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**REPLIES OF THE COMMISSION TO THE SPECIAL REPORT OF THE
EUROPEAN COURT OF AUDITORS**

"EU PRE-ACCESSION ASSISTANCE TO SERBIA"

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EXECUTIVE SUMMARY

IV. IPA is focused on needs and its priorities are based on assessments of level of fulfilment of EU related criteria, included in particular in the Commission's enlargement strategy paper and the annual reports. The allocation criteria take account of Serbia's capacity to use and to manage the funds and their respect of the conditions for accession. In this way, IPA provides the link between the political framework for enlargement and the EU budgetary process.

VI. The Commission acknowledges the fact that the Decentralised Implementation System (DIS) process has been built for the management of IPA funds. Serbia is currently preparing a comprehensive Public Finance Management (PFM) Reform Programme, which will be based on a comprehensive diagnostic of the PFM sub-systems. Therefore a Public Expenditure and Financial Accountability (PEFA) Assessment is going to be carried out.

OBSERVATIONS

11. The Commission has already supported the government in improving quality of its strategic documents through a number of mitigating measures funded from IPA. The Commission has over the last year conducted a number of sector evaluations on the past IPA and other donor assistance in Serbia in order to support preparations for IPA II, where the objective is to support implementation of coherent sectoral strategies/programmes through sectoral approach.

First indent:

The – limited – support provided by IPA to the decentralisation process was based on the public administration reform (PAR) strategy adopted by the Government of Serbia in 2004 and its related Action plans. The particular areas of IPA support have derived directly from the PAR Strategy action plans. The selected Project 5 (Municipal Support Programme) focused on building local administration capacities in priority areas of EU integration. In addition, in line with the PAR Strategy Action plan, the project was designed to support elaboration of the decentralisation strategy as requested by the then Ministry in charge of decentralisation. However, the project suffered of lack of political will. Nevertheless, the outputs of this project's component are further used by the newly established Council for Decentralisation that has re-convened in autumn 2013 to proceed with elaboration of the strategy. Under the new government, the mandate for drafting the decentralisation strategy is given to the Ministry for Regional Development and Local Self Government.

The Commission agrees that any further support under IPA II for any decentralisation process would need to be based on a clear national decentralisation strategy and its action plan.

Second indent:

The Commission acknowledges that there was no overarching PFM strategy covering all key aspects of PFM. Rather, different aspects of PFM have been covered under specific strategies such as the fiscal strategy or the Public Internal Financial Control (PIFC) strategy, so that a strategic basis for supporting specific IPA projects existed even in the absence of a formal overarching PFM strategy. The new enlargement strategy "Fundamentals first" from October 2013 puts special emphasis on economic governance as well as public finance management and foresees that enlargement countries should prepare specific PFM action plans. Therefore, support under IPA II in this area will be based on a more coherent PFM framework than in the past. It is important to note that the new Serbian PAR strategy for the period 2013-16 also encompasses PFM. This is an important improvement in comparison with the past, because it highlights the fact that PFM

concerns all budget users, not only the Ministry of Finance, and that there is a need for coordination and coherence in implementation. Further on, the planned PEFA assessment will contribute to an overall picture of PFM systems in place.

13. The purpose of the European Partnerships has been to provide a general reference framework rather than a policy framework, to indicate the priority areas for reform and to provide general guidelines for financial assistance in these priority areas with the expectation that the country respects the principles and priorities highlighted in it. These principles have been consistently agreed with Serbia and reflected in the national programmes during the first years of IPA programming. A more specific and accession relevant framework has been provided by the annually updated enlargement strategy and country-specific annual Progress reports.

14. The Commission recognised the need for improved indicators in the programming of IPA assistance and has addressed this issue in the IPA II framework. The Indicative Country Strategy Papers, which will define the long-term strategic orientation for IPA funding per country, include an annex detailing indicators at diverse levels. These, among others, also include indicators in the fields of economic governance and fight against corruption.

16. The Commission recognises that under the earlier IPA programmes some projects were selected due to their importance for Serbia based on assurances provided by the government for their smooth implementation. Much stricter requirements concerning project readiness have already been introduced under IPA 2012 and 2013 programmes and will be enforced even more systematically under IPA II. The Commission has supported through IPA assistance the development of a new methodology for selection of investment projects that will be part of the national single project pipeline. The methodology aims to help the Serbian government to assess a) prioritisation and b) maturity of projects/programmes in the infrastructure sectors.

