



SIGMA

Support for Improvement in Governance and Management

A joint initiative of the OECD and the European Union, principally financed by the EU

CROATIA

PUBLIC EXPENDITURE MANAGEMENT SYSTEM

ASSESSMENT MAY 2008

Introduction

This report is the fourth standard assessment report on Croatia against the baselines that have been applied by Sigma since 1999 for the assessment of the public expenditure management system in EU candidate countries. This report is based on information gathered up to May 2008.

Since June 2006 there have not been major changes in the public expenditure management system in Croatia. If the year 2006 was regarded as a year of consolidation, 2007 can be seen as a year of transition. In particular, the general elections that took place in November 2007 not only affected the budget preparation and adoption, so that a small budgetary transition towards 2008 was secured, but above all slowed down the reform process in this area. However, the official endorsement in October 2007 of the long-awaited Treasury Reform Strategy could result in major changes if the new government confirms its commitment, which should be the case since basically the same persons responsible for implementing the strategy are also in charge of budget matters. In addition, the new parliament could favour the introduction of changes that up to now have proved difficult to decide upon.

This means that Croatia now benefits from all of the basic conditions and the government from a broad window of opportunity to launch in practice this important and well thought-of reform, which can only exercise a tremendously positive impact on the Croatian public finance arrangements.

1. Budget Legislation

The Constitution of Croatia, which was adopted in 1990 and subsequently revised, contains very few provisions regarding the distribution of fiscal powers between parliament and the government. It is stated that parliament is to adopt the state budget (art. 80), that state revenues and expenditure are to be determined by the state budget (art. 90), and that the government is to propose the state budget and the annual accounts (art. 112).

In the Standing Orders of Parliament, there is a section on “Passing the Central Budget”. In three articles (articles 174-176), brief provisions deal with the government’s submission of the draft central budget and budgets of extra-budgetary funds, procedures for debate and vote on the budget, and the responsibility of the government to submit a report on budget execution. In principle, this means that the general procedures for enacting laws also apply to the passage of the state budget. In neither the Constitution nor the Standing Orders is there any mention of deadlines, which makes it difficult to respect the timetable that has been set in the Budget Act.

The revised Budget Act that came into effect on 1 July 2003 contains some 150 articles and covers most of the relevant issues that should be laid down in law. The Budget Act frequently indicates that detailed provisions are to be included in a rulebook. In the transitional provisions of the Budget Act (art. 147), it is stipulated that the government must pass some nine specific regulations within two months of the date when the act comes into force, and that the Minister of Finance is to pass within three months some 20 specific regulations. So far only a few of these regulations have actually been passed, and the adoption of the

This document has been produced with the financial assistance of the European Union. The views expressed herein can in no way be taken to reflect the official opinion of the European Union, and they do not necessarily reflect the views of the OECD and its member countries or of the beneficiary countries participating in the Sigma Programme.

remaining secondary legislation has not been a priority so far. The review of the Budget Act was initiated in early 2006 and should have assessed, among other issues, the necessity of this secondary legislation. The view has indeed already been expressed that some of these regulations were in fact not needed. The review should be finalised before the summer of 2008 and will provide the basis for the amendments to the Budget Act, resulting from the adoption and implementation of the Treasury Reform Strategy. An important part of these amendments will be devoted to introducing provisions related to the budgetary management of EU funds (multi-year budgeting, improving of the carry-over of capital project funds from one year to the next, amongst other improvements).

A specific feature (which can also be found in other states of former Yugoslavia) is that parliament, at the same time as it approves the state budget, adopts in a separate vote an annual Act on the Execution of the State Budget. This act regulates details regarding revenue, expenditure, guarantees, borrowing, debt, etc.

The Constitution, Standing Orders of the Parliament, Budget Act, and Act on the Execution of the State Budget together contain the necessary provisions for regulation of the preparation, approval and execution of the state budget. However, it is a disadvantage that the rules laid down in the Constitution and in the Standing Orders of Parliament are so brief and that even fundamental provisions for the regulation of fiscal powers are included in the organic Budget Act. This means that even fundamental rules can be changed by a majority vote of all members of parliament.

