Support for Improvement in Governance and Management
A joint initiative of the OECD and the EU, principally financed by the EU

ASSESSMENT

THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA

MARCH 2012

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CONSTITUTION, DEMOCRACY AND THE RULE OF LAW

The text of the constitution of the former Yugoslav Republic of Macedonia is in line with European standards of parliamentary democracy. It recognises the rule of law, equality before the law and legality in the action of public powers. It grants fundamental freedoms and human rights, freedom of expression and religion, and respect for minorities. However, in the political reality, departures from democratic values remain.

Despite the constitutional principle of separation of powers between the executive, legislative and judiciary, the state de facto concentrates power in the hands of the predominant and omnipotent executive branch, which directly and indirectly controls the two other branches (legislative and judiciary). This hinders the development of institutions able to strengthen the checks and balances, thereby undermining public accountability mechanisms.

A longer process of cultural and social adjustments and material reform efforts would be needed to develop respect for, and build confidence in democracy, which implies that the political establishment understands and accepts the importance of the Parliament in a parliamentary system of state powers. These reforms will have to take place through a democratic debate, at a technical level, and through a slow process of public awareness raising, and can only be driven by the country's individuals and institutions, with very limited influence from outside the country.

Freedom of speech remains at risk, in particular if the Law on Lustration is not brought in line with the rule of law principle of proportionality and the principle of democracy. The number of independent media is marginal, and media tends to be dominated by external political interests.

The extent to which the public governance system fails to properly respect the rule of law continues to be a key problem. This is not primarily a matter of low quality legislation, but rather of its deficient implementation. Rules and procedures are easily ignored or circumvented and the realisation of substantive rights encounters many hurdles, including a certain degree of arbitrariness in public decision-making. Administrative authorities often ignore Administrative Court rulings and obligatory decisions of other administrative bodies.

Government

The system for policy planning, policy making and co-ordination fulfils the necessary requirements. A basic set of rules of procedure make provision for a co-ordinated system with appropriate processes and instructions. However, they have not been revised for many years, have undergone numerous piecemeal amendments (many of which have not been consolidated) and contain much wording that is imprecise or unhelpful. The process would benefit from a thorough revision and consolidation.

In formal terms, the General Secretariat of the Government has the mandate to support the policy system, but, because Governments do not make full use of it, it stagnates. The role recently assigned to the general Collegium is a partial reversal of this trend, but the performance of the system put in place over the last ten years can be improved.

The need to produce legislation too quickly prompts ministries to contract the stages in the policy development process, and they often fail to consult other ministries and bodies affected, or set

impossibly short deadlines for response. This often results in legislation of poor quality. The majority of such rushed legislation is related to European Integration. The professional Collegium and the weekly Collegium of State Secretaries can only partially correct this.

Public Administration

The former Yugoslav Republic of Macedonia's system of public administration has been further backsliding into politicisation and towards a lack of respect for the rule of law. Confusion between politics and administration is rife, and the public administration is further becoming de-professionalised. This makes the public administration unreliable and unpredictable. Quite often arbitrariness drives administrative decision-making. In the 2010 Annual Report, Ombudsman described discrimination on the basis of political affiliation as the "cruelest one", while adding that ethnic and religious discrimination were also practiced.

During the period assessed, the new Ministry for Information Society and Administration (MISA), operational since 1 January 2011, showed pro-activeness on its large scope of competence. It is now the central administrative and policy making body for all general public administration and civil service matters. However, the MISA still needs to prove whether it has the capacity and the political mandate to resume the change processes undertaken before 2009. Nevertheless, and even were it to be considerably strengthened, MISA will not be able achieve substantial and sustainable results if it remains the only engine of public administration reform.

A new and promising development may have been initiated by the High Level Accession Dialogue (HLAD) launched by the European Commission and the Government of the former Yugoslav Republic of Macedonia in March 2012. The purpose of the HLAD is to stimulate new dynamism in the EU accession reform process, and public administration reform is one of the five priority policy areas. Two more sessions of the HLAD are scheduled for May and September 2012.

Shortly after the first HLAD session, the Government decided to fundamentally modernise the system of administrative decision-making by elaborating a new Law on General Administrative Procedures (LGAP). This legislative initiative could lead to real progress, since a good system of administrative procedures is the basis of good administrative behaviour in general. A good LGAP ensures the quality of administrative decisions as much as their legal correctness. Furthermore, it avoids unnecessarily complicated, formalistic and lengthy processes and enhances transparency and accountability. Good administrative procedures serve the community and promote social trust in the executive power, thereby contributing to political stability and fostering economic development and social wealth. On the contrary, a malfunctioning administration is an obstacle to productive investments and can lead to citizen's resistance and protest against the state and, in worst case scenarios, to a failing state.

Since the Law on General Administrative Procedures is a component of horizontal administrative law, the legislative process will involve a thorough review of three more key factors of the malfunctioning administration: *i)* the inappropriateness of the existing system of general administrative inspections, *ii)* the lack of delegation of decision making authority within administrative bodies (lack of managerial accountability) and *iii)* the system of administrative legal remedies against administrative decisions, for which a State Commission was established in November 2011, but whose institutional set-up raises serious concerns about both its political independence and its effectiveness.

Another legislative initiative is dealing with the system of civil service and public employees through the review of two basic pieces of legislation, the Law on Civil Servants and the Law on Public Employees, and by combining them into one consolidated Law on Public Administration. However, the urgent need for significant changes in the public sector personnel system is only partly the consequence of an inappropriate legal framework. The main reason why a merit-based civil service

still doesn't exist, even ten years after the introduction of the Law on Civil Servants, is the non-observance of the existing legal framework. Recruitment and other decisions regarding the career of a civil servant are increasingly based on political or private motives rather than on merit. It appears that the political establishment has still not understood the values of a professional civil service and the risk for the stability of the state caused by a crisis of public confidence in the professionalism and impartiality of the civil service.

During the period assessed, the authorities' tendency to overestimate the role and importance of information technology (IT) for public administration reform process became apparent. The use of IT in public administration is a prerequisite for modern administration, but the focus on technology must not overshadow the need for organisational, structural and cultural changes in the public sector. The real material shortcomings outlined in the assessments cannot be tackled just through the purchase of equipment and introduction of IT as a way, among others, of communicating between citizens and authorities. This is particularly true for a society in which the digital divide is still significant.

The public expenditure management system contains many of the attributes of an effective administration, characterised by the control of public funds and political commitment to fiscal discipline. However, while the basic management tools, or building blocks, are in place, poor use is being made of them. This is due to poor capacity throughout the administration but also to a lack of political will to drive the necessary change. The Government's main focus should now be on developing capacities within the administration to make optimum use of these building blocks.

In this regard, it should be noted that there are tendencies to award state jobs to ruling party loyalists with the result that trained professionals have been replaced by less qualified party members. Unless this type of issue is dealt with, for which political culture plays a highly relevant role, only minor improvements will be possible in the areas of financial management and control.

Alignment with the *acquis* in the field of concessions and public-private partnerships (PPPs) has been completed through a new law. Some amendments to the Public Procurement Law have been made, with the primary aim of reducing the number of tendering procedures cancelled. Their implementation is properly conducted. The decrease in number of complaints observed in 2010 was confirmed in 2011. These various features confirm that the public procurement institutional set up is now established and that the legal framework is well on its way to becoming fully compliant with the *acquis*, although the EU Defence Directive has not yet been transposed. The new framework law on concessions and PPPs should now be systematically reflected in relevant sectoral laws and properly completed by a whole set of secondary legislation. Its implementation as well as capacity-building at sub-national and regional levels should also be consistently supported and monitored.

Judiciary

The High Administrative Court started operating in June 2011, dealing with administrative matters as a second instance. At the same time the Judicial Council decided to increase the number of judges in the first instance Administrative Court from 25 to 33. Both developments could strengthen the system of legal protection of citizens, which is essential given the huge backlog of cases of the first instance Administrative Court (approximately 10,000 cases).

Integrity

Despite adopting many laws as well as numerous strategies and action plans, corruption remains a critical problem. A major reason for this is that legislation is simply either ignored or not applied effectively. Anti-corruption control in several important sectors, such as conflict of interest of senior officials in the executive branch and politicians, and the control of political party financing, remain

insufficient. Public institutions frequently disregard legal provisions or binding procedures as they see fit.

The new State Programme for the Prevention and Repression of Corruption, the new State Programme for the Prevention and Reduction of Conflict of Interest, and the action plan for their implementation for the period 2011-2015 could provide a fresh start. However, given the track record so far, there are reasons to be sceptical.

Recommendations

To the former Yugoslav Republic of Macedonia

- A malfunctioning administration is not only an obstacle to economic development but also leads to citizen's resistance and protest against the state, contributes to political instability and in worst case scenarios, to a failing state. The unaltered practice of creating a politicised, *i.e.* non-professional, civil service, although severely criticised for years, is the major reason for the current malfunction of the administration. It may be possible that this causal relation is still not understood by the political establishment. Therefore, a high-level political dialogue on this matter should be organised, followed by a campaign to raise awareness, in and outside the public sector, of why a professional civil service is imperative for a functioning state.

- The recent election of a new Parliament should lead to new initiatives aimed at strengthening the role of the Parliament as the legislative and controlling power within the state system of checks and balances. This requires first and foremost the understanding by the political establishment of why the constitution gives such a substantive role to the Parliament. The development of such an understanding could be supported by the involvement in political dialogues taking place at all levels with the EU of not only the executive but also, and as much as possible, of the Parliament (represented by committees, groups, individual members).

- The Government should endorse stronger managerial accountability and delegation of decision-making authority at all levels of the administration.

CIVIL SERVICE AND ADMINISTRATIVE LAW

Main Developments Since the Last Assessment (May 2011)

Although some legislation has been passed, no significant progress was noticeable during the period assessed.

However, a new and promising development may have been initiated by the High Level Accession Dialogue (HLAD) launched in March 2012 by the European Commission and the Government of the former Yugoslav Republic of Macedonia. The purpose of the HLAD is to stimulate new dynamism in the EU accession reform process, and public administration reform is one of the five priority areas. Two more sessions of the HLAD are scheduled for May and September 2012.

Shortly after the first HLAD session the Government decided to fundamentally modernise the system of administrative decision-making by elaborating a new Law on General Administrative Procedures (LGAP). Because a good system of administrative procedures is the basis of good administrative behaviour in general, this legislative project could pave the way for real progress. A good LGAP ensures the quality of administrative decisions as much as their legal correctness. Furthermore, it helps to avoid unnecessarily complicated, formalistic and lengthy processes and enhances transparency and accountability. Good administrative procedures serve the community and promote social trust in the executive power, thereby contributing to political stability and fostering economic development and social wealth. On the contrary, malfunctioning administration is an obstacle to productive investments and can lead to citizen's resistance and protest against to the state and, in worst case scenarios, to a failing state.

The Parliament passed the Law on Establishment of a State Commission for Decision-making in Administrative Procedures and Labour Relations Procedures in Second Instance in April 2011, (see SIGMA 2011 assessment), and on 8 November 2011, elected its seven members. The Commission's legal mandate is to decide on citizens' appeals against individual administrative acts or on issues in the field of labour relations. This institution represents a further attempt to politicise state institutions. In effect, the Commission is under the authority of Parliament which ensures that this allegedly independent body is under the strict control of politics, in particular of the ruling party. This can be corroborated by looking at the identity of the members of the Commission appointed by Parliament.

Although official data on the number of temporary employees in the public administration has not yet been published, estimates are that the total figure for public employment has grown by over 40,000 over the past three years, while institutions remain overstaffed. Recruitment continues to be based on patronage and party affiliation. Members of the Albanian community continue to be recruited under the Employment of Community Members Scheme, only to be generally sidelined once in office.

In February 2012, the Government General Secretariat published an advertisement for the recruitment of 152 new junior civil servants, a number which is questionable given the generalised overstaffing. By looking at the recruitment requirements, the advertised positions seem "tailor-made" for pre-chosen candidates (*e.g.* candidates for administrative tasks are required to have a degree in social sciences, medical sciences or mathematics).

As explained in detail in the SIGMA 2011 Assessment Report, the introduction of a semi-annual performance appraisal is also contributing to the gradual recourse to arbitrariness in public human resource management thereby further endangering the professionalism of the civil service system as a whole.

In January 2012, the Parliament adopted amendments to the Law on Civil Servants (LCS) stipulating the postponement until 31 January 2013 of the administration of psychological and integrity tests to the selected candidate for a civil service position.

These tests were introduced by the amendments to the LCS of December 2010, but their administration has been postponed twice. The official justification for the second postponement in January 2012 was that the first postponement period of 6 months (until 1 October 2011) had been insufficient to ensure that all the necessary preconditions were met, because "the procedures for administering the psychological and integrity tests by licensed experts of independent and fully accredited professional institutions are complex"[1].

The January 2012 amendments to the LCS also stipulate that employment procedures commenced up to the day the amendments entered into force (January 2012) will proceed without the administration of psychological and integrity tests. However, this provision does not apply to the employment procedures that not only commenced but also finished during the period October 2011-January 2012. Consequently, these employment procedures may be challenged by legal remedies.

The whole postponement exercise reflects both the poor quality of legislation and the limited administrative capacity of the Agency for Administration (AA) and the Ministry of Information Society and Administration (MISA).

In February 2012, the Parliament amended the Civil Service Law and the Law on Public Servants (LPS) to promote staff mobility. New provisions allow for staff transfers from non-civil service positions to civil service positions and vice versa. These amendments further weaken the job stability of public sector staff and widen the room for discretionary interpretation and arbitrary use of mobility for reasons other than professional. On 22 February 2012, the Minister of ISA and the Director of the State Administrative Inspectorate, implicitly acknowledging the problem, announced that the State Administrative Inspectorate, through regular and random inspections, will control abuse in the implementation of the new legal provisions on mobility in the administration. It remains to be seen whether this will be done.

Although the MISA has been pro-active, no significant improvement can be seen as flowing from the new civil service management system initiated in January 2011, which transferred the competences on the civil service to the newly established MISA, leaving the AA with residual powers. The Register of Public Servants, which according to the deadlines set by the Law on Public Servants should have been established by June 2011, is not operational yet.

The MISA and the AA adopted, within the scope of their competences, some amendments to secondary legislation, such as the Rulebook on Systematisation and the Code of Ethics (MISA) and Rules of Procedure for the Second-instance Commission (AA). Those amendments only change mere formalities required in the sequel of the reorganisation of the civil service management system in January 2011.

[1] "Full text of the material" of the Government's "Proposal of a Law Amending the Law on Civil Servants in a shortened procedure", dated November 2011, page 5 http://www.sobranie.mk/ext/materialdetails.aspx?Id=0d1cb08f-a645-44c4-8547-fce3a54552f3

Plans for future public administration reform projects developed during the period assessed have given e-government an extreme predominance, a sign of misunderstanding of the role of information technology (IT) for public administration in general and its modernisation in particular. Of course, the use of IT in public administration is a prerequisite for modern administration. However, the focus on technology must not overshadow the need for organisational, structural and cultural changes in public sector. IT will not tackle the real problems the public administration is suffering from, which are: *i)* the disrespect of rules and procedures, or, in other words, contempt of the rule of law, *ii)* the politicisation of administrative decisions, and *iii)* the absence of managerial accountability (lack of delegation of decision-making authority within administrative bodies). The reasons for these shortcomings are complex and substantial in kind, and cannot be remedied by purchasing computers and introducing IT as a technical means. This is particularly true for a society in which the "digital divide" is still significant. The belief that IT-based communication is a panacea for public administration reform is a fallacy leading the process down the wrong track.

On 25 January 2012, the Constitutional Court initiated the examination of the constitutionality of numerous articles of the Law on Lustration. Amendments of February 2011 had extended the period of lustration up to 2019 and widened its scope by including now former office holders, journalists, media editors, university professors and NGOs. These changes are highly problematic, because they open the door for using this Law as an instrument of political contestation of today and the future rather than a method to ensure reconciliation with the past. By interlocutory ruling the Court suspended the execution of the individual decisions adopted and other activities taken by the Lustration Commission based on those articles. Two months after its adoption, this interlocutory ruling has still not yet been published in the *Official Gazette.* The Lustration Commission has stopped applying the suspended articles waiting for the final Court decision on the constitutionality of these provisions. The Government announced that it will again re-establish the same concept of lustration in a new legislation process, even if the Constitutional Court annuls the provisions on the period of lustration and its coverage by a final Court ruling.

Main Characteristics

As it can be deduced from the main developments explained in the previous section of this report, the former Yugoslav Republic of Macedonia has been further backsliding into politicisation and towards a lack of respect for the rule of law. The system of democracy is gradually deteriorating, confusion between politics and administration is rife, and the public administration is further becoming de-professionalised. This renders the public administration unreliable and unpredictable.

Disrespect for the rule of law and the principle of legality is a basic feature of the public governance system. Quite often arbitrariness drives administrative decision-making. In his 2010 Annual Report, the Ombudsman described discrimination on the basis of political affiliation as the "cruelest one", while adding that ethnic and religious discrimination were also practiced.

The existing system of general administrative inspections is inadequate, even after the new legislation on the matter, which entered into force in early 2011. This controlling mechanism is ineffective, weakens rather than supports the protection of citizens against illegal administrative actions, negatively affects accountability, and can be misused as an instrument of (political) arbitrariness against public officials.

