

## **Convergence of Croatian Financial and Budget Regulations of the Framework and Practices of the European Union**

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**Abstract.** *As of 2004 intensive preparatory activities for the accession of the Republic of Croatia into the European Union have started. Significant changes have been taking place in legislation, institutional and administrative respect. The so called "silent reform" is changing the appearance and the way of work of state administration. Institutions acquire the rules and way of work of the European Union through the usage of pre-accession programmes. General opinion moves in the direction of successfulness, competitiveness, attainment of results and added values. Financial regulations regarding stipulation of budget processes have been changing through the introduction of the following elements: strategic planning, multi-annual budget framework, fiscal discipline, internal audit as well as financial management and control system based on clearly set work processes and procedures. This document provides the description of the most significant changes regarding financial management and budget regulations in the Republic of Croatia which have taken place in the course of adapting (developing) the system to the European practices and rules.*

**Keywords:** reforms; public finance management; European funds; public internal financial control; strategic planning; multi year planning; outcomes; performance.

**JEL Codes:** E61, F36.

**REL Codes:** 13F, 20J.

## Introduction

The model of financial management, which is to be applied in member states, is not defined by the Community's *acquis communautaire*. However, in the area of fiscal policy and budget management, several requirements are laid down to be fulfilled by member states. The requirements are mostly related to the following: 1) provisions referred to in the Treaty of Maastricht on the European Union (signed in 1992) defining fiscal policy objectives as a deficit amounting to 3 percent of the GDP, 2) criteria of statistical nature and data, 3) procedures in combating irregularities and fraud, 4) regulations on public internal financial control system and 5) the status and manners of external audit work.

In other areas of financial management there are no concrete rules or the EU legal framework which member states obligatorily apply. However, each of member states is responsible for developing its own management system. In this context it is important to take into consideration the need for the following (Richard, 2002):

- clear correlation of the Government's strategic political and economic priorities with the budget,
- ensuring effective and high quality implementation and utilisation of European Funds,
- creating relations of trust with other member states, European institutions, and particularly with the European Commission.

For the purpose of satisfying the above mentioned criteria and expectations set before the member states, the majority of countries has already in the accession phase started with reforms in the area of public finance management. *Reforms* are primarily related to defining and introducing: *the multi-annual fiscal framework, strategic and programme planning, the policy of capital projects management*, special mechanisms of monitoring the implementation of programmes as well as supervision and reporting on *objectives accomplished*.

Through the system of various conditions<sup>(1)</sup> set by the European Union before candidate countries, the more comprehensive framework is created enabling the implementation of the reforms in practice as well as their sustainability. In order to achieve high-quality adjustments, i.e. the convergence, the harmonisation but also the Europeanization in a wider sense<sup>(2)</sup>, it is not sufficient that legal criterion is satisfied but also that all other – political, economic and, above all, administrative criteria are met. The administrative one means ensuring the stability of the institutions and the

capacity to take the obligations derived from the quality of being European Union Member State (Matei, 2009).

Below paragraphs provide for the overview of changes which were encouraged in the Croatian public finance system and budget management in the course of accession process and adoption of the European Union practices.

## **2. Preparation for the management and implementation of European Funds**

Pre-accession assistance programmes<sup>(3)</sup> implemented by candidate countries for their accession into the EU present the preparation for the management and implementation of forthcoming European Funds once a country becomes an EU member state.

By introduction of pre-accession assistance programmes *the European rules for managing public finance* were also partially introduced. In order for these programmes to start being used, the country, i.e. the institutions involved in their implementation are *obliged to satisfy a whole set of criteria* laid down by EU regulations and financial agreements concluded with the European Commission, regarding the implementation of a particular programme.

