

1. Budget documentation consists of: budget, revenues, expenditures, deficit/surplus, suggested fiscal measures, fiscal strategy, macroeconomic policy, there is need for more information on risks and quasi fiscal activities, there is need for publishing quarterly reports with proper explanatory notes and report with the results achieved,
2. In presenting the last year's results at least the last two years should be presented, at aggregate level a forecasts for the next 5-10 years can be presented together with the assumptions outlining the forecasts, changes in the classification should be presented together with the explanatory notes on why the changes occur,
3. It is a good practice to present the fiscal effects of all tax relief (the so called tax costs) which Macedonia has from introducing relatively high amounts of agricultural subsidies for example, (for example the Germany's report on subsidies), contingent liabilities are potential future costs and they should be analyzed, quasi fiscal activities should be presented and quantified especially when they can have a higher economic impact (for example the case of the electricity importation in Macedonia and the impact on the current account), there should be risk presentations, their quantification and usage for building simulations and managing the contingent liabilities,
4. There is need to present the consolidated budget that will include the local government finances as well, the local government should report on their quasi fiscal activities from the enterprises they control², public finances of the local governments should be accessible to the public, the sector within the budget department within the Ministry of finance is weak and not up to the task, the administration needs training in fiscal transparency,
5. Long term reports (for example each 5 years to be produced 10-40 years annual forecasts) are in need because of the ageing population, climate changes, energy policy, technological change, investment in knowledge (for example: government introduced mandatory secondary school, increased spending on higher education and there is no assessment on the potential impact), change in social attitudes (for example the "YOU are Macedonia" campaign),
6. Information presenting could be through guideline for citizens where in a transparent and clear and simple way the main achievement by outputs, results by strategic priorities and priority goals and government programs will be presented, the government should think to adopt a fiscal transparency charter and proper standards for dissemination of fiscal information

² Especially now when PPP activities are more desirable and they are an off budget category.

The **fourth pillar of fiscal transparency** is about the assurances of integrity i.e. about the quality of the fiscal information and the need for independent analysis of fiscal information.

Fourth pillar evaluation for Macedonia:

1. There is need for analysis of the determinants of the differences between the planned and executed revenues and expenditures, there is a need to present cross check of fiscal data with monetary and BoP data for consistency reasons,
2. UN in 1996 adopted an International code of conduct for public officials to: avoid conflict of interest, comply with any applicable requirements to disclose their personal assets and liabilities, not solicit or accept any gift or favor that may influence the performance of their duties, respect the confidentiality of any information in their possession and not engage in political activity outside the scope of their office such that it impairs public confidence in the impartial performance of their duties.
3. The employment should be based on the merit system as there are still discretionary employment practices,
4. There is need for further development and implementation of the internal audit and publishing annual report for the public,
5. The state audit should be enhanced in its independence, their reports (audit reports) should be reviewed by the Parliamentary commission for financing and budgeting, it is a good practice to invite independent think tanks to make macroeconomic forecasts and/or ex post assessment of the government forecasts, there is a need to enhance technical capacity of the State statistical office and for them to have active part in making it clear about the interpretation of the statistical data when there is political abuse of in interpreting different statistical indicators and data

Positive characteristics of Macedonian budget

From institutional and legal point of view in Macedonia there exist a proper legal framework for the budget process that prescribes the budget calendar and it is a good base for stability and predictability of the process itself. It is especially of importance that year by year there are improvements in the legislation, institutionally, planning, execution, monitoring, reporting and this practice should continue (law on budgets, program budgeting, internal audit, managing the public debt, fiscal strategy, PEP, the so called development part of the budget). The trend of continuous improving is in need of proper strategy for budget process development which Macedonia is lacking.

The legal framework of the budget process is generally clear and proper but there is need for enhancing accountability, participation and transparency. The treasury system allows for proper control of the budget execution and through the State audit office-SAO it is allowed for external audit of the budget execution (there is a need for enhancing the independence of the SAO). Within the Ministry of finance there is the Sector for internal financial audit as well. Even though the two control mechanisms are established there is need for their further development and enhancing.