It would be preferable to have fundamental provisions regarding the distribution of fiscal powers between parliament and the government in the Constitution rather than in the Budget Act, e.g. parliament's powers to change the proposed budget (art. 32). The Standing Orders of Parliament could also include a special procedure for the debate and vote on the budget and annual report. The review of the need for the detailed regulations referred to in the Budget Act should determine whether or not such secondary legislation is indispensable and, if it is not, should conclude in due course with the relevant amendment of this act.

2. Parliament/Executive Relationship

The Budget Act (art. 30) sets the deadline for submission by the government of its budget proposal at 15 November. The main content and structure of the budget proposal, as well as the explanations, are also regulated.

The state budget is a typical line-item budget and includes some 7,000 lines. The explanations to the budget proposal have been improved in recent years. Since 2006 the explanations comprise a summary, including macroeconomic projections, as well as motives and details regarding various sections of the budget. The explanations were reported to be useful for members of parliament. Efforts are being made to improve them further.

According to the Standing Orders, parliament closes by 15 December. This leaves parliament 30 days to analyse, debate and vote on the state budget (if the session is not prolonged). Given the detailed line-item structure of the budget, parliament has comparatively little time for the approval of the state budget. The very small number of staff supporting the Budget Committee and the other committees constitutes another obstacle for analysis of the content of the draft budget.

In the OECD's *Best Practices for Budget Transparency*, it is stated that in no event should the draft budget be submitted to parliament less than three months prior to the start of the fiscal year.

Parliament's powers to change the proposed state budget are limited. According to the Budget Act (art. 32), any increase in budget expenditure must be compensated for by a simultaneous proposal for reduced expenditure. The government also has to approve any changes.

There are also rules regarding the preparation and adoption of the Annual Statement of Budget Accounts (see section 8 below).

The very short time available for parliament to review, debate and adopt the state budget and the very small number of staff supporting the Budget Committee and other committees put parliament at a disadvantage. More ample time and staff would contribute to a fuller parliamentary involvement and commitment to the approved state budget.

3. Scope of the State Budget

At the same time as the draft state budget is submitted to parliament, draft financial plans for extra-budgetary funds are also submitted. In addition, a consolidated state budget is presented. Thus, although there are six extra-budgetary funds and three public enterprises, parliament has access to all central government budgets when it discusses and adopts the various budgets. Consolidated general government final accounts are also supplied for the three-year period.

Many budget-users have “own resources” from fees and other contributions linked to their activities. These funds are included in the state budget on a gross basis.

The state budget is divided into a general part and a special part. In the general part, revenues and expenditures are structured according to economic categories, and in the special part expenditures are structured according to main budget-users, activities/programmes and expenditure categories. The classification is presented and approved on a four-digit level. The budget is presented on a gross basis, and all revenues and expenditures seem to be included.

The Act on the Execution of the State Budget includes provisions regarding the additional amounts that the government may borrow for financing the budget and for some public enterprises. It also contains a ceiling for the total public debt for the ongoing year.

There is a long-standing tradition in Croatia to use the GFS 1986 and 2001 classifications. There are therefore uncertainties as to how some institutions and transactions should be classified in order to achieve full statistical compliance with ESA 95 definitions of the general government sector and its sub-sectors and of net lending/borrowing.

Efforts to further integrate extra-budgetary operations into the state budget should continue. It is necessary to bring statistical definitions of the government sector and finances in line with the ESA 95 standard as soon as possible (see section 4 below).

4. Medium-Term Expenditure Framework

In the spring the Ministry of Finance prepares Economic and Fiscal Policy Guidelines for a three-year period. This document provides comprehensive macroeconomic projections, fiscal objectives, estimates of expenditure and revenue in government sectors, expenditure ceilings for budget-users, etc. The projections are compared to the deficit and debt requirements of the Maastricht Criteria. The preparation of the Guidelines is mainly the work of the Bureau for Macroeconomic Analysis and Planning. The government approves the Economic and Fiscal Policy Guidelines. In 2005 and in 2006 the Guidelines were adopted only in July as they still depended on the agreement between the IMF and the Croatian Government on the level of deficit. This was again the case in 2007, despite the provision of the Budget Act prescribing the adoption of these guidelines in May. The document is made public, including on the Ministry of Finance’s website. The Guidelines constitute the basis for preparation by the government of the Pre-Accession Economic Programme (PEP) and are in line with the Strategic Development Framework 2006-2013. A summary version of the Economic and Fiscal Policy Guidelines is also included in the explanations submitted to parliament concurrently with the draft budget. Parliament approves the Guidelines for the medium-term fiscal policy. In due course the Croatian authorities may consider the possibility of organising a debate in parliament, and eventually a vote, when the guidelines are released, including overall budget ceilings, in order to provide a general framework for the end-of-year budget discussion.