### **2.1. Accreditation criteria – public internal financial control system established**

Satisfying accreditation criteria is the main condition to be fulfilled for gaining work permission from the European Commission and for managing European Funds. In accordance with the above said, all institutions involved in the implementation of EU pre-accession programmes are obliged to carry out detailed and comprehensive preparations regarding the establishment of control environment, risk management, control activities, monitoring and evaluation system as well as information and communication system. All the above mentioned is defined in the Annex to the European Commission IPA Implementing Regulation<sup>(4)</sup> (hereinafter: IPA Regulation).

These areas actually constitute parts of the comprehensive concept of the sound financial management, i.e. the basic components of the public internal financial control system defined by the Law on public internal financial control system<sup>(5)</sup>.

Therefore, during the period of accession to the EU, *internal financial control system is being introduced into the practice of a candidate country through two processes*. One of the processes includes preparation and utilisation of EU pre-accession assistance programmes for which all institutions must have fully established internal financial control system, in accordance with EU requirements. The other one is the negotiation process in the framework of

which, in Chapter 32 - Financial Supervision, a candidate country becomes obliged to set up and apply internal financial control system.

Through the system of managing pre-accession assistance programmes the Republic of Croatia acquires *practical experience on the European Commission requirements* in the framework of each particular element of the internal financial control system. This experience has been developed since 2004 when preparations for the utilisation of first pre-accession assistance programmes – PHARE, ISPA and SAPARD took place.

At the same time from 2004 in the framework of negotiations the activities on primary and secondary legislations regarding public internal financial control system have commenced (PIFC)<sup>(6)</sup>.

At the very beginning of 2004, but also during following few years, it was still not sufficiently recognized that these were all identical processes of financial management through which, on one side, the system of EU pre-accession assistance programmes was built, while, on the other side, the processes have been introduced into the existing system in order to improve the financial management of state (and local) budget.

The reason for a separation and a kind of parallel work on the system of managing EU pre-accession assistance programmes and the system of state budget was the speed at which certain knowledge on and elements of the internal financial control system were supposed to be adopted. Therefore, for example, the accreditation process for PHARE, ISPA and SAPARD programmes took place throughout 2005, and it was already then that all institutions managing the programmes were supposed to have regulated and described work procedures, process maps, audit trails, risk management methodology, irregularity management functioning and irregularity officers appointed, including all other elements of the internal financial control system elaborated and established in details. On the other side, legal and implementing regulations just started to be developed and thought over at the national level. The exact elements of internal financial control system were clarified, i.e. the process of learning on the theoretical framework of internal financial control system was underway.

As of 2008 these two processes have been connected for the purpose of speeding up the overall process of developing internal financial controls at the level of central state as well as of local (regional) self-government units through 2009 and 2010 so that Croatia, as a member state, could include as many institutions as possible into the system of managing EU Funds. In this way Croatia would also ensure the most effective and efficient usage of the funds offered. Only those institutions which have implemented all elements of internal financial controls may be a part of system of managing and

implementing EU Funds. A system established and formed in the above mentioned way is also essential for national funds while strict criteria of sound financial management shall also be laid down in the budget system.

The overview of EU requirements is given in the paragraphs below for individual components of the internal financial control system and outlining the changes encouraged in the management of finance and taking place during their introduction and implementation.

### **2.1.1. Control environment**

This criterion relates to the establishment of a *good quality organisational structure and human resources management*. The areas being evaluated are as follows: 1) ethics and integrity, 2) irregularity management and reporting, 3) human resource development comprising organisation development planning, employment policies, education and trainings, manners for motivating employees and retention policy, 4) sensitive work posts' management and prevention of conflicts of interest, 5) legal base for respective bodies – institutions and responsible persons, 6) job descriptions – formally established and followed principles of accountability, clear-cut segregation of duties and delegation of tasks as well as rights and responsibilities throughout the overall organisation. These elements of the control environment are defined in IPA Regulation. The definition of control environment and a part from the Law on public internal financial control system are not identical to the one from IPA regulations. However, in the essence of both regulations the control environment is highlighted as the basis of the internal financial control system which ensures conditions for the effective functioning of controls.

