

## **PUBLIC ADMINISTRATION REFORM MONITORING**

### **PUBLIC FINANCE**

**2014**

*This document has been prepared under the Public Administration Reform Monitoring (PARM) project, implemented by TI BiH and CIN, with financial support from the Swedish International Development Agency (SIDA) and the Government of Denmark. The views and opinions expressed herein are solely those of TI BiH and can in no way be taken to reflect the views of SIDA or the Government of Denmark.*

**March 2015**

## Acronyms and abbreviations

BiH	Bosnia and Herzegovina
BD	Brčko District
FBiH	Federation of Bosnia and Herzegovina
RS	Republika Srpska
GOF	Global Framework of the Fiscal Balance and Policy
IMF	International Monetary Fund
BFP	Budget Framework Paper
DEP	Directorate for Economic Planning
IAS	International Accounting Standards
ITA	Indirect Taxation Authority
MAU	Macroeconomic Analysis Unit of the ITA Governing Board
ERP	Economic Reform Programme
MFT	Ministry of Finance and Treasury
MF	Ministry of Finance
IPSAS	International Public Sector Accounting Standards
GFS	Government Finance Statistics
PARCO	Public Administration Reform Coordinator's Office
SBA	Stand-by Arrangement
ESA	European System of National and Regional Accounts

## Table of Contents

I Introduction.....	6
II Data collection methodology .....	7
III Findings of the public finance reform monitoring in BiH .....	7
1. Increasing efficiency and effectiveness of budget management .....	8
1.1 Transparent expenditure of public funds .....	11
1.2 Communication between management of institutions and finance units .....	13
1.3 Introduction of programme-based budgeting in public administration in BiH.....	13
1.4 Including parliaments in the budget approval process .....	14
1.5 Inclusion of extra-budgetary funds in the medium-term expenditure framework and budget process .....	15
2. Improving the accounting framework and the treasury system operations.....	16
3. Introduction of PIFC in full compliance with EU requirements.....	17
4. Improving the organisational structure and investing in capacity-building.....	18
5. Improvement of public debt management efficiency.....	19
IV Recommendations for achieving PAR objectives in the area of public finance .....	20
Annexes .....	22
Annex 1.....	22
Annex 2.....	23

# I Introduction

The Council of Ministers of Bosnia and Herzegovina (BiH), the Government of the Federation of Bosnia and Herzegovina (FBiH), the Government of the Republika Srpska (RS) and the Government of the Brčko District of Bosnia and Herzegovina (BD BiH) adopted the Public Administration Reform Strategy of BiH in 2006, assuming responsibility for reform implementation. By adopting the Strategy, the governments took on the obligation to regularly inform the public on the reform progress as well as a commitment to revise it accordingly.

The public administration reform in Bosnia and Herzegovina is aimed at creating a public administration which will be more effective, efficient and accountable, and provide better quality services to their citizens at a lower cost, on the basis of transparent and open procedures.

The Strategy is a single document applicable to all levels of government in BiH. It provides a strategic framework for reform. Concrete actions, measures, deadlines and competent institutions were defined in the first Action Plan for the Implementation of the Strategy, which was adopted together with the Strategy.

Based on the analysis of the situation in reform areas and the progress made in the implementation of measures envisaged under the Action Plan, a draft Revised Action Plan 1 for the period 2010-2014 was prepared. The Revised Action Plan 1 (RAP1) was adopted by all governments in BiH in 2011, thus becoming an operational document as well as the basis for the implementation of the Public Administration Reform Strategy in Bosnia and Herzegovina.

Activities to achieve the objectives in the area of public finance are defined in RAP 1 and include eight chapters: policy dimension of the public finance system; increasing efficiency and effectiveness of budget management; improving the accounting framework and the treasury system operations; introduction of PIFC in full compliance with EU requirements; improving the organisational structure and investing in capacity-building; public-private partnership development; public procurement system; and improvement of public debt management efficiency.

This report does not include chapters on policy dimension of the public finance system, public-private partnership development and public procurement system because the institutions that are in charge of implementation of these objectives were not subject to monitoring.

## II Data collection methodology

Monitoring of reform results achieved in the area of public finance in 2014 includes 16 public institutions at the state and entity levels and the level of the Brčko District<sup>1</sup>.

Of the 16 institutions included in the sample, those that refused to fulfil their legal obligation to disclose information of public importance and thus contribute to the monitoring are:

- at the BiH level: Ministry of Foreign Affairs of BiH and Ministry of Justice of BiH,
- at the FBiH level: Ministry of Education of FBiH,
- at the RS level: Ministry of Administration and Local Self-Government of RS and Ministry of Finance of RS,
- Institutions at the level of the Brčko District did not submit data.

This shows that the above institutions are in the initial stages of the reform process, and therefore refuse to participate in the results monitoring, but also that these institutions are not sensitised to the need for providing the general public with comprehensive presentation of the results of their work.

Report on the public finance reform in line with RAP1 was prepared on the basis of: desktop review of existing primary sources of information, including relevant laws, administrative procedures, financial and other data on the performance of all governments in BiH; collection of additional information by way of questionnaires that were submitted to 16 institutions at the levels of BiH, FBiH, RS and BD. The response and the quality of the submitted data was in line with our expectations.

## III Findings of the public finance reform monitoring in BiH

Bosnia and Herzegovina has a complex public finance system consisting of the State level, two entities and the Brčko District. The question is how to accelerate growth and what are the obstacles arising from such a complex public finance system and economy with low economic growth, employment and investment rates. From the standpoint of public finance, it suffices to mention only a few obstacles to growth in BiH, such as: a dreadful state of the public finance system in terms of high public spending and high budget deficit, and a steady trend towards growing public debt. Therefore, improving public finance management remains one of the priorities of the structural reform that is to be undertaken in BiH, with special emphasis on improving fiscal discipline and streamlining the internal financial control system.