The current legal framework for administrative decision making is technically very deficient and substantively unsuitable, as it ignores citizens' basic rights. Article 293a of the current LGAP (adopted in April 2011) is a "graphic illustration". It creates a whole sub-system to regulating administrative silence for which a new Chapter XVIII-a -- consisting only of one article 293a -- was added. The result is an outlandish regulation on administrative silence, difficult if not impossible to handle by administrative bodies, administrative court and citizens. The 15 (!) paragraphs of this article create

overly complicated and long procedures, burdensome for both the citizen and the administrative authorities and an enormous amount of legal uncertainty in administrative decision-making. Over seven layers of appeals were added, leading to an almost 40-day delay after the normal deadline within which the citizen could normally expect an answer to his/her request. Such a bureaucratic procedure obstructs legal protection of the citizen and is detrimental to the rule of law.

Reform Capacity

Reform capacities are low and the willingness to reform in the right direction of democratisation, civil service professionalisation and solidification of a state ruled by law is hardly to be seen.

The few well-intended reforms undertaken so far have been driven mainly from abroad, especially under the auspices of the European Commission, which is pushing hard to approximate the country to EU member states' administrative principles and public management standards. The sustainability of these reforms cannot be guaranteed.

The MISA still needs to prove whether it has the capacity and the political mandate to resume the change processes undertaken prior to 2009. Furthermore, and even if it was considerably strengthened, the MISA will not be able to achieve substantial and sustainable results if it remains the only engine of public administration reform.

The Ombudsman's recommendations could represent a valuable source of information on the shortcomings of the public administration, so as to identify most pressing reform areas as felt by citizens. The same could be said of the jurisprudence of the High Administrative Court.

Recommendations

To the former Yugoslav Republic of Macedonia

- The Government should implement appropriate measures (*e.g.* awareness raising campaigns) targeted at senior and top level management of ministries and other administrative bodies in order to develop a culture of managerial accountability in the public administration, so that ministers and other senior staff see themselves as responsible for the legality of administrative actions in their area of authority and are enabled to act accordingly.

- The Ministry of Information Society and Administration should take the lead in promoting in all administrative bodies the use of delegation as a managerial tool for organising administrative decision-making processes. This needs to be done through regulatory means as well as awareness-raising/training measures.

- The working group of the Ministry of Information Society and Administration should complete the process of drafting a new Law on General Administrative Procedure by the end of 2013. After adoption of the Law, a 12 to 18-month programme should be carried out before the adopted Law comes into legal effect, with the aim of preparing its proper implementation.

INTEGRITY

Main Developments Since the Last Assessment (May 2011)

Corruption remains a serious problem in the country. Only very few developments have taken place since the last assessment, none of them was leading to a perceivable improvement in the integrity of the public sector in its every day practice.

In December 2011, the State Commission for the Prevention of Corruption (SCPC) – which was established in 2006 - adopted a new State Programme for the Prevention and Repression of Corruption, a new State Programme for the Prevention and Reduction of Conflict of Interest, and an action plan for their implementation for the period 2011-15. In the elaboration of the programme, the SCPC took into account the conclusions and recommendations adopted at the annual conferences for assessment of the implementation of the previous state programmes, as well as the recommendations of the GRECO Third round of evaluation, the EC's 2011 Progress Report, the PAR strategy 2010-2015, and the National Programme for Adoption of the Acquis (NPAA) for the period 2011-2013. A high number of stakeholders, both public and private, were involved in the preparation of these programmes through 22 thematic workshops.

The new programme identifies 11 sectors in which the risks and problems of corruption and conflict of interest are the most prominent: politics;[2] judiciary;[3] public administration; law enforcement bodies; customs administration; local self-Government ; public procurement sector; private sector; media and civil society; education and sports; and for the first time health, labour and social policy. A total of 51 specific problems in these 11 sectors are detailed in the programme, as well as 156 activities for overcoming them. The Action Plan lists the planned activities, institutions responsible for their implementation, priorities, timeframes and financial implications, to the extent it was possible to be estimated at the time the Action Plan was adopted. It also establishes indicators for monitoring the implementation of each activity (220 in total), while for some of them it also establishes indicators for measuring the effectiveness of the implemented activities (146 effectiveness indicators).

The new (combined) programmes cover a wide range of issues. The description of the current perception of the forms of corruption and conflict of interests in the sectors covered by the programmes, although not measured empirically, is informative and reflects to certain extent the

[2] Problems identified in the programme are *e.g.* insufficient transparency and supervision over the regular material and financial operation of political parties, trade unions and civil society organisations; weaknesses in the Electoral Code and other regulations on elections that generate risks of direct breaches of the regulations; high level of discretionary powers and great differences in their concentration among different public offices; lack of effects of the implementation of the Law on Lobbying; high percentage of laws adopted in shortened, *i.e.* urgent procedure, which prevents the participation of socially relevant entities and stakeholders in the legislative process.

[3] Problems identified in the programme are *e.g.* lack of "stable and permanent" independence of judges and courts; insufficient transparency in the operation of the courts; lack of overall capacity of the Public Prosecution Office for performing its new role under the Law on Criminal Procedure; insufficient autonomy of the State Attorney Office; lack of regular controls of the work of notaries, practicing lawyers and enforcement agents.

reality. Problems and risk factors for corruption and conflict of interests are identified. The different types of measures and activities for the prevention of corruption and conflict of interest (regulatory, institutional, educational, etc.) are, in general, well planned. However, the content of some of the activities raises questions about their opportunity. The implementation of the in total 220 activities will depend, as stated in the programme, on the continued political will and commitment of the involved institutions, but also on the availability of state funding. The experience of the SCPC with previous state programmes showed that the planned activities not allocated budget funds by the Government were the ones that remained unimplemented. In general, the programmes appear overambitious and doubts are justified whether the action plan is realistic given the large amount of activities envisaged.

The SCPC is in charge of monitoring the implementation of all the activities included in the Action Plan and for that purpose it will develop reporting forms that the designated contact persons in the responsible institutions must complete and return. It is planned that the progress reports to be prepared by the SCPC shall contain quantitative and qualitative analyses about the progress of the implementation of the activities and shall be sent to the Secretariat for European Affairs, the Ministry of Justice and the Inter-institutional Body for Co-ordination of the Activities Against Corruption.

The October 2011 amendments to the Law on Financing of Political Parties introduced some procedural clarifications. The most important change is related to a new controlling mechanism. Now, instead of submitting quarterly reports on donations, the Public Revenue Office (PRO) and the State Audit Office (SAO), political parties are required to submit annual reports, a fact which could reduce rather than increase transparency. Moreover, the annual financial accounts of the political parties are no longer submitted to the Ministry of Finance but to the SAO, the PRO and the Central Registry. The SAO can either submit an initiative for a misdemeanour procedure or a report to the competent public prosecutor if it establishes that there are irregularities in the reports. Other institutions involved in controlling the financing of political parties and electoral campaigns are the Ministry of Justice, the SCPC, and the State Election Commission. Their remits are not always clearly defined and leave space for overlapping and conflicts of attributions.

On 26 December 2011, the President of Parliament distributed a draft Code of Ethics for MPs to the co-ordinators of the MP groups. They were to give their opinion on the draft before 1 February 2012. The text of the draft code is not publicly available, but according to information in the media, the proposal is almost identical to a text that was submitted in the summer of 2010 but never adopted.

The Law on Conflict of Interest was amended in January 2012 with a view to respond to the critical comment contained in the EC 2010 Progress Report that interest statements are only compiled and registered but not verified. The amendments now specify an explicit obligation of the SCPC to check the interest statements and require secondary legislation to be adopted by the Government within 30 days of the entry into force of the amendments (20 February 2012).

The Law on Free Access to Public Information amended in 2010 was operational. No statistics are kept by public bodies on the number of applications received, but the Commission for Protection of the Right to Free Access to Public Information considered 406 complaints in 2011 of which 296 were against the failure of public bodies to respond to requests, 34 were against refusal and 44 against replies with which claimants were not satisfied. Over three-quarters of complaints came from NGOs. Public bodies mostly comply with the commission's decisions on complaints. The Commission's staff undertakes training of central and municipal Government staff on the requirements of the legislation.

The Law on the Judicial Council was amended in July 2011, abrogating the voting rights of the Minister of Justice. The Minister does, however, remain a member of this body. These amendments

only partially heed the recurrent recommendation in the EC Progress Reports and those of the Venice Commission to discontinue the Minister of Justice's membership of the Council. Full compliance with this recommendation would require amending the constitution.

According to a public statement of the President of the Judicial Council made in December 2011 the insufficient budget provided in the last three years for the judicial system has lead to substantial debts in court budgets and thus seriously impairs the functionality of the system.

Main Characteristics

Despite adopting many laws as well as numerous strategies and action plans in the past, corruption remains a critical problem. A major reason for this is that legislation is simply either ignored or not applied effectively. Anti-corruption controls in several important sectors, such as those concerning conflicts of interest of senior officials in the executive branch and politicians as well as the control of political party financing, remain insufficient. Public institutions frequently disregard legal provisions or binding procedures as they see fit. According to international experience, this cultural phenomenon, in combination with a low institutional capacity and highly politicised institutions, is the fertile soil on which corruption grows.

The new State Programme for the Prevention and Repression of Corruption, the new State Programme for the Prevention and Reduction of Conflict of Interest, and the action plan for their implementation for the period 2011-2015 could turn out to be a fresh start. However, given the track record so far, there are reasons to be sceptical.

The constitutional dispute related to the Law on Lustration, explained in more in detail in the 2012 Civil Service and Administrative Law Assessment, reflects how problematic the current state of this Law is. The February 2011 amendments opened the door for its misuse for political purposes.

Reform Capacity

The SCPC holds a key position in the institutional set-up for horizontal anti-corruption activities, but it appears that its implementation and controlling capacity is still insufficient. Its limitations in terms of staffing and budget have been restricting the efficiency of its efforts. The 2011 change from part-time to full-time employment of the seven members of the SCPC has not shown visible improvements so far. Therefore its potential to become the main driver of reforms conducive to a better public integrity system is still open to question.

The role of domestic NGOs, especially Transparency International Macedonia, in airing corruption cases and raising awareness represents an invaluable contribution against corruption. However, so far the main drivers for the reform have been abroad; the European Commission, in particular, plays a significant role in triggering reforms, a fact which raises concerns about their durability and sustainability in the medium-term.

Recommendations

To the former Yugoslav Republic of Macedonia

- The success of the implementation and consolidation of anti-corruption policies presupposes that illegal or unethical practices are no longer accepted by the large majority of the society as a natural way of dealing with public affairs. The rejection of such practices will require a long-term process aimed at changing mentalities and attitudes. The first prerequisite for this is public trust in the role of the law and in public governance institutions needs to be given

greater importance. It is indispensable to lawfully treat and respect individual rights and to reduce arbitrariness in public decision-making.

- More informative campaigns are necessary and must be extended throughout the country, showing how to identify corruption and what are the damages that corruption can cause for every citizen, for the international reputation of the country (which in turn affects foreign investment), and finally for democracy. Providing further training on ethics for civil servants could also have a positive impact.

- Higher priority should be given to the implementation of existing laws rather than to law-drafting activities. It is first and foremost the responsibility of the executive level of administrative authorities (such as ministers, directors of departments and heads of units) to ensure, within their respective realms, the compliance of civil servants with the law and integrity of administrative behaviour. Awareness raising measures are required to improve the executive level of administrative authorities' understanding that ensuring transparency and preventing corruption is in the first instance an internal executive and supervisory task within the respective administrative authority.

- The SCPC needs to be fully staffed and provided with an adequate budget; otherwise the substantial parts of the very ambitious new five-year programmes, the State Programme for the Prevention and Repression of Corruption and the State Programme for the Prevention and Reduction of Conflict of Interest, will remain unimplemented, as it happened with the previous programmes.

PUBLIC EXPENDITURE MANAGEMENT AND CONTROL

Main Developments Since the Last Assessment (May 2011)[4]

The changes to the **public expenditure management system (PEM)** in the former Yugoslav Republic of Macedonia over the past year have not been comprehensive. While the basic management tools, or building blocks, for a strong public expenditure management system were already in place, poor use is being made of them. The Government's main focus now should be on developing capacities within the administration to make optimum use of these tools.

The main changes are:

- The parliamentary Budget and Finance Committee will benefit from Parliament's plan to recruit 23 experienced technical staff, including 3 economists, for a parliamentary institute to provide technical support. This plan is well advanced and is expected to be operational by April 2012.

- The scope of the Budget is satisfactory. All donor funds, including EU funds, now are included in the state Budget.

- On debt management, the project to replace a spread sheet system with a more comprehensive database has nearly been completed. This will enable the department to: *i)* better monitor funding requirements and debt servicing costs; and *ii)* improve its capacity to assess risk associated with raising debt and servicing it, which should mean a better trade-off in terms of liquidity requirements and the cost of raising funds.

- The Fiscal Strategy is submitted to Parliament as an annex to the Budget and is no longer sent separately.

- A medium-term economic and fiscal framework is gradually being introduced although it is not yet regarded as an important instrument for assessing future financial liabilities.

Limited progress in terms of legislation has been made in the area of **Public Internal Financial Control (PIFC).** In 2011, the Minister of Finance adopted:

- The Decree for the procedure for preventing irregularities, the manner of mutual co-operation, the form, the contents, the deadline and the manner of reporting on the irregularities.
- A Decision about establishing the Committee for Financial Management and Control; and
- A Decision for establishing the Audit Committee.

[4] The Minister of Finance of the former Yugoslav Republic of Macedonia requested on 6 September 2011 that SIGMA carry out a peer review or a full assessment of public expenditure management and control in the country. Following consultations between the Minister and the EU Delegation in Skopje, the decision was taken in October 2011 to carry out a full assessment.

The main developments since the last assessment in the area of **External Audit (EA)** refer to:

- An amendment to the Law on the Financing of Political Parties (October 2011). The State Audit Office (SAO) now has a full obligation to carry out audits on the finances of all political parties;
- The audit of the accounts of the SAO is carried out by a private audit company, selected by Parliament and since the last amendment (2011) to the State Audit Law, it is also paid for by Parliament;
- The SAO has developed a plan to incorporate the latest international auditing standards into its work practices; and
- The SAO has continued efforts to have the constitution amended in order to get constitutional anchorage. It has been successful in the sense that Parliament adopted a resolution in February 2011 to amend the constitution in that sense, but this has not yet led to concrete results.

Main Characteristics

The former Yugoslav Republic of Macedonia had made significant progress towards complying with baseline standards for **public expenditure management** but the momentum has been coming to a stop over the past three years. Nevertheless, the former Yugoslav Republic of Macedonia's public expenditure management system provides most of the essential preconditions for an effective and efficient administration characterised by a high level of fiscal discipline and control of public funds.

Among its strengths are the following:

- There are individuals in key positions across the Ministry of Finance who have the competence and enthusiasm to help the ministry fulfil its role as guardian of the public purse – as long as they are adequately resourced and supported by the Government;
- The Liquidity Commission, headed by the Ministry of Finance, has a good record of ensuring adequate funding and the treasury system tightly controls expenditures and produces timely and informative reports on budget evolution and deviations;
- The cash-based accounting system is appropriate for the purpose of budget monitoring and execution;
- A well-operating Liquidity Commission, headed by the Ministry of Finance, has a good record of ensuring adequate funding at most times during the year.

Nevertheless, there are significant weaknesses that must be addressed in the short-term:

- Staff are not encouraged to accept responsibility and staff in budget users tend not to understand the importance of soundly based data and projections, or that inefficient expenditure can have a serious impact on the economy, business and the general public;
- Fiscal policy is reactive: expenditure is increased when revenues are ahead of target, thus increasing the expenditure base;
- On the other hand, when revenues are behind, expenditures are cut quite arbitrarily, including deferring payments due until the following year. Deferring payments underestimates the deficit and is anti-business in that it creates cash-flow problems for suppliers;

- Strategic planning is lacking and budget users generally ignore top-down expenditure ceilings and do not attach any importance to the medium-term expenditure projections, focusing solely on securing as much funding as possible for the upcoming year. This calls into question the reliability of annual and three-year strategic plans, which ministries prepare and submit along with their budget propositions;

- Despite the strong legal controls over municipalities' budgets, there is no monitoring of non-guaranteed debts which is a contingent liability on central Government. While the Ministry of Finance has a unit responsible for local Government budgets, the unit only has a staff of three, thereby making it impossible to comprehensively monitor and control these expenditures from the ministry's perspective;

- There is insufficient emphasis on the costs of new current and capital proposals and in-depth analysis is lacking in many cases. The Ministry of Finance can provide "an opinion" that the projected cost is not realistic but this does not prevent the proposal from being approved by the Government.

Among the strengths regarding **PIFC** is the capacity of putting in place a legal framework and the gradual introduction of internal audit units and financial affairs units. The PIFC legislation supported by these organisational structures provides the basis for the development process. In general, it seems a shift is taking place in management's perception of the audit function. In the past the auditor was seen as an inspector that looks over management's shoulder with a checklist. Several institutions now express that management is slowly realising that the audit function can be to their benefit.

A critical weakness is that the principles underlying PIFC are not wholly embraced by all levels of management. Budgetary control is exercised through the Treasury system and managerial accountability for that expenditure is limited. There doesn't appear to be any definition of what is intended to be or is being achieved with that expenditure. In general, an "analytical discipline" on the budget process appears to be missing. Government policies are not analysed regarding their long-term financial implications on operations. There is no "bridge" between the overall macro perspective and the utilisation of funds. There is also sometimes a gap in the policy dialogue between line ministries and the agencies that perform programmes on behalf of the ministry. The Financial Affairs Unit needs to be more strategic in nature so that managers of other programmes and functional areas across a ministry (agency, municipality) will take greater heed of the need to properly address the financial/economic considerations of what they do and what they propose to do.

Regarding **external audit**, the State Audit Office (SAO) enjoys a high level of independence, although its status has not yet been laid down in the constitution. In terms of work programme, reporting, professional standards and audit mandate, the SAO is independent, and enjoys autonomy in respect of budget. Its relations with Parliament have been a matter of concern as so far reports do not receive the systematic attention they deserve. Nevertheless, auditees consider audit reports useful, and by having a direct impact on auditees, the SAO has an effect.