20. The Commission shares the importance of Civil Society Organisations (CSO) and will further continue to encourage and support the involvement of CSO in IPA programming.

Box 3 – Example of weak needs assessment

Supplies were synchronized with the inputs of a parallel twinning in support of the institutional development plan for the Paying Agency (PA). The PA had been allocated 105 posts in the systematisation of the Ministry of Agriculture. During the lifetime of this project the government was reshuffled three times, leading to disruptions in the planned recruitments for the PA.

26. Measures have been taken to improve the capacity for retaining lessons learned from previous experiences and thereby improve the IPA II (2014-2020) programming process. Lessons learned and recommendations of the IPA Component I Sector assessments in Serbia have been applied in the design of the IPA 2014 programme. A table with the recommendations for each sector individually and for programming as a whole has been introduced as key starting document for the Sector Working Groups in the 2014 programming process.

27. Since IPA 2012 programming conditionalities are used in a targeted way, are clearly defined in sector/project fiches in a measurable way and enforced during implementation. Numerous projects have been postponed in programming if critical pre-conditions were not in place. The Commission however plans to enforce conditionalities more rigorously and made it clear to the Serbian government that only fully mature projects will be considered for programming.

33. Indeed, the Commission's reports of the authorising officer by subdelegation present the high targets met and the contracting rates, which have been consistent year after year, therefore demonstrating high absorption capacities.

37. The Commission reacted, in particular in the first Monitoring Committees in order to safeguard the successful implementation of on-going projects, which resulted in flexible contract management. This process evolved to stronger monitoring mechanisms and stricter decisions when difficulties appear during the implementation on a case by case basis.

Box 7 – Examples of mixed results from governance-related projects

Reply to the first paragraph:

The volume of municipal bonds for the city of Novi Sad represents the second largest local government borrowing in Serbia. The results achieved under this programme are still influencing the market in 2014, where e.g. it is envisaged to introduce further municipal bonds for the cities of Sabac and the Municipality of Stara Pazova. The standing conference of towns and municipalities continues to receive requests for providing support for municipal bond issues, representing an alternative to loans. The Commission is of the opinion, that without that support, municipal bond market in Serbia would probably not exist and municipalities would continue to face high interest rates on bank loans. Therefore, the municipal bond support was an important starting point for local government credit market in Serbia, for communal infrastructure finance and for savings in local budgets.

Reply to the second paragraph:

IPA financial support is assisting the government in meeting the EU criteria and complements the policy dialogue. The Commission highlighted the shortcomings in terms of activities of CHU and staffing of internal audit units in the relevant structures of its political dialogue with the Serbian authorities, in particular in the relevant sub-committee of the SAA as well as in the screening report for chapter 32. Improvement is therefore expected in the short term in the framework of accession negotiations. If the 2008 project was not sufficient to solve all difficulties, it greatly contributed to reaching a level of preparation that would allow the Commission to propose opening of chapter 32.

43. Generalised conclusions can not be drawn about effectiveness of EU support in the field of public works on the basis of this specific project. The majority of delays have been assessed by the engineer to be attributable to the contractor. Further on, in particular as of IPA 2011, this type of difficulties is now addressed through the improved links between the policy elements and the programming.

45. The Commission acknowledges the absence of a summary monitoring document on the history of failed tenders. However, the reasons for a cancelled or failed tender are analysed on a case by case basis and taken into account for a possible re-launch.

Box 10 - Examples of problems in tendering and procurement

Reply to the first paragraph:

The tendering process for the Police reform project failed due to submission of the only application after the formal deadline. After the failure of the tendering process the beneficiary (the internal affairs unit at the Ministry of Interior) remained committed to the project, while the issues of lack of autonomy of the unit, adequate staff and support from senior manager in the Ministry of Interior continued to affect the internal control department's capability to effectively combat corruption within the police force. These issues have been the object of specific letters sent by the Head of the Delegation and the Ambassador of the twinning partner to the Minister.