Ministries and other state administration bodies have already developed and introduced the majority of areas above mentioned, and the only issue which stays open is the level and the quality of their application.

#### **2.1.1.1. Ethics and integrity**

Code of conduct of civil servants in the Republic of Croatia is stipulated by the Act on civil servants, the Act on servants and employees in local (regional) self-government and by the Code of Ethics of civil servants and employees. These documents define *rules of good behaviour of civil servants*.

Bodies which are not in the system of state administration have their own codes of ethics, e.g. State Audit Office, State Attorney Office or courts.

Bodies using and managing EU assistance funds have manuals which contain provisions on code of conduct and ethics of employees, arising from the above mentioned acts and code of ethics. In these bodies all employees are

obliged, immediately after commencement of employment, to sign the Declaration of Confidentiality and Impartiality.

The European Commission auditors have particularly addressed to the issues regarding the actual functioning of the system: starting with cases of reporting and manners of dealing with non-ethical behaviour up to the trainings on ethics which need to be constantly organised for all employees and which should present a compulsory part of the induction trainings for newcomers.

Although from a legislative point of view we have a well-defined system regarding ethics and integrity, it was exactly the accreditation process, i.e. the course of receiving work permission in bodies dealing with the implementation of pre-accession assistance programmes, that indicated the elements in this area which still need to be further built and enhanced in the overall state administration.

#### **2.1.1.2. Irregularity management and reporting**

The procedure of irregularity management and reporting has been developed in the system of managing pre-accession funds as early as 2005, in the framework of preparations for the first accreditation. In all bodies irregularity officers were appointed, and they are obliged to train other employees on the irregularity system and to send irregularity reports on a quarterly basis to the Department for Combating Irregularities and Fraud within the Ministry of Finance<sup>(7)</sup>.

On the other side, in December 2006 the Law on public internal financial control system was adopted. The Article 36 of the law prescribes the obligation of a head of a body to set up a system for preventing the risks of irregularities and fraud and to undertake activities against irregularities and fraud. The obligation of appointing the irregularity officer who will receive notifications on irregularities and suspicions of fraud or who will independently undertake activities against irregularities or fraud is introduced. As opposed to the system of managing EU pre-accession funds, in this national part the process of irregularity management and reporting has not been described, therefore it is crucial to define the future role of irregularity officers.

In the EU part, one step forward was taken relating to the protection of EU financial interest, the part constituting one of the items in the Negotiating Chapter 32 – Financial Supervision.

*The AFCOS<sup>(8)</sup> system was established, encompassing the following:*

- 1) Network of bodies managing and using EU pre-accession funds (irregularity reporting system; their representatives in the AFCOS system are irregularity officers),

- 2) Network of bodies dealing with suppression of fraud, corruption or any other form of irregularities in the system (AFCOS network),
- 3) Ministry of Finance – Department for Combating Irregularities and Fraud, fulfilling coordinative role within the system and representing a contact-point to the European Anti-Fraud Office (hereinafter: the OLAF).

The Department for Combating Irregularities and Fraud is obliged to undertake activities related to further, professional development of bodies in the AFCOS system, in the area of *prevention, detection, proceedings, reporting and follow-up of irregularities and fraud*.

In accordance with recommendations from OLAF, drafting of the proposal of National Anti-fraud Strategy for the Protection of EU Financial Interest has started.

Subsequent to the described system of irregularity management which was developed for the purpose of protecting EU financial interest, the following needs are to be defined:

- the way in which the coordination between different state administration bodies is to be enhanced in order to ensure effective prevention, detection, proceedings with and reporting on irregularities, and
- the role of the irregularity officer together with work procedures, within the system of managing budgetary funds in which the protection of financial interests also plays an important role.

#### **2.1.1.3. Human resources development**

The European Commission particularly highlights this element of internal financial controls, not only during the accreditation period, but also afterwards, during monitoring the quality of system work.