The SAO carries out financial and performance audits. Apart from the audit departments, the SAO also has departments for audit methodology and quality control, for IT audits, for legal and general affairs and public relations, for finance, and two units reporting directly to the General State Auditor or the Secretary General of the SAO. The financial audits carried out cover both the reliability of financial statements and the regularity of expenditure/revenue, and include audit opinions on both. Performance audit started in 2005 and has developed at a steady pace since. During its 13 years of operation, the SAO has received technical assistance from the Netherlands Court of Audit through a World Bank funded project, followed by a bilateral twinning project, and a another bilateral project

between 2003-2010. From the end of 2011 until mid-2012 a small-scale World Bank funded project with the Netherlands Court of Audit is focusing on the relationship between the SAO and Parliament. A new twinning project is planned for the period starting in 2015.

Reform Capacity

With regard to **PEM**, little improvement has been made in the past year. There is no evidence of increased recognition that better expenditure management feeds through to the business sector in many ways and that it therefore has a significant impact on the rate at which the economy grows. This is due to weak capacity throughout the administration and a lack of political will to drive the necessary change. A key challenge involves improving co-operation between policy departments and departments responsible for financial management; currently, developments in public expenditure management are carried forward without any real internal demand for these changes and therefore the public expenditure management system does not support the actual decision-making process. Discussions with financial management staff, however, both in the Ministry of Finance and the line budget users, gave the strong impression that many individuals have the knowledge and ability to carry out their role well and contribute to more effective expenditure management. It also seems that good performers who change jobs do so by staying within the public sector so a brain drain to the private sector may not be as problematical as in other countries. There is, therefore, some capacity to further improve the system.

Concerning **PIFC,** significant efforts have been made to comply with the legal requirements of the European Union for PIFC through the development of the current legal framework. The realistic development of PIFC though is limited by the overall operating environment of the public sector and the ability of public organisations to accommodate the responsibilities that PIFC requires of them. This part of the PIFC reform is beyond the capacity of the CHU and requires a concerted public administration reform. Managers cannot be responsible for efficiency and effectiveness if they are not delegated that responsibility along with the mechanisms to exercise it. However, there is no apparent appreciation of the management oriented elements of PIFC. For these to succeed, the drive has to come from highest political levels.

External audit (the SAO) has engaged in major reforms with regard to its organisation, audit practices, and relations with stakeholders, based on the forthrolling Strategic Development Plan (SDP). The clear willingness to engage in this major reform demonstrates that the SAO is determined to further improve its practices and increase its impact. The process should constitute an important contribution to strengthening public accountability in the former Yugoslav Republic of Macedonia. However, the SAO's development will not be effective if it is implemented in isolation. Further development in the areas of financial management and internal audit in budget beneficiaries will also be needed so as to ensure a continuous process of evolution of the former Yugoslav Republic of Macedonia's public administration.

Recommendations

To the former Yugoslav Republic of Macedonia

- Focus more on improving results or outputs. The political impetus, without which reform cannot be made, has come to a halt in recent years. While this assessment focuses mainly on expenditure management tools (the "inputs"), the Government's main focus should be on getting better results ("outputs"). The future introduction of new management tools should be directly linked to achieving desired results. The management tools already in place offer a sufficient basis for achieving better results as long as there is a clear political commitment to do so.

- The Government should ensure that the deadline for presenting the Budget to Parliament is always respected. Furthermore, the documentation should include a clearly defined overall budget and economic strategy framework, along with the basic strategies and objectives of the Government's expenditure proposals. The availability of appropriately qualified staff is essential to analyse and challenge budgetary projections and their underlying assumptions. It is also essential that Parliament's power to review and act on reports by the State Audit Institution be enhanced.

- The Government must now make the development of a more effective public administration a core policy if the recommendations in this assessment are to be realised in practice. Staff must be given the confidence to assume more responsibility and take a more analytical approach without the fear that it will have a negative impact on their careers. Such an initiative would benefit from the assignment of a clear mandate to a task group led by a strong minister to take charge of the reform programme, sufficient and unambiguous financing for projects, and a structured sequence of reform steps. The role and scope of technical assistance should be clearly spelled out. To optimise the resources offered to the former Yugoslav Republic of Macedonia's administration, it is important to co-ordinate technical assistance projects and – in the worst cases – to avoid any conflicting advice.

- Macroeconomic and fiscal data must be timely and must stand up to robust challenge and debate. Fiscal risks should be analysed and presented in the budget documents.

- Top-down expenditure ceilings must be respected. To impose analytical discipline at the budget planning stage, the Government must decide that the expenditure ceilings are binding and that new policy initiatives must be funded within the overall ceiling. The expenditure ceilings set in the early stages of the budget process should follow a more purely functional division to facilitate the process of setting political priorities between areas and should not be negotiable at a later stage due to increased expenditure pressure.

- Much greater emphasis must be placed on accurately calculating the costs of new proposals. Far greater weight must be given to the stance of the Ministry of Finance rather than regarding its views as mere "opinions". The Government must decide that new policy proposals will not be approved unless the Ministry of Finance advises that they have been properly costed over the medium-term. Proposals which turn out to have been poorly evaluated should be terminated or scaled back. It is advisable to gather empirical evidence to show that proposals are being evaluated properly.

For the Minister of Finance

- Unpaid commitments should be included in the deficit figure. Excluding unpaid commitments understates the real deficit figure and violates basic principles of transparent and reliable public accounting. Therefore, these commitments should be calculated, published and added to the cash deficit figure. Apart from enhancing transparency, this would benefit business and the economy in general and complement the other pro-business reforms of recent years.

- The preparation of investment expenditure should be better linked to the strategic planning process and co-ordinated with the planning of current expenditure. Capital projects require careful appraisal and management to ensure that they are cost-effective and delivered on schedule and within budget. Comprehensive guidelines for appraising and managing capital investments should be compiled and complemented by a project management training programme. Finally, the "30%" rule, according to which at least 30% of the annual capital budget must be spent in the first half of the year, incites budget users to incur inefficient

expenditures so as to avoid losing funds that have been budgeted; this rule should be scrapped.

- There should be stronger monitoring of municipalities' revenue and expenditure. A formal restriction should be in place to prevent municipalities from financing ongoing expenditure out of receipts from the sale of land in their area by the central Government. As for debt, as the unguaranteed debts of municipalities are a contingent liability of the state, they should also be calculated and monitored to ensure that they are decreasing and that the interest payable is not increasing.

- The longer term overall objective should be to gradually relax the tight, centralised payment control system. This requires budget users to have a strong budgetary management and control process. The existing system should, therefore, remain given the relatively weak internal financial control systems among budget users. Before the existing treasury control mechanisms are reduced, it is vital to ensure the sufficient control of financial resources by alternative control systems.

- The Financial Affair Unit's capacities should be strengthened to support the Head of the entity and sector heads with strategic long-term oriented financial advice. The Financial Affairs Unit (FAU) appears to provide administrative support, but provides financial advice for managerial decision making to a lesser extent. Most of the Financial Affairs Unit's activities focus on budget preparation, co-ordination, control and accounting

For the State Audit Office

- Given the fact that a new twinning project, if approved, will not start before 2015, the SAO might benefit from short-term technical assistance in some of the areas identified for the twinning project, especially in respect of practical training in financial and performance audits. A peer review might be a useful tool to identify in more depth the development needs.

Detailed Analysis

Public Expenditure Management

Legal framework

The baseline standard for a legal framework that underpins a sound public expenditure management system, which requires clearly defined principles to be set out in the constitution, an Organic Budget Law and/or related laws, is generally satisfied. Public expenditure matters are regulated by the constitution, the Law on Budgets, the (annual) Law on the Execution of the Budget, the Public Debt Law, the Law on Local Financing, the Law on Accounting for the Budget and the Budget Users, the Law on Public Internal Financial Control, and related implementing legislation.

The constitution specifies that the Government proposes the budget but that the Parliament adopts it and determines public taxes and fees, *i.e.* it recognises the separate roles of the legislature and the executive regarding public finances.

The Law on Budgets regulates the procedures for the preparation, adoption and execution as well as the reporting and control of the state budget, the budgets of local municipalities and the extra-budgetary funds. This law complies with the fundamental principles required under the baseline standards. Though not related to the baselines, Article 56 also provides for fines to be imposed on the Head of a budget user where the expenditures are not executed in accordance with the law.

The Public Debt Law regulates the procedures for borrowing by the central Government, municipalities and public enterprises. Although it does not provide that municipalities may only borrow from the central Government, it does stipulate that their borrowing is subject to the approval of the Ministry of Finance (See Article 25) and provides for sanctions to be imposed on entities and individuals that circumvent this (See Article 28a). The authorities consider that the requirement for prior approval from the Ministry of Finance and the provided sanctions ensure strict enforcement of the Law. There were some amendments to this law in 2011 including a provision that municipalities and public enterprises may only borrow with the approval of the Ministry of Finance [previously the approval of the Government was required, See Article 25(1)].

The legal framework generally conforms to the baseline standards. There is no legal basis for fiscal rules on deficit and debt ratios but there is a political commitment to respecting key limits, which is more important than having a legal basis. Although there is no consolidated budget containing local Government budgets, this is not unusual in an EU context. Accordingly, legislative reform is not a prerequisite to achieving European standards on expenditure management.

Parliament/executive relationship

The Government's right to propose a budget is determined by both the constitution and the Law on Budgets and it is assigned a clear role for preparing, executing and monitoring the budget. Parliament's right to determine public revenue and expenditure is established by the constitution. The power of Parliament to amend the budget is within the constraint of having to propose balancing savings elsewhere so as to remain within the Government's overall expenditure target.

The Law on Budgets also sets out the timetable for the approval of the budget by Parliament. The budget is debated in a plenary session but parliamentary scrutiny of the budget proposals is given effect primarily through the Budget and Finance Committee. Procedural rules allow for a 20-day period of debate through the plenary and committee sessions. The committee has the power to question the Minister of Finance and/or his/her deputy and officials (and other ministers when required) during the year.

The duty of the committee and Parliament is to scrutinise the budget and question the Government about its budget proposals, but this role is severely compromised by:

- The budget often being submitted to Parliament later than the legal deadline of 15 November (although Budget 2012 was submitted before the deadline). This deadline is later than in many EU countries and late submission further reduces the already limited time for debate.

- A general lack of transparency in the Government's budget proposals, with insufficient detail about the Government's overall economic and budgetary strategy and no explanation of the assumptions that underpin the budgetary calculations, such as, for example, the effects of agricultural subsidies on tax revenues. Moreover, there is a lack of transparent information even for high-expenditure proposals such as Skopje 2014, other large construction projects and transfers to local Government.

- Inadequate resources. One economist is assigned permanently to the committee but cannot complete all of the required analysis in the time available. Consequently, the committee relies heavily on information provided by the Minister of Finance. There is a plan to recruit 23 experienced technical staff, including 3 economists, for a parliamentary institute modelled on the Czech and Slovak Parliamentary Institutes by April 2012 but this remains to be seen.

- Parliament not having established proper arrangements to review reports by the State Audit Institution on unauthorised spending. Despite previous recommendations in this regard, there has been no progress in putting parliamentary powers of review into practice and good quality reports have not resulted in any action on the part of Parliament or the State Prosecutor. There is a severe lack of progress in reaching European standards in this regard.

The Government should ensure that the deadline for presenting the Budget to Parliament is always respected. Furthermore, the documentation should be more detailed and transparent. If Parliament is to fulfil its role of scrutinising the Budget and questioning the Government on its fiscal policies, the Government must present a clearly defined overall budget and economic strategy framework along with the basic strategies and objectives of its expenditure proposals. The availability of appropriately qualified staff is essential to analyse and challenge budgetary projections and their underlying assumptions.

Scope of the Budget and quality of budget documentation

Scope of the Budget

In general, the scope of the Budget is satisfactory. This is important because a Budget which is comprehensive in scope promotes prioritisation within the constraints of the financial resources.

The Law on Budgets provides that the annual budget comprises budget users and spending units. Budget users are defined as first-line users in legislative, executive and judicial authorities (central Government), the four extra-budgetary funds and municipalities. A spending unit is a second-line user that is financed by a budget user. Since the funds are budget users, they are subject to the same degree of scrutiny by the Ministry of Finance as other first-line users. The funds are required to submit revenue and expenditure forecasts to the Ministry of Finance in accordance with the annual budget circular; and all their transactions are effected through the Treasury. Furthermore, transfers to the extra-budgetary funds from ministries and other budget users are subject to normal scrutiny.

All donor funds, including EU funds, are incorporated into the state Budget. Articles 8 and 9 of the Law on Budgets determine how EU funds and co-financed expenditures are to be treated.

Quality of budget documentation

The quality of the budget documentation made available to the Parliament and the general public has improved in recent years. However, this is still at a developmental stage and below the required transparency standards.

The budget documentation includes background information on programmes, including achievements in the out-going year and indicators for the upcoming year, and the Budget shows own revenues, foreign donations and inflows from loans as well as the use of these funds (according to administrative and functional classifications) on the expenditure side. Nevertheless, the evidence suggests that the importance of soundly based data and projections is not fully appreciated. They are vital from both the perspective of informing the public and making robust, soundly based projections throughout the administration.

The Ministry of Finance publishes a significant amount of budgetary information on its website in both Macedonian and English, including:

- Fiscal Strategy
- Public Debt Management Strategy;
- the Pre-accession Economic Programme (PEP); and monthly, quarterly and annual reports on the execution of the Budget.

The Fiscal Strategy, which sets out the macroeconomic framework and the policy basis for the budget, and contains fiscal policy objectives, is submitted to Parliament as an annex to the Budget. In future, it will include the Public Debt Management Strategy. This eliminates overlap and improves efficiency but one hopes that debt management issues will still be debated by Parliament since the Debt Strategy was adopted by Parliament, whereas the Fiscal Strategy is only approved by Government. Furthermore, three weaknesses cause concern.

- The strategy is prepared in May and is considerably out-dated by the time Parliament considers the Budget. Even though the formulation of the Budget in the autumn takes account of revised macroeconomic indicators, the data provided to Parliament are from the spring.
- The strategy fails to take account of the macroeconomic or fiscal effects of significant revenue or expenditure changes and contains no presentation of fiscal risks, including information on contingent liabilities arising from state guarantees. Furthermore, there is no risk or sensitivity analysis. The PEP contains sensitivity analysis with regard to the budget deficit and public debt, which shows it can be done.
- The strategy was not published in the last years because the Government thought the data were too unreliable in light of the continued economic downturn. This shows the disadvantage of not having a sensitivity analysis. It also suggests that the Fiscal Strategy is regarded as “nice to have” but not a vital component of the Budget.

The budget documentation still lacks some basic information. For example, comparative budgetary information is only provided for the previous budget year, and information is not provided on the impacts of current budget decisions on the budgets of future years.

While a medium-term economic and fiscal framework is gradually being introduced, it has a long way to go before it becomes an important instrument for assessing future financial liabilities. Insofar as this information is produced, it is seen by many as a box-ticking exercise. This attitude

must change. Macroeconomic and fiscal data produced by the administration must be timely and must stand up to challenge and debate.

Monitoring the Government deficit and Government debt

Both the deficit and Government debt, which are published on a GFS 1986 basis (IMF Methodology), are closely monitored.

The key elements of Government fiscal policy are adherence to the political commitments that:

- the annual budget deficit (measured on a cash flow basis) cannot exceed 3% of GDP;
- general Government debt (central Government , funds and municipalities) cannot exceed 30-35% of GDP; and
- public debt (which includes certain public enterprises and the National Bank) cannot exceed 40-45% of GDP.

Despite the economic and financial crisis of recent years, the deficit has been kept within the 3% limit and the debt ratio, although it increased slightly from 24% to 26%, remains around 25%. The former Yugoslav Republic of Macedonia has retained its BB stable (S&P) and BB+ stable (Fitch) ratings, which is a positive achievement in current economic circumstances.

The Public Debt Department is highly competent and staff in the front, middle and back offices carry out their respective roles effectively.

The cash management function is well-integrated with the debt management function. By concentrating available liquidity in the Treasury Single Account, the Ministry of Finance has been able to benefit from the economies of scale of cash management in the Government sector, as well as limiting the need for cash and thus the costs of borrowing. The Liquidity Commission, on which the department sits along with the Treasury Department, the Budget Funds Department and the Public Revenue Office, plans liquidity requirements. The commission functions well, with several budget users confirming the Public Debt Department's assertion that it receives weekly details of payments due in the upcoming week. However, funding shortages result in payments being delayed from time to time and particularly towards the end of the year.

Municipal borrowings

The Law on Local Self Government allows municipalities to borrow on a long-term basis up to 100% of the total revenues of their operational (current) budget from the previous year, as well as to borrow free of interest from the central Government. However, municipalities' borrowing, must be approved in advance by the Ministry of Finance even if sourced from the central Government. The National Bank will not facilitate the flow of funding from a foreign entity to a municipality without this approval and domestic banks are also aware of this necessity. This control is underpinned by the Public Debt Law 2005, which limits the purposes for which municipalities may borrow. The department believes that the Treasury system prevents municipalities from circumventing these rules, which is less likely to happen in any event as a result of an improved relationship between the ministry and municipalities with regard to reporting and training in recent years.

However, the fact that liabilities that municipalities incurred before the Public Debt Law took effect are not included in the public debt data, which is limited to guaranteed debt, is a weakness. It is not certain what would happen should a municipality default on this type of liability but it is likely that the central Government would have to step in and cover it. Another weakness is that the Budget Department cannot verify the quarterly debt reports submitted by municipalities and the ministry

accepts them at face value on the basis that individual mayors have signed off on them. Furthermore, the system that allows municipalities to retain 80% of sales of land for construction and 78% of receipts from mining concessions should not enable municipalities to use such proceeds to finance ongoing expenditure.