Box 11 – Examples of risks to sustainability

Reply to the first paragraph:

The Commission applied already the lessons learned from this experience. In the IPA 2012 programme, the IT aspect for justice includes a needs analysis as the first activity. Any further assistance can only be deployed upon the finalisation of this needs analysis.

Reply to the second paragraph:

The Commission agrees that a lack of clear regional policy framework presented a sustainability risk. There was however no single EU model that could have been proposed as organisational aspects have to be defined nationally as a political decision of the Serbian government. Sustainability became an area of concern when it became apparent that Serbia would not get a regional policy and legislative framework in place early in the process, as well as clear financing mechanisms. The Commission wants to point out that all EU-funded RDAs have remained operational after completion of the project and the EU funding. While still largely project dependent, most of them have gained regional recognition and benefit from Cross Border Cooperation Programmes, national funds, bilateral donors' funds and also private income from various business service provisions. An important lesson to be learnt from the programme is to organise a clear sequencing of activities by which, for example, the adoption of the strategic/legislative framework is a pre-condition for the granting of further support.

Reply to the third paragraph:

The project can be considered as a one-off government assistance to the municipal structures, which have only then become responsible for the maintenance and procurement of equipment and infrastructure in their health institutions.

At the time of purchase, the Ministry of Health intended to procure more vehicles to cover for more needs (the fleet should have been 1,000 and Serbia had only close to 400 including the EU donation of 252 vehicles). However, the financial resources are more and more scarce and only repairs and sporadic procurement was made as available to the municipal budgets.

The procurement made by the EU could be considered as emergency rehabilitation assistance since no such purchases were made before 1991 and these vehicles were a serious need for the system. Otherwise the implications on service delivery and health of the population would have been grave. These vehicles are still the newest ones available in the country and are still used to the maximum and the project-achieved enhanced capabilities are therefore still sustained. Vehicle renewal is depending on the country's future economic development.

Box 12 – Examples of personnel issues in governance-related projects

Reply to the first paragraph:

The Commission agrees to the fact that internal audit staff is difficult to recruit in some Ministries. However, Serbia informed the Commission that an internal audit function has been established within 76 budget users (55 at central government level, 21 at local government level). These users account for 90% of public funds. All ministries have set up internal audit units, but in two ministries positions were still not filled. The smaller budget users can meanwhile either build up a joint internal audit unit or enter into an agreement with budget users who have an internal audit function and use their auditors.

This issue will be covered under chapter 32 in the negotiations, and progress is therefore expected and will be closely monitored in this respect before closure of the chapter.

Reply to the second paragraph:

The Commission recognises the difficulty of retention of trained staff in key administrative structures as a horizontal challenge in the candidate countries. This issue will be monitored in all fields during the negotiations as a chapter can only be closed when legislation is fully aligned with that of the EU and administrative capacity is identified as sufficient for implementation of EU policies.

48. Steps to mitigate weaknesses in the field of sustainability have already been taken. The 2014 ROM monitoring schedule includes a number of ex-post ROM exercises with the aim of checking the medium and long-term sustainability of the IPA projects' results.

59. The formal opening of accession negotiations with Serbia in January 2014 starting with the rule of law chapters (chapter 23 judiciary and fundamental rights and chapter 24 justice freedom and security) put great emphasis on the need to ensure a sound and predictable rule of law climate conducive to overall improved governance environment. This entails in particular, and as a matter of priority, efficient and deterrent fight against corruption at all levels and in all sectors, including at project level.

61. In all programming periods cross-cutting issues were included under the more general rule of law issues. Even if not explicitly mentioned in previous years, the Commission tackles those in a cross-cutting manner, acknowledging however that explicit references may serve for more clarity in this regard.

66. Serbia is currently preparing a comprehensive Public Finance Management (PFM) Reform Programme, which would be based on a comprehensive diagnosis of the PFM sub-systems. Therefore a Public Expenditure and Financial Accountability (PEFA) Assessment is going to be carried out. A comprehensive and reliable PFM Reform Programme represents one of the key requirements in Serbia's accession negotiations with the European Union and at the same time, also represents one of the key elements for planning and implementing long term reforms.