In the fiscal part positive is that the capital expenditures for roads, education and health are higher in the last few years because of the historically low appropriations for O&M but the problem is the lack of skills and knowledge to publicly procure the programs and hence execute the appropriations. There are some improvements in transparency as some documents and information (at synthetic level) can be find at the web site of the Ministry of finance, still there is a need to publish a calendar for publishing a fiscal information. In that sense there is a need for publishing a summary for the general public of the budget, fiscal strategy and the macroeconomic policy and the PEP as well where one can see the components by economic, functional, organizational, program classification for the both government's level.

Negative characteristics of Macedonian budget

Even though there is the prescribed budget calendar still it is not respected and doesn't allow enough time for the budget users. There is need for the strategic planning to be better integrated with the budget process. There is a need to enhance the strategic sectors within the ministries and their communication with the other sectors. The ministries have they own strategic documents that are not integrated among themselves.

Even though the Ministry of finance started to set and control the limits of the budget users still there is lack of performance measurement and there is the risk for the budget users to care only for maximizing the absolute volume of the appropriations.

Even though there is progress in the technical forecasting of the economic-fiscal variables still there is a need for more comprehensive analyses about the impact assessment, risk analysis, preparation of scenarios. Even though the Ministry of finance is preparing the fiscal strategy that is prescribing the revenues, expenditures and the risks still there is a need for proper mid-term budget plan that will be useful for the next years and also the analysis of the main determinants of the expenditures, integrating plans for O&M of the newly purchased assets, fiscal space and new initiatives reserves, assessment of the expenditures sensitivity, donations, managing natural resources and proper risk management analysis, quasi fiscal analysis, tax cost analysis and contingent liability analysis.

It is good that the rolling over fiscal strategy³ started to illustrate the intergovernmental transfers, IPA components and the public debt elements but there is a need for more in depth fiscal sustainability analysis. It is a good practice for the Ministry of finance to ask for annual forecasts and analysis of the previous year's fiscal outcome from independent organizations that can contribute for enhancing fiscal transparency. For the PIP there is need for better integration with the strategic priorities and goals, better integration with the budget process and for stronger project management skills. There is need for clearer role of the Commission for the strategic projects within the government with the PIP and the budget process in general (one has the feeling that the PIP itself is good but with low contribution for the budget process). This last note

³ The fiscal strategy in 2010 is late. The Budget Law prescribes in Article 16 that the Fiscal strategy will be adopted by the Government at latest 31st of May in the current fiscal year. This literary means that the Government is behind the legal budget calendar, the budget users cannot plan, the budget users and the economy overall is under uncertainty as no one can position itself against the Government finances.

is especially important now when the government announced its 8 billion euros worth projects. In that sense it is important to note that instead to integrate still there is strong separation between the government policies, administration and the Macedonian budget.

There is a procedure for employment of civil servant but the procedure is not respected in general and still there is the practice of discretionary employments (latest developments between the anticorruption commission and the director of the money laundry agency). That is why the independence of the SAO and the Civil Servant Agency should be enhanced as well.

Unfortunately the civil sector is not part of the budget process and this is a huge shortcoming for the Macedonian strategic planning and budget process.

OTHER RECOMMENDATIONS

There is space for presenting the quasi fiscal activities of the public enterprises (for example the importance of the subsidized electricity price and its importation were causing serious risk for BoP crisis in Macedonia), enhancing transparency in discretionary expenditures (enhancing the accountability and responsibility in spending the so called “functions of the government” item), improving the intergovernmental transfer system and more efficient Commission for monitoring the development of the process of decentralization, enhancing the independency of the SAO and the internal financial audit.