Work in the Bureau for Macroeconomic Analysis and Planning is focused on analysis of fiscal statistics, macroeconomic analysis and forecasting, and fiscal analysis and planning, including short and medium-term forecasting of revenues from major taxes. The Bureau has ten staff members. For macroeconomic forecasting, mainly judgemental forecasts are made, but a simple computerised model provided by USAID is used to ensure consistency between the various real and financial elements of national accounts. Quarterly national accounts data as from 1997 are available from the Croatian Bureau of Statistics. The Bureau for Macroeconomic Analysis and Planning maintains a professional exchange of views with the Zagreb Institute of Economics, the Institute for Public Finance, and the Research Department of the Croatian National Bank. The latter uses a simple IT-based economic model provided by the International Monetary Fund.

Together with the Bureau of Statistics and the National Bank, efforts are being made to reconcile current statistics with the ESA 95 standard. The first Fiscal Notification of Croatia, which was submitted in the spring of 2005, was based on GFS 2001, and adjustments were later made in order to achieve a rough

compliance with ESA 95, according to which the second Fiscal Notification was submitted in the spring of 2006.

In 2005 a small CARDS-financed project developed a bridging table between the existing chart of accounts for budget statistics and the accounting structure required by ESA 95. This bridging table was a prerequisite for a major CARDS twinning between the European Commission and the Croatian Bureau of Statistics and Statistics Finland (with Statistics Sweden as a junior partner), with the Ministry of Finance and the Croatian National Bank as beneficiaries. The objectives of the project, which began in 2005 and extended until the end of 2007, were to develop public finance statistics, define the general government sector and its sub-sectors, and harmonise fiscal data with ESA 95 standards.

There is a macroeconomic team in the Ministry of Finance, methods are being developed, and statistical data are improving. A medium-term fiscal policy plan is approved annually by the government and used in the budget process, which constitutes an encouraging start.

It is now the intention of the Croatian authorities to develop a full-fledged medium-term fiscal framework that will provide a solid base for the budget process. This is one of the major goals of the Treasury Reform Strategy adopted by the government in October 2007. According to the strategy, the procedures for the establishment of a medium-term budget framework should be in place by the end of 2008.

5. Budget Process

The various steps in the budget preparation process are generally well defined and dated in the Budget Act (e.g. articles 18, 20 and 30). Based on the guidelines for economic and fiscal policies (see section 4 above) adopted by the government, the Ministry of Finance prepares and issues instructions to budget-users for preparation of the fiscal plans that they must submit to the ministry.

The instructions, which repeat essential elements of the Fiscal Policy Principles, include fiscal policy goals, fiscal policy priorities, key indicators regarding GDP growth, price increases, salary increases, exchange rate, projected revenues, expenditure ceilings for main budget-users, programmes, projected expenditure of different economic categories, etc. These instructions contain the forms that are used for the preparation of the proposed financial plans and investment programmes. The instructions cover a three-year period. Thus, the contents of the instructions correspond to the usual contents of a budget circular.

The instructions are, according to the Budget Act [art. 20 (3)], to be issued by the end of May. Although the instructions specify financial ceilings for programmes and main budget-users, many budget-users propose unrealistic financial plans, which they then try to justify. In the course of negotiations in September and October, the Ministry of Finance adjusts the financial plans to what is realistic. Obviously, the budget-users still need some time to get accustomed to the top-down budget procedure, where firm expenditure ceilings for main budget-users are deduced from the overall fiscal restrictions and political priorities.