The PEFA assessment will provide the Government of Serbia with a snapshot of broad PFM performance allowing to assess the current status in key areas and to identify where the limitations and risks are in moving forward with a new PFM reform strategy. This will also include the assessment of IPA structures withing the Serbian authorities.

67. The Commission agrees with the need for further efforts in order to safeguard the financial interests of the EU. The internal audit function has been progressively set up in a way to cope with a decentralised management basis. The number of internal auditors and performed audits has increased over time. An effective and functioning internal audit system however still remains to be established in line with the Budget System Law requirements for many budget authorities and beneficiaries. The internal control focus is on ex-post checking of compliance with laws and detecting potential irregularities, as evidenced by the work performed by internal auditors, centralised budget inspectors and also the State Audit Institution. In line with the managerial accountability principle, however, the focus should gradually move towards making managers responsible for setting up and implementing appropriate FMC structures, supported by an internal audit function, to prevent irregularities in the first place.

70. The Commission has introduced measures to mitigate risks of high staff turnover. Staff takes actively part in tasks performed by the Delegation in the current centralised set-up in order to benefit from practical experience on real cases before carrying out the transactions themselves when the decentralised set-up will eventually be introduced. These tasks include observing evaluation committees, participating in on-the-spot checks and verification mission to projects.

71. Strengthening protection of whistleblowers is an important element already identified in the screening report on chapter 23. The development of a functioning whistleblowers protection system should feature prominently in the action plan Serbia is currently preparing to answer the opening benchmark for this chapter. A draft law on whistleblowers protection was prepared and is to be adopted.

CONCLUSIONS AND RECOMMENDATIONS

74.

(a) The Commission acknowledges some design-related shortcomings, in particular for early IPA projects. Therefore the Commission improved its Sector fiches in this respect. The IPA-funded sector evaluations have drawn lessons from the implementation of the IPA I (2007-12). The recommendations from these assessments have been fed into working groups and are in the process of being reflected under IPA II programming. Some of the specific recommendations addressed in the sector evaluations have already been reflected in the new IPA II setting (EU Regulation 231/2014), the Common Implementing regulation (EU Regulation 236/2014) and draft Framework Agreements, to be concluded with each individual beneficiary.

(b) The Commission acknowledges isolated problems in the implementation of earlier projects, which were addressed by the Contracting Authority in order to safeguard the contractual implementation and provide for sound financial behaviour in contract management. Complexity and technically demanding tendering procedures have led to some failures and were repealed when re-tendered.

(c) The Commission recognises the difficulty of employment and retention of trained staff in administrative structures as a cross-cutting challenge in all candidate countries. This issue will be monitored during the negotiations as a chapter can only be closed when legislation is fully aligned with that of the EU and administrative capacity is identified as sufficient for implementation of EU policies.

76. Serbia is currently preparing a comprehensive Public Finance Management (PFM) Reform Programme, which would be based on a comprehensive diagnosis of the PFM sub-systems. Therefore a Public Expenditure and Financial Accountability (PEFA) Assessment is going to be carried out. A comprehensive and reliable PFM Reform Programme represents one of the key requirements in Serbia's accession negotiations with the European Union and at the same time, also represents one of the key elements for planning and implementing long term reforms.

78. In all programming periods cross-cutting themes were included under the more general rule of law issues. Even if not explicitly mentioned in previous years, the Commission tackles those in a cross-cutting manner, acknowledging however that explicit references may serve for more clarity in this regard.

80.

(a) The Commission accepts the recommendation. The prioritisation and selection process has overall already improved over the lifetime of IPA I. Further progress are expected for IPA II projects, in line with the newly developed methodology and the move to sectoral approach which will increase links between policy priorities and assistance programming. The key policy priorities for programming will be reflected in the country strategy paper, and gaps yearly assessed in the Commission's Strategy document and progress reports. Following opening of accession negotiations, in each sector, programming should be directly linked to priorities identified in the relevant chapters, first in the screening reports and subsequently in the opening or closing benchmarks, wherever applicable. Another clear improvement in the investment field should result from the development of a national single pipeline of strategic projects in the fields of transport, energy, environment and business infrastructure, to be adopted by the government and used as single basis for IPA support to infrastructure projects.