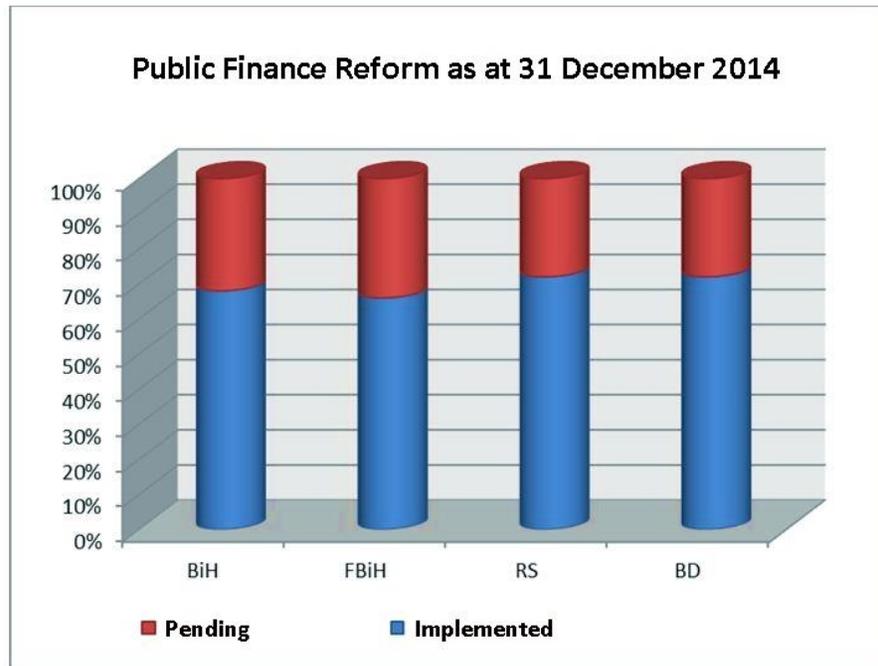
The Public Administration Reform Coordinator's Office (PARCO) monitors the implementation of the Public Administration Reform Strategy across activities defined in RAP1, with a view to creating a public finance management system which will ensure fiscal discipline, compliance with

---

<sup>1</sup> The list of institutions is provided in Annex 1.

strategic priorities and efficient use of public funds. PARCO produces semi-annual and annual reports on the implementation of public administration reform which are adopted by the Council of Ministers of BiH. Based on the available PARCO reports, Figure 1 shows the ratio between the implemented public finance reforms and those that are still pending for the period 2011 - 31 December 2014.

Figure 1. Implementation of public finance reforms as at 31 December 2014



Source: PARCO reports

### **1. Increasing efficiency and effectiveness of budget management**

The delay in adopting the 2014-2016 Global Framework of the Fiscal Balance and Policy (GOF) by the Fiscal Council meant that the governments were left with less time to prepare the Budget Framework Paper (BFP). As regards the adoption of budgets for the fiscal year 2015, it is evident that the three budgets in BiH (with the exception of RS) were not adopted on time. Deadlines for adoption of the 2015 budgets were breached due to the delays in forming the Council of Ministers at the state level, the Government of FBiH and the Assembly of BD.

Each of the four levels of government has its own budget law (the Law on Financing the Institutions of BiH, the Law on Budgets in FBiH, the Law on the Budget System of RS and the Budget Law of BD)<sup>2</sup>. These laws govern the preparation of the Budget Framework Papers and annual budgets for each government level.

<sup>2</sup> The list of laws is provided in Annex 2.

FBiH adopted a new Law on Budgets, which has been in force since 1 January 2014. This Law provides a sounder basis for the preparation of BFPs. The Law makes it mandatory for all budget beneficiaries (entity, cantons, local governments) and extra-budgetary funds to prepare BFPs. Improvements introduced by this Law include a provision requiring that the budget documentation be more detailed as well as one that stipulates that financial plans of public enterprises with the share of public revenues in total revenues higher than 50% and of those companies for which the Ministry of Finance has issued borrowing guarantees must be enclosed as annexes to the BFP.

The 2015-2017 Budget Framework Paper of FBiH was prepared in accordance with the Law on Budgets of FBiH. It constitutes the preliminary draft budget of FBiH for 2015 and contains the preliminary budget projections for 2016 and 2017.

The Government of RS prepares one BFP, which includes projections for the entity, local governments and extra-budgetary funds. All budget beneficiaries participate in the preparation of the BFP (RS, local governments and extra budgetary funds) as defined by the budget calendar.

The 2015-2017 Budget Framework Paper of RS includes analyses and projections of: the budget for the central Government of the Republika Srpska, budgets of local governments, and financial plans of extra-budgetary funds, public enterprise “Roads of the Republika Srpska” and public enterprise “Highways of the Republika Srpska”. As part of the BFP data, besides the Budget of the Republika Srpska, there are also data on funds for projects financed from the ESCROW account (Development Programme of the Republika Srpska), projects financed from abroad, projections of the RS budget beneficiaries which operate within the Treasury General Ledger (TGL) system, and projections of the RS budget beneficiaries that have their own bank accounts and operate outside the TGL system.

The 2015-2017 Budget Framework Papers were prepared transparently for the Institutions of BiH and for both entities and are available on the websites of the respective ministries of finance.

Budget-related legislation for the level of Institutions of BiH and both Entities is harmonised in the part that refers to the process of adopting annual budgets according to the “ten-step” principle, while the Brčko District uses the Budget Law of 2008, which has yet to be harmonised with the laws of the other government levels.