The macroeconomic policy document should be replaced completely by the PEP document and the government should think of amending the Law on budgets and allow for the fiscal strategy and the PIP to be adopted by the parliament before the budget. The idea for the fiscal strategy to be adopted before the budget by the Parliament is to relax the political debate about the fiscal policy of the government and thus give room for more efficient discussion about the budget in the Parliament given the highly politicized society in bipolar political set up in Macedonia. For the PIP it is important to be adopted before the budget as the Commission for the strategic projects within the government is acting as “beyond the budget ad hoc body” and thus, the very important capital projects can have its consensus in the Parliament given the importance of the volume of the resources and the shortcomings in the implementation due to weak and politicized administration.

There is need for more in depth and thorough analysis of the budget process and the strategic planning that will identify all the stakeholders, will analyze their needs, goals and their involvement in the budget process. Such an analysis must give answers on how to provide better coordination, communication, consensus and support in the budget process. Macedonia needs such an analysis because if there is no needs analysis of the budget users and their programs then there is no way one to understand the needs of the citizens as final users of those programs.

There is need to enhance the skills of the budget sector within the Ministry of finance, to prepare proper guidelines, rules of procedures for the budget analysts at all budget users, there is need to synchronies the General secretariat in monitoring the execution and reaching strategic goals, enhancing the strategic planning and project management skills as well.

If proper measures are not taken to further enhance the budget transparency, the over centralized decision making within the government, weak capital expenditures execution, lack of coordination and synchronization will continue.

The Parliamentary commission for financing and budgeting should review not only the annual report of the SAO but the detailed audit reports as well and to cooperate more with external experts given the lack of expertise they face. That commission should consider new organizational set up in three areas: public finance, budgeting and audit.

INTERNAL FINANCIAL SYSTEM

The process of strengthening of the Public Internal Financial Control (PIFC) system has been started in 2000 and it is conducting through development and applying of the principles of decentralized responsibility of the management and establishing functionally independent internal audit. General compliance and budget discipline was increased with the introduction of the treasury system in 2000. The Treasury system is effective in controlling expenditure in line with the budget and in terms of managing cash flow. While the budget is planned on a three digit code, budget execution is based on a six digit code. All budget users are required to submit quarterly cash flow forecasts and, at the beginning of each quarter, to prepare monthly plans for that quarter.

Lately, Public Internal Financial Control system in the Republic of Macedonia has been regulated with the Law on Public Internal Financial Control (“Official Gazette of Republic of Macedonia”, no. 09/09) and the Law on state audit (“Official Gazette of Republic of Macedonia”, no. 66/2010). It is expected in 2010 the Law on finance inspection in the public sector to be adopted.

As for the legislative alignment and administrative capacity there is the rulebook on financial management and control – FMC prepared. For the FMC, there is a need for establishing financial affairs units-FAU responsible for FMC (in 65 budget users in accordance with the AP). There is a need to strengthen the independence of the internal auditors, to set up criteria for establishing internal audit units (2 IA for 50 mln. Denars, 4 IA for 500 mln. Denars and 5 IA for up to 2 bln. Denars) and to design a certification procedure for internal auditors.

There is a need for equipping the departments of the newly envisaged financial affairs units, trainings and adopting by-laws to the PIFC law and preparing and publishing a manual for the IA.

There is a draft Strategy for development of PIFC in Macedonia 2010 – 2012 but still not adopted. The main elements to strengthen the PIFC in Macedonia as per the draft Strategy is the enhancing of capacity of the IA units, the CHU within the Ministry of finance. Also, there will be established a Committee for FMC and an IA Committee within the Ministry of finance. Also, there will be appointed persons to whom one can submit irregularities in the public sector and a public sector financial inspection will be established.

The Committee for FMC will be a consultative body to the Minister of finance and will comprise the heads of the FAU. The IA Committee will be a consultative body to the Minister of finance and will comprise the heads of the IA in the public sector. There is a need to develop a rulebook to these committees.