All bodies in the system of pre-accession assistance programmes implementation are obliged to have documents and procedures already adopted, as follows:

1. *annual work plans* with defined: a) objectives that each organisational unit must fulfil throughout the year, b) activities which they plan to carry out in order to fulfil their objectives, c) deadlines of the completion of the activities, and d) indicators by which the successfulness of performance of activities, i.e. the fulfilment of objectives is measured;
2. *workload analyses* outlining the number of people needed for carrying out activities having been planned and for fulfilling objectives having

been envisaged; moreover, on the basis of the analyses, recruitment plans are developed;

3. *training plans* for each employee (defining trainings needed for an employee, when he will have the opportunity to attend the trainings and who are potential trainers, i.e. where the training is going to be performed, etc.) and they are obliged to keep a training register (the list of all trainings for each employee and for the institution as a whole),
4. *procedures for monitoring the successfulness of each employee's performance*, appraising in compliance with the successfulness and awarding in accordance with the marks received in the appraising process.

The above mentioned elements of control environment are difficult to be developed separately, just for one part of the Ministry or a body involved in the implementation of EU pre-accession assistance programmes. *It would be of significant importance to introduce mechanisms of work planning and monitoring the success in achieving results horizontally, i.e. for the overall system of state administration.* Moreover, employment policies, awarding and promotions, have to be developed as a unified instrument, and it is difficult to separate them to be specialised for only one smaller part within the organisation. This becomes particularly visible when taking into consideration the requirements laid down for the utilisation of EU funds. In the system of EU funds implementation it is necessary to develop the following:

- each institution included in the implementation system should have adopted organisation development strategy based on the SWOT analysis of the current state of play, analysis of training needs, recruitment (employment) plans and capacity building plans;
- unified and comprehensive institution development and capacity building strategy for the management of EU funds must be developed, based on the risk analysis of all bodies in the implementation system, including also final beneficiaries, if they are known;
- satisfactory careers' planning and salary strategy.

#### **2.1.1.4. Managing sensitive work posts and preventing conflict of interests**

All bodies in the system of the implementation of EU pre-accession assistance programmes performed the analysis of sensitive work posts and identified measures for mitigating risks from potential irregularities or abuse of authority at the sensitive work post. One of the options in managing sensitive work posts is the introduction of the so called rotation or transfer of employees after several years to another work post. Until now this mechanism has not been used in the system, but rather sensitive work posts are largely and closely



supervised in the following ways: internal audits are more often performed and the system of internal control lists is enhanced. *Sensitive work posts' management policy has not been horizontally developed for the overall system of state administration.* Therefore, in this context the regulations should be expanded so that in this part as well we have a uniquely developed system of managing both EU and national funds.

#### **2.1.1.5. Legal base for particular bodies – institutions and responsible persons**

This control environment element has been uniquely fulfilled for institutions in the system of the implementation of pre-accession assistance programmes, but also both for all ministries and for other state administration bodies through legal acts and Government regulations establishing particular bodies, and defining both their scope of work as well as the organisation.

#### **2.1.1.6. Job descriptions**

In all state administration bodies acts on job organisation and classification have been adopted, outlining and describing all work posts of the body. It is required in the control environment that job descriptions arise from work processes and procedures, and that the audit trail clearly indicates that the segregation of duties and the four-eye-principle are followed. Also, each body needs to have the adopted substitution plan in which the above mentioned principles need to be followed.

The need for the set up of the financial management model among related institutions is particularly important in this part regarding the *segregation of tasks, duties, rights and responsibilities.*

Therefore, in the system of managing pre-accession assistance programmes there is an institution responsible for bringing strategic decisions and for planning, while the other is responsible for the implementation: from public procurement procedure to paying and monitoring project implementation.