Budgets are planned and recorded using a variety of software, ranging from simple Excel spreadsheets to the latest budget management software (BPMIS<sup>3</sup>). Year 2014 marked the completion of the project “Gender Responsive Budgeting – Expansion of the budget management information system – BPMIS”, which included a software component for gender responsive budgeting. The 2015 budgets for the Institutions of BiH and the Entities were planned in the same format in BPMIS. However, according to the staff in the ministries of finance, this software is not compatible with the treasury software so budget execution is managed within the treasury system.

---

<sup>3</sup> The Public Administration Reform Fund of BiH funded the procurement of the BPMIS software “Budget Planning and Management Information System”

Budget calendars of the four government levels (Table 1) are largely harmonised. However, it is important to note that only RS has no legal obligation to publish the BFP online, although in practice the BFP is published on the website of the Ministry of Finance of RS. Brčko District has an obligation to publish the BFP online; however, it does not comply with this obligation. The only BFP of the Brčko District available online on the website of the Government of BD is the 2012-2014 Budget Framework Paper.

Table 1. Budget Calendar

Budget calendar				
	FBiH	RS	BD	BiH
Instruction 1; MF – Beneficiaries	15.02	15.02	31.01	31.01
Beneficiaries' proposals	15.04	30.04	15.04	15.04
MF preliminary BFP draft				28.04
MF – Government	15.06		15.06	15.06
BFP adoption	30.06	30.06	30.06	30.06
MF – BFP – municipalities, cities, funds		01.07		
Publication of BFP on MF's website	15.07		15.07	15.07
Submission of BFP to parliament (information)		15.07		
Instruction 2 – Budget constraints	15.07	01.07	01.07	01.07
Beneficiaries' budget requests	15.08	01.09	01.08	01.08
Consultation MF and beneficiaries	15.09			01.10
MF – Government draft budget	15.10	15.10	15.09	01.10
CoM – Presidency draft budget				15.10
Government determines draft budget	01.11	05.11	01.10	
PM/Presidency/Mayor– Parliament	05.11	15.11	01.10	01.11
Final budget proposal		01.12		
Adopted budget	31.12	15.12	01.12	31.12

*Source: Law on Financing the Institutions of BiH, Law on Budgets in FBiH, Law on the Budget System of RS and Budget Law of BD*

## 1.1 Transparent expenditure of public funds

Increased transparency in the expenditure of public funds is achieved by ensuring that budgets are planned and budget execution is monitored in accordance with programmes and monitoring indicators. For the introduction of programme-based budgeting in BiH, it was first necessary to create legal conditions and then work towards concrete implementation of this objective. The Law on the Budget System of RS, which was passed in 2012, created legal preconditions for the introduction of programme-based budgeting, considering that its Article 15 stipulates that the budget shall be prepared, adopted and executed on the basis of standard budget classification: fund based, organisational, economic, sub-economic, functional and programme classification.

Articles 13 and 14 of the Law on Budgets in FBiH, which was passed in 2014, provide that the financial plans of budget and extra-budgetary beneficiaries shall contain programmes specified in planning documents. Under this law, budget classification is: organisational, economic, functional, programme, and by fund/sources of funding.

The Law on Financing the Institutions of BiH, as amended in 2009, provides that the BFPs and

annual budgets shall be prepared by the economic and programme classification. The 2008 Budget Law of BD provides that the budget shall consist of a general and a special part and the development programme plan.

The budget management system (BPMIS), which was implemented by PARCO at the state and entity levels of government in January 2014, contributes to the introduction of multi-year budgeting and has created technical preconditions for the introduction of the programme-based budgeting methodology in BiH public administration. Submission of budget beneficiaries' requests according to the Instruction for Budget Beneficiaries No. 1, for the purposes of preparation of the 2015-2017 BFP, was done through BPMIS. Further, Instruction No. 2 and requests for amendments to the budget are also submitted through BPMIS. Entity budgets are planned according to the programme-based budgeting methodology but are not adopted as such and are not published on the websites of the entity ministries of finance. Budget execution through treasury operations is managed by means of another piece of software. Budget execution reports are prepared and adopted by the competent authorities only by economic and functional classification, while the budget execution report in RS is also presented by organisational codes.

Until 31 December 2014, reports on the expenditures of the government sector in BiH by functional classification were not comparable at all levels of government, since the methodology for classifying expenditure and expenses of the government sector is not harmonised.

Comparison of the data for the general government sector in BiH, published by the Macroeconomic Analysis Unit (MAU), shows that the total expenditure for 2014 was nearly 4% higher than the expenditure in 2013, and that compensation of employees (gross wages and employee benefits) increased by 2.3% in 2014 compared to 2013.

Table 2. Distribution of Expenditures 2013-2014

Reports in million KM	2013	2014
Expenditure	11,196.6	11,951.3
Expense	10,844.0	11,261.5
<b>Compensation of employees</b>	<b>3,218.3</b>	<b>3,293.2</b>
Use of goods and services	2,045.3	2,144.7
Social benefits	4,413.7	4,693.7
Interest	172.6	207.6
Interest payments to non-residents	93.7	104.7
Interest payments to residents	78.9	102.9
Subsidies	371.8	353.7
Grants, transfers	206.5	125.9
Other expense	415.7	442.7
Net acquisition of nonfinancial assets	352.6	689.8
Acquisition of nonfinancial assets	388.7	742.5
Disposal of nonfinancial assets	36.1	52.6

Source: MAU ITA BiH

## **1.2 Communication between management of institutions and finance units**

Communication between management of institutions and finance ministries (sectors, departments, services) should take place on an ongoing basis throughout the budget preparation process.

