

**Report on
Assessment of capacities
for budgeting
at the local level in Montenegro**

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Acronyms

Acronym	Definition
CAF	Capacity Assessment Framework
CARDS	Community Assistance for Reconstruction, Development and Stabilisation [for the Western Balkans]
CBC	Cross-Border Cooperation
CD	Capacity Development
DIS	Decentralized Implementation System
EC	European Commission
EF	Equalisation Fund
EU	European Union
IPA	Instrument for Pre-Accession
ISPA	Instrument for Structural Policies for Pre-Accession
MF	Ministry of Finance
MI	Ministry of Interior
MDG	Millennium Development Goals
NGO	Non-Governmental Organisation
NP	Neighbourhood Programmes
NTS	The National Training Strategy for Local Governments
PHARE	Pre-accession instrument for Central and Eastern European Countries
SAA	Stabilisation and Association Agreement
SAPARD	Special Accession Programme for Agriculture and Rural Development
TAIB	Transition Assistance and Institution Building
UNDP	United Nations Development Programme
UoM	Union of Municipalities of Montenegro

Executive summary

In order to continue building transparent and accountable public finance system at the local level there was a need to improve overall municipal budgeting process, support fiscal equalisation system and mechanisms at the same time to explore more sustainable approach to financing of municipal infrastructure and capital investments. Therefore, the project “Strengthening mechanisms for public finance at the local level in Montenegro” was initiated by UNDP in partnership with the Ministry of Finance, Ministry of Interior and the Union of Municipalities; financial support was provided by the Kingdom of Netherlands.

The overall objective of the project is to facilitate socio-economic development at the local level through strengthening accountable, transparent and results oriented public finance mechanisms.

The Project “Strengthening mechanisms for public finance at the local level in Montenegro” is designed with a specific purpose to support development of capacities of the municipal stakeholders and stakeholders at the central level to introduce transparent, accountable, results oriented budgeting reflecting capital investments, local and national strategic priorities.

In order to achieve this, the project activities are organized around three pillars (results):

Result 1: Mechanism for transparent and accountable public finance at the local level established and operational;

Result 2: Municipal bonds market in Montenegro is strengthened through better understanding of benefits and opportunities among municipalities;

Result 3: Fiscal equalisation mechanisms in Montenegro further strengthened;

First phase of the project envisaged a comprehensive review and analysis of municipal capacities for budgeting.

UNDP Montenegro has designed and carried out comprehensive assessment of municipal capacities for budgeting, including assessment of capacities of municipal financial departments. This assessment was conducted as a combination of meetings, interviews, questionnaires and review of relevant materials, which provided a basis for the analysis.

Specifically, the assessment focused on few dimensions:

- review and analysis of all the segments of the budgeting process, including budget preparation, public participation, budget execution and financial reporting; this also included and analysis of debt and municipal property management (current practices);
- assessment of capacities to introduce programme budgets at the local level in Montenegro;
- review and analysis of the capacities for preparation and implementation of capital budgets, including identification, planning, priority setting and preparation of capital investment projects; part of this was the assessment of municipal capacities for strategic planning;

- exploration of municipal bonds, benefits and opportunities, for financing of municipal capital investments.

The assessment highlighted that the development of public finance at the local level in Montenegro has to be approached holistically, strengthening all elements of the budgeting cycle (budget preparation and planning; budget implementation, reporting and revisions including budget spending system and audit and financial reporting) and enhancing capacities for capital budgeting, including innovative and strategic options for financing of municipal infrastructure (through effective municipal borrowing and issuing municipal bonds). In addition, the fiscal equalization system, being one of the key components of the local finances, has to be addressed as well.