Paying commitments

The prevailing attitude within the system that a supplementary budget each year is normal reflects a poor understanding of budgeting principles and is a serious weakness in fiscal policy. In previous years when revenues were ahead of target, expenditure was increased, when it would have been more prudent to run down the stock of debt and only use the additional resources after having planned the best use of them as possible in the context of the following year's budget.

On the other hand, when the limit looked likely to be breached in recent years, extra efforts went into gathering revenue and expenditures were cut quite arbitrarily, including deferring payments due until the following year. The reality therefore was that the deficit was understated since these payments due, or commitments, should have been added to the official cash deficit calculation. Another fundamental problem with not paying commitments is that it has a domino effect on business as suppliers waiting for the Government to pay them are likely to pass the problem on to their suppliers and so on. Apart from underestimating the deficit, this practice is anti-business and should be stopped.

The annual deficit and Government debt ratio do not comply with ESA 95 requirements. While the targets are well monitored they both exclude important factors. As long as unpaid commitments are excluded from the deficit figure, the real deficit is understated. Therefore, these commitments should be calculated, published and added to the cash deficit figure. Apart from enhancing transparency, this would benefit business and the economy in general.

As for debt, the unguaranteed debts of municipalities are a contingent liability of the state. These should therefore also be calculated and monitored to ensure that they are decreasing and that the interest payable is not increasing. Furthermore, accepting municipalities' reports at face value is a weakness; some effort should be made to check them, even on a sample basis. A formal restriction should be in place to prevent municipalities from financing ongoing expenditure out of receipts from the sale of land in their area by the central Government.

<u>Medium-Term Expenditure Framework</u>

There is a medium-term expenditure framework for budget users including the extra-budgetary funds but further improvements must be made to meet European standards. The Law on Budgets provides for a medium-term budget process with top-down elements, based on fiscal policy objectives and macroeconomic projections. A medium-term baseline projection of revenue and appropriations are included in the Budget. The PEP, the Public Investment Programme (PIP), and the Fiscal and Debt Management Strategies are presented on a three-year basis. The investment projections in the Budget are planned in a three-year rolling framework and the PIP is consistent with these projections.

However, the quality of the medium-term data is questionable. With the annual Budget being revised every year, it is clear that the capacity of the administration to make reliable medium-term fiscal forecasts remains a challenge despite the significant advances in recent years. Furthermore, strategic planning is almost totally lacking and budget users generally pay no heed to the medium-term expenditure projections, focusing solely on the forecasts for the upcoming year.

Expenditure ceilings

The budget process starts with the Government agreeing on its strategic priorities by 15 April. By 31 May the Government is required to adopt its Fiscal Strategy, which forecasts revenue and appropriations for the next three years. The Ministry of Finance then issues the Budget Circular to budget users. This provides budget users with top-down expenditure ceilings for each of the three years. The budget users are supposed to comply with this but the ceilings for the latter two years are indicative at best and even the ceiling for the budget year can be breached.

For example, the limit does not apply to new policy initiatives introduced after the ceiling was agreed by Government and budget users routinely seek to negotiate additional funding for existing programmes. Budget users give no thought to providing for new initiatives from within an allocation that respects the ceiling, even though there is a reserve that provides for new initiatives that may be approved after the Budget. Budget users will not respect the ceilings until the Government decides that each individual minister will have to operate within the ceiling.

Macroeconomic forecasting

A medium-term fiscal strategy is a prerequisite for sound, sustainable fiscal management and accurate medium-term fiscal projections are heavily dependent on good quality macroeconomic forecasts for the same period. The Macroeconomic Policy Department of the Ministry of Finance, which is responsible for these forecasts, gives the impression that it has good quality staff. However, economic modelling is in a development stage and with 14 staff allocated across four units, the department is operating below its full allocation of 24. It is hoping to be allowed to recruit an additional economist in the latter half of 2012.

In recent years the Macroeconomic Policy Department has had to perform its role against a background of business-friendly tax reforms and administrative efficiency reforms, which has had a positive effect on the economy and revenues but has made forecasting more difficult. In the less stable economic situation that now prevails, the capabilities of the individual staff members will be more important than ever. The department has received technical assistance in recent years and an IPA twinning project to further improve the macroeconomic database and modelling expertise is planned. This project should have started sooner but an appropriately qualified expert is still being sought.

The basis for a medium-term expenditure framework exists but if the projections are to be as realistic as possible, there must be enhanced capacity in both the Ministry of Finance and line ministries. The Macroeconomic Policy Department recognises the importance of developing both its economic model and the skills of its staff. In this context, the IPA twinning project is welcome. However, staff turnover may remain a problem in the long-term and the ministry needs to ensure that appropriate succession planning takes place in advance of staff departures. In order to impose analytical discipline at the budget planning stage, the Government must ensure that the medium-term expenditure ceilings are calculated more realistically.

Annual budget process

In general, the budget process in the former Yugoslav Republic of Macedonia complies well with baseline standards in terms of the sequencing of steps and the definition of roles, although the time allotted to some of the steps may be too short. It also tries to comply with most of the essential points contained in the baseline standard. However, these attempts are not always successful.

The budget process is regulated by the Law on Budgets. The first step is the Government's agreement on its main strategic priorities by mid-April, then its fiscal strategy by 31 May, using an assessment and forecast of central macroeconomic parameters provided by the Ministry of Finance.

By 15 June the Ministry of Finance issues the annual budget circular. This circular is consistent with the Government's strategic priorities, its overall fiscal strategy and the above-mentioned expenditure ceilings. The circular also includes macroeconomic forecasts and technical issues concerning the preparation of draft budget requests. An explicit attempt is made to take factors into account that affect expenditure, such as macroeconomic parameters, volumes of entitlement systems or new, recently agreed policies.

The Circular sets expenditure ceilings for about 30 of the 75 budget users including each of the four extra-budgetary funds. This corresponds to a quasi-functional allocation structure. However, even the budget ceiling for the Budget year is not seen as binding by budget users and, as stated above, little consideration is given to the latter two years. The procedures for setting overall expenditure restrictions are therefore not fully consistent with a top-down approach to budgeting, where available resources determine the scope for Government policy.

Draft budget requests must be submitted to the Ministry of Finance by 15 August. Only policy changes agreed by the Government may be included. The strategic plans of each institution are also included, covering programmes and activities for the realisation of the Government's strategic priorities as well as the goals of the budget user over the next three years. However, very little credence is attached to the projections beyond the upcoming Budget year. This calls into question the value of the three-year strategic plans that ministries are required to submit along with their budget submissions. If budgetary planning is poor, it is difficult to see how the strategic plans can be robust in terms of service delivery. A high degree of discretion is given to the heads of budget users in deciding how to allocate available resources to spending units. It is unclear how this can be effective, however, given that many senior-level managers in line ministries do not know how much money is spent in their area.

It is claimed that the budget is presented on a 2-digit programme classification basis. In reality, however, it is still planned at the 3-digit item level. Attempting to incorporate information on programmes and their intended results into the budget documentation is a good step forward, but considerable efforts need to be made to make the programme classification and indicators meaningful and usable in the actual policy-planning process. The programme classification in use provides very little added-value because not all of the programmes are actually sets of related activities and projects aimed at the realisation of a common goal (which is how the term "programme" is defined in the Law on Budgets). Not only does this make it impossible to set meaningful indicators, but the medium-term targets set are not in line with budget limitations.

The Budget and Funds Department has primary responsibility for calculating salary expenditure provisions. The Budget shows the allocated number of staff for each budget user, including its spending units, but there is no disaggregation between the two levels.

The Ministry of Finance scrutinises the draft requests and engages in negotiations with budget users. It then prepares a draft budget proposal for submission to the Government by 1 November. After adopting the draft budget, the Government submits it to Parliament by 15 November, where it is discussed for at least 20 days before its adoption by 31 December.

The OECD's *Best Practices for Budget Transparency* recommends that Government submits its budget proposal to Parliament at least three months prior to the start of the fiscal year. The challenges associated with fiscal forecasting in a small administration such as the former Yugoslav Republic of Macedonia's, however, mean that beginning the process at an earlier stage or attempting

to telescope other parts of the budget formulation cycle could lead to even weaker projections, which could unravel before the new fiscal year begins.

The Government must decide that the overall ceiling is binding if the top-down elements of the process are to be strengthened. The expenditure ceilings set in the early stages of the budget process should follow a more purely functional division to facilitate the process of setting political priorities between areas and should not be negotiable at a later stage due to increased expenditure pressure.

The Government also must ensure that capacities for analysing and compiling financial aspects are improved, with regard to both the next fiscal year and the medium-term.

Improving capacity for programme budgeting and performance-oriented evaluation -- both at the level of the budget user and in the Ministry of Finance -- should be a much more long-term goal.

Budget management and management of public investments

There is non-compliance with the required standards for multi-annual development programmes involving careful co-ordination between partners at different levels of Government and across ministries, well-designed co-financing procedures and sound technical and economic appraisal of such programmes. The key to complying with the required standards is that new programmes are approved only after being subjected to sound technical and economic appraisal. It also demands the integration of procedures for preparing and approving budget proposals for capital expenditure with those for current expenditure.

The fiscal impact of new proposals is summarised in the standardised Fiscal Impact Assessment (FIA) forms. Theoretically, this strengthens the link between the overall policy making process and the budget but in-depth analysis is lacking in many cases. The Ministry of Finance can provide “an opinion” that the projected cost is not realistic but this does not prevent the proposal from receiving Government approval. The advice of the Ministry of Finance should not be regarded as “only” an opinion on equal footing with that of the spending budget user but should be regarded as a prerequisite for approval by the Government.

The Budget contains all appropriations for investment purposes. However, it is doubtful that budget users have the capacities to subject investment proposals to the required cost-benefit analysis. It is likely that many capital projects are approved on the basis of spurious appraisal techniques. Although budget users are expected to take account of all recurrent costs directly associated with an investment project, it is clear that some of the biggest budget users do not do this and that total costs are regularly underestimated.

It is also worth noting that the PIP 2009-2011 states that, with a view to furthering economic growth, “fiscal policy would continue to be more relaxed in the area of capital investments”. This suggests an assumption that capital investment always has a return on that investment, which is not necessarily the case. Although the PIP 2011-2013 does not repeat this assertion, it contains nothing to suggest that investment proposals are subject to rigorous cost-benefit analysis.

In recent years, development programmes have been introduced into the Budget as a step towards integrating capital investment within the budget allocation process. They also include EU co-financed programmes. Development programmes are shown on a three-year basis in the Budget. Yet while year one of the development programmes can be reconciled with the budget users’ allocations in the main part of the Budget, they do not distinguish between capital and current expenditures, such as labour activation measures. Nor do they contain all capital expenditures.

The track record of capital investment projects being completed on budget and in the time envisaged is poor. To improve this, funds for investments from the development programmes may be carried forward and used during the first half of the next budget year. However, budget users have in the past been required to spend at least 30% of the annual capital budget in the first half of the year. This rule was introduced to ensure that large outlays did not put pressure on funding in the latter part of the year, but this could have the opposite effect to the carry-over regulation by inciting budget users to incur inefficient expenditures in order not to lose the funds that have been budgeted. In 2010 and 2011, realised expenditures were higher than planned, which suggests that this may have happened. Although this rule has not applied in the past two years, it has not applied only because budget users had spent in excess of 30% in the first half. It was not unapplied because of a recognition that it could encourage inefficient expenditures.

Capital projects require careful appraisal and management to ensure that they are delivered on schedule and within budget. Budget users need to further develop staff capacity in running investment projects and in liaising with donors. Comprehensive guidelines for appraising and managing capital investments should be compiled and complemented by a project management training programme.

The Government must decide that new policy proposals will not be approved unless the Ministry of Finance advises that they have been properly costed over the medium-term. It is advisable to gather empirical evidence to show that proposals are being evaluated properly. Proposals which turn out to have been poorly evaluated should be discontinued or scaled back.

The "30%" rule, which may be encouraging inefficient spending, should be scrapped permanently.

Budget execution and monitoring

Budget execution and monitoring is thoroughly regulated by the Law on Budgets, the annual Law on the Execution of the Budget and the Guidelines for Treasury Operations. It works well from a control perspective and complies with the baseline standards in many respects.

Budget execution process

The budget execution process is heavily focused on expenditure control through a consolidated Treasury Single Account. All Government entities, including the municipalities and the funds (with the exception of regional offices of the Pensions and Disability Fund), are incorporated in the Treasury Single Account. Donor funds, including EU funds, are included in the system. Payments from the Employment Agency to beneficiaries, which were made through commercial banks up until the end of 2011, are now made through the Treasury. This centralised budget execution provides a solid control of payments and makes it possible to closely monitor adherence to the detailed line-item specification in the budget.

There is a commitment ledger in which budget users are required to register in advance financial commitments above EUR 5,900. These commitments can be included in or excluded from the various cumulative reports that Treasury can send to budget users. The reports can be produced daily in hard copy only. Other reports are available electronically as long as the budget user's system is compatible with the Treasury's system.

The execution of the budget is based on the apportionment of the annual budget for each spending unit, which is reflected in a quarterly financial plan that each spending unit is required to submit to its budget user. Each budget user is required to consolidate these financial plans, which may be revised during the year, and submit them to the Ministry of Finance. Budget users also prepare a monthly financial plan (based on the quarterly financial plan) according to budget classification, which is submitted to the Treasury for approval before the beginning of the quarter. The quarterly

financial plans may be changed within the limits approved for the respective quarter. Controls are also exerted through the 6-digit economic classification that applies to every transaction.

Individual payments

When a payment is due, the respective budget user issues a payment request in paper format to one of the 17 regional offices of the Treasury. The Treasury manually verifies whether a requested payment is in line with the submitted payment plan, corresponds to what has been entered in the commitment ledger, and matches the purpose stated in the budget. All other aspects of the Treasury system, such as verifying whether there is a sufficient balance in the appropriate account, are electronic. If the request is approved, the Treasury sends a payment order to the National Bank, which is responsible for the payment system. Executed payments are registered in the Treasury General Ledger.

This system has fundamentally been designed for control purposes. The centralised control of individual payments reduces flexibility at the level of budget users. Nonetheless, given budget users' relatively weak internal financial control systems, any relaxation in the existing Treasury control mechanisms should be accompanied by alternative control systems that ensure the sufficient control of financial resources.

Municipalities' budgets

The 85 municipalities' budgets may not be controlled as tightly as possible. Since 2005, municipalities have been responsible for paying many second-line users under a fiscal decentralisation process. For example, over 20,000 employees in schools are paid by the municipalities. While these payments are effected through the Treasury, there is no evidence to suggest that municipalities' expenditure is subject to the same controls as expenditure under the state budget. While the Ministry of Finance has a unit with responsibility for local Government budgets, it only has a staff of three, thereby making it impossible to comprehensively monitor and control these expenditures from the ministry's perspective.

Cash planning and liquidity pressure

Through cash planning, based on the historical trends of payments and the information in the commitments ledger, the Treasury has a reasonably good picture of its cash position. In recent years, the Government has built up reserves in the National Bank, which could yield higher returns if it were managed more aggressively. However, obtaining higher yields means higher risks, and it may be that a lower yield but less risky approach is more appropriate when the objective is to maintain a sufficient balance in the National Bank.

Although the Liquidity Commission minimises liquidity pressures, payments are sometimes delayed due to a lack of funds. While this can be alleviated by reallocating across line items, reallocation is excessive due to poor planning capacity within budget users and it ties up a considerable amount of personnel resources in the Ministry of Finance. This situation was expected to improve with the introduction of new budget and accounting software in 2008 but this does not seem to have happened.

Reallocations and carrying forward expenditures

Government permission is needed for reallocation between budget users who are themselves responsible for reallocation between spending units. Parliamentary approval is required for any transfer above 20% or between central Government budget users and the funds.

Changes to the rules on carrying forward expenditures have been postponed until 2014. At the moment, 50% of unspent funds can be carried forward into the following year up to a limit of MKD 20 million. So if MKD 50 million out of a total allocation of MKD 100 million is not spent, MKD 20 million can be carried forward and MKD 30 million surrendered.

The budget execution and monitoring system works well. However, consideration could be given to exerting stronger control over the municipalities' operations. The Treasury can make a lot of information available to the Ministry of Finance but the ministry must have the resources to use the information and the information should be consistent with sound financial management based on appropriate principles of segregation of duties.

The overall objective should be to gradually relax the tight, centralised payment control system. This, however, requires budget users to have a strong budgetary management and control process.

Accounting and reporting

Budget accounting and reporting is based on cash transactions registered in the Treasury General Ledger. Commitments are also entered into the system. There is no accrual accounting.

Accounting

Since the chart of accounts, which is based on the IMF Government Finance Statistics (GFS) 1986, is identical for all budget users, it is easy to compile aggregated information on Government finances. Work has been underway for several years to make the chart of accounts compatible with the European System of Accounts (ESA 95), and it is clearly progressing at a slow rate. Some progress has been made in developing a consolidated cash-based budget statement incorporating state, funds' and municipalities' budgets, with consolidated municipality budget data available internally to the Treasury Department.

There is an interest in moving to accrual accounting and in developing performance reporting. While performance budgeting is a necessary step in the longer term, other areas should be given priority beforehand. If there is to be an increased emphasis on performance reporting, the focus should be on keeping it simple, with just a few overall performance measures. As in most OECD countries, performance information should be aimed at informing, rather than determining, the allocation of resources. As for accruals, given the complexities of managing and the expense of introducing such an accounting system, it should not be a priority at all. While the move to the more accrual-based ESA 95 is to be encouraged, this is not a full accruals system and, in any event, the basic building blocks of these returns for several EU member states are cash-based accounts.