(b) The Commission accepts the recommendation. In the context of thematic sector evaluations, lessons learnt from project implementation, relevant across countries and or sectors, are already shared, and notably IPA-funded sector evaluations have drawn lessons from the implementation of the IPA I (2007-12). As a result, some of the specific recommendations addressed in the sector evaluations have already been reflected in the new IPA II setting (EU Regulation 231/2014), the Common Implementing regulation (EU Regulation 236/2014) and draft Framework Agreements to

be concluded with each individual beneficiary. They are also reflected where applicable in IPA II programming. For internal monitoring and reporting purposes, a specific table reflects the evolution on steps taken to implement the main findings and recommendations on past evaluations relating to both sectors and forms of assistance. Additionally, the Commission intends to study - in the context of setting up a monitoring and reporting framework to meet the reporting requirements flowing from the IPA II legal framework – whether an efficient and cost-effective reporting tool also addressing the tendering process can be established, possibly building on existing tools. Moreover, in line with the recently updated policy orientations on evaluation of DG Enlargement, a review of current monitoring practices and tools is foreseen as well as strengthening of the synergies between the evaluation and the monitoring functions which will contribute to ensuring consistent follow-up to past findings and recommendations.

(c) The Commission accepts this recommendation and intends to take it into account by improving the logical framework of interventions within Action documents in IPA II, in particular as regards results and outputs of activities, as well as by further improving the documentation related to the needs assessments as annexes of the Action Documents.

(d) The Commission accepts this recommendation. De facto, it is already largely taken into account, as since IPA 2012 programming, conditionalities are used in a targeted way, are clearly defined in sector/project fiches in a measurable way and enforced during implementation. Numerous projects have been postponed in programming if critical pre-conditions were not in place. The Commission however plans to enforce conditionalities more rigorously and made it clear to the Serbian government that only fully mature projects will be considered for programming. This policy will be further supported, as regards infrastructure, by the establishment of the single project pipeline, which will include an individual assessment of all projects as to their level of maturity (and fulfilment of conditionalities).

(e) The Commission accepts this recommendation. An improved audit trail for the entire project is planned to be included in the 2014 report of the authorising officer by subdelegation, i.e. for the contracts that are included in the Annual Assurance Strategy for 2014 and for the Audit plan 2014 onwards. Results, findings and recommendations from the audits and on-the-spot monitorings will be presented in the overview reports containing data regarding the entire project/sector. Those reports will be improved in such a way to facilitate and meet given recommendations.

(f) The Commission accepts this recommendation and envisages to establish a system in order to include samples of such checks in its annual audit and on-the-spot verification plans.

81.

(a) The Commission accepts the recommendation. The Commission is in the stage of supporting a Public Expenditure and Financial Accountability assessment in order to provide the government of Serbia with a broad snapshot of PFM performance. Such an assessment will assess the status in key areas and identify where the limitations and risks are in moving forward with a new PFM reform strategy. This will also include the assessment of IPA structures within the Serbian authorities. Serbia is currently preparing a comprehensive Public Finance Management (PFM) Reform Programme, which will be based on a comprehensive diagnostic of the PFM sub-systems. Progress will be closely steered and monitored during the negotiations in the framework of chapter 32 on financial control.

(b) The Commission accepts this recommendation and welcomes any further involvement of CSOs in the policy and programming processes. It is actually of the opinion that these measures are already largely in place. The Commission has already provided IPA support for the establishment of an Office for Cooperation with Civil Society. The office was established in 2010. In 2010 national authorities have also established a mechanism called SECO (Sector civil society organisations) for

the participation of civil society in the planning, programming and monitoring of IPA assistance. The SECO mechanism is organised on a sector basis. For each sector, representative CSOs have been registered. IPA support has been provided through technical assistance for the design of the SECO mechanism and for strengthening its influence towards wider policy making. Even though CSOs have been consulted on regular basis on programming of IPA, they have in the past made rather limited use of this mechanism.

(c) The Commission accepts this recommendation and will issue guidelines to ensure that the need for sector specific anti-corruption or other good governance measures is, where relevant, assessed in the project design.

(d) The Commission accepts this recommendation and will ensure that the audit work done in the context of the accreditation and conferral of management decision from March 2014 is going to be taken into account for the PFM reform process.