In accordance with the Law on PIFC, there is a need for the direct budget users to establish the FAU. By the end of April 2010 only 20 of 71 are established. However, by then additional 16 started the procedure thus, we can assume that 50% of them have FAU established. Heads are appointed to 10 direct budget users. As for the LSG 33 of 85 have started the procedure but only 3 have established FAU.

The CHU within the Ministry of finance initiated request to budget users and the LSG to appoint responsible accountant. By the end of April 2010, in 86% of the direct budget users there are appointed responsible accountant and in 65% of the LSGs.

RECOMMENDATIONS

- Strengthening the capacity of the newly established units
- Raising awareness and managing obstacles about the need of PIFC within public sector as a management tool
- Preparing the by-laws and proper regulations as of certification, standards
- Preparing the Manual for IA
- Preparing rulebooks for the committees on FMC and IA within Ministry of finance
- Preparing a Training program
- Be especially sensitive to the devolution and design the PIFC system development in the LSGs
- Be clearer about the appointed persons to whom one can submit irregularities in the public sector. A proper by law should be developed.

PUBLIC PROCUREMENT

The first law on public procurement was adopted in 1998 and the second was adopted in 2004. The new law is from 2007 (in effect from January 1st 2008; "Official Gazette of Republic of Macedonia", no. 136/07). Latest legislation developments are that there was a Law on amendment and modification to the Law on public procurement-PP Law ("Official Gazette of Republic of Macedonia", no. 130/08). The practical implementation of the PP Law is well supported by the PP Bureau that officially started to operate in 2005.

The State Appeals Commission-SAC is now a legal entity on a professional basis appointed by the Parliament. Integrated e-procurement system is in place. This e-system includes e-publication, e-tendering and e-auctions.

According to the assessment of the European Commission, the text of the Law is of good quality, being highly harmonized with the respective EU Directives in the field of public procurement.

EU Directives on Public Procurement adopted by the European Parliament and the Council on 31 March 2004 are incorporated in the Law on Public Procurement, as follows:

- Directive 2004/17/EC of the European Parliament and of the Council of 31st March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sector;
- Directive 2004/18/EC of the European Parliament and of the Council of 31st March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public services contract;
- Commission Directive 2001/78/EC of 13th September 2001 on the usage of standard forms during the publication of contract notices.

Two-year application of the Law, being the first Law at this level of harmonization with the respective EU acquis in the field of public procurement, shows many positive aspects in the functioning of the public procurement system, as follows:

- Increased transparency through the mandatory electronic publication of contract and contract award notices on the Electronic System of Public Procurement operated by the Web Publication System of the Public Procurement Bureau;
- Increased procurement efficiency by applying the simplified contract award procedures (simplified competitive procedure with and without publication of a contract notice). These procedures stipulate shorter time limits for submission of tenders and submission of simplified documentation for the contracts with lower estimated value than the regular value thresholds stipulated by the Law.

In the period from October 2009 by the end of the year, the Bureau worked intensively on modifications and amendments to the Law, all aimed at its harmonization with the provisions in the Criminal Code (note that this has not been yet adopted by the Parliament). One of the more significant novelties, introduced with the envisaged modifications and amendments to the Criminal Code, is the criminal liability for legal entities and, consecutively, introduction of respective sanctions. Article 10 of the Law on Modifications and Amendments to the criminal Code envisage changes to the provisions in the whole chapter of the General Provisions of the Criminal Code, which cover sanctioning of legal entities, and proposed changes supplement the scope of secondary sanctioning and set conditions for their pronouncement.

Law on Public Procurement envisages 14 bylaws so as to facilitate its implementation. All envisaged bylaws were adopted within the envisaged deadline. Taking into account that pursuant to latest modifications and amendments to the Law, new training model in public procurement was introduced, and as a result of the integration of both electronic systems for public procurement, four new rulebooks were adopted in the course of 2009.