Reporting

Most of the reporting is produced by or through the Treasury Department, although budget users are also required to keep their own accounts. According to the Treasury Manual (article 79), budget users should, on a monthly basis, reconcile the data for revenues and expenditures realised in the Treasury Ledger with data from their accounting records. Budget users also receive daily account statements and specifications for expenditures (from the e-treasury system or from treasury branches), and these statements are used for their accounting records.

The centralisation of budget accounting facilitates the production of budget execution reports, which can be used to monitor the evolution and deviations of in-year revenue and expenditure. The Treasury produces reports on the cash execution of the budget with virtually no delay. Daily reports showing payments and the balance on sub-accounts in the Treasury Single Account are sent to the Minister of Finance and the Prime Minister, and are made available to budget users as well. Monthly reports, showing deviations from the planned budget, are produced and distributed to the

Government within 30 days following the end of the month. These reports are also published on the Ministry of Finance's website. A semi-annual report on budget execution is sent to the Government and published no later than 31 July.

Final accounts

According to the Law on Accountancy, final accounts are to be submitted to the State Audit Office and the Central Registry by end-February. According to the Law on Budgets, the Minister of Finance is required to submit to the Government by 31 May the final accounts of the previous year's budget, together with the audit report of the State Audit Office. After approval by the Government, the final accounts are to be submitted to Parliament no later than 30 June. There is no COFOG classification, which casts doubt on the accuracy and the use of the COFOG presentation in the draft Budget. There is no formal parliamentary debate associated with the publication of the report. While it could be argued that structures need to be put in place to facilitate debate, it should be noted that the report is used in the monthly "question time" of the Minister of Finance.

For the purpose of monitoring budget execution, cash-based accounting is clearly appropriate. The introduction of full accruals-based accounting should not be a priority as long as more basic weaknesses remain to be addressed, particularly as the cash-based accounts can be used as the basis for the ESA 95-based accounts that should be developed in the more immediate future.

Capacity to further develop the system

Despite previous advice that greater efforts had to be made to improve capacity and performance throughout the administration in order to comply with international standards, little improvement has taken place in the past year. The changes that have been implemented have been technical and limited to certain areas.

General impact

There is no evidence of increased recognition that better expenditure management feeds through to the business sector in many ways and that it therefore has a significant impact on the rate at which the economy grows. While the reduction in the corporation tax rate in recent years was driven by the Government's recognition of the relationship between lower taxes and higher growth, there seems to be no significant emphasis on eliminating inefficient and ineffective expenditures to create greater scope for further tax reductions (improvements in certain areas notwithstanding).

Furthermore, there is anecdotal evidence to suggest that the system is so inefficient that it is encouraging corruption as citizens seek to overcome delays in service delivery.

Good knowledge and ability

Discussions with financial management staff, however, both in the Ministry of Finance and the line budget users, gave the strong impression that many individuals have the knowledge and ability to carry out their role well and contribute to more effective expenditure management. It also seems that good performers who change jobs stay in the public sector so brain drain to the private sector may not be as problematical as in other countries. There is, therefore, some capacity to further improve the system although it should be a policy that movements within the administration are only effected after a suitable transition period allowing replacements with the appropriate skills to be adequately trained.

Co-operation between departments

Another key challenge involves improving co-operation between policy departments and departments responsible for financial management. Currently, developments in public expenditure management are carried forward without any real internal demand for these changes, and therefore the public expenditure management system does not support the actual decision-making process. In the context of public internal financial control in the former Yugoslav Republic of Macedonia, steps have been towards more delegated authority and accountability. However, key personnel in budget users are allowed to opt out of training courses with no apparent penalty. This suggests that these efforts are not being taken seriously at the highest level.

Although the Government can be praised insofar as previous reforms were both ambitious and effective, the political impetus, without which reform cannot be made, has come to a halt in recent years. The Government now must make the development of a more effective public administration a core policy if the recommendations in this assessment are to be carried out in practice.

Furthermore, staff must be assured that assuming more responsibility and taking a more analytical approach will not have a negative impact on their careers.

Public Internal Financial Control

Baseline questions

Is there a coherent and comprehensive statutory base defining the systems, principles and functioning of PIFC in place?

The basic law governing public internal financial control (PIFC) in the former Yugoslav Republic of Macedonia is the Law on Public Internal Financial Control published in the *Official Gazette* no. 90/09. This law replaced the previous Law on PIFC from 2007 and the 2004 Law on Internal Audit in the Public Sector. The Law on Budgets, the latest consolidated amended version of which is dated 2011, provides the framework for public expenditure management and covers the central Government, local Government units and extra-budgetary funds. The Law on Accounting for the Budget and Budget Users of 18 July 2002, which entered into force on 1 January 2003, covers all specific accounting procedures and control responsibilities of budget users and also defines the role and responsibilities of the accountant within an organisation. These laws and related texts, such as the Law on Procurement (185/2011), the laws on local Government, and the annual Budget Execution Law, together provide the overall framework for internal financial control, defining roles and responsibilities and setting the overall financial context within which PIFC occurs.

In 2010, a revised Strategy for Development of PIFC (2010-2012) was adopted by the Minister of Finance. A draft PIFC Policy Paper (2012-2014) is currently being considered with the intention of officially launching the paper in the second quarter of 2012. The paper includes a thorough analysis of the gaps between the expected standards and the actual practice in the Government administration.

The PIFC Law has an extensive list of definitions where some uncertainties appear which suggests that there is a vague appreciation of at least some elements of PIFC that might cause confusion. Thus, the law reads: “Financial management and control shall mean a system of policies, procedures and activities established by the Head of the Entity, in order to provide reasonable assurance that the objectives of the entity have been accomplished”. This definition does not encompass the idea of being responsible for the achievement in terms of effectiveness, efficiency and economy. The same legislation then defines: “Sound financial management and control shall mean transparent, regular, economical, efficient, and effective use of the disposable means”. The adoption of a single definition of financial management encompassing both points would be more appropriate and reduce the risks for confusion.

The PIFC Law envisages arrangement whereby the head of the organisation is to provide a certificate of self-assessment of the quality of internal financial controls. This is an ambitious objective. In 2010, the rate of response at central level was as high as 89%. Despite the fact that the questions are very specific, it is difficult to assess the contributions in terms of the quality of the financial control processes and what has been done to correct errors and reduce losses. The value of the assessment is therefore limited.

The law also refers to the use of risk management. This is an intricate area to develop since risk management cannot be properly developed or become an effective support for improving the quality of public financial management unless management reform occurs first or at least in parallel. In the former Yugoslav Republic of Macedonia, there is such a concentration of responsibility at the top of the organisation with little practical delegation that risk management is only effective when clear objectives have been set, defined by standards and time.

Rulebooks

Following the adoption of the 2009 PIFC Law (and the previous Law from 2007), the CHU produced a set of rulebooks:

- rulebook for the Form and Content of the Reports and the Statement for the Quality and the Condition of the Internal Controls from the Annual Financial Report (147/2010);
- rulebook for the Way of Implementation of the General Financial Processes (147/2010);
- Rulebook for the Way of Implementing of the Competences of the Finance Affairs Unit (147/2010);
- rulebook for the Manner for Granting Authorizations (mandates) (147/2010);
- rulebook for the Basic Elements of Financial Management and Control and Internal Control Standards in the Public Sector (130/07);
- rulebook for the Form, Content and the Way for Submission of the Statement for Quality and Condition of the Internal Controls (8/2008);
- rulebook for Code of Ethics of the Internal Auditors (90/2009);
- rulebook for the Program and the Manner of Taking the Exam for Certified Internal Auditor in the Public Sector (90/2009);
- rulebook for the Charter for Internal Audit (90/2009);
- rulebook for the Manner of Performance of the Internal Audit and the Manner on Reporting for the Audit (90/2009).

These rulebooks were published in the *Official Gazette* between 2007 and 2010 and are now mandatory for all public sector entities. The rulebooks provide detailed instructions regarding various processes as well as the required forms and templates.

In general, the rulebooks and manuals produced by the PIFC Department (CHU) of the Ministry of Finance are being used. However, it has also been said that these rulebooks and manuals are way too detailed whereas the purpose of such detailed regulations has not yet been made totally clear. In this regard, there is a risk that all the PIFC requirements are recognised as an extra burden for management rather than something that it could benefit from.

There is a specific rulebook about financial affairs units ("Rulebook for the Way of Implementing the Competences of the Finance Affairs Unit"). The responsibilities of the unit are described in terms of supervising:

- the complete and timely collection of revenues;
- the timely payment of expenditures in accordance with the procedures for undertaking commitments and executing payments;
- the compliance of the budget execution as a whole or for separate budget accounts with the procedures adopted by the head of the entity and/or the Minister of Finance; and
- the budget and financial reporting.

In general, the rulebook is more technically than strategically oriented even if it sometimes implies strategic views. The rulebook mentions that the "Financial Affairs Unit advises and motivates the heads to implement effective, efficient, accurate, verifiable and complete financial management and control"; however, their role as strategic advisor is missing.

The Rulebook for the Manner for Granting Authorizations deals with the formal process of delegating powers. It entered into force 1 September 2011. The rulebook regulates authorised persons for undertaking financial commitments and payments.

This rulebook is an example of when rulebooks seem to focus technicalities without addressing the purpose of either the exercise or the general prerequisites. The formats for breaking down a budget to sub-programme and activity level to facilitate managerial accountability, as well as the practical arrangements for effective delegation and accountability and the requirement for managers to become financially literate, are missing in the rulebook.

Manuals

In addition, a manual for financial management and control has been developed (July 2010). The manual has the ambition to explain the essence of financial management and control and its components. It should assist managers in developing and maintaining an adequate system of financial management and control in their organisations. To a large extent, this ambition is probably met.

There is also an internal audit manual (latest revision December 2010), that deals with the methods and techniques for internal audit and has the ambition to serve as a guide for performing the day-to-day tasks and activities of internal auditors. The manual also contains forms and examples. It is compulsory for all public internal auditors although variations of the manual are permitted after agreement with the Ministry of Finance (an example is the manual specifically concerned with the audit of EU funds). The foundation of the manual is system based audit methodology, which appears to be an adequate tool for the auditor.

The manuals that have been developed (by the PIFC Department of the Ministry of Finance) are known and used by the institutions. It has been said that these guidelines are useful in general but that they also contain too detailed information.

Committees

The Minister of Finance adopted a decision on 1 August 2011 establishing the Committee for Financial Management and Control and a decision for establishing the Audit Committee. Both committees are consultative bodies providing advice mainly to the Minister of Finance. On 2 December 2011, the Committee for Financial Management and Control held its first working sessions. During these sessions the draft procedure for working of committees and the PIFC Policy Paper were discussed.

Overall, it would appear that there is a coherent and comprehensive statutory base in place, defining the systems, principles and functioning of financial control. The development of the current legal framework represents the significant efforts made to comply with the legal requirements of the European Union for PIFC. Putting in place a legal framework, while important, is only one aspect in the development of an effective PIFC system. What is critical is that the principles underlying PIFC are wholly embraced by management at all levels.

Are relevant management control systems and procedures in place and functioning?

Budgetary arrangements and Treasury controls

General compliance and budget discipline were increased with the introduction of the Treasury system in 2000. The main provision concerning financial management and control had been set out in the Law on Accounting for the budget and budget users, which states that budget users should have a regular system of internal accounting control to ensure that transactions are executed in accordance with legal regulations, accounting documentation is appropriate, and financial statements are reliable.

The main accounting system is the Treasury system. This system has fundamentally been designed for Treasury and budgetary control purposes. What is unclear is how far the information available from the system is relevant to the needs of line management in the wide range of budget organisations. In cases where organisations maintain their own accounting systems, there is no systematic reconciliation between the Treasury system and budget users' own accounting systems.

The budgetary arrangements are based on traditional input budgets and the control arrangements focus on cash control against the budget. Budgets tend to be held centrally and are only allocated to a limited extent to individual line managers but it is expected by the first quarter 2012 that about 50% of the spending units from central and local levels will implement the decentralised budget management system (Rulebook for the Manner for Granting Authorizations).

Internal audit carries out checks on the operation of the Treasury system but seems to focus on compliance with the regulations. There hasn't been an IT audit of the Treasury system in the past five years.

General management control systems and procedures

The overall impression from general management and control procedures is that management teams are committed to improving the internal control environment. The appreciation of financial management in terms of improved efficiency and effectiveness is, however, not that evident. In general, management has an understanding of the need for objective setting, risk assessment and delegation but there does not appear to be any commitment to transform this understanding into practice. A reason for this might be that the purpose of introducing the listed features is not made transparent. In general, what is missing appears to be "analytical discipline" on the budget process. The long-term financial implications of Government policies on operations are not analysed. There is no "bridge" between the overall macro perspective and the utilisation of funds. There is also sometimes a gap in the policy dialogue between line ministries and agencies that perform programmes on behalf of the ministry.

There has been a considerable growth in the extent of financial affairs units (FAU) and responsible accountants over the past three years:

Central level	2009	2010	2011
Number of institutions that established a financial affairs unit	14	32	39
Number of appointed Heads of financial affairs units	0	20	30
Number of institutions that assigned a Responsible accountant	57	65	67
Local level			
Number of institutions that established a financial affairs unit	1	14	27
Number of appointed Heads of financial affairs unit	0	10	22
Number of institutions that assigned a Responsible accountant	51	57	59

Despite the considerable growth of FAUs, only 55% of the total expected number of central level units have been established. The corresponding figure for the local level is 33%. Future recruitment to these units should be based on transferring already employed staff from other departments. Official data is not yet published on the number of temporary employees in the public sector but there are indications that it has increased by around 40,000 during the past three years. When creating new structures like the FAUs, it is important not to promote this negative trend.

The Financial Affairs Unit appears to provide administrative support, but gives financial advice for managerial decision making to a lesser extent. Most of the financial affairs units focus on budget preparation, co-ordination, control and accounting. The consequence of this is that less capacity is available for the role FAUs should play in supporting the head of the entity and sector heads with strategic long-term financial advice. The above-mentioned observation regarding the lack of "analytical discipline" in the budget process is a part of this problem. There appears to be a need to strengthen the capacity of the financial affairs units in order to enable them to provide guidance and advice to heads of sectors regarding the long-term financial implications on operations that flow from Government policies.

Managerial accountability

In terms of FMC, actions have previously taken the form of training that was largely focused on understanding the relevant laws and regulations. What practical development has occurred has tended to focus on the financial control element of FMC, leaving aside the financial management element. Although managerial accountability underpins the whole concept of PIFC, an appreciation of the impact that the development of managerial accountability should have on management organisation, including delegation of authority with the corresponding establishment of accountability, appears to either not have been fully understood or appreciated. As a result, the practical impact of FMC on improving the quality of the management of public expenditure has been limited, even though the legislative framework may have fully allowed for the introduction of financial management.

To create a real understanding of both financial management and control and internal audit, a twin track approach is required. First, senior managers have to be encouraged to understand and take over their responsibilities for the management of public expenditure and for delivering services and activities efficiently and effectively. This will require developing a better understanding of the concept of management and the differences from a traditional administrative approach.

Preparations for the decentralised implementation of IPA funds

The Framework Agreement between the Government and the Commission on the Rules for Co-operation Concerning EC Financial Assistance was signed on 30 October 2007. The Law on IPA Audit was adopted by Parliament on 6 May 2010. According to the law, the audit authority must be an independent legal entity.

The former Yugoslav Republic of Macedonia has obtained the accreditation for decentralised management and implementation of IPA components I, III, IV and V. As a lead body within the operating structure, the Central Financing and Contracting Department (CFCD) within the Ministry of Finance retains the overall responsibility for tendering, contracting and payments to all projects funded under IPA components I, III and IV. However, the task is sometimes delegated to the respective ministry or beneficiary institution.

The CFCD has established a proper supervision of the operating structure (tendering, contracting and payments functions). The Management Information System (MIS) is operational but will not be fully functional until a number of findings from a recent IT audit report (November 2011) are attended to. In accordance with normal procedures, the National Authorising Officer (NAO) issues on an annual basis the Statement of Assurance for each IPA component.

As of March 2012 the CFCD had 20 staff. The needs are estimated to be 31. In January 2012 a recruitment procedure for six positions was initiated.

Arrangements for irregularities and fraud

In May 2011, the Government adopted the Decree on the procedure for preventing and reporting on irregularities. The decree applies to the public sector and European Union funds. The Anti-Fraud Co-ordinating Structure (AFCOS) within the Ministry of Finance (Financial Police Office) is, according to the decree, in charge of developing strategies, organising training, and co-ordinating control measures and reporting arrangements on irregularities, fraud and corruption. The decree envisages Irregularity officer positions to be established in the public sector (the PIFC Law requires the head of each public sector organisation to appoint an Irregularity officer). If such a position is not established or filled, the head of the public entity is responsible for monitoring irregularities.

The Irregularity officer receives reports on irregularities and suspicion of fraud or corruption and independently has to take adequate action. It is stressed in the decree that an internal auditor cannot be appointed as Irregularity officer. To date, 56 Irregularity officers have been appointed at the central level and 54 in the municipalities. This corresponds to 79% of the entities at the central level and 63% at the local level.

A Financial Inspection Law was drafted in 2011 and will in the first instance be submitted to the Government in March 2012. The provision in the PIFC Law on Financial Inspection is due to be repealed following the adoption the Financial Inspection Law in the future. The future Law on Financial Inspection is also foreseen in the PIFC Policy Paper (2010-2012). The former Yugoslav Republic of Macedonia already has a system of general administrative inspection. The new Law on Inspection Supervision came into effect in the beginning of 2011. The law regulates the basic principles of inspection supervision such as the organisation of inspection services, co-ordination of inspection services, and inspectors' rights and obligations. This general law, however, does not regulate the control and sanctioning of violations of budget funds or damages to the public financial interest. That is regulated by the draft Financial Inspection Law.