The Budget Preparation Sector consists of two units, namely one for state budget preparation and one for local and regional budgets (with 12 staff planned, and 5 actually in place). The state budget unit also encompasses the budget analyses and capital project evaluation and a unit for local government financing

The role of the Ministry of Finance – the Budget Preparation Sector in particular – was strengthened by a provision stating that the Ministry of Finance was to approve an assessment of the fiscal impact of all new laws and regulations. This procedure, introduced in June 2005, includes a Standard Methodology, with forms prescribed by the Ministry of Finance. The full implementation of this new practice took place in 2006, thus allowing the initiation of some changes and improvements to the methodology as well as to the form used. A web-application has in particular been developed by the Ministry of Finance in order to collect the data relevant to the fiscal impact assessment, improve the communication between the Ministry of Finance and budget-users, and better connect fiscal impact assessment and the medium-term expenditure framework.

This development should be linked to another important and promising reform, the linkage between strategic planning and the budget process. The Ministry of Finance first decided at the end of 2006 to become more proactive in this area and ordered a survey to take stock of existing practices in terms of strategic planning, with a view to looking at the possibility of standardising the current multiple processes and establishing strong links with the budget process. This should now happen with the expected new budget act, which will introduce three-year government programmes strategy. These strategic choices are to be reflected in the budgets for each of the three years. Responsible ministries and other state bodies prepare their strategic

plans in accordance with the instructions given by the Ministry of Finance. Furthermore, the new Budget Act envisages the adoption by parliament of the state budget for the next year as well as the budgets for the following two years. The budget will be adopted on a third level of economic classification, and the projections on a second level.

The draft budget submitted to parliament includes proposals for the first fiscal year and estimates for the two following years. This scope is consistent with the medium-term fiscal framework but has so far remained very formalistic: what is adopted and executed is only the annual budget; estimates for the two following years are established in a relatively mechanical way.

The explanations submitted to parliament concurrently with the draft state budget are prepared in the Ministry of Finance based on material provided by line ministries. The 7,000 items of the state budget submitted to parliament are classified primarily according to organisation, programmes and economic nature. The detailed nature of the draft budget makes it difficult for members of parliament and the general public to fully understand the content and implications of the budget proposal, although the current level of detail is said to comply with the requests of most members of parliament. However, the new leadership of the parliamentary Budget Committee now seems to be more open to a reform of the budget classification in the direction of greater simplification. The Treasury Reform Strategy now contains suggestions for the implementation of this simplification, which, if properly carried out, would greatly improve the daily execution of the Croatian budget.

The annual budget process should start in the Ministry of Finance earlier in the year. This would be the case for the issuing of instructions for the preparation of fiscal plans for budget-users, including expenditure ceilings. The latter should be enforced by the government in order to emphasize the top-down character of the budget process. With regard to the improved information included in the explanations, it should be possible to reduce the number of line items from a four-digit to a three-digit classification, and this suggestion is now reflected in the Treasury Reform Strategy. Continued efforts should be made to present the budget in programme terms. The draft state budget, including extra-budgetary financial plans, should be submitted to parliament earlier in the autumn (15 October would be a reasonable date).

The number of staff in the Budget Preparation Sector is small by any standard. An organisational integration with parts of the Budget Execution Sector might make valuable information more readily available for the preparation of the budget. A somewhat less detailed cash planning and execution of the budget might also make it possible to reallocate some staff from the execution stage to the preparation stage of the state budget (see section 7 below). The introduction of fiscal impact assessment and generalised and standardised strategic planning practices are promising projects. They should be linked to other reforms, such as the reduction of the number of budget items, so as to become useful tools for managers and budget-makers rather than additional administrative procedures.

6. Budget Management of Public Investments

The Budget Act includes provisions for the preparation of investment programmes, and the instructions issued by the Ministry of Finance include details regarding the presentation of investment or development programmes. However, the Minister of Finance and the minister responsible for the economy, public works, reconstruction and construction are only now working on the required detailed rules for planning investments (art. 27), despite the fact that these rules constitute one of the nine specific regulations that should have been passed two months after adoption of the revised Budget Act.

The preparation of current expenditure and investment expenses is integrated in the budget process. The National Fund – which is integrated in the state budget – has been set up to meet the requirements of managing EU pre-accession funds. Financial flows, including national co-financing, are handled on a gross basis in the budget, thus providing transparency. The same procedures apply to Phare, ISPA and CARDS funds. The process for accreditation of the SAPARD Agency has been completed, and it is currently underway for the IPA programme.