Since BFP is basically an estimate of the resources that are necessary to achieve strategic and operational objectives of the budget beneficiaries, it is essential that all managers within institutions participate actively from the BFP adoption phase. Accordingly, communication between finance personnel at all levels of government and budget beneficiaries needs to start as early as the BFP preparation phase, i.e. from budget Instruction No. 1, to Instruction No. 2, to the adoption of the budget.

However, according to data collected from the surveyed institutions that are the subject of this analysis, it is still evident that some budget beneficiaries leave it to the employees of the Ministries of Finance to “represent” them, i.e. to prepare budget proposals for their organisational units. Only 27% of the surveyed institutions provided data on their planned and actual expenditures for 2014.

The Law on Budgets in FBiH has created preconditions for the establishment of the Fiscal Coordination Body. In addition to other competences and responsibilities, this body would be in charge of coordinating activities to ensure compliance with budget calendars during preparation, adoption, execution and audit of the budgets. This body has not yet been established in FBiH.

The Law on Financing the Institutions of BiH provides that the finance officer of each budget beneficiary reports directly to the head of the budget beneficiary and performs such tasks as financial planning, budget preparation and execution of the budget of the given budget beneficiary. Additionally, this officer is responsible for establishing and maintaining appropriate systems for the management and accounting control of the approved budget and the allocation of budget funds, approved cash flow plans and operating budgets, revenues, all expenditures and payments, as well as for implementation of audit recommendations.

RS has not adopted a law on fiscal accountability. This law is expected to be adopted in 2015.

## **1.3 Introduction of programme-based budgeting in public administration in BiH**

Technical requirements for the introduction of programme-based budgeting in the planning phase at all four levels of government have been fulfilled through implementation of BPMIS. Once the technical requirements have been fulfilled, it is necessary to work towards improving the existing programme formats, facilitating better integration with the strategic objectives, and monitoring and keeping records of expenditures by individual programmes.

The introduction of programme-based budgeting also leads to enhancing and strengthening links with the public investment programme, i.e. planned budget funds that are allocated based on governments’ decisions and include investments which result in an increase in the value of

non-financial assets. In this way the public investment programme is based on the creation of a link between strategic planning and budgeting for projects.

As part of BPMIS implementation at the level of BiH, FBiH and RS budgets are prepared in the programme format but are not adopted in the programme format. Programme-based budgeting has been introduced through BPMIS only in the planning phase, and not in the execution and financial reporting phases.

As part of the IPA-funded project “Strengthening Public Financial Management”, a manual on programme-based budgeting was developed and training was organised for budget beneficiaries to which assistance is provided by project experts in analysing and possibly redefining the current programme structure. Workshops were organised for budget beneficiaries and budget analysts at all levels of government. Budget analysts also received training for trainers.

With a view to providing additional technical assistance to finance ministries at all four levels of government under the project “Strengthening Public Financial Management”, five pilot budget beneficiaries were selected in the first phase. As a result of the direct technical assistance, they corrected and upgraded the existing programme format and fully implemented the programme-based approach to budgeting.

As a result of workshops and technical assistance provided under the project, the ministries of finance engaged in more appropriate definition/redefinition of programmes, objectives and performance indicators.

While budgets at entity levels are planned in BPMIS in the programme format, they are still adopted and published only by economic classification in both RS<sup>4</sup> and FBiH<sup>5</sup>.

#### **1.4 Including parliaments in the budget approval process**

The Rules on Financial Reporting for Beneficiaries of the Budgets of the Republic, Municipalities, Cities and Extra-budgetary Funds of RS, which has been in force since 2011, sets forth the format and contents as well as methods of preparation and presentation of financial reports for budget beneficiaries of the Republic, municipalities, cities and funds. The financial reports include: monthly, quarterly and annual financial reports of individual budget beneficiaries and annual financial reports for certain levels of government. The Rules introduced a reporting form for budget expenditures and expenses in accordance with UN’s Classification of the Functions of Government – COFOG<sup>6</sup>.

Of all levels of government in BiH, only RS has regulated monthly reporting, and these reports are

---

4

[http://www.vladars.net/sr-SP-Cyrl/Vlada/Ministarstva/mf/Documents/%D0%91%D1%83%D1%9F%D0%B5%D1%82%20%D0%A0\\_%D0%B5%D0%BF%D1%83%D0%B1%D0%BB%D0%B8%D0%BA%D0%B5%20%D0%A1%D1%80%D0%BF%D1%81%D0%BA%D0%B5%20%D0%B7%D0%B0%202016th%20%D0%B3%D0%BE%D0%B4%D0%B8%D0%BD%D1%83\\_498890977.pdf](http://www.vladars.net/sr-SP-Cyrl/Vlada/Ministarstva/mf/Documents/%D0%91%D1%83%D1%9F%D0%B5%D1%82%20%D0%A0_%D0%B5%D0%BF%D1%83%D0%B1%D0%BB%D0%B8%D0%BA%D0%B5%20%D0%A1%D1%80%D0%BF%D1%81%D0%BA%D0%B5%20%D0%B7%D0%B0%202016th%20%D0%B3%D0%BE%D0%B4%D0%B8%D0%BD%D1%83_498890977.pdf)

<sup>5</sup> <http://www.fmf.gov.ba/v2/userfiles/userfiles/file/budzet2016/Prihodi%20-%20bos.pdf>

<sup>6</sup> <http://unstats.un.org/unsd/cr/registry/regcst.asp?Cl=4>

prepared for each month of the fiscal year regardless of the obligation to prepare quarterly and annual reports.