In the system of budget and budget users, the analysis of activities carried out at the budgetary user will definitely indicate that, due to the segregation of duties and four-eye-principle, a larger number of employees is needed to deal with activities in financial management processes. In this case it has to be decided that either more people should be employed at the level of a budget user (however, this is definitely not a sound solution) or that particular processes and activities at the level of local or regional self-government unit are centralised. It is crucial to define which tasks need to be performed in a centralised way – at the level of a competent budget of a local and regional

self-government unit, and which activities may be carried out at the user. In accordance with the above mentioned, and in order to ensure that the sixth element of financial management is regularly applied, the Ministry of Finance is in the process of developing the financial management model which will be presented to all local and regional self-government units.

*It may be concluded that these six elements of control environment significantly influence the organisation and manners of work.* Therefore, in the process of Croatia's accession through the implementation of these elements significant changes take place and they positively influence the quality and efficiency of operations of state administration. Concrete outcomes will be visible at the time when all elements are fully implemented.

### **2.1.2. Risk management**

This criterion encompasses a lot more than just defining, assessing and monitoring risks. A unified methodology of risk management has been developed for all institutions in the implementation system of EU pre-accession assistance programmes. In accordance with this methodology every employee, through their everyday work, detects risks which are detrimental to the accomplishment of objectives which were laid down. They report on these risks, by filling a special risk reporting form, to the risk management officer who keeps risk register. Twice annually during meetings with managers and heads, activities are determined for risks referred to in risk register which are followed in the process of their elimination or for mitigating their impact.

*The basic preconditions for the introduction of risk management system* are previously described and already implemented elements of control environment, particularly the following: a) objectives are defined through the whole organisation, b) all stages (activities) needed for meeting the objectives are well planned, c) all necessary resources per each activity are defined, d) the segregation of duties regarding specific objectives is clear and set.

### **2.1.3. Control activities**

*The quality of the procedures established within each of the financial management processes and the efficiency of their implementation in practice* are evaluated in the context of this criterion.

Apart from developed procedures of procurement, payments, budgetary procedures for ensuring financing, procedures for ensuring the continuation of organisation functioning (substitution plan, transfer of knowledge in cases of employees leaving their posts, etc.), accounting procedures, data reconciliation, security, archiving, recording and reporting on weaknesses of the internal

control system, in the context of this criterion it is crucial to develop a system in a proper way to ensure: 1) additional check of all transactions, and 2) active supervision of system work carried out by a responsible person.

The two last elements above mentioned introduce significant changes in the financial management system. All ministries and other state administration bodies which make payments to final beneficiaries are required to introduce mechanisms of on-the-spot controls – *not a single subsidy, donation or assistance may be paid out without a detailed control of activities and costs which the final beneficiary financed from these funds, as well as without the evaluation whether defined objectives were satisfied*. Active supervision of the system work comprises the following: a system defined in detail about reporting on the implementation of activities; regular monthly meetings of responsible persons; monitoring of the fulfilment of work plan and objectives laid down; and finally a responsible person issues a statement by which they acknowledge and guarantee that the system functions in compliance with the rules laid down, and following all the elements of internal control system.

#### **2.1.4. Monitoring and evaluation system**

It is required by this criterion that institutions establish a system which will ensure that top-level managers/heads receive independent reports on functioning of the system which falls under their responsibility. In these reports it is important to focus primarily on the *evaluation of the effectiveness and efficiency of the system* and the quality of organisational structure, i.e. on the evaluation of the internal financial control system. For the fulfilment of this criterion one element was essential to be introduced. This was the element of internal audit. During the accreditation process and precisely due to the importance of internal audit in the context of sustainability of operations of the system established as a whole, the EC auditors paid a special attention to the organisation and functioning of internal audit. They also highlighted the need for the urgent capacity building and for enhancing their function.

The internal audit, as a part of the comprehensive internal financial control system, is stipulated by the Law on public internal financial control system.