Specific procedures for the budgeting of EU funds are currently being considered as a consequence of the changes to be made to the Budget Act and resulting from the implementation of the Treasury Reform Strategy.

Detailed rules for selection among competing programmes and a methodology for the development of procurement programmes of an investment nature should be issued.

7. Budget Execution and Monitoring

Once parliament has approved the state budget, preparations are made for its execution. An important element in the execution is the preparation and execution of monthly cash appropriations for each budget-user.

Budget-users submit plans to the Budget Preparation Sector, which checks that these plans are consistent with the approved budget and with revenue projections. The Budget Execution Sector approves cash execution plans on a monthly basis for each of the 51 main budget-users on the same detailed level as the budget adopted by parliament. A budget-user often has 30-50 lines in the budget and in the cash plan. A large budget-user like the Ministry of Defence has 156 lines. Payment commitments, or reservations, can be recorded in the system just one month in advance, which is not satisfactory. This should be improved if the Treasury Reform Strategy is implemented, as this point is clearly identified as a weakness. It intended to both strengthen and expand the system of commitment control. Budget-users order their own payments in compliance with the monthly cash plan, but the Budget Execution Sector approves each payment or group of payments. Considerable efforts are required for cash planning and for the execution of payments. In the Budget Execution Sector at least 10 persons are busy with these tasks. The Treasury Reform Strategy aims to remedy this problem by reducing the number of budget lines, which would offer more flexibility to budget-users to make reallocations during the year and would ensure the full integration of the financial management information systems (FMIS) of budget-users with the system used by the Treasury in the Ministry of Finance. However, a complete integration would not be in place before the end of 2009 at the earliest, assuming that first steps have already been taken by then.

During the execution phase, the government is allowed to take some specified (art. 36) temporary measures to reduce expenditure, if necessary, so as to preserve the budget balance. The very detailed budget unavoidably entails a large number of changes. The Minister of Finance is allowed (art. 38) to reallocate funds between budget items and between budget-users for an amount of up to five per cent of the concerned items. If more far-reaching measures are needed, the government must submit a supplementary budget to parliament. This seems to be a reasonable distribution of power between the executive and legislative branches.

When they occur, rebalances are in any case an extremely tedious and time-consuming process because of the detailed line-item structure, with the four-digit level of approval.

Appropriated funds that are not spent by a budget-user during the fiscal year normally cannot be carried over to the next year. However, earmarked revenues can often be carried forward.

The Treasury Single Account (TSA) was introduced in 1996 and has been improved over the years. The Croatian National Bank has been assigned to provide the TSA, but the bank has outsourced this task to FINA¹. In principle, all budget-users must have an account in the TSA system, and all state payments are to be channelled through the TSA (art. 62). Since January 2006 the payments of the Croatian Motorways and the Croatian Roads have been included in the TSA. However, a few budget-users, e.g. universities and courts, and extra-budgetary operations still do not carry out their payments through the system. This again will be subject to change with the Treasury reform.

Up until 2006, all budget-users were allowed to have one bank account in the Postal Bank, in principle for minor revenues and payments (referred to as own resources). These bank accounts have now been closed and the revenues are paid to the state through the TSA. A special code for this source of financing makes it possible to keep track of these resources without separate accounts.

FINA reports frequently (daily, weekly) to the Ministry of Finance and budget-users on the receipts and expenses paid through the TSA. In principle, data is available on a real-time basis, which allows close monitoring of the implementation of the state budget.

The preparation and implementation of monthly cash planning requires substantial resources in the Ministry of Finance and in all budget-users. It should be possible to reduce the number of details in

¹ FINA (Financial Agency) is a state-owned body that settles state payments, produces financial reports, and provides other technical services to the Croatian Government.

the cash planning and execution in order to reduce staff requirements. The TSA system should have complete coverage and include all state institutions. The most relevant and useful changes are supposed to be implemented with the process of reform of the Treasury due to start in 2008.

