PROJECT INFORMATION DOCUMENT (PID)
IDENTIFICATION/CONCEPT STAGE

Report No.: PIDC22139

Project Name	Technical assistance for reform of financial reporting in Serbia
Region	EUROPE AND CENTRAL ASIA
Country	Serbia
Sector(s)	Public administration- Financial Sector (20%), SME Finance (10%), General finance sector (70%)
Theme(s)	Corporate governance (10%), International financial standards and systems (70%), State-owned enterprise restructuring and privatization (20%)
Lending Instrument	Lending Instrument
Project ID	P154862
Borrower Name	IBRD
Implementing Agency	111Ministry of Finance
Environment Category	C - Not Required
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Estimated Date of Approval	08-Jan-2016
Initiation Note Review Decision	The review did authorize the preparation to continue

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I. Introduction and Context

Country Context

Serbia is currently classified as an upper middle-income country, but it faces significant challenges to maintain and improve competitiveness and living standards. As of 2013, Serbia has a GDP of US $42.52 billion and Gross National Income (GNI) per capita of US $ 5,730. However, of the population in the country (about 7.2 million), about 20% are over the age of 65. The ratio of formally employed workers to retirees is about one to one. As of 2013 unemployment is over 20%, and only 47 % of Serbia’s working age population is employed, one of the lowest rates in Europe. Almost 20% of the working age population, and as much as third of those actively employed, work in the public sector, including in the large sector of State-Owned Enterprises (SOEs), many of which are bloated with excess workers and uncompetitive.

Serbia was later than other post-socialist countries in launching serious efforts to create a market economy, beginning only in 2001, after a decade of conflict and international isolation. From 2001 through 2008, Serbia experienced continual annual growth in its GDP, ranging from about 2.5% to about 9.3%, for an average of about 5%. The country was then hard hit by the financial crisis, suffering four years of contraction or anemic growth before recovering to a 2.5% growth rate in 2013. Then, in 2014, the country experienced devastating floods and is expected to register a decline in GDP for the year. The National Bank of Serbia also currently forecasts that GDP is not likely to grow in 2015 because of anticipated austerity measures and consequent contraction of consumption.

The business climate is relatively unfavorable, and does not appear to be significantly improving in recent years. In 2015, Serbia ranks 91st of 189 countries in the ease of doing business, a decline from 77th in 2014. For comparison, Croatia and Slovenia—other former Yugoslav Republics that have since become part of the European Union—rank 65th and 51st, respectively, for 2015. Serbia also fares relatively poorly in Transparency International's Corruption Perceptions Index, but with some modest recent improvement, ranking 72nd out of 177 countries for 2013, up from 80th in 2012 and 86th in 2011.

According to the World Bank's 2015 Systematic Country Diagnostic ("SCD") for Serbia, to achieve broad based and sustainable growth, Serbia will need to promote higher investment, increase productivity, and improve external competitiveness. It especially needs to improve its governance and institutional capacity to implement reforms; tackle the large and unfinished agenda of restructuring and privatization of SOEs; make its regulatory and business environment more predictable and friendly; ensure that fiscal policy is sustainable; improve access to finance; and invest in infrastructure and trade and logistics.

Improvements in the quality and use of financial reporting should play an important role in this reform agenda. Developing a more attractive business and investment climate depends in part on improving transparency and financial discipline in Serbian businesses. Sound financial reporting frameworks and practices can help improve business governance, provide foreign and domestic investors with reliable and useful information to assess businesses for potential investment, and enhance public accountability of business. High-quality financial reporting should improve investor confidence, increase the flow and efficiency of credit and other forms of finance, and contribute to the long-term growth of the Serbian economy. In addition, better understanding of financial reporting and other financial information from SOEs would assist Serbian authorities in conducting successful privatizations on favorable terms and monitoring and restructuring those enterprises that remain in state hands. Finally, Serbia needs to conform its laws, standards, institutions, and practices in financial reporting to the EU's acquis communautaire ("the acquis") to support its accession efforts, which will lead to increased trade and investment.