Despite adopting new laws as well as introducing irregularity officers, irregularities remain a critical area. A major reason for this is that legislation is simply either ignored or not applied effectively. This in turn makes the public doubt the Government’s commitment.

Budgetary control is exercised through the Treasury system and managerial accountability for that expenditure is limited. It does not seem to be specified what is intended to be achieved or is being achieved with that expenditure. The role of the FAUs should be strengthened in supporting the Head of the entity and sector heads with strategic long-term oriented financial advice.

Systems, although on the right path to preventing and taking action against irregularities and to recovering any amounts lost as a result of irregularity or negligence, are not yet robust enough to assure an efficient and law abiding process.

Are functionally independent internal audit arrangements with relevant functions, remit and scope in place and functioning?

The 2009 Law on Public Internal Financial Control (PIFC Law) describes the role of internal audit, its position within organisations, the independence of internal audit, and the protection of the head of the internal audit unit (IAU). The law ensures a high level of independence. This law also requires the preparation of strategic and annual audit plans (a continuation of previous legislative requirements), and stipulates that the CHU is to be informed of any variations in those plans. In addition, this draft law prescribes the responsibilities of the CHU, covering both internal audit (IA) and financial management and control (FMC).

There has been considerable growth in the extent of internal audit over the last six years. The average staff of an internal audit unit is 1.5. Maximum staff is five auditors. Due to this lack of staff, the scope and focus of the audits performed are very limited. Internal auditors currently focus on compliance with regulations.

Central level	2006	2007	2008	2009	2010	2011
Established internal audit units	24	35	46	58	64	71
Internal auditors	52	68	81	90	111	120
Heads of internal audit units	/	/	27	34	34	35
Internal audit reports	142	204	222	252	245	
Recommendations	1,472	1,502	1,262	1,672	1,688	
Percent of implemented recommendations	39	44	47	54	56	

Local level	2006	2007	2008	2009	2010	2011
Established internal audit units	0	17	32	40	49	59
Internal auditors	15	27	33	35	44	52
Heads of internal audit units	/	/	15	18	19	18
Internal audit reports	88	107	134	132	172	
Recommendations	455	626	707	815	1,033	
Percent of implemented recommendations	60	68	69	58	72	

The overall conclusion of these statistics is that there are a lot of small units with limited staffing. This might result in reduced capacity to professionally deliver services.

Internal Audit Units

The IAUs think that they can function independently. This is because of their position in the organisation and due to their opinion that there is good co-operation with their principal manager. The fact that the State Audit Office (SAO) receives the audit reports is also seen as an extra guarantee of their independence.

IAUs have, in general, developed strategic and annual audit plans. The scope of the audits is compliance oriented. The strategic audit plan is mainly used to mirror the scope and the focus of the audit function in the long-term perspective. The annual audit plan contains the audits to be performed in the upcoming year. Both the strategic and annual audit plans are based on risk assessments, which are generally developed in co-operation with the FAUs and the principal manager, who also approves them. Recommendations usually are followed up by management.

The IAU in the Ministry of Finance has been reorganised and the audit of the IPA fund structure is now within the remit of this unit. The head of the unit reports to the Minister of Finance. The Audit Authority, with its function to audit EU funds, used to be a functionally separate entity of the State Audit Office. The new Law on the Audit Authority resulted in a complete separation of these two bodies as from May 2010.

In general, the IAUs do not have in-house capacity for IT system audits. IT systems can be prone to fraudulent attacks. Internal auditors should over time develop capacity to test these systems; otherwise IAUs should hire external experts. IT audits are to some extent provided by the external audit (State Audit Office) which has some capacity in this matter.

Management's perception

It seems a shift is taking place in management's perception towards the internal audit function. In the past, the auditor was seen as an inspector looking over management's shoulder with a checklist. Several institutions now express that management is slowly seeing that the audit function can be to their benefit. This perception is supported by the fact that management every now and then actively seeks advice from the IAU to improve the primary processes.

Considerable progress has occurred in developing the number of internal audit units and the number of internal auditors, and it could therefore be construed that a viable and independent internal audit service is emerging. Management appears to have a greater awareness of the benefits of internal audit and its usefulness as a management tool. However, the scope and focus of the audits performed are limited. Internal auditors currently focus on compliance with regulations. In the sense of practical application, the internal audit profession is therefore still in a development phase.

Are adequately resourced and competent central harmonisation arrangements for FMC and IA in place and functioning?

According to the PIFC Law (Article 2) the tasks of the Central Harmonisation Unit (PIFC Department) are:

- harmonisation and supervision of the financial management and control;
- harmonisation and supervision of the internal audit; and
- preparation and issuance of bylaws, manuals and directives.

These general tasks are defined more in detail in Article48 of the law.

The present PIFC Department has two units: one for financial management and control and the other for internal audit. The department is comprised of 15 staff (head, assistant head, six FMC experts and seven internal audit experts). Generally speaking, it is well informed and trained. Although the technical understanding of FMC is well understood, the capacity for applying the principles, understanding their implications and general practice leaves room for improvement. There is an appreciation within the PIFC Department of compliance audit for internal audit units. The CHU is still engaged in a learning process, which is natural for a CHU. Some of the key staff has valuable experience in both FMC and internal audit.

Annual surveys of both FMC and internal audit are carried out by the CHU. As a result, the PIFC Department could analyse the current implementation process of FMC in practice. The department also compiles the results of the budget users' and spending units' self assessments regarding their opinion about the quality of internal financial control arrangements.

Substantial support has been provided to the PIFC Department over the years: in 2007-2008 there was a Twinning Project "Strenghtening of Public Internal Financial Control System" and currently there is another Twinning Project "Supporting the Process of Fiscal Decentralisation through Strengthening the Capacities for Sound Financial Management and Internal Financial Control on Local and Central Level". In between the two twinning projects a bilateral co-operation took place involving the Dutch Ministry of Finance.

The PIFC Department undertakes all tasks according to the PIFC Law in a satisfactory way. However, the afore-mentioned problem regarding strategic financial advice for managerial decision making also applies to the PIFC Department. The general focus on budget preparation, co-ordination, control

and accounting leads to a situation where the PIFC Department allocates less capacity to promote the adoption of long-term financial strategies among budget users and spending units. One example of a financial strategy could be how to proceed with providing the corresponding functions of financial affair units and internal audit units in small budget users and spending units. This issue addresses the challenge of implementing PIFC in local Government. The establishment of the Committee for Financial Management and Control and the Audit Committee could be seen as an attempt to fulfil more strategic and integrated approaches.

The extent to which the PIFC Department is accepted by the management of budget users and spending units is unclear but, based on the positive comments regarding training courses, there are reasons to assume that the relationship is good. The PIFC Department is visible in the public administration. However, within the Ministry of Finance, there appears to be a certain lack of communication and co-ordination and between the Budget and Treasury function and the PIFC Department.

The PIFC Department is well-organised and has a balanced number of staff. It can undertake most of the functions that would normally be associated with a CHU. Although there is capacity for applying the principles of PIFC in practice, understanding the implications and providing adequate advice in line with this leaves room for improvement

Capacity to further develop the system

Even considering incipient positive steps in some assessed areas, whose sustainability needs to be further monitored, the general feeling is that the political situation is undermining the country's development and the capacity of budget users and spending units to solve the real problems of citizens and companies. Administrative efficiency depends on the willingness to introduce the principle of delegation in making decisions within the organisation. Whether or not the former Yugoslav Republic of Macedonia's institutions will have the capacity to absorb the benefits of PIFC will depend fundamentally on their willingness to adopt a managerial approach to the delivery of public services. This will require a shift away from an approach that requires the head of the organisation to take all decisions and towards a system where the role of the most senior manager is to set the strategic direction and objectives, monitor performance in the achievement of those objectives, and ensure that the entire approach within the organisation is designed to comply with the law and regulations and to provide value for money.

A cause for concern is the risk of increasing politicisation in the former Yugoslav Republic of Macedonia's public administration. The need to strengthen the capacity to anticipate the long-term financial implications on operations of Government policies is related to this concern. If the execution of the budget does not respect or reflect the intentions behind Government policies there is a risk for arbitrary behaviour.

Considerable work has been done to put arrangements in place and as necessary to draft legislation. It is, though, still unclear to what level the strategic and operational levels of management are fully aware of the implications of the PIFC Law. It appears to be common understanding that PIFC is a responsibility of the financial affairs and internal audit units.

The real concern is not the willingness of the Ministry of Finance to develop the necessary legislation but rather the feasibility and motivation for implementing that legislation in substance, rather than just in form, within the former Yugoslav Republic of Macedonia's public administration. Until recently there was hardly any delegation of responsibilities regarding the budget. Some institutions that will formally implement the decentralised budget management system have drawn plans to effectuate this. Still, it has to be stressed that improvement of delegated managerial responsibility and accountability is noted as one of the biggest challenges for the future. As has been shown above,

there is concern about the lack of understanding of what financial management actually means in practice in both strategic and operational terms. There are also reasons to question to what extent internal audit is understood to fit into the management process and the overall control structure. These developments represent a major agenda for the Central Harmonisation Unit (CHU) and will require the continuation of significant support over time before real results will emerge.

In summary, the willingness to develop PIFC does exist at the technical level but the long-term sustainability is questionable. It will be very difficult for the Ministry of Finance to develop FMC or internal audit as effective tools for improving the quality of public management without active political leadership (or active leadership by the minister) and before managerial accountability has been introduced more widely and is understood across Government institutions.

The development of managerial accountability is directly related to public management reform efforts. The Ministry for Information Society and Administration (MISA) should take the lead in this process of change, but it will not be able to achieve substantial and sustainable results if it remains the only engine of these reforms (see the Civil Service and Administrative Law Assessment for further information). The MISA and MoF need to work together to achieve meaningful results.

External Audit

Introduction

The State Audit Office (SAO) of the former Yugoslav Republic of Macedonia was formally established in 1997 on the basis of the Law on State Audit and became operational in 1999. Before 1999 state audit was performed by the Directorate for Economic and Financial Audit at the Payments Operations Agency. A new State Audit Law was adopted by Parliament in May 2010 and came into force that same month. The General State Auditor is the Head of the State Audit Office, appointed by Parliament for a non-renewable nine-year term. The Deputy General State Auditor is also appointed by Parliament for a nine-year term. The current General State Auditor was appointed in December 2007, and on the basis of a transitional provision in the 2010 law, her term is for ten years. Both the State Audit Law and the organisational set up clearly reflect the choice of an audit office model for the Supreme Audit Institution (SAI) of the former Yugoslav Republic of Macedonia.

The SAO enjoys a high level of independence, although its status has not yet been laid down in the constitution. However, in terms of work programme, reporting, professional standards and audit mandate, the SAO is independent, and it enjoys autonomy in respect of the budget. Its relations with Parliament have been a matter of concern as so far reports do not receive the systematic attention they deserve. Nevertheless, auditees consider audit reports useful, and through direct impact on auditees the SAO is having an effect.

The SAO carries out financial and performance audits, and while the development of performance audit was fostered in a separate audit department for some time, this department was dissolved in 2009 and the experienced performance auditors were allocated over the seven other audit departments so as to form a nucleus of performance audit capacity inside these departments from which the development of performance audit could be fostered. Apart from these seven audit departments, the SAO has departments for audit methodology and quality control, for IT-audit, for legal and general affairs and public relations, and for finance, as well as two units reporting directly to the General State Auditor or the Secretary General of the SAO (the unit for internal audit – so far without staff – and the unit for human resource management – with only one staff – respectively). In total, the SAO has 94 staff members, 79 of whom are auditors. The systematisation (complement) of the institution counts 283 staff, 243 of whom will be auditors. It is clear that occupying all of these job positions is a matter of the very long-term. The budget for 2012 amounts to MKD 97.4 million (approximately EUR 1.6 million), and three-quarters is spent on salaries.

During its 13 years of operation the SAO has received technical assistance from the Netherlands Court of Audit through a World Bank funded project, followed by a bilateral Twinning project, and another bilateral project in the period 2003-2010. From the end of 2010 through the end of 2012, a small-scale World Bank funded project with the Netherlands Court of Audit is focusing on the relationship between the SAO and Parliament. A new twinning project is planned for the period starting in 2015.

Baseline Questions

Does the SAO have clear authority to satisfactorily audit all public and statutory funds and resources, bodies and entities, including all EU resources?

Mandate and Remit

The State Audit Law clearly describes the mandate and remit of the SAO. Article 22 lays down that the SAO is entitled to audit the Parliament, the President, the budget of the republic, all budget users at state and municipal level including public companies with a majority stake by the state and

second-level budget users, other institutions financed with public funds, the National Bank, political parties in as far as financed from the state budget, beneficiaries of EU funds or of funds from international institutions. Entities that are financially or economically connected to these audit subjects can also be audited by the SAO. Obligatory annual audit is restricted to the budget of the republic and the budgets of the funds. All other potential audit subjects can be selected for audit in the annual work programme that the General State Auditor adopts on the basis of selection criteria which take into account volume of budget, risk, results from previous audits, rotation, etc. The number of potential auditees is around 1,400, which makes it impossible to cover these even in a rotational system. Through thematic (horizontal) audits, the SAO tries to increase the number of auditees covered each year, even if only partially on the basis of a topic selected. However, even then the coverage is limited. In 2009, 189 auditees were covered one way or another; in 2010 the number was 169. Financial audits covered 85 and 81 auditees respectively. These figures show that as a whole, coverage is not satisfactory. On the other hand, in terms of the budget under the mandate of the SAO, over 2009 62% of the expenditure of the central budget, budget of funds, and budgets of local Government was covered. No data are available for later years but from the statistics available in the last Annual Report (2010) and the budget documents from the Ministry of Finance, it can be estimated that over 2010 the coverage slightly decreased. Revenue is covered to a much larger extent.

Although article 22 of the State Audit Law states that the SAO has the mandate to audit beneficiaries of EU funds, it excludes from its mandate the audit of the system for implementation, management and control of the pre-accession instrument. This seems to stem from the time that the Audit Authority was part of the SAO, which made it difficult to be part of the control system and at the same time have the mandate to carry out external audit on the system. With the separation of the Audit Authority this is no longer a problem, and there is no argument why auditing the whole system for management and control of EU funds should not be within the SAO's mandate.

Focus on Financial Audit

The focus within auditing is on financial audit. In 2010, 77 financial audits were carried out (covering 81 auditees), out of a total of 87. These 77 financial audits resulted in 192 reports: separate reports are prepared for each set of financial statements and entities prepare separate sets of financial statements for each source of revenue. Consolidation of these sets of financial statements at the level of the audited entity does not take place. Separate reports are prepared for second-level budget users.

Access to information

The State Audit Law contains provisions which allow the auditors access to all necessary documents and data (art. 24), which allow access to the premises of the auditee (art. 25-1), which obliges the auditee to co-operate with the auditors (art. 24-2, art. 25-2,3), even within strict timelines, and which fines legal persons and responsible persons in an audited entity if they fail to submit documents, or otherwise hamper the work of the auditors (art. 39-1,2). In practice, the SAO auditors do not encounter any problems in receiving the necessary information and co-operation. Article 28 foresees functional immunity for auditors, they are not to be held personally responsible for their opinions in respect of the performance of auditees.

The SAO has clear legal authority to audit all public funds and entities in the former Yugoslav Republic of Macedonia, although this excludes from its mandate the audit of the system for implementation, management and control of the Instrument for Pre-Accession. This authority is defined for both the institution and for the state auditors working in the institution. The number of potential auditees far outreaches the resources of the SAO to carry out audits on

each entity regularly. Many smaller entities will therefore not be audited at all for a long period of time.

Does the type of audit work carried out cover the full range of regularity and performance audit set out in INTOSAI auditing standards (1.0.38-1.0.44)?

Article 2 of the State Audit Law gives definitions of regularity/compliance audits, financial audit and performance audit. In article 18-2 of this law, the SAO is mandated to carry out compliance (regularity) and performance audits, but from the more detailed description in article 19 it is clear that the SAO is mandated to carry out all types of audit, from financial audit leading to audit opinions on the reliability of financial statements, through compliance/regularity audits leading to opinions on the level of compliance/regularity of expenditure or revenue, and performance audit. Moreover, article 18-1 sets as a general framework for all audits the INTOSAI auditing standards which are to be published in the *Official Gazette*. Auditors are bound to comply with these standards (art. 20-2), and non-compliance can even be sanctioned with a fine (art. 39-3).

All Types of Audit

In practice, the SAO carries out all types of audit. The many financial audits that are carried out are broad financial audits, covering both the reliability of financial statements and the regularity of expenditure/revenue, and including audit opinions on both. Compliance opinions in the audit reports for 2010 were distributed as follows: 37% of the auditees received a positive (unqualified) opinion, 23% a qualified opinion, 32% an adverse opinion, and in 7% of the cases a disclaimer of opinion was given. It has to be taken into account that the materiality threshold applied is 4%, which is relatively high in international comparison. The result implies that irregularity of public expenditure is a real problem in the country. In 2010, a large number of entities had never been audited before, accounting for two-thirds of all opinions, but the overall picture is comparable to the year before.