The 2007 Rules on Financial Reporting and Annual Budget Account of BD define the content, financial reporting methods and instructions for the preparation of periodic, annual and additional financial reports on budget execution. The Rules prescribe periodic reports for periods shorter than one year and annual reports for review of the fiscal situation. The Instruction on the Preparation and Development of Additional Financial Reports of the Treasury regulates the process of preparing additional financial reports that the Treasury is required to prepare on the basis of its data and records. Additional financial reports are all those reports that are not mandatory by law, and are prepared on the basis of submitted requests for the purposes of senior civil servants in the BD Finance Directorate, and as per request and for the purposes of external users.

The institutions of BiH and FBiH need to supplement or amend their Rules on Reporting, harmonise them with the GFS methodology and implement the COFOG classification.

All levels of government in BiH use a harmonised chart that is aligned with GFS (prepared by the IMF) for the purposes of quarterly and annual reporting under SBAs, but this form has not been adopted as an integral part of their Rules on Financial Reporting.

In addition to training sessions organised under the project “Strengthening Public Financial Management”, it is important to note that in 2014 the EU-funded project “Capacity Building for the compilation of accounting data within the scope of General Government and Public Finance Statistics” held a series of training sessions for project beneficiaries (three ministries of finance and the BD Finance Directorate) in the area of reporting to the GFS and the ESA95 (European System of National and Regional Accounts 95).

### **1.5 Inclusion of extra-budgetary funds in the medium-term expenditure framework and budget process**

The Law on the Budget System of RS, which was adopted in December 2012, governs the preparation, the planning, the method of drafting, the adoption and the execution of the budget of RS, the budgets of local governments and extra-budgetary funds, the borrowing and debt repayment, accounting, reporting and control of budget of the Republic, of local governments, and of the extra-budgetary funds. The budget system of RS consists of the budget of the Republic, the budgets of local governments and the budgets of extra-budgetary funds. As at 31 December 2014 none of the extra-budgetary funds in RS was included in the treasury system.

The Government of RS prepares BFP and includes projections for local governments and extra-budgetary funds. Local governments in RS do not prepare their own BFPs, unlike FBiH; instead, they consult with the Ministry of Finance of RS during the preparation of their annual budgets about ceilings for projected revenues and the structure of budgetary spending.

The 2014-2017 BFP of FBiH includes revenue projections for: the budget of FBiH, the budgets of

cantons and local governments, the budgets of extra-budgetary funds (primarily the Pension and Disability Insurance Fund, the Health Insurance Fund and the Employment Office) and the funds of public enterprises that are collected as public revenues from special fees prescribed by law. As regards public expenditure management, the BFP of FBiH is focused on expenditures of the Government of FBiH, whereas other levels of government prepare their BFPs and determine the structure of budgetary spending for their respective levels of government.

When planning a budget for a fiscal year, all levels of government include known and certain grants. Grants received after the adoption of the budget are recorded in accounting and are subject to financial reporting in accordance with the reporting rules of each level of government.

## ***2. Improving the accounting framework and the treasury system operations***

By adopting the International Public Sector Accounting Standard (IPSAS) 23 – Revenue from Non-Exchange Transactions (Taxes and Transfers), RS began to implement accrual accounting from 1 January 2013 and has since recognised revenues on an accrual basis in the financial reports defined under the Rules on Financial Reporting for Beneficiaries of the Budgets of the Republic, Municipalities, Cities and Extra-budgetary Funds.

For the purposes of reporting on budget execution, a modified accrual basis is applied. The form that is prepared for the purposes of reporting to the IMF is prepared from the budget execution report and as such shows modification of the accrual basis on the revenue side, while the expenditures are recognised on an accrual basis.

All other levels of government in BiH record transactions following a modified principle whereby revenues are recorded in the period in which they become available and measurable (on a cash basis) and expenditures are recognised the moment a liability arises, regardless of when the payment is made (on an accrual basis). Accordingly, all financial reports are prepared following the modified principle.

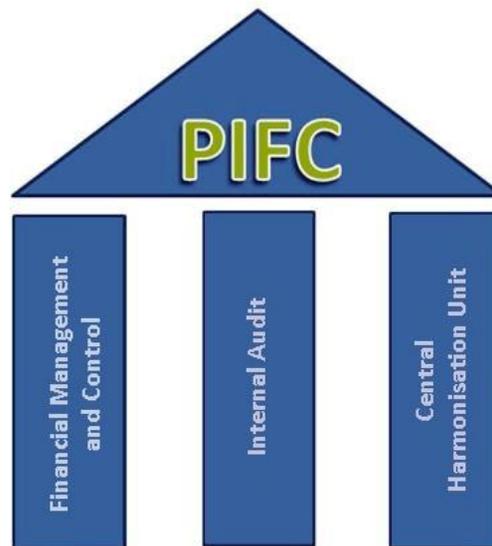
By law, local governments in FBiH were obliged to introduce the Treasury system of operations by 2011; however, the system has not been fully implemented yet. Federal and cantonal levels of government have introduced the treasury system of operations. Some extra-budgetary beneficiaries at the cantonal level are included in the treasury system, e.g. road directorates in seven cantons.

Treasury software for all four main levels of government and the cantons was procured from grants, while for local governments treasury software was provided by various donor projects or its purchase was financed from local governments' own budgetary resources. For the full introduction of treasury operations in the public administration in BiH, it would be necessary to seek donor support.

### **3. Introduction of PIFC in full compliance with EU requirements**

Countries that are in the EU accession process, such as Bosnia and Herzegovina, are recommended to adjust their legislation and practices in the field of internal financial control. All levels of government in BiH have implemented activities in this field such as the adoption of legislation, establishment of new organisational units within the ministries of finance, adoption of implementing regulations and training of staff.