In the context of this criterion it is also important to ensure the monitoring of the implementation from the project level up to the programme as a whole. On the basis of the monitoring, the evaluation is performed on whether all activities were carried out legally, in accordance with procedures prescribed, and whether the objectives were attained. In compliance with the above mentioned requirement in the system of EU pre-accession assistance

programmes, each step in the management of a project is precisely defined, while the Monitoring Committee is obligatorily designated in order to monitor the implementation. The Committee convenes for the purpose of monitoring the progress of the project at least twice annually. At the level of priorities and measures as well as a programme in the overall, the committees are also formed for the purpose of monitoring the progress at these higher levels of the programme structure. For the purpose of evaluations, i.e. evaluating the progress, external experts are engaged in order to perform evaluations on the basis of precisely defined economic and financial indicators of the programme success.

#### **2.1.5. Information and communication system**

Information and communication system requires clearly defined information enabling the management and control of businesses.

In the framework of this criterion within pre-accession assistance programmes the following are crucial to be fulfilled:

- *regular coordinating meetings* for all institutions involved in the implementation of a certain programme;
- *regular reporting* on the status of the planned activities per programmes and per projects;
- *reporting on projects' implementation* in relation to the implementation plan laid down (implementation of procurement plans, analysis of deficiencies and evidence on activities undertaken aiming to improve the quality of work, contract implementation or comparison of costs in relation to results);
- regular reporting from all employees on the effectiveness and efficiency of internal controls so that they are informed on shortcomings identified and improvements needed.

In the system of pre-accession programmes several levels of audits perform checks on the system before the European Commission awards a work permit, i.e. evaluates that the system satisfies all described criteria laid down. Taking into consideration that, so far, we have received work permission for CARDS, PHARE, ISPA and SAPARD programmes, as well as in IPA components I – IV, it may be concluded that in the operational practice of state administration the rules of internal financial control system are being largely and more significantly applied.

The above described content of the accreditation criteria indicates that all institutions involved in the implementation of pre-accession assistance programmes had to acquire new knowledge and manners of work, and to *implement in practice certain activities which have not been adopted yet in*

*other parts of state administration.* This significant progress which was introduced into parts of financial management system dealing with EU programmes is extremely important for a faster and a higher quality development of the system in the overall.

### **3. Changes in budgetary processes**

Basic budgetary processes are as follows: planning, executing, accounting monitoring, supervision and reporting. These processes are applied both in the budget system and in the system of the implementation of EU pre-accession programmes, but also afterwards during the implementation of European Funds. By the adoption of the new Budget Act<sup>(9)</sup> some important novelties were introduced in the processes of planning and executing, which enable easier implementation of the public internal financial control system, *the main task of which are monitoring and evaluating whether objectives which were set are being achieved in a legal, regular, efficient and effective way.*

#### **3.1. Planning**

The planning process of EU Funds is based on the following: programmes and application of the chronological principle. Since planning is a programmatical event, *only and exclusively well set and defined programmes are being financed.* Planning process falls under responsibility of line ministries and is coordinated by the Central Office for Development Strategy and Coordination of EU Funds (hereinafter: the CODEF).

The planning encompasses the proposal and *adoption of strategies for particular areas*, and in accordance with priorities of certain areas it includes proposal and preparation of projects to be financed from pre-accession programmes.

At all programme levels<sup>(10)</sup> *objectives and indicators of success in attaining objectives are defined, which is monitored in detail afterwards during the implementation.*

The CODEF will, for the first time, prepare National Strategic Reference Framework for operational programmes 2011-2013. This is a strategic document brought by all member states for each financial perspective of the European Union<sup>(11)</sup>.