Internal Control Systems and Internal audit

A standard component of financial audit is assessing the internal control systems and reviewing the work of internal audit whenever relevant. This is also explicitly laid down in article 19-2 of the State Audit Law. If internal audit is considered of good quality, the SAO is to rely on internal audit work, in line with international auditing standards. This is also the case in practice. Performance audit started in 2005 and has developed since. Performance auditors were trained, amongst others through pilot audits in the framework of the twinning project with the Netherlands Court of Audit. The separate department in which performance auditors gained their first experience was dissolved in 2009 when the performance auditors were distributed over the other audit departments with the aim to establish in each of them a core capacity for performance audit from which the development of performance audit could be fostered. The number of performance audits carried out annually is still limited, but increasing (from three in 2007-2009 to six in 2010 and seven in 2011; for 2012 the same number is foreseen). This demonstrates not only a steady pace of development in performance audit, but that the experience with performance audit is being spread out over the seven different audit departments as well.

Annual Report

The SAO summarises the outcome of its audits in an Annual Report that is submitted to Parliament before the end of June. The Annual Report gives an overview of coverage, opinions and types of audits, and provides a summary of the annual state budget audit and other important audits. The report also contains a summary of the activities of the SAO and the audited accounts of the SAO. Since the last amendment (2011) to the State Audit Law, the audit of the accounts of the SAO is now carried out by a private audit company, selected and paid for by Parliament.

Follow up on Recommendations

In order to monitor the follow up on recommendations made in audit reports, each audit looks at what the auditee has done with the recommendations from the previous audit. If an auditee is not included in the annual work programme and the findings and resulting recommendations from a previous audit are considered serious, a specific follow-up audit is carried out. In 2010, 72 such follow up audits were carried out, against 37 in 2009. Thematic audits are also carried out: financial audits covering a series of auditees, not aimed at separate audit opinions on those auditees but focusing on a specific topic or problem area. This type of audit will allow all municipalities to be covered by at least a thematic audit before the end of 2014. The first IT audits were carried out in 2010. IT auditors are also involved in the financial audits as well in order to cover information systems if relevant.

The SAO carries out all types of audit as defined in the INTOSAI standards. Financial audits result in professional audit opinions on the reliability of financial statements and the regularity of expenditure and revenue. Performance audit is developing gradually, but at a steady pace.

Does the SAO have the necessary operational and functional independence required to fulfil its tasks?

The SAO does not have a constitutional anchorage. The SAO has repeatedly made efforts to change this situation, and has been successful in the sense that Parliament adopted a resolution in February 2011 to amend the constitution in that sense. However, since this proposal has been added to other proposals to amend the constitution, for which no sufficient parliamentary majority exists, amending the constitution to create a position for the SAO is not in sight for the time being.

Constitutional anchorage may be lacking, but the State Audit Law itself ensures a high level of independence. Article 3 lays down that the SAO is independent in its operations, and this is reflected in the provisions concerning the adoption of the work programme (art. 9-2) and other competences of the General State Auditor (art.9). The position of the General State Auditor is secured through the provisions for appointment and dismissal. Dismissal by Parliament is only possible in the case of accepting a public function incompatible with the position of General State Auditor as defined in article 5-4, or in case of a sanction or verdict for an act of misdemeanour. Functional immunity for the General State Auditor and his deputy are regulated by article 13 of the law. Remuneration is based on general provisions for appointed and elected persons.

Although the number of possible auditees by far outreaches the possibilities of the SAO, the fact that the number of annual mandatory audits is limited to the state budget and (the limited number of) budget funds implies that the formal independence of the SAO to decide on its work programme is also a material independence. The obligation to make all final audit reports public is in line with international standards, and contributes as well to the independence of the SAO.

Civil Servant Status

Auditors and other qualified staff have civil servant status since the last amendment of the State Audit Law. Setting the requirements and organising the examination for authorised state auditors remain the competence of the General State Auditor. Also the salary of the different categories of functions, the structure of which has been laid down in the law, is set by the General State Auditor. Auditors cannot be members of political parties or fulfil functions in management or supervisory boards of any other entity, and are not allowed to take part in an audit if they have been employed by or were involved in bookkeeping or financial reporting of an auditee during the past five years, or have family relations with the manager of the auditee (article 21). At the same time, auditors are protected from possible accusations by article 28, which in essence regulates their functional immunity.

Budget Procedure

The budget of the SAO is prepared by the SAO itself and submitted to Parliament for adoption, which is to vote separately on the SAO's budget. The State Audit Law states that the budget shall be prepared within the framework of the annual limits in compliance with the established fiscal strategy. This means that general budget constraints have an impact on the SAO's budget, which explains the great discrepancy between the number of job positions in the systematisation and the actual number of staff. The procedure as such, however, does allow for Parliament to decide separately on the budget of the SAO and therefore gives an opportunity for the SAO to explain and justify its budget requests. In this way, budgetary autonomy is ensured to a satisfactory level.

Audits of Political Parties

The mandate of the SAO includes the use of the state budget by political parties. Since the amendment of the Law on the Financing of Political Parties in October 2011, the SAO has the full obligation to carry out audits on all the finances of all political parties. Although from the perspective of more transparency and control on the finances of political parties this may seem to be an appropriate approach, from the perspective of the SAO it is not. As was stated in last year's assessment report, the stature of the SAO as the independent state audit body may be negatively affected by this obligation, which also has resource implications.

Another aspect of independence is the attitude of audit staff and their management. Article 18 of the State Audit Law refers to the Code of Ethics of INTOSAI as the leading principle for staff engaged in audit. Requiring compliance with this Code of Ethics is not sufficient; a more concrete policy to strengthen integrity within the institution would be helpful. The SAO has decided to use a tool developed by the Netherlands Court of Audit, and presented to the INTOSAI Congress in November 2010. This tool, Into-SAINT, helps to define and implement integrity policies, amongst others by mapping the existing risks for integrity. SAO staff attended a workshop on how to use this tool in practice.

The SAO has satisfactory operational and functional independence to carry out its duties in all respects, although resources are scarce compared to the wide audit remit. The SAO is still not anchored in the constitution, which is desirable in order to ensure its independent position. Budgetary autonomy is ensured in the procedure for the adoption of the SAO's budget; the level of the budget is, however, by far insufficient to recruit the planned audit staff even in the medium-term. Recent amendments to the Law on Financing of Political Parties introduced a new obligation for the SAO which may adversely affect its image of independence and objectivity, and which also affects the freedom to use its audit resources according to its own decisions.

Are the SAO's annual and other reports prepared in a fair, factual and timely manner?

The State Audit Law sets the rules for reporting and for the opportunity for auditees to comment on a draft. A draft report, prepared by the responsible authorised state auditor, is sent to the legal representative of an auditee, who has 30 days for submitting comments. The state auditor then prepares a final audit report, which is sent to the auditee, submitted to Parliament and published on the website of the SAO. The report contains the comments from the auditee. Internally, within the SAO, there are procedures in place to ensure a harmonised and co-ordinated approach. Each report is discussed in a meeting of an expert body, chaired by an Advisor to the General Sate Auditor, and further consisting of three Assistant General State Auditors, one of whom is the responsible head of the Audit Department, one is the head of the Audit Methodology Department, and the other was equally not involved in the audit. This body discusses the draft final report, the comments from the auditee, and the reaction from the auditors to the comments. It may lead to suggestions as to how to improve the text of the report. The General State Auditor or the deputy is not directly involved in the

precise text of audit reports. Meetings with the auditee, both at the beginning of the audit procedures and at the end when the draft report is presented, help in reducing factual errors and in increasing understanding about the SAO's approach and criteria. The SAO introduced quality control procedures in 2009 and quality assurance procedures in 2010 starting with pilots. So far, quality control is based on paper documents; an electronic audit documentation with a built-in quality control function is lacking. Such a system would enhance the efficiency of audit procedures as well as supervision and quality control. The SAO has applied for technical and financial assistance from INTOSAI's International Development Initiative (IDI) in order to buy the necessary software and introduce such a system into the work practice.

After a final report is issued (sent to auditee, submitted to Parliament, published on the website of the SAO), the auditee has 90 days to inform the SAO and the relevant authority responsible for supervision and control which measures have been taken in response to the findings and recommendations in the report. These procedures make it possible for the SAO to keep track of the follow up given to its recommendations.

Auditees are generally satisfied with the professionalism of the SAO and the opportunities given to explain and comment. They confirm the factual correctness of findings in audit reports, but would appreciate if the audit reports paid more attention to achievements. Audit opinions are considered to be well-founded and recommendations are considered useful.

In 2011, the SAO managed to implement fully its annual work programme, which means that all deadlines were met. The Annual Report was submitted before the end of June, in compliance with the deadline in the State Audit Law.

The SAO has procedures in place to ensure that its reports are factually correct and that recommendations and opinions are well-founded and in line with the audit standards applied as laid down in the respective audit manuals. Reports are submitted on time, and the full work programme is being accomplished. In order to further increase the impact of audits, the reports should pay due attention to improvements made by auditees.

Is the work of the SAO effectively considered by Parliament, *e.g.* by a designated committee that also reports on its own findings?

The SAO has invested a lot of energy in strengthening co-operation with Parliament. Its main objective is to ensure that audit reports are adequately followed up by Parliament. Up to now, the competent parliamentary committee, the Committee on Budget and Finance, only reserves time for a discussion of the annual report from the SAO. The committee drafts its own conclusions on the basis of this annual report, which is transmitted to the plenary. This report and the annual report are then discussed in the plenary, where the General State Auditor gives a speech by way of introduction. None of the other reports are dealt with in a systematic way by Parliament, although members do sometimes use information from individual reports for their political debates. During a workshop in June 2010 in Skopje, and a study tour to Slovenia in January 2011, SAO staff and members of the parliamentary Committee on Budget and Finance explored opportunities for more effective review of audit reports in Parliament. One of the options identified is the establishment of a separate committee or subcommittee with the responsibility to systematically deal with the audit reports. Parliament has so far not taken steps to install such a committee. Opposition and ruling parties have not been able to reach an agreement. The focus of SAO's current project with the Netherlands Court of Audit will be on strengthening relations with Parliament, focusing on developing a manual for members of Parliament to improve their understanding of audit reports, a workshop with examples of good practices, and on better understanding the needs of members of Parliament through a survey. This project is to be finalised mid-2012.

Although the parliamentary attention for audit reports is restricted to the annual report, the SAO has a direct impact through its reports on the auditees, and the percentage of recommendations implemented shows that this impact is real. The SAO has a clear strategy to continue to add value directly in its communication with auditees and to continue efforts to convince members of Parliament to introduce proper procedures for dealing with audit reports. A major point is that without sufficient parliamentary attention, systemic problems identified in audits are difficult to address. The SAO uses its communication with the Ministry of Finance for those issues, but some external pressure might be helpful. So far, the SAO has not been active in drawing media attention for audit reports, fearing that such attention would provoke biased and politicised reactions, without positive influence on the SAO and its reports.

The SAO also submits its annual work programme for information to the Committee on Budget and Finance, in December of the prior year.

Parliament pays occasional attention to individual audit reports, but only the SAO's Annual Report is dealt with in a more or less systematic way. The SAO has made several efforts to introduce procedures in Parliament which would allow for systematic review of relevant audit reports, potentially leading to more political pressure to improve the systems of internal control in the public sector. Apart from continuing its efforts to create procedures or a separate body within Parliament to deal systematically with audit reports, the SAO should also explore possibilities to more actively involve the media in results from audits, so as to avoid negative effects.

Has the SAO adopted internationally and generally recognised auditing standards compatible with EU requirements, and if so, how far have they been implemented?

The State Audit Law states in article 18-1 that the SAO is to apply the auditing standards from INTOSAI. Of course, each SAI has to assess how far it is able to fully apply all INTOSAI standards, application is to take the situational context into account. A large body of new auditing standards was approved by the INTOSAI Congress in November 2010. These standards are, to a certain extent, already incorporated in the SAO audit manuals since drafts were available earlier which could be incorporated in the manuals the SAO has issued. For the whole ISSAI framework – all INTOSAI standards – a translation project has started. For 2012 it is foreseen to make an inventory of those (parts of) ISSAIs which have not yet been translated. External assistance is solicited for the translation which still needs to be done, and also for assistance in training the audit staff to actually apply those standards. This is currently planned to be a component of the twinning project the SAO will apply for. Actual application of all INTOSAI standards is not foreseen before 2015. It shows that the SAO is committed to apply the international auditing standards as far as possible.

Quality Control and Quality Assurance

This is also demonstrated in the quality control and quality assurance arrangements. After pilots in 2009 and 2010 respectively, the SAO has undertaken to carry out quality control and *ex post* quality assurance as standard procedures inside the SAO. Quality assurance started with pilots in 2010 and 2011, and will cover three financial audits in 2012. From 2012 onwards it will be carried out by two advisors to the General State Auditor who previously were heads of audit departments, therefore very experienced audit staff. Quality control took off in 2010 after the pilots were carried out. Team leaders are to fill out checklists for each stage of the audit. These checklists are part of the quality control guidelines. While filling out these checklists, team leaders verify, amongst others, that the audit work carried out by the team member is in line with the audit manual, sufficiently documented, and that findings are based on sufficient audit evidence.

The expert body, consisting of an advisor and three assistant auditors-general, aims to ensure the harmonised application of the audit manuals and audit standards. For financial audits, the conclusion

or audit opinion is a major item for review. The materiality threshold applied is 4%, a relatively high level which should be reconsidered in the future. One option is to differentiate between different categories of entities.

Annual Work Programme

The annual work programme is very much based on departmental proposals, which are prepared by individual audit staff. Selection criteria for audits exist, and proposals follow these criteria. On the basis of departmental proposals, the General State Auditor decides on the work programme. For performance audits, each department submits three possible topics, with a ranking. The General State Auditor, after consultation, selects the most appropriate topics for inclusion in the annual work programme, sometimes combining several suggested topics into one audit or changing the focus somewhat. Although it is good practice to involve audit staff in suggesting audits, and the existence of selection criteria is also good practice, the SAO would gain from having programming that is more strategic and based on risk-oriented assessment. Instead of only applying selection criteria to the annual work programme, the SAO should strengthen its capacity to look at the allocation of its audit resources from a more strategic and multi-annual perspective. This has already been identified as an area for improvement, since it is to be one of the five components of the twinning project for which an application is being prepared.

In line with what the State Audit Law prescribes, the SAO adopted the international auditing standards from INTOSAI as a reference for its audit work. The audit manuals that are used are basically in line with these standards, and the SAO is actively seeking for its audit staff to apply the newest INTOSAI standards through a systematic approach of translation, distribution and training. Audit quality control procedures are in place, and audit quality assurance is starting to become a standard procedure in the SAO. Programming could benefit from a more strategic approach.

Is the SAO appropriately aware of the requirements of the EU accession process?

The SAO has for some years hosted the Audit Authority for pre-accession aid, and some of their former audit staff was transferred to this Audit Authority. This implies that the SAO is very well aware of requirements related to the EU accession process. The SAO has been an active member of the Network of the European Court of Auditors and SAIs of candidate and potential candidate countries since 2006, and was the host of the Network's Presidents meeting in 2007. Staff participate in workshops and other activities organised in the framework of this network. Also, a substantial number (so far 11) of audit staff have followed a five-month internship at the European Court of Auditors, receiving on-the-job training. This demonstrates EU-awareness, and at the same time it enhances EU-awareness in the SAO by sharing experiences.

At the same time, EU requirements also have an impact on the audit environment and corresponding risks. For instance, the introduction of PIFC and managerial responsibility is a huge change in the way public finances are managed, and this implies a risk in audit terms. Such risks should be subject of the risk assessment the SAO makes when programming and planning its audits. This might be a relevant component for the more strategic set up of multi-annual programming.

The SAO is well aware of the requirements surrounding the EU-accession process, but has not to date systematically taken the corresponding changes in the audit environment into consideration for its own work.

Capacity to Further Develop the System

The SAO has established a structured approach towards its development, with a multi-annual strategic development plan that is updated every two years. The first plan covered the years 2006-2010, followed by the 2008-2012 plan, and currently the 2010-2014 plan is being implemented.

Multi-annual strategic development plans are accompanied by annual action plans with more detailed objectives and related activities. This is a sound basis for development, as resources are allocated systematically to priorities. Also, training needs are linked with training opportunities as far as possible.

The SAO is active in seeking external assistance and international co-operation. Apart from the current project with the Netherlands Court of Audit, the SAO applied for assistance from IDI for buying audit management software, is involved in training both for the application of the integrity tool from the Netherlands Court of Audit as well as in training organised together with the SAIs of Croatia and Latvia, has contacted the German SAI in view of co-operation in respect of the implementation of new ISSAIs, and the application for a new twinning project is being prepared. The components for this twinning project have been identified as follows: ISSAI implementation, strengthening of multi-annual planning, strengthening of the audit capacity by more pilot audits in financial and performance audit, strengthening relations with Parliament, and IT/IT audit.

From this picture it is clear that the SAO is committed to further development, strengthening its professionalism, increasing its impact, and working towards high-quality and efficient audit practices.

PUBLIC PROCUREMENT

Main Developments Since the Last Assessment (May 2011)

The public procurement system in the former Yugoslav Republic of Macedonia has continued to evolve, with the following main developments:

- a new Law on Concessions and Public-Private Partnerships (PPP Law), published on 13 January 2012 with entry into force on 15 March 2012;
- two sets of amendments to the Public Procurement Law (PPL), were published on 14 April 2011 and on 30 December 2011 respectively.

The new **Law on Concessions and Public-Private Partnerships (PPP Law)** is compliant with Directive 2004/18/EC and represents an important step forward in bridging the gap created by the previous, inadequate PPP provisions. This framework law must nevertheless be systematically reflected in the relevant sectoral laws.

The first set of amendments to the **Public Procurement Law (PPL)** aimed to provide further details concerning the review body's *ex officio* proceedings and time limits for reaching decisions (15 days after the filing of the appeal has been completed).