8. Accounting and Reporting

The basic principles of state budget accounting can be found in the Budget Act (articles 115 and 121). The immediate impression is that budgeting and accounting are to be carried out according to IPSAS standards² for the public sector. The applied practices, however, differ substantially from these principles and standards.

In practice, budgeting and the approved state budget are on a strictly cash basis. Consequently, the reporting and monitoring of implementation of the budget are also in cash terms. During the past year, increased attention has been paid to the problem of arrears, i.e. bills received but not paid.

However, the accounting of ministries and other budget-users is carried out on what could be referred to as a modified cash basis. In practice, this means that revenues are recorded when cash has been received by a state budget-user, and expenditures are charged to the accounts when an invoice has been received.

The Minister of Finance has issued the required (art. 117) regulations for accounting, including the chart of accounts and classifications. There is no unified IT-supported accounting system used by budget-users, and they are often obliged to make entries in two – or even more – different accounting or reporting systems.

Extensive rules for reporting are set down in the Budget Act (articles 122-129). The Minister of Finance has also issued the required detailed regulations for reporting. All state budget-users must deliver monthly, quarterly, semi-annual and annual statements. These reports are based on accounting figures, not on payments. The reports are consolidated at various levels.

A semi-annual statement on budget execution must be forwarded to parliament by 5 August. The contents of this statement are elaborated in the Budget Act and in the Rulebook issued by the Minister of Finance.

In the Budget Act precise dates are set for the submission of the consolidated statement of the budget accounts by budget-users, line ministries and the Ministry of Finance. In addition, according to the Budget Act [art. 128 (5 and 6)], the government is required to submit the annual statement of budget accounts to the State Audit Office and to parliament at the beginning of June. According to the State Audit Act [art. 11 (2)], the audit report must be submitted no later than five months following expiry of the date for submission of annual financial statements.

The annual statement of budget accounts is usually submitted to parliament at the beginning of June and approved by parliament by the end of June. This time frame is satisfactory. However, it is very surprising to observe that the State Audit Office's audit report is submitted to parliament only in October or November. Parliament therefore approves the accounts before having received the Auditor's opinion.

In 1997 the government decided to acquire a SAP system to support budget preparation, budget execution and budget reporting, etc. The system became operational in 2001 and is today the core Government Financial Management and Information System (GFMS). The system is currently being developed and improved in order to provide an efficient support to the overall budget process. The system has some reported shortcomings. The applied system is cash-based and difficult to link directly to budget-users' accounting systems, which are on an accruals basis. Also in other respects links with budget-users' local systems are missing. This means that repeated entries have to be made in different systems, with unnecessary work and errors as consequences. The Ministry of Finance has now launched projects to realise the integration between the Treasury's financial management information system and the systems existing in budget-users by creating adequate interfacing and allowing data exchange and inter-operability.

A strategic decision still needs to be taken regarding the bases for budgeting and accounting. In the present situation, it seems appropriate to continue budgeting on a cash basis. A progressive move in the direction of more or less full application of accruals for accounting purposes should be regarded as a medium-term perspective. This would require a clear strategy and plan on the part of the Croatian authorities to develop sufficient professional accounting skills, accounting policies, and complete and accurate registers for financial and non-financial assets of budget-users on all (including ministerial) levels. Further integration of the financial management, budget and accounting systems remains

² IPSAS = International Public Sector Accounting Standards

desirable, and it is expected that the upcoming additions to the FMIS set-ups will contribute to this development.

The fact that parliament approves the final accounts before it has received the State Audit Office's opinion is not in line with normal and standard practice, and is actually illogical. Consideration should therefore be given to submitting the final accounts to parliament and to the SAO earlier in the year, e.g. in late April. The SAO should develop its work in order to be able to present its opinion within six to eight weeks (this would imply that interim audit work would have to be done during the execution period). In that way, parliament would have the necessary information to approve the final accounts before the summer or at least before it has to deal with the new budget in the autumn.

9. Capacity for Upgrading the Public Expenditure Management System

The Ministry of Finance units mainly concerned by this review are the Bureau for Macroeconomic Analysis and Planning and the State Treasury.