Precisely because of this strategic and multi-annual approach in the European budget it was important *to improve the planning process by introducing strategic and multi-annual budgetary framework.*

This was done in the Republic of Croatia through adoption of the new Budget Act:

- *The commitment of the strategic planning and of drawing up a strategy covering the period of three years for government's programmes has been introduced.* This was performed so that strategic priorities and objectives of government's policy could directly influence the allocation of funds in the framework of the budget. Moreover, the objective is to connect the National Strategic Reference Framework (NSRF) with the strategy for a three-year-long period since only in this way the sustainability of the implementation of the first and the second document may be ensured, taking into consideration that all priorities referred to in the NSRF are supposed to be co-financed by budgetary funds.
- *Multi-annual dimension of the budget is ensured* by the provision which defines that the Croatian Parliament, i.e. the representative body (at the local level), adopts the budget for one budgetary year, but also the projection for the following two years.

### 3.2. Execution

After tender procedure and contracting of activities forecasted by a project, the financial implementation commences together with the execution of payment. Contrary to the budget in which, according to the Budget Act, advance payments are possible only exceptionally and in agreement with the Minister of Finance, in the system of EU pre-accession programmes and depending on the type of a contract, the specific percentage of the overall amount envisaged by the contract is paid to a supplier immediately upon the signing of the contract. The subsequent payments to the suppliers are executed in compliance with costs declared. Prior to payment stage, again depending on the type of a contract, the report on the implementation of a project is also submitted enabling the monitoring of and supervision over the implementation. Moreover, the last payment is not executed prior to final report on the successfulness of the project implementation and results achieved in relation to objectives set. The above mentioned procedures indicate that *the focus on results and on the successfulness of work is not reflected only in the way of planning and selection of projects, but is reflected through the whole implementation cycle – from contracting to paying.*

In the planning process the overall amounts, to be allocated for an individual programme/measure or priority, are defined. The funds distributed per projects within a priority may be reallocated without special procedures of European Commission approvals. The amounts are not planned according to types of expenditures per projects. It is only determined which types of

expenditures are eligible to be financed, and which are not. Therefore, the implementation of projects, priorities, measures or programmes is completely flexible in respect of economic classification (i.e. individual types of expenditures to be financed).

In the process of budget execution this level of flexibility has not been reached, however improvements were introduced even in this part by the new Budget Act as follows:

- *more flexible budget execution and focussing on the outcomes of work is ensured* through the adoption of budget at the higher level of economic classification, i.e. at the level of a subgroup (the third level) in relation to the, so far, fourth level of a section. Projections shall be adopted at the second level of the economic classification.

In the framework of negotiations, in Chapter 22 – Regional policy and coordination of structural elements, apart from introducing strategic planning and the possibility of multi-annual planning, as well as more flexible budget execution, it is also required that the *funds for capital projects could be transferred from one budget year to another*. This was stipulated by the new Budget Act as Article 55, Section 3 reads:

- The possibility is introduced of transferring activities and projects for which funds have been ensured in the budget but have not been realised in the year concerned to the subsequent year. Namely, accounts for certain activities and projects received at the end of a year, the payment of which arrives in the subsequent year are drawn from the budget of the subsequent fiscal year. Therefore, it is important to enable their payment in the subsequent year although the funds have been ensured in the year concerned. Due to public procurement procedures being late or repeated, projects, particularly capital projects unpredictably move from one year to another. The accounts, relating to a concrete project which was envisaged in the user's plan to be completed by the end of a fiscal year, in which the funds were ensured, but it was completed at the beginning of the subsequent year, cannot be paid until the budget revision of the subsequent fiscal year. These examples indicate that it was very important to regulate by the Act the possibility for the transfer of activities and projects from one year to another without needs for amending the budget.

All the above described indicates the fact that *in the Republic of Croatia significant changes have been started in the process of acceding to the European Union regarding the system of managing public finance*. The utmost objective of the changes comprises the improvement of work quality, the efficiency and the effectiveness in the management of public funds.

#### 4. Conclusion

As a candidate country for the membership in the European Union the Republic of Croatia is the beneficiary of EU pre-accession programmes (firstly the following programmes: CARDS, PHARE, ISPA and SAPARD, and afterwards the new IPA programme), while when it becomes the member of the EU the Republic of Croatia will have the possibility to use European funds becoming a part of the implementation of European Cohesion policy.