This report provides overview of the main challenges and provides recommendations related to the mentioned areas:

a) Budget preparation and planning practices in Montenegro: The focus should be to i) Increase capacities to collect and analyse data; ii) Improve the overall budget planning practices (revenues and expenditures planning); iii) Improve capacities for collection of taxes and revenues at the local level; iv) Enhance participation of citizens in local decision and policy-making processes and practices;

b) Budget implementation, reporting and revisions: The focus should be to: i) Improve functioning and strengthen the role of municipal treasury departments; ii) Design and implement budget monitoring system; iii) Strengthen internal control framework at the local level and iv) Support quality and transparency in the reporting practice;

c) Capital budgeting in Montenegro: The focus should be to: i) Improve strategic and investment planning practices in all municipalities in Montenegro; ii) Explore opportunities and benefits from inter-municipal cooperation; iii) Enhance capacities for implementation of capital investment projects and iv) Enhance capacities of municipalities to better understand and approach IPA funds/ EC funding opportunities;

d) Fiscal equalization system in Montenegro: The focus should be to i) Prepare an overview of best practices and models for fiscal equalization; ii) Support preparation of the analysis of fiscal capacities of municipalities; iii) Organize and deliver trainings to municipalities on fiscal equalization system; iv) Provide support to enhance capacities for the members of the Commission for Monitoring Development of the System of Fiscal Equalization; v) Organize study tours and facilitate exchange experience and vi) Enhance cooperation and coordination among the key partners for the reform of public finance system in Montenegro;

e) Financing of municipal infrastructure: The focus should be to i) Enhance capacities among municipalities for management of debt; ii) Improve municipal property management practices; iii) Support municipalities to improve creditworthiness; iv) Analyse the current situation related to municipal bonds in Montenegro and prepare recommendations for the next steps; v) Prepare a user-friendly Handbook for issuing of municipal bonds and vi) Develop training programme on issuing of municipal bonds

1. Introduction

"Strengthening mechanisms for public finance at the local level in Montenegro" In order to continue developing more transparent and accountable public finance system at the local level in Montenegro, a number of needs and priorities that have to be addressed: need to improve the overall municipal budgeting cycle; need to explore more sustainable approach to planning and financing municipal infrastructure and capital investments and need to enhance and improve system for fiscal equalization among municipalities. Therefore, UNDP Montenegro in close partnership with the municipalities, Government of Montenegro- the Ministry of Finance and the Ministry of Interior, the Union of Municipalities and the Kingdom of Netherlands has initiated the project "Strengthening mechanisms for public finance at the local level in Montenegro".

partnership: the Government of Montenegro, the Kingdom of the Netherlands and UNDP

Objective... The overall objective of the project is to facilitate socio-economic development at the local level through strengthening accountable, transparent and results oriented public finance mechanisms.

Purpose... The project is designed with a specific purpose to support development of capacities of the municipal stakeholders and stakeholders at the central level to introduce transparent, accountable, results oriented budgeting reflecting capital investments, local and national strategic priorities.

Results... Activities envisaged within the framework of this project are organized around three results: *Result 1:* Mechanism for transparent and accountable public finance at the local level established and operational; *Result 2:* Municipal bonds market in Montenegro is strengthened through better understanding of benefits and opportunities among municipalities and *Result 3:* Fiscal equalization mechanisms in Montenegro further strengthened.

Specific methodology

Analysis of municipal capacities for budgeting and capacities of financial departments

First phase of the project envisaged a comprehensive review and analysis of municipal capacities¹ for budgeting (municipal/ departmental level) including capacities of municipal financial departments (individual level). Hence, this capacity assessment was designed and carried out in response to the needs of the country for strengthening accountable, transparent and results oriented public finance mechanisms at the local level, as one of development goals towards the country's accession to the European Union.

Data-collection

This assessment was conducted as a combination of meetings, interviews, questionnaires and review of relevant materials, which provided a basis for the analysis.