The introduction of Public Internal Financial Control (PIFC) in BiH institutions took place in part according to the action plan stemming from the Strategy for Introducing Public Internal Financial Control in the Institutions of BiH. Development of the PIFC system is the responsibility of the Central Harmonisation Unit (CHU). Its purview and responsibilities are defined by the Law on Internal Audit of the Institutions of BiH and the Law on Financing the Institutions of BiH. At the level of the BiH Institutions a decentralised model of internal audit has been implemented and theoretical and practical training is organised on a continuing basis for CHU staff, internal auditors and financial officers.



*Schematic representation of the PIFC concept*

CHU published on the website of the MFT BiH annual consolidated reports on internal audit for 2011, 2012 and 2013<sup>7</sup>.

The 2010-2014 Strategy for the Development of Internal Financial Control of FBiH was the basis for the introduction of PIFC in FBiH. CHU is located in the FBiH Ministry of Finance (FMF) and acts as a coordinating body for the development of the FMC and IA methodology and work standards, organising training, and checking the quality of the internal financial control system. In accordance with the Law on Internal Audit, CHU has to date prepared four annual consolidated

---

<sup>7</sup> [http://www.mft.gov.ba/bos/index.php?option=com\\_content&view=article&id=706&Itemid=100034](http://www.mft.gov.ba/bos/index.php?option=com_content&view=article&id=706&Itemid=100034)

reports (for 2011, 2012 and 2013) on the state of internal audit, which the FMF submitted to the Government of FBiH. In practice, however, internal audit function has not yet been established in all institutions, or if it has, it is not always fully compliant with applicable regulations in terms of its location in the organisational structure and the description of its tasks. One of the problems is the inability to staff them with qualified personnel due to the complex administrative structure of FBiH and a large number of institutions that are under obligation to establish the IA function. Also, internal auditors cannot be tolerated to perform any other tasks in addition to their internal audit duties, e.g. to serve as a member of a commission, as this clearly constitutes a conflict of interest. CHU is working on an ongoing basis to provide training to internal audit staff.

RS has formed the CHU that proposes legislation in the field of financial management and control (FMC) and internal audit (IA), and oversees the implementation of adopted legislation. CHU prepares consolidated annual reports on the financial management and internal control system in public sector institutions and annual reports on internal audit function in the public sector of the Republika Srpska. CHU has four departments: department for FMC regulation and supervision; department for IA regulation and supervision; department for information and communication; and department for the development and supervision of training programmes for internal auditors and financial management staff.

The website of RS CHU<sup>8</sup> contains relevant laws and implementing regulations, forms, instructions and information. However, transparency of CHU's work leaves much to be desired as the only report available on its website is the consolidated report on internal financial control for 2011.

The Audit Office for Public Administration and Institutions in the Brčko District of BiH was established in 2007 and operates in accordance with the Law on Audit of Public Administration and Institutions in the Brčko District of BiH ("Official Gazette of the Brčko District of BiH", No. 40/08). BD Government adopted the 2014-2017 Strategy for Development of Public Internal Financial Control (PIFC) with the aim of establishing the internal control function. The Law provides that the Office shall prepare annual audit plans to be adopted by the Assembly of the Brčko District of BiH. The Office is supposed to produce reports on implemented audits on a year-round basis, but no such reports are available on the website of BD, which suggests that these reports are not prepared at all, making the work of this Office opaque.

#### ***4. Improving the organisational structure and investing in capacity-building***

Ministries of finance adopt their respective staffing/recruitment plans as well as training plans in accordance with their priorities and available financial resources.

The Budget Department of MFT BiH planned systematically and its current staffing levels are therefore satisfactory. Also, its staff has received several training sessions to date. Since the Budget Department has enough personnel to carry out reforms, investments will be made in the coming period to strengthen and develop their personal skills and knowledge. The Sector agrees internally on the annual recruitment plan and training plan for the current year.

---

<sup>8</sup><http://www.vladars.net/sr-SP-Cyrl/Vlada/Ministarstva/mf/OM/harmonizacija/Pages/default.aspx#collapsible0>

The Rules on Internal Organisation and Staffing in the Ministry of Finance of RS provides for a sufficient number of public sector analysts in the Budget and Public Finance Department, as well as staff in other departments of the ministry. The Rules on Staffing in the Ministry of Finance of FBiH provides for a staff complement of 24. However, only 13 positions have been filled to date. Staffing levels improved significantly in 2013 following recruitment of three new employees. The Finance Directorate of BD does not have enough IT experts.

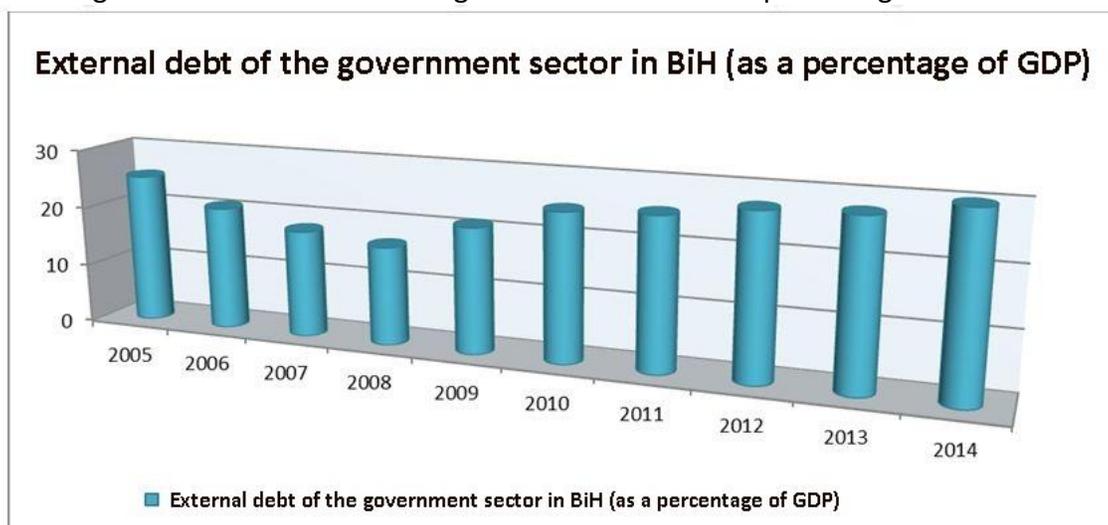
### **5. Improvement of public debt management efficiency**