Taking into account the positive reactions by the contracting authorities and the economic operators regarding the three brochures being prepared last year, aimed at getting the public acquainted with the novelties in the national legislation on public procurement, in 2009, the Bureau started preparing new brochures. They cover the following:

- Manual on determining qualifications of economic operators in contract award procedures;
- Manual on awarding non-priority (“B”) services, and
- Framework Agreements – EU regulations and experience.

The importance of the growing public procurement in Macedonia is illustrated in the next table.

Year	Budget in mln. Denars	GDP in mln. Denars	Value of contract in mln. Denars	Value of PP in % of GDP
2007	108,634	353,786	21,842	6%
2008	128,740	398,640	27,553	7%
2009	149,594	406,651	47,713	12%

If one analyses these data, one can see that insignificant increase of the number of concluded contracts is evident on one side, and there is still high increase of the total value of the concluded contracts on the other. However, such increase is due to several multi-year contracts, i.e. capital investments of the Government of the Republic of Macedonia, with high single value (concentration of 10 bln. Denars for the 4 biggest projects-more than 160 mln. euros).

In 2009 there were 1,174 (17%) cancellation notices and total of 6,900 PP. Of these 1,174, almost one third (368) are concentrated in 9 operators. The most frequent reasons for cancelations are: no acceptable tender was submitted, needs of contracting authority changed, tender documents had major shortcomings or faults thus, one can suspect the need for better technical expertise in preparation of tender technical documents and bid assessment.

RECOMMENDATIONS

- The PP Bureau helped in developing proper human capacity for PP. It should continue with its good practice. Even though in September 2009 the Bureau become a legal entity, an analysis maybe should be prepared as of if the Bureau should be independent or to remain as a body within the Ministry of finance.
- Further strengthening the capacity of the PP Bureau and the SAC.
- Strengthen exchange information with SAO and SAC.
- More engagement of technical expertise in preparation of tender technical documents and bid assessment.
- Adopt by the Parliament the modifications and amendments to the Law, aimed at its harmonization with the provisions in the Criminal Code.
- Contracting authorities should pay on time upon contracts.

EUROPEAN FUNDS

In May 2010 the new Law on IPA audit was adopted (“Official Gazette of Republic of Macedonia”, no. 66/2010). Within 2011-2012 the handbooks for IPA audit and the audit guidelines will be updated (as per the draft Strategy for development of PIFC in Macedonia 2010 – 2012).

It is expected that the GoM will adopt a rulebook on the procedures on fighting and reporting irregularities.

To protect the financial interests of the EU, the Financial Police in the Ministry of Finance are to co-ordinate their activities with OLAF and provide guidelines to institutions for the reporting of irregularities. Through these arrangements, the Financial Police are to consolidate information with regard to fraud involving EU funds or funds that are co-financed by the state and the EU. A department for co-ordination of the prevention of fraud (AFCOS) is established in the Financial Police administration and is to serve as a national focal point for working with the European Anti-Fraud Office (OLAF). An appropriate rulebook will be published. The aim had been to have the appropriate department established by the end of 2008, but at the time of writing this had not yet occurred (this process has been envisaged for some time and was referred to in Sigma's previous assessment report in 2008). A Division for International Co-operation and Detection of Financial Infringements regarding EU and domestic funds, currently with three employees, has been established in the Financial Police administration.

EXTERNAL FINANCIAL AUDIT

Since its establishment until today (the State Audit Office (SAO) was established by the Parliament of the Republic of Macedonia in 1997) the SAO has been developing in circumstances of intensive reform processes of the financial control system and the public administration, and intensive activities and processes for cooperation with the international institutions for the purpose of implementing the strategic goals of the state in accessing the EU and the European -Atlantic integrations.

Legal framework

The legal framework for the state audit, and the position, role and the mission of the SAO and its independence and autonomy as well as the authorities of the state organs and institutions, eliminating the illegal and unintended use of the public funds, and following the recommendations of the authorized state auditors presented in the issued audit reports, have been regulated by the Law on State Audit (LSA) first adopted in 1997 (by December 2007 the Law was amended five times).