Several of the measures envisaged under the latest amendments to the PPL aim to reduce the number of tendering procedures that are cancelled, a situation that was denounced in the last EC Progress Report and challenged through the decisions of the State Appeals Commission (SAC). These measures include the following: group procurement is facilitated; recurring procurement must be totalised with regard to the threshold; additional funds may be provided; the conduct of technical dialogue with the business community is prescribed for contracts above EUR 130,000; certification of public procurement officers is mandatory; when cancelled for objective and unforeseeable circumstances, a tender cannot be reinitiated for a period of six months; and cancellation for incorrect tender specifications is allowed only up until the time limit for bid submission.

The "negative reference", a measure concerning the wrongdoing of suppliers, has been introduced. When a contracting authority withholds the tender guarantee (which is possible in four precisely defined cases) or when it withholds the guarantee for implementation of the contract (*e.g.* delivery deadlines that are not met, incomplete work or use of inferior substitutes), the contracting authority shall publish a negative reference. This results in the exclusion of the tenderer from any contract award procedure for a period of a year, which is extended for an additional year for every subsequent negative reference. There is support for this provision, including from some chambers of commerce, which see it as a mechanism for eliminating rogue suppliers. However, various stakeholders have voiced concern, especially in relation to the appeals system against a negative reference. Concern about the risk of reducing competition has also been expressed, and all the more so since the ban affects any affiliated company as well as the group of economic operators that has an excluded member, without any consideration as to whether the group had agreed on joint liability.

Other developments aim to increase transparency or efficiency while reducing corruption. These developments include the following:

- All simplified competitive procedures (for low-value procurement) are to be subject to prior notice as from July 2012.

- Economic operators will have to pay fees in order to use the Electronic System for Public Procurement (ESPP), as contracting authorities have already been obliged to do.

- A code of ethics for procurement officers will be introduced, defining their role and serving as the basis for disciplinary measures.

- Under the IPA multi-beneficiary project on "Training in Public Procurement in the Western Balkans and Turkey", the localisation of the training manual has been completed (*i.e.* translating and supplementing the text with relevant national legal and administrative provisions), although further work in this area may be required in view of the recent amendments. A programme is underway for the training of 20 additional procurement trainers between April and July 2012.

- A 16-month twinning project with the German Federal Ministry for Technology and Economy was launched at the end of 2011, while the twinning light project in the State Appeals Commission (SAC) was completed in March 2012.

Main Characteristics

The total value of procurement at the national level in 2010 was EUR 743 million (11% of GDP), and the Government and other public institutions are the main trading partners of many businesses.

According to former amendments of the PPL in 2008 and 2010, contracting authorities are obliged to use electronic auctions in a proportion that has gradually increased and in 2012 has reached 100% of the number of contract notices for open and restricted procedures as well as for negotiated and simplified competitive procedures with prior notice. As the latter must be advertised as from July 2012, the scope of e-auctions has been extended to all low-value procurement, thus incurring significant administrative costs in terms of time and effort for contracting authorities. Electronic auctions were actually used in more than 50% of the procedures in 2011 (legal objective: 70%). A considerable portion of the drive for the ambitious target of 100% use has been based on the principles of transparency and openness. However, the obligation of public opening of bids prior to e-auctions, although regarded by stakeholders as essential in view of those principles, constitutes a real risk of providing an opportunity for collusive behaviour, particularly where the competition is limited. An e-auction may not always be practical or desirable, but a positive feature is that its use may be bypassed whenever it is not appropriate.

Contracting authorities often justify cancelled e-auction procedures by an insufficient budget, because e-auctions do not provide the best value, or because the prices quoted by economic operators are much higher than expected market rates, thereby obliging the contracting authorities to enter into a negotiated procedure, which yields closer prices. Incorrect tender specifications constitute another reason for so many cancellations.

The national public procurement institutional set-up has been established and the legal framework is well on its way to becoming fully compliant with the *acquis*, although the EU Defence Directive has not yet been transposed.

The **Public Procurement Bureau (PPB)** now employs 20 full-time staff, with a 2012 budget of EUR 504,000. The PPB has continued to develop and enhance the public procurement system so that

it is not only harmonised with the EU *acquis* but also gives consideration to local needs, as shown by the recent amendments to the PPL. The quality of training and support provided by the PPB is generally praised by contracting authorities as well as economic operators, although currently there is no tailored training programme for the latter. Some economic operators attend the training conducted for contracting authorities and find it useful. The advice of the PPB is timely, thorough and considered.

The communication and consultation of the PPB with other bodies, such as the State Audit Office (SAO), State Appeals Commission (SAC) and State Commission for Prevention of Corruption (SCPC) has been established. With regard to the amendments to the PPL, the PPB held sessions with these organisations to inform them of the changes, although very little time was allowed for formal consultations as the political timetable drove the implementation of the amendments.

The Ministry of Economy (MoE) is responsible for implementing the new PPP Law. The MoE is developing a set of regulations and guidance to bolster the Law on Concessions and PPPs, which is to be completed within three months of the date of the law's entry into force.

To date, the shortcomings of the former law covering public-private partnerships (PPPs) have potentially hindered viable and important projects, with current PPPs limited to infrastructure projects: four procedures are underway in the energy sector, two of which are covered by the laws prior to 2008 and two ruled by the latter; 47 concessions for hydropower stations have been granted in the Department of Energy of the MoE.

The State Appeals Commission (SAC), which is the review body, is composed of a president and four members appointed by the Assembly for a term of five years. The SAC is a state authority, established as a legal entity, which is independent in its operations. The total number of SAC staff is 14, and the budget, which has decreased from EUR 146,000 in 2011 to EUR 130,000 EUR in 2012, is insufficient to contract additional staff, needed especially in view of the SAC's new competence for concessions and PPPs, not to mention the costs of external technical expertise. Complaints are subject to a fee ranging from EUR 100 to EUR 400 depending on the value of the contract; they are filed simultaneously with the contracting authority and the SAC, within a time period of eight days following the event provoking the appeal (three days in the case of a contract award notice pursuant to a framework agreement). The SAC received and resolved 690 complaints in 2011, a slight decrease from 868 in 2010. The SAC has reported an increase in the number of cancelled procurement procedures and an improvement in the quality of the appeals received from economic operators.

Some contracting authorities have criticised the appropriateness of the SAC in challenging award decisions based on qualitative criteria rather than on price alone, and they have questioned whether the SAC had the authority and expertise to do so. The main reason for rejected appeals is that they have not been lodged in due time, *e.g.* an appeal concerning the tender documentation that is only raised at the time of the selection decision. Cases where an economic operator's appeal is upheld are usually based on the following:

- the criteria used were discriminatory;
- the tender evaluation was flawed as it was not in line with the scoring criteria;
- the tender evaluation was flawed as the technical and professional expertise required to properly review it was lacking;
- the tender was wrongfully cancelled without any acceptable reasoning.

The State Audit Office (SAO) has reported that contracting authorities are competent in applying the PPL. The SAO has identified the main problem as being the extension of the scope, particularly in

relation to construction contracts. This problem is caused by poor planning and by the practice of avoiding the use of experts in the development and preparation of tender documentation in order to save money. Inevitably, this situation has led to omissions or to inappropriate tender specifications and to additional costs incurred downstream, as denounced by NGOs.

The SAO has admitted that it would be beneficial to undertake more performance audits in the area of procurement, but it was currently under-resourced to do so. In 2011, two cases related to public procurement were referred to the Public Prosecutor while two were referred to the State Commission for Prevention of Corruption (SCPC). Overall, the SAO is satisfied with its co-operation with the Public Prosecutor. Six of the cases submitted in 2010 are currently being investigated and in only in one has a misdemeanour been proven. However, so far there has been no prosecution for a criminal offence.

The SCPC has captured the attention of the public and raised awareness through its reports, but to date its referrals have not led to any successful prosecution. The SCPC referred ten cases concerning procurement to the Public Prosecutor in 2011, and all of these cares are still pending investigation.

Reform Capacity

The next challenge will be to implement the amendments to the PPL and ensure that the targeted outcomes are delivered. After a suitable timeframe of one year to 18 months for embedding the last changes in the daily practice of the procurement community, the Public Procurement Bureau (PPB) has the capacity to do so, to review the effectiveness of its laws and policies and to make adjustments where appropriate.

The State Appeals Commission (SAC) is able to cope with its new competence in the area of concessions and PPPs and to face the novelties introduced in the PPL, provided that it receives sufficient organisational and budgetary support. It needs to be well-staffed by experts and administrators, underpinned by adequate technology, including office facilities and IT systems. It must also have the financial capacity to seek independent, technical advice of specialists when necessary.

The capacity of the unit responsible for PPPs and concessions in the MoE remains a problem. It is still insufficiently staffed (2 persons), and its new responsibilities are simply an addition to an already congested workload. There is a risk of overlooking the need for ensuring a good understanding and operational effectiveness of all contracting authorities and economic operators. The harmonisation of the various sectoral laws dealing with concessions is a key issue, particularly with the opening-up of the electricity market as from 2015. Co-ordination with the PPB and other relevant departments and organisations is still a critical factor for the successful implementation of concessions and PPPs. Finally, as already signalled in previous years, the capacity of the MoE to complete the reform and to conduct policy in the field of concessions and PPPs will remain questionable unless it is given additional staff and authority. However, there are no plans to do so.

To date, there has been no penal prosecution on the findings and recommendations submitted by the SAO or the SCPC to the Public Prosecutor. The reasons for the lack of action by the Public Prosecutor are unclear, and this situation raises the question of the independence of the judicial system in the eyes of the public. Finalising some of these actions would strengthen the image of good procurement and of the effectiveness of these bodies in the eyes of the public.

Recommendations

To the former Yugoslav Republic of Macedonia

- The Ministry of Economy (MoE), with the support of the Public Procurement Bureau (PPB), needs to ensure the effective management and implementation of the new Law on Concessions and PPPs by recruiting staff with a basic understanding of the subject matter and a background in law, economics or one of the major technical disciplines required to deal with PPPs/concessions, and also by identifying individual officials in the state's main ministries and in the larger entities of local Government who could serve as "lead officials" on the subject.

- The PPB should develop and communicate to contracting authorities and economic operators the process for implementing the "negative reference" measure. This process must include criteria for a negative reference regarding implementation of the contract, a procedure for appealing a negative reference prior to being listed, management of the negative reference list, and possibly a process for removal from the list in less than one year under conditions involving self-cleaning measures. The exclusion of affiliated firms and of the entire group of economic operators should also be reconsidered.

- The PPB should develop training on tender specification and on contract management. Tailored training for economic operators needs to be introduced, and the PPB should call for other experts in procurement from the private sector and from chambers of commerce. This sharing of experience and knowledge would increase the understanding of each of the parties and develop a mechanism for continual improvement and enhancement of public procurement training.

- The State Audit Office (SAO) could consider reviewing the number of procurement-related performance audits once their multi-annual Strategic Development Plan has been updated.

- In the medium-term, the PPB should consider removing the public openings of bids prior to e-auctions in order to prevent potential collusive behaviour and to ensure the best value-for-money.

POLICY MAKING AND CO-ORDINATION

Main Developments Since the Last Assessment (May 2011)

The structures and processes supporting decision making by means of the weekly Government meeting and its commissions have remained stable. One positive development is the adoption in November 2011 and the implementation of an Instruction on the Operation of the General Collegium of the General Secretariat of the Government (GSG). This body meets weekly under the chairmanship of the Secretary-General of the Government and consists of the GSC heads of sector and secretaries of the Government commissions. It reviews all items submitted for approval by the Government meeting, both for procedural compliance and "for content" with a particular focus on whether all concerned institutions have been consulted. The Professional Collegium must prepare an opinion on each item, which is discussed with the originating ministry and then submitted with the proposal to the relevant commission and the Government meeting. The instruction also provides: "If a discussion on some material requires co-ordination between the material's sponsor and other concerned institutions, the Chair shall charge a professional collegium member to organise a co-ordinative alignment meeting between the institutions concerned with the content of the material." This systematic technical/expert review represents a welcome strengthening of policy co-ordination arrangements and of the role of the GSC.

The Prime Minister has instituted an Economic Council (meeting weekly) and six other committees (meeting less often) covering economic areas such as mineral resources, entrepreneurship, foreign investment and tourism. These bodies have a mixed membership of ministers, civil servants and external experts and the Prime Minister usually attends all meetings. These serve to give strategic direction, formulate policy and supervise implementation. The Prime Minister's four advisers act as secretaries and undertake follow-up work with the responsible ministries. These bodies operate separately from the three "filter" commissions of the Government, but their conclusions are reported to the Government meeting.

In late 2011, responsibility for regulatory impact assessment was transferred from the Unit for Regulatory Reform at the General Secretariat to the Ministry of Information Society and Administration (MISA) with instructions to report monthly on the quality of regulation. At the time of the assessment, MISA had only just started to exercise these functions.

MISA is responsible for overseeing the implementation of (and is also working on upgrading) the National Electronic Register on which draft legislation is posted by ministries for public comment. For the first time, the Government consulted publicly in 2011 on the content of its annual work plan.

Implementation of Phase III of the process for reviewing regulations (commonly referred to as the Regulatory Guillotine process) has continued, focusing on removing administrative barriers to business development, including the implementation of the 'silence is consent' rule. Phase IV, focusing on small and medium enterprises, is under preparation. For further details on the 'silence is consent rule', see the Assessment on Civil Service and Administrative Law.

The code requiring ministries to consult with civil society on draft legislation was approved by the Government in July 2011. This includes many positive features including notification to stakeholders that a consultation is beginning, minimum periods for response and publication of summaries of

responses. This is reinforced by a Government decision that ministries must meet monthly with NGOs operating in their field to keep them informed of developments.

In 2011, the Secretariat for legislation trained 212 civil servants in European Integration harmonisation.

Main Characteristics

A basic set of Rules of Procedure is in place. These rules make provision for a co-ordinated system for policy making and co-ordination system with appropriate processes and instructions in place. However, they have not been revised for many years, have undergone numerous piecemeal amendments (many of which have not been consolidated) and contain much wording that is imprecise or unhelpful. The process would benefit from a thorough revision and consolidation.

An electronic system is in place to support Government sessions, and it appears to be working well. The General Secretariat of the Government is well structured and, in formal terms, has the mandate to support the policy system, but faces stagnation due to the fact that Governments do not make full use of it. The role recently assigned to the General Collegium is a welcome partial reversal of this trend, but there is room for the system put in place in the past ten years to improve its performance.

The need to produce legislation too quickly prompts ministries to contract the stages in the policy development process, and they often fail to consult other ministries and bodies affected, or, when they do, set impossibly short deadlines for response. This often results in legislation of poor quality. The majority of such rushed legislation is EI-related. The professional Collegium and the weekly Collegium of State Secretaries can only partially act as correctives to this.

There are arrangements concerning fiscal impact assessment overseen by the Ministry of Finance. This issue is considered in more detail in the assessment dealing with Public Expenditure, Management and Control. The wider Regulatory Impact Assessment arrangements are developing in the right direction. However, it would be helpful if the output from both were incorporated into the explanatory memorandum that accompanies proposals submitted to the Government and its commissions.

The Secretariat for European Affairs (SEA) and the Secretariat for Legislation continue to play important and constructive roles in policy co-ordination. The EU co-ordination mechanisms remain as described in the 2011 assessment and seem to be effectively performing their co-ordination and monitoring roles. However, while the arrangements for transposing legislation appear to work well, the implementation can be further improved.

The strategic and work planning systems appear to be stable and operate well, with effective mechanisms to link the strategic priorities of the Government with the annual workplan and the NPAA. Ministries have three-year strategic plans linked to Government-wide planning documents and to the budget. The quality of ministries' plans and capacities in ministries for policy planning, analysis and co-ordination remain variable and are still developing, but units have been established in all ministries and receive training from the GSG twice a year. Ministries' strategic plans are submitted to the Ministry of Finance for review, together with the budget proposals. The problem reported in last year's assessment, that GSG was being bypassed in this process, appears to have been overcome.

The introduction of the Code of Consultation and associated measures for participation by civil society are welcome, but implementation capacities in ministries need to be strengthened. Capacities within civil society to respond effectively to consultation are also weak and the quality of comments received by ministries is generally poor, with many irrelevant or unconstructive

responses. An exception was the Regulatory Guillotine process which drew on consultation with 200 companies and the chambers of commerce.

Reform Capacity

The more active role accorded to the General Collegium of the GSG in late 2011 and the creation of various committees by the Prime Minister demonstrate a demand at the central political/administrative level for more effective policy making and co-ordination, and also demonstrates the potential within the present machinery to deliver.

The Unit for Regulatory Reform continues steadily to pursue its programme of reform. At the time of the assessment MISA was just starting to engage with its new responsibility for RIA.

GSG has effectively carried through the new public consultation requirements and is updating of Government's Public Participation Strategy but promotion and entrenchment of this work require resources that GSG does not possess.

Recommendations

To the former Yugoslav Republic of Macedonia

- The rules of procedure should be revised in order to incorporate amendments made over the years, remove extraneous and unnecessary provisions, and provide a concise and consolidated statement of procedures to be followed.

- The general rules for policy making and reporting by ministries should be strengthened by ensuring the inclusion into the explanatory memorandum of the results of the RIA and fiscal impact assessment processes, which would provide an evidence base for legislative proposals.

- The committees recently instituted by the Prime Minister should be incorporated into the existing system of commissions supporting the weekly Government meeting. Secretarial and administrative support (including preparation of reports, monitoring implementation of committee decisions, etc.) should be provided by the GSG, relieving some of the pressure on the Prime Minister's advisers. More generally, more effective use should be made by the political leadership of existing professional capacities in the GSG.

- Support should be provided to ministries to implement the Code on Consultation, and to civil society to participate effectively in this work. This would be a suitable project for donor support, preferably over a long period of time.