During the 1980s and 1990s most OECD economies experienced a rapid growth in public debt. Introducing fiscal discipline for policymakers of these countries required the establishment of new fiscal rules and discipline. To that end ceilings were imposed at the EU level on deficit and debt as well as medium-term budget targets.

BiH has a highly decentralised fiscal system and it was necessary to introduce fiscal discipline as the basic precondition for planning and monitoring fiscal policy and establishing a harmonised methodology for fiscal discipline monitoring. The establishment of the Fiscal Council of BiH was the first attempt to harmonise methodologies and ensure macroeconomic stability and fiscal sustainability of BiH, FBiH, RS and BD.

According to the Central Bank of BiH (CBBH), the share of the external debt of the government sector in GDP in 2005-2014 varied from 18% to 30% (Figure 3).

Figure 3. External debt of the government sector as a percentage of BiH GDP



Source: Central Bank of BiH

The public debt of the government sector in BiH, in addition to external debt, includes data on the amount of internal debt. According to data published in the 2015-2018 National Economic Reform Programme, the share of total public debt in 2014 exceeded 40% of GDP and is projected to start falling in 2017 at the earliest.

## **IV Recommendations for achieving PAR objectives in the area of public finance**

The time frame of the Public Administration Reform Strategy, which is the basic strategic document for the implementation of public administration reform in BiH, is the end of 2014. Recommendations for further reform in the area of public finance were formulated on the basis of the monitoring and are presented by chapters and reform objectives.

### **1. Increasing efficiency and effectiveness of budget management**

**Recommendation: Facilitate further steps in the introduction of programme-based budgeting, strengthen existing programme formats and ensure better connectivity with strategic objectives.**

**Rationale:** Successful implementation of “Budget Management Information System – BPMIS” at all four levels of government in BiH contributes to increasing the efficiency and effectiveness of budget management and creates technical preconditions for the introduction of programme-based budgeting in the public administration in BiH. Through the project “Strengthening Public Expenditure Management”, which is financed from IPA 2010, it is necessary to continue to provide technical support to governments to prepare, adopt and publish their BFPs and budgets in the programme format.

### **2. Improving the accounting framework and the treasury system operations**

**Recommendation 2: Fulfil the objective of introducing treasury operations in the entire public administration in BiH. The International Public Sector Accounting Standards (IPSAS) need to be implemented at all levels of government. Donor support is recommended to be sought for implementation of these objectives.**

**Rationale:** Improvement of the treasury system is reflected in the introduction of the treasury system in public administration at all levels of government. The treasury system was introduced at the levels of BiH, RS, FBiH and Cantons. In RS, all beneficiaries of the Republic budget and all beneficiaries of municipal and city budgets have been operating within the treasury system since 1 January 2013. In FBiH not all local governments have the treasury information system in place. PARCO has initiated the project “Treasury Information System of the Brčko District of BiH”, which is currently in the public procurement procedure.

### **3. Introduction of PIFC in full compliance with EU requirements**

**Recommendation:** The objective of introducing PIFC in full compliance with the relevant EU requirements has not been reached within the timeframe defined under the Strategy. All levels of government need to continue to work on a comprehensive development of PIFC because, along with ensuring legality and compliance in the expenditure of funds, it is also essential to achieve prudence, efficiency and effectiveness in the management of public budgetary resources.

**Rationale:** Central Harmonisation Units (CHUs) have been established at the levels of BiH, RS and FBiH. The PIFC Development Strategy has been adopted in the Brčko District. Internal auditors have received comprehensive training organised under the project “Strengthening Public Expenditure Management”, which is financed from IPA 2010. Laws and implementing regulations in the field of internal audit are in place at all levels, but given that most of them were adopted in 2008, it is necessary to make some amendments to the laws at all levels of government in 2015.

CHU BiH has published on its website consolidated annual internal audit reports for 2011, 2012 and 2013. CHU FBiH has published on its website four consolidated annual reports on the state of internal audit for 2011, 2012, 2013. The website of CHU RS contains only the consolidated internal financial control report for 2011, which does not contribute to CHU’s transparency.

### **4. Improving the organisational structure and investing in capacity-building**

**Recommendation:** It is necessary to make plans, systematically and on a continuing basis, for capacity-building in the ministries of finance, as well as the number of training sessions and number of participants; in 2015 it is necessary to fill the remaining positions as envisaged by the adopted staffing plans.

**Rationale:** Significant progress has been made in improving the organisational structure and investing in capacity-building in the ministries of finance at all levels of government. Training of employees in the ministries of finance is implemented on an ongoing basis through workshops, seminars and presentations. Rules on internal organisation and staffing have been adopted by the ministries of finance and positions are currently being filled.