Sectoral and Institutional Context

The World Bank performed a comprehensive assessment of the accounting, financial reporting and auditing requirements and practices within the enterprise and financial sectors in Serbia in 2004. The resulting Report on the Observance of Standards and Codes (A&A ROSC) for Serbia was issued in 2005 and is publicly available . This report noted certain progress in corporate financial reporting ("CFR") reforms achieved by the country, highlighted the main areas of weakness in the financial reporting infrastructure, and provided a series of recommendations for improvements in statutory framework, institutional capacity building, and strengthening accounting education and literacy in the Republic of Serbia, including:

- Serbia should amend its laws and regulations in a manner that is consistent with the acquis.
- Serbia should create a business registry to accept filings of legal entity and consolidated financial statements, together with the auditor's report (where applicable), and to make these documents readily publicly available
- A program should be developed to specifically target the significant need for training, retooling, and capacity-building for accountants in industry.
- Serbia should modernize and strengthen its institutional framework governing financial

reporting and auditing by creating:
o A quality assurance system for the audit profession, in line with the requirements set forth in IFAC's Statement of Membership Obligations and the acquis, to ensure that auditors comply with applicable auditing and ethical standards, as well as independence requirements.
o A 'Chamber of Auditors', constituted as a professional body enjoying delegated regulatory authority. The Chamber should regulate "external auditors," i.e. those responsible for financial statement audit in accordance with "full ISA."
o A public oversight body, consisting of a majority of non-practitioners, to oversee the Chamber in its quality assurance functions.

- An active role for regulatory authorities at least in the enforcement of accounting standards in the general-purpose financial statements of public interest entities

Since the 2005 A & A ROSC, Serbia has made significant progress in conforming its formal laws and standards to requirements of the acquis and other international norms, and also in establishing some of the institutions necessary for a robust framework of financial reporting. A business registry was created and put into operation. The Accounting Law of 2013 largely conformed Serbian law on accounting to the acquis as it then existed. Serbia transposed into its own statutory framework the requirements of the EU's 2006 Statutory Audit Directive. A Chamber of Auditors was created and recognized by law, and has since then developed a system of quality control inspections for auditors and conducted its first round of inspections. A Public Oversight Board was created, governed by a majority of non-practitioners, and now oversees the Chamber.

However, actual practices in accounting, auditing, and financial reporting and the capacities of relevant regulators and other authorities are still in need of significant improvement. Further, 2014 changes in the acquis will also require significant changes in the framework for regulation of auditing. Finally, the size and significance of SOEs in the economy, and the need to privatize or restructure them, create a need for the Ministry of Finance, the Privatization Agency, and other relevant authorities to enhance their capacity to understand, analyze, and use financial reporting and other financial information from SOEs.

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Relationship to CAS/CPS/CPF

The World Bank is currently finalizing a new SCD for Serbia, which will lead to a new Country Partnership Framework ("CPF'). This Project will help address some of the growth constraints and institutional deficiencies identified in the SCD process, and is consistent with the existing (2012-215) Country Partnership Strategy ("CPS").

The Concept Note for the Serbia Systematic Country Diagnostic (SCD) has noted, among other things, that (1) Serbia needs to improve governance, institutional capacity, and the quality of regulation affecting the business climate, and (2) Serbia has a substantial number of inefficient and often insolvent state owned or socially owned enterprises that still need to be reformed, privatized, or phased out. Meanwhile, the existing World Bank Country Partnership Strategy (CPS) for the period FY2012-2015 rests on two pillars. The first focuses on strengthening competitiveness through a continued focus on financial sector stability, SOE reform and investment climate reforms related to property rights. The second focuses on improved efficiency and outcomes in public spending.

With respect to the constraints on growth identified in the SCD, this Project will help strengthen capacity in relevant institutions responsible for overseeing corporate financial reporting. Further,

the Project seeks to improve the quality of regulation in the area of CFR by helping Serbia conform to the acquis and develop regulations that improve quality with due regard to avoiding unnecessary costs for business. Better regulation of financial reporting will improve the business climate by promoting transparency and sound corporate governance, making it easier, less costly, and less risky for foreign and domestic investors to finance growing businesses. Further, better regulation of financial reporting, and better quality reporting, will enhance trust in reported financial information, eventually leading to an environment where lenders may be willing to provide financing based on reported cash flows and income rather than on collateral, which would substantially increase access to finance. Finally, better regulation and use of financial reporting and other financial information from SOEs would help support Serbia's efforts to privatize some of its SOEs on favourable terms and restructure and reform others.
Similarly, the Project would support the two pillars of the existing CPS through its support for SOE reform and promotion of financial sector stability through improved financial transparency. Further, the Project could indirectly assist in tax collection through improved business transparency.