The leading principles of audit of the Lima Declaration have been embedded in the provisions of the Law on State Audit to a certain extent. A new SAO Law ("Official Gazette of Republic of Macedonia", no. 66/10) is on power as of May 2010.

Legal framework shortfalls

Not defined as a constitutional category

Despite the efforts of the State Audit Office to have its independence and autonomy embedded in the Constitution of the Republic of Macedonia, in compliance with the international standards and the good practice in the EU countries, and the recommendations of the Lima Declaration of the leading principles of audit, this matter has not been resolved yet, although it is one of the major preconditions for further accession to the EU. The independence and the autonomy of the

SAO are only regulated by law even though in the Annual program of the SAO it is stated that they will work for in 2010 to become a constitutional category. In 2010 the new Law adoption didn't brought that.

Inadequate independence and autonomy

“The chief aim of the Lima Declaration is to call for independent government auditing. A Supreme Audit Institution which cannot live up to this demand does not come up to standard. It is not surprising, therefore, that the issue of the independence of Supreme Audit Institutions continues to be a theme repeatedly discussed within the INTOSAI community...”; Dr Franz Fiedler, Secretary General of INTOSAI, 1998.

Although the legal framework regulates the independence and the autonomy of the SAO, given the fact that the SAO abides by the same regulations as any other budget user, in practice the independence and the autonomy of the institution are limited from several aspects: legal framework, financial resources, process of enhancing the human resources and other capacities, new employments. This delays the process of dynamic development of the SAO and the harmonization of its operation with the best European practices regarding enhanced security and accountability of the financial management of the public funds.

The Auditor General and his/her deputy are appointed for a nine-year term. Both officials can only be dismissed by parliament on very specific grounds laid down by law, article 6: upon end of the mandate, upon their own request; upon reaching the retirement age; upon death; upon discharging. The “discharging” is defined in the next article 7 of the new Law as: when not fulfilling the basic preconditions listed in article 5 to become a Chief State Auditor, not being able to perform its duty longer than 6 months upon sickness or other justifiable reasons.

Absence of financial independence

The existing legal framework does not provide financial independence and autonomy for the State Audit Office as the SAO abides by the same regulations as any other budget user; part of the financial resources for operation of the SAO is to be provided by performing and charging for commercial audits. No basic preconditions have been created for independent and autonomous budget for state audit.

Inadequate legal framework to regulate the action of a state auditor upon reasonable suspicion for misdemeanor or crime

The existing legal framework does not include authority of the SAO to legally act and to impose sanctions on the legal entity that have failed to follow the recommendations of the authorized state auditor or have failed to provide feedback for the SAO regarding the status of the recommendation.

The existing legal framework does not clearly define the obligation of the authorized organs to act upon notification of the authorized state auditor on their reasonable suspicion for a misdemeanor or a crime, and to inform the SAO on regular basis about the measures taken until

a final decision is reached by the Public Prosecution Office or the authorized judicial organs on previous SAO notification.

Practical aspects and problems

In compliance with the legal framework determined by law, the State Audit Office issues and submits to the legal entity being subjected to audit and to the authorized organs (Parliament of RM, Government of RM, Ministry of Finance, Public Prosecution Office of RM, State Commission for Prevention of Corruption, end users and the line ministries, and other organs that have supervisory functions according to systemic laws regulating the relative area) the following:

- Preliminary audit reports, and
- Final audit reports.

The authorized organs are obligated by law to review the submitted audit report and to act upon the recommendations of the authorized state auditor, and to provide feedback on the measures taken for elimination of irregularities not later than 30 days (90 days in the previous Law).

In compliance with the obligations and deadlines specified in the Law on State Audit the SAO draws up quarterly reports and an annual report, and submits the same to the Parliament of the Republic of Macedonia.