Undoubtedly the present staff of the Macroeconomic Bureau have all of the qualities needed to successfully develop their methods and work. The number of staff, however, is not ample. Intensified co-operation, for example, with the Zagreb Institute of Economics and the Institute of Public Finance might be one way of increasing the capacity. Additional technical assistance should be considered, if requested by the Bureau.

It is an advantage that the various units involved in the budget process are all organised within the State Treasury, which is headed by one person reporting directly to the Minister of Finance. Another advantage is that within the Treasury there is a unit for development and support. Several of the leading staff in the various Treasury units have displayed an interest in developing various elements of the treasury system, and they have an obvious capacity for designing and managing reforms. In the event of a request for support – and with the establishment of clear ownership – technical assistance should be considered.

The areas covered by this assessment have been subject to activities of the World Bank, the International Monetary Fund, the European Commission, and other institutions and consultants. Consequently, a number of proposals for improving elements of the public expenditure management system have not always been co-ordinated. In 2005 and 2006 efforts were made in the Ministry of Finance to prepare a comprehensive Treasury Reform Strategy, and Sigma provided some support for this activity. This document was finalised in the summer of 2007 and formally adopted by the government on the eve of the elections in October 2007. Implementation of the strategy would require the designation of a structure within the Ministry of Finance for the co-ordination of technical assistance projects, not only in terms of project management procedures but also in terms of substance.

There have been no material changes since last year's assessment, largely because of the elections. However, the new parliament may show more interest in innovative and useful developments in the public finance area. For this reason, the Ministry of Finance should make an effort in terms of raising awareness in this area – for example, of new members of parliament.

It is still true, in parts of the Croatian administration, that the rapid and large-scale turnover of junior officials in the Ministry of Finance and the general lack of appeal of public jobs make the introduction and sustainability of reforms a fragile process. In that respect, the Ministry of Finance, however, seems to have been comparatively more immune than other Croatian public administration bodies in recent years.

10. Summary and Next Steps

Although considerable progress has been made over the last decade, the public expenditure management system in Croatia still partially achieves the baselines, and continued reform is very necessary. Most of the recommendations below should be regarded as related to mid-term objectives, but their implementation should start now.

- The state budget proposal should be submitted earlier to parliament.
- The State Audit Office should develop its audit approach in order to be able to submit its annual audit report, including an opinion to parliament, at the same time as the government final accounts.
- The review of the Budget Act should be completed to enable a decision concerning the secondary legislation that is still needed to facilitate the implementation of this act, as well as what is superfluous, and to amend the act in consequence.
- The budget process should start earlier in the Ministry of Finance and should have a firm top-down nature.
- The number of line-items in the budget should be reduced; instead of a four-digit classification, a three-digit classification should be sufficient.
- A programme structure could be developed for the state budget.
- Some extra-budgetary operations should be integrated into the state budget.
- The National Accounts system needs to be developed so that it complies in all respects with the ESA 95 standard.
- The methods used for preparing the medium-term fiscal framework should be enhanced.
- The detailed monthly cash planning for the execution of the state budget should be simplified.
- The possibility of further integrating budget preparation and budget execution and also of reallocating resources from execution to preparation should be considered.
- The capacity of the Budget Preparation Sector should be strengthened, with priority being given to the linkage between the budget and overall and sectoral planning. In any event, the analytical capacity of this sector needs further development.
- The Treasury Single Account (TSA) system should be further expanded so that it covers all payments and revenues of all budget and state institutions.
- A strategic decision should be taken regarding the bases to be used for budgeting and accounting.
- The Ministry of Finance should continue to improve the co-ordination of technical assistance projects to ensure consistency and to profit to the fullest from a considerable amount of external support.

All of the above recommendations, a number of them already included in Sigma's June 2007 assessment report, remain valid. However, most of them have been considered by the Croatian authorities and are included in the Treasury Reform Strategy, so that actually a unique recommendation could be made, summarising all of those above, and this would be to implement the approved Treasury Reform Strategy. This recommendation also implies that the Ministry of Finance should put in place the adequate instruments for steering and monitoring this reform process.

Moreover, the government and the Ministry of Finance should now seize the opportunity of the newly elected parliament to bring forward the public finance reform plans that are in need of legislative support and to raise the awareness of interested parliamentarians concerning the desirable changes in the budgetary process.