II. Project Development Objective(s)

Proposed Development Objective(s)

The Project's development objective is to establish and implement a sound institutional framework for corporate financial reporting, drawing on good international practices, and to build capacity for preparing, teaching, regulating, auditing and using reliable financial reporting.

Key Results

Statutory framework for corporate sector accounting and financial reporting revised to meet international standards and conform to the acquis, including updated by-laws; IFRS translation process is established. Financial reporting practitioners and stakeholders are adequately prepared to apply the IFRS and IFRS for SMEs as applicable, or to rely on the financial information published.
Audit public oversight board institution equipped with appropriate regulations, procedures and tools to fulfill its function; POB board members and staff of the public oversight institution trained.
Quality Assurance System institution equipped with regulations, procedures and tools for its effective implementation and QAS inspectors trained and equipped with appropriate knowledge, skills, and tools.
ISA translation process is established.
Auditors and stakeholders are adequately prepared to apply the ISAs as applicable or to rely on the audit reporting information published.
Tertiary level accountancy education benchmarked with international standards and best practices. This includes development of the report with the recommendation on the best curriculum model for the university sector.
Professional educational programs for auditors upgraded and aligned with the EU audit directive international standards and good practice. This includes the development of the toolkit for strengthening and delivering CPD courses for auditors.
Professional educational programs for accountants upgraded and aligned with the International Education Standards and good practice. This includes the development of a toolkit for strengthening and delivering CPD courses for accountants.
Improved monitoring, understanding, and use of financial reporting and other financial information from SOEs

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III. Preliminary Description

Concept Description

A. Concept

This Project will use a multi-pronged strategy to enhance formal laws and standards, knowledge, institutions, and practices in CFR in Serbia (including reporting for State-owned Enterprises). An effective approach should support adoption of formal laws, standards, and other rules governing financial reporting and auditing that are consistent with international good practices; enhance the education of future accountants and auditors and support the continual upgrading of knowledge and skills by current practitioners; develop the capacity of regulators, professional bodies, and other authorities to monitor, use, and improve the quality of financial reporting and auditing; and enhance the understanding and use of financial reporting in the broader economy and among members of the public. This Project addresses all of these needs through its component activities.

The Swiss State Secretariat for Economic Affairs (SECO) expressed their interest in financing implementation of the Project, focusing on building sound statutory framework, strengthening institutional capacity of the parties involved, improving monitoring and use of financial information from SOEs, and enhancing the accountancy education and literacy, including raising public understanding and awareness of financial reporting. The World Bank Project team has informed all the key development partners active in the Republic of Serbia about its intention to support implementation of the Strategy with donor grant funding, thus opening a possibility for mobilization of additional grant financing for the second, follow-on phase of the Strategy.

The Project is planned to be 60% Recipient-executed and about 40% Bank-executed. In general, the Bank-executed programs are those perceived to require the closest involvement and most expertise from the CFRR.

1. Description

To address the current capacity challenges (described in section I.B above) and align the Project's design with the Government's Strategy to enhance and develop financial reporting and auditing framework, the project activities will comprise five components with the following implementation arrangements:

- Component 1 [Recipient executed]: Completing and Enhancing the Accounting and Financial Reporting Framework. Through this Component, (a) analysis will be performed of Serbia's existing legislation, bylaws, rulebooks, and charts of accounts governing financial reporting, including recent changes made to the Law on Accounting, resulting in an assessment of gaps between Serbian formal laws and standards and good international practices, including the acquis, and appropriate amendments will be proposed; (b) support will be provided to develop a sustainable process for translating and adopting IFRS standards; (c) support will be provided to the Ministry of Finance to enhance its capacity to monitor and regulate corporate financial reporting; (d) a technical guide will be designed describing approaches and methodologies for conducting policymaking activities including for updating concordance tables and maintenance of relevant webpages on the Ministry of Finance website; (e) training in use and application of IFRS will be provided for financial reporting practitioners; (f) events and activities will be conducted to promote public understanding and awareness of the importance and uses of financial reporting.