One shortcoming of the Law is that it is stated in article 33 that the Annual SAO report will be **SUBMITTED** to the Parliament and the Parliament will **REVIEW** the Annual SAO report. The same is not symmetrical for the Audit reports itself. Namely, it is stated in the Law that the SAO will **SUBMITT** the Audit reports but it is not stated that the Parliament will **REVIEW** the Audit reports. This doesn't give frame for improving the existing situation of financial scrutiny, where for several years the SAO has emphasized the need of introducing a standard procedure for reviewing the audit reports in the Parliament, to include the SAO and be corroborated by institutionalized contacts between the SAO and the Parliament (establish a special commission with specific authority for audit or use the existing Commission for Financing and Budget).

Despite of the intensive activities and the efforts of the State Audit Office no authorized state organ has devoted necessary attention to the submitted audit reports. The reports are not reviewed, and no adequate efforts for elimination of the current situation are made, especially by some legal entities.

The only occasion when the Parliament and the Government of the Republic of Macedonia pay some attention to the audit is the parliamentary debate on the annual reports the conclusions the implementation of which is not monitored.

We must however, mention here the recent joint workshop of the SAO and the Parliament members on improving the cooperation between SAO and the Parliament (also participating Sigma, European Audit court, Dutch Audit Court, Slovenia Audit Court). Also, there was a project on strengthening the financial scrutiny by the Parliament members organized by WFD-

Westminster foundation for democracy and Center for Economic Analyses-CEA where SAO members were also trainers among others (first of that kind Reader is also available).

Inadequate acting upon the SAO findings/ reports

Regarding the legal entities being subjected to state audit/auditees, and the final audit reports that include findings of weaknesses and illegal and unintended use of funds as well as recommendations for their elimination, it may be concluded that the efforts and the engagement of the legal entities and the authorized state organs have been inadequate; this conclusion has been corroborated by the following indicators and facts:

Tabel. Feedback from auditees to the SAO within the 90-day deadline (the new Law prescribes 30 days deadline).

	Audits performed	Feedback provided	Feedback not provided
2005	144	49	95
2006	166	23 (until 28 Feb 2008)	143

In compliance with its legal obligation the State Audit Office submitted final audit reports on regular basis to the authorized organs in the past years.

Table. Number of submitted audit reports.

Annual Report on SAO Operation for	No. of submitted audit reports			
	Parliament of RM	Govt. of RM	Ministry of Finance	State Commission for Prevention of Corruption
2004	24	79	112	9
2005	68	42	105	20
2006	73	62	159	45
2007	56	37	71	16
Total	221	220	447	90

In this context, very disturbing is the situation where the State Audit Office identifies many systemic weaknesses, collision between legal documents and regulations and organizational weaknesses; however, they continue repeating in several annual reports in a row. This means absence of efforts by the authorized organs.

At the same it has been identified that the Parliament of the Republic of Macedonia reviews the Annual Financial Statement of the Budget of RM for the previous year; however, it does not review the SAO Final Report to identify the actual situation and take appropriate measures to eliminate the weaknesses.

The fact remains that the SAO and the Sector for Public Internal Financial Control at the Ministry of Finance signed the Protocol for Cooperation in 2006, the purpose of which is to enhance the system of management and control of public funds. However, the Protocol has not been implemented in all its segments yet.

The situation is slightly better with the level of engagement of the Public Prosecution Office and the audit reports that the authorized state auditor submits to the Public Prosecution Office upon reasonable suspicion for a misdemeanor or a crime.

Inadequately defined internal and organizational procedures of organs authorized to act upon the SAO findings/reports

Analysis of the poor effects from the previous SAO engagement showed that one of the main reasons for inadequate engagement of the organs authorized to act upon SAO findings/reports is inadequately defined internal structure. Namely, the Rules of Procedure of the Parliament and the Government of RM or other internal regulations of the authorized organs do not define procedures and authorities of organs and bodies, or the operational method for implementing the role of financial scrutiny organs, and organs responsible and authorized to take measures and activities for eliminating illegal and unintended use of the public funds.