The objectives of the Cohesion policy include equal and sustainable development of all European regions (NUTS II level – statistical region), and through its implementation in member countries the following investments are financed: transport, environmental protection, power, regional competitiveness (i.e. enhancing business and society infrastructure, strengthening the economy), human resource development aiming to increase employment and employment opportunities of the labour force.

The above mentioned areas, encompassed by the Cohesion policy, are part of the special interest in each country, and accordingly in the Republic of Croatia they have been recognized as development drives from the local to the central level in the country.

*The coordination of strategic priorities at the local, regional and national level as well as their harmonisation with the objectives of the Cohesion policy presents one of the key challenges.*

For this reason primarily, the new Budget Act which entered into force as of 1st January 2009 introduced the strategic planning and a three-year-budget framework. For the first time the Strategy of the Governmental programmes was adopted for the period 2010 – 2012, clearly highlighting strategic priorities related to the budget, objectives were set and manners of measuring the successfulness of accomplishing the objectives were defined. This strategic consideration at the national level in the context of the state budget constitutes the basis for the adoption of strategic documents and connection of national priorities with the objectives of the EU Cohesion policy.

*The adjustment of the financial and budget regulations to the frameworks and practices of the European Union is one of the key reforms and together with the institutional and legislative changes and strengthening of administrative capacities present the basis for high quality integration into the EU Cohesion policy.*



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**Notes**

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- (1) See Matei, L., 2009, Romanian Public Management Reform, Administration and Public Services, Volume 1, Economica Publishing House, Bucharest, Romania, page 77-78 European conditionality, Available on SSRN: <http://ssrn.com/abstract=1469995>.
- (2) Europeanization should not be confused with other concepts, such as convergence, harmonization, integration and policy making. Europeanization is a process, while convergence represents its consequence. Also, Europeanization should not be confused with the harmonisation process, which reduces the diversity of regulations, offering a certain action model. Contrary to harmonisation, Europeanization provides the idea of open diversity. The result of Europeanization may be diversity of regulations, increased competition or its distortions. See Matei, A., Matei, L., 2009, Globalization and Europeanization. A Projection on a European Model of Public Administration, Available on SSRN: <http://ssrn.com/abstract=1310129>; Matei, L., 2009, Romanian Public Management Reform, Volume 2, Civil Service, Economica Publishing House, Bucharest, Romania, Available on SSRN: <http://ssrn.com/abstract=1470028>.
- (3) A unified Instrument for Pre-Accession Assistance (IPA) replacing CARDS, PHARE, ISPA and SAPARD pre-accession programmes was introduced in the financial perspective 2007-2013.
- (4) Annex to the Commission Regulation No. 718/2007 of June 2007 implementing Council Regulation No 1085/2006 establishing an instrument for pre-accession assistance (IPA).
- (5) Official Gazette No. 141/2006.
- (6) In September 2004 the Government of the Republic of Croatia adopted the first PIFC Strategy. In the same year the Memorandum of understanding on administrative cooperation between the Ministry of Finance and the EC Directorate General for Budget was concluded.
- (7) By the second quarter of 2008 the reports were sent to the National Fund, after that and in accordance with amendments of procedures, the reports are sent to the Department for Combating Irregularities and Fraud. The Department reports to the NAO on the detected irregularities. The Department also reports to the European Commission – OLAF and respective DGs on behalf of the NAO.
- (8) The system for combating fraud and corruption.
- (9) New Budget Act was published in the summer of 2008 (OG No. 87/2008), and entered into force on 1 January 2009.
- (10) Programmes consist of measures, measures consist of priorities and priorities consist of projects.
- (11) Financial Perspective lasts for seven years, and the implementation of the Financial Perspective 2007-2013 is ongoing.

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