The Ministry of Finance will be responsible for implantation of this component, with enhanced implementation support from the World Bank's Centre for Financial Reporting Reform (CFRR). This Component will be allocated 32% of the total funding of the Project (Euro 1,090,000).

- Component 2 [Bank executed]: Building an Effective Audit Oversight and Quality Assurance System: Through this Component, the Project will (a) support development of regulations and guidance for Serbia's Public Oversight Board for the auditing profession; (b) help

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develop the capacity of POB members and staff to fulfill their functions; (c) support development of regulations, methodologies, and guidance for audit quality control inspectors; (d) help develop a sustainable system for translation of International Standards on Auditing (ISAs) and provide training to practitioners in use of ISAs; (e) conduct activities and events to promote public and business understanding of the importance and use of external audits.
The Component will be implemented directly by the CFRR specialists and consultants with involvement of various stakeholders, international and local consultants and professional partners. This Component will be allocated 15% of the total funding of the Project (Euro 510,000).

- Component 3 [Recipient executed]: Improving Accounting and Auditing Curricula for University and Professional Education Programs. Through this Component, the Project will support (a) assessment and possible improvement of the accountancy curriculum in the university sector; (b) implementation of effective professional education programs through the Chamber of Auditors and other competent professional accountancy organizations, including pre-qualification education, training, examinations, seminar, and workshops; and (c) provision of assessments, toolkits, and other support for Continuing Professional Development (CPD) programs.

The Ministry of Finance will be responsible for implantation of this component, with enhanced implementation support from the World Bank's Center for Financial Reporting Reform (CFRR). This Component will be allocated about 28% of the total funding of the Project (Euro 950,000).

- Component 4 [Bank executed]: Institutional Strengthening and Monitoring of SOEs. Through this component, the Project will (a) assess the legal framework and practices for state monitoring of financial statements from SOEs; (b) develop a methodology and tools for reviewing the financial reports prepared by SOEs and a dashboard to input and analyze key financial performance indicators, (c) develop the capacity of Ministry of Finance staff and other authorities responsible for monitoring financial reporting from SOEs to use the methodology, dashboard, and guidelines through training courses, study visit(s) to countries with a strong track record in monitoring SOEs, and /or other appropriate capacity-building activities; (d) develop the capacity of staff from the Ministry of Finance, the Privatization Agency, and other relevant authorities to analyze and use financial information from SOEs in fulfilling their functions.

The Component will be implemented directly by the CFRR specialists and consultants with involvement of various stakeholders, international and local consultants and professional partners. This Component will be allocated 15% of the total funding of the Project (Euro 510,000).

- Component 5: Enhanced Implementation Support, Project Management, Monitoring and Evaluation [Bank executed]. This Component will include necessary incremental costs related to enhanced implementation support to the Ministry of Finance, management of the Project, including overall reform management and coordination, monitoring of the reform activities supported under the Project, as well as the Project's fiduciary activities.

This Component will be allocated 10% of the total funding for the Project (Euro 340,000).

The Project will be structured as part of the REPARIS trust fund, implemented jointly by the Bank and the Recipient. The donor grant is yet to be established and documented. SECO expressed their interest in financing the Project over the estimated time of 30 months, for approximately EURO 3.4 million.

IV. Safeguard Policies that Might Apply

Safeguard Policies Triggered by the Project	Yes	No	TBD
Environmental Assessment OP/BP 4.01		x	

Natural Habitats OP/BP 4.04		×	
Forests OP/BP 4.36		×	
Pest Management OP 4.09		×	
Physical Cultural Resources OP/BP 4.11		×	
Indigenous Peoples OP/BP 4.10		×	
Involuntary Resettlement OP/BP 4.12		×	
Safety of Dams OP/BP 4.37		×	
Projects on International Waterways OP/BP 7.50		×	
Projects in Disputed Areas OP/BP 7.60		×	

V. Financing *(in USD Million)*

Total Project Cost:	3.4	Total Bank Financing:	0
Financing Gap:	0		

Financing Source	Amount
REPARIS - Road to Europe Program for ACC	3.4

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