The fact remains that the authority on state audit matters should rest with the Commission for Financing and Budget; however, this has not been clearly defined by the Rules of Procedure of the Parliament. It is also necessary to define the authority of the appropriate commission of the Parliament depending on the audited area (exp. the audit report following the audit of the Ministry of Culture should be also reviewed by the Commission for Culture of the Parliament).

The fact remains that the Government of RM amended its Rules of Procedure in September 2007 and established the Audit Committee as a permanent expert body to review the audit reports and the follow-up audit reports/reports on the measures taken by the auditees following the recommendations for elimination of irregularities included in the audit reports. The Audit Committee submits to the Government written reports including opinions and recommendations about the measures taken following the findings included in the audit reports, based on which the Government should come to appropriate conclusions.

It is not satisfactory that the Government amended its Rule of Procedures and established the Audit Committee, since this Committee has not reviewed a single audit report of audits performed at legal entities yet nor has it provided feedback to the SAO about the ways to eliminate the systemic weaknesses, especially because such weaknesses are exclusive authority and responsibility of the Government.

No instruments for permanent communication of the SAO with the Government Audit Committee have been determined, and no cooperation has been established by the moment this Document was completed.

Inadequate expertise of organs and bodies of the supervisory institutions authorized to act upon the findings/reports of the SAO

The analysis of the reasons for inadequate engagement of the organs responsible for financial scrutiny upon the findings and the recommendations of the authorized state auditors as well as the discussions at plenary sessions of the Parliament of RM or sessions where the annual reports are reviewed (wrong interpretation or reading of a finding, linking totally different findings etc) shows that the main reason for absence of defined internal and organizational procedures at organs authorized to act upon the findings/reports of the SAO is inadequate expertise of the supervisory organs and bodies authorized to act upon the findings/reports of the SAO and the supporting departments (state administration, elected and appointed persons, members of the Parliament).

RECOMMENDATIONS

1. Adopt an amendment to the Constitution at the very next occasion, to include the state audit as a constitutional category, and define the SAO as independent and autonomous supreme audit institution in the Republic of Macedonia.
2. Adopt an amendment to the Constitution at the very next occasion to provide full financial independence of the state audit, and create an independent budget of the State Audit Office to be approved by the Parliament of RM upon proposal of the SAO and the opinion of the parliamentary Commission for Financing and Budget prior to approval of the Budget of RM
3. The Audit reports should be reviewed by the Parliament
4. Enhance the rights and the authorities of the State Audit Office for cases when a legal entity or an authorized organ fails to follow/act upon the recommendations of the authorized state auditors.
5. Adopt relevant amendments to certain systemic laws and determine the legal framework and the obligation of the Parliament of RM to review the annual reports of certain users of public funds together with the audit report as well as the obligation to review the Annual Financial Statement of the Budget of RM based on an expose of the General State Auditor about the findings of the audit of the Budget, in accordance with the best practice in the European countries (in the Netherlands, the state audit has the Accountability Day, when the Parliament reviews and discusses the report of the performed audit of the Budget and the budget users).
6. Organize a training system to provide:
 - a. Enhanced capacities of the state administration to understand the state audit.
 - b. Enhanced capacities of the state administration to draw up internal procedures about the manner of reviewing and acting upon submitted audit reports.
 - c. Enhanced capacities of elected and appointed persons at the authorized organs to exercise their authorities and to understand the need and benefits of financial scrutiny.

LITERATURE AND REFERENCES

1. Proper laws, by laws, strategies, action plans and other documents from the:

- a. www.finance.gov.mk
- b. www.dzr.gov.mk (SAO)
- c. <http://javni-nabavki.finance.gov.mk/mk/root/intro.html> (Bureau for PP)
- d. <http://www.dkzjn.gov.mk/?q=node> (State commission for PP)
- e. <http://www.finance.gov.mk/node/92> (on PIFC)
- f. http://www.sigmaweb.org/pages/0,2987,en_33638100_33638151_1_1_1_1_1,00.html