### **5. Improvement of public debt management efficiency**

**Recommendation:** Progress in enhancing public debt management efficiency has not been achieved as planned. It is necessary to achieve agreement among all levels of government on the adoption of a single public debt management methodology and ensure better coordination.

**Rationale:** Implementation of the project “Strengthening Public Debt Management Capacity”, which was financed from IPA 2011, has partially contributed to more efficient public debt management. The project provides for the purchase of hardware. Hardware procurement procedures are under way and should be completed in 2015.

## Annexes

### Annex 1

#### List of institutions covered by monitoring

Public Finance
State level
<ol style="list-style-type: none"><li>1. Ministry of Justice</li><li>2. Civil Service Agency</li><li>3. PARCO</li><li>4. Ministry of Foreign Affairs</li><li>5. Directorate for European Integration</li></ol>
Federation of BiH
<ol style="list-style-type: none"><li>1. Ministry of Justice of FBiH</li><li>2. Ministry of Finance of FBiH</li><li>3. Ministry of Education of FBiH</li><li>4. Civil Service Agency of FBiH</li><li>5. Tax Administration of FBiH</li></ol>
RS
<ol style="list-style-type: none"><li>1. Civil Service Agency</li><li>2. Ministry of Public Administration and Local Self-Government</li><li>3. Ministry of Finance</li><li>4. Ministry of Labour and Veterans Protection</li><li>5. Helicopter Service of RS</li></ol>
Brčko District
Subdivision for Human Resources

## **Annex 2**

### **BiH**

- Law on Indirect Taxation System in Bosnia and Herzegovina (BiH) (“Official Gazette of BiH”, Nos. 44/03, 52/04, 34/07, 4/08, 49/09 and 32/13)
- Law on Payments into the Single Account and Distribution of Revenues (“Official Gazette of BiH”, Nos. 55/04, 34/07 and 49/09)
- Law on Financing the Institutions of Bosnia and Herzegovina (“Official Gazette of BiH”, Nos. 61/04, 49/09)
- Law on the Council of Ministers of Bosnia and Herzegovina (“Official Gazette of BiH”, Nos. 30/03, 42/03, 81/06, 76/07, 81/07, 94/07 and 24/08)

### **Brčko District**

- Budget Law of the Brčko District of BiH (“Official Gazette of the Brčko District of BiH”, No. 34/08);
- Treasury Law of the Brčko District of BiH (“Official Gazette of the Brčko District of BiH”, Nos. 03/07, 19/07, 02/08);
- Law on Accounting and Auditing of the Brčko District of BiH (“Official Gazette of the Brčko District of BiH”, Nos. 06/06, 19/07);
- Decree on Budget Accounting of the Brčko District of BiH (“Official Gazette of the Brčko District of BiH”, No. 25/07);
- Rules on Budget Reporting and Annual Budget Account of the Brčko District of BiH (“Official Gazette of the Brčko District of BiH”)
- Decision on Accounting Policy for the Budget Beneficiaries and the Treasury of the Brčko District of BiH (“Official Gazette of the Brčko District of BiH”)

### **Federation of BiH**

- Law on Budgets in the Federation of BiH (“Official Gazette of FBiH”, Nos. 102/13, 9/14, 13/14 and 8/15)
- Law on Allocation of Public Revenues of FBiH (“Official Gazette of FBiH”, Nos. 22/06, 43/08, 22/09, 35/14 and 98/15)
- Law on Accounting and Auditing in FBiH (“Official Gazette of BiH”, No. 83/09)
- Rules on Financial Reporting and Annual Budget Account in FBiH (“Official Gazette of FBiH”, No. 69/14)
- Law on Treasury in FBiH (“Official Gazette of FBiH”, Nos. 58/02, 19/03, 79/07)

- Accounting Policies for the Budget Beneficiaries and the Treasury of the Federation of BiH (“Official Gazette of FBiH”, No. 9/11)
- Rules on Budget Accounting in FBiH
- Rules on Financial Reporting and Annual Budget Account in FBiH (“Official Gazette of FBiH”, Nos. 69/14, 14/15)
- Rules on the Payment of Public Revenues of the Budget and Extra-budgetary Funds in the Territory of FBiH (“Official Gazette of FBiH”, Nos. 3/11, 6/11, 9/11,18/11,39/11, 64/11i 87/11 , 5/12, 41/12, 69/12, 93/12, 101/12 and 105/12)

### **Republika Srpska**

- Fiscal Accountability Law of RS (“Official Gazette of RS”, No. 94/15)
- Law on the Budget System of RS (“Official Gazette of RS”, Nos. 121/12, 52/14 and 103/15);
- Law on Budget Execution for Fiscal Year of RS (“Official Gazette of RS”, Nos. 128/06, 116/12);
- Law on Accounting and Auditing of RS (“Official Gazette of RS”, No. 36/09) – consolidated version (“Official Gazette of RS”, No. 52/11);
- Order on Budget Classification, Account Contents and Use of the Chart of Accounts for Users of Public Revenues, Municipalities, Cities and Funds (“Official Gazette of RS”, No. 90/10);
- Rules on Budget Classification, Account Contents and Use of the Chart of Accounts for Beneficiaries of the Budget of the Republic, Municipalities, Cities and Funds (“Official Gazette of RS” No. 90/10)
- Rules on Accounting, Accounting Policies and Accounting Estimates for the Budget Beneficiaries in RS (“Official Gazette of RS”, No. 127/11);

### **Fiscal coordination**

- Law on Fiscal Council in Bosnia and Herzegovina (“Official Gazette of BiH”, No. 63/08)
- Rules of Procedure of the Fiscal Council