The data for this assessment were collected by following main sources:

Analysis of documents and materials

i) Analysis of existing materials, documents and available data: to gain an overview of the socio-economic and political situation with special focus on local governance and financing of municipalities. The documents provided information on the current

¹ UNDP defines capacity as "the ability of individuals, institutions and societies to perform functions, solve problems, and set and achieve objectives in a sustainable manner". Capacity development (CD) is thereby the process through which the abilities to do so are obtained, strengthened, adapted and maintained over time. A capacity assessment is an analysis of current capacities against desired future capacities, which generates an understanding of capacity assets and needs, which in turn leads to the formulation of capacity development strategies "Capacity Development Practice Note", UNDP, 2007

development challenges and perspectives, including substantive overview of governance and local governance legal and policy framework. In addition, municipal documents provided information on the organizational structure, existing staff and their structure as well as their duties and responsibilities in the municipalities.

Questionnaires defines according to the core elements of budgeting cycle

ii) Questionnaires were created for municipal finance departments (primarily for the senior level management and professionals within the Secretariats) for all municipalities. The design of the questionnaire was based in the UNDP's Capacity Assessment Framework (CAF)², the Public Expenditure Tracking Survey³ and the EIPA's Common Assessment Framework⁴.

The questions have been grouped according to the core issues:

- Budgeting cycle (including budget preparation, public participation, budget execution and financial reporting and audit and internal control mechanisms);
- Preparation and implementation of programme budgets at the local level;
- Budget implementation, reporting and revisions (including capacities for debt and property management);
- Capital budgeting (including identification, planning, priority setting and preparation of capital investment projects; part of this was the assessment of municipal capacities for strategic planning;
- Municipal bonds as an instrument for funding of infrastructure.

Interviews, meetings

iii) Interviews, meetings and consultations: with the senior level managers at the local level⁵, the officials from the Government of Montenegro (the Ministry of Finance and the Ministry of Interior) and the key national institutions (the Human Resource Management Agency and the Union of Municipalities), the representatives of international organizations operating in Montenegro (The Delegation of the European Union, the Council of Europe, USAID- CHF Montenegro) and the experts in the field of public finance.

Recommendations provided in this report are not only for the purposes of the project "Strengthening mechanisms for public finance at the local level in Montenegro", but it also could serve for planning and programming in the area of local governance in Montenegro in the future.

² See Capacity Assessment Practice Note, UNDP, September 2007 www.capacity.undp.org.

³ The purpose is to track the effect of public expenditure on growth and/or social outcomes; as this tool assess public financial management it can be used for the analysis of public expenditure management reforms, reforms to improve the efficiency of public expenditure, cross-cutting public sector reforms, anti-corruption, and service delivery reforms; for more details, see <http://go.worldbank.org/AGLWHoRV40> or <http://go.worldbank.org/1KIMS413Ko>

⁴ CAF is designed to assist public-sector organizations in using quality management techniques to improve performance; the CAF assesses leadership, civil service management, public financial management, policy-making system and service delivery and it can be used holistically or be part of single unit or department.

Homepage at www.eipa.eu/en/topics/show/&tid=191. English-language brochure with method at www.eipa.eu/files/File/CAF/Brochure2006/English_2006.pdf

⁵ Presidents of municipalities/ mayors, Secretary of the Secretariats for municipal finances, Heads of municipal budget units, Heads of municipal treasury departments...

2. Municipal finances and budgeting at the local level in Montenegro

2.1. Montenegro- background

Structural reforms as the key priority

After declaring independence, Montenegro started the process of rapid reforms, moving towards a functioning market economy. The country recorded significant macroeconomic results in terms of economic and financial sectors growth and improved efficiency of the economy. However, mixed progress on reform of the public sector is affecting the economy of the country. The main challenges that the country is facing remain implementation of laws and policies; reform of the overall judicial system and fight against organized crime and corruption⁶.

Membership to international organizations

Montenegro's vibrant international cooperation resulted in the country's membership to the UN, OSCE, ILO, ITU, ICRC and other international organizations. In 2007, Montenegro also became member of the Council of Europe. In October 2007, Montenegro adopted the Constitution, conform international standards and recommendations of the Council of Europe.

EU candidate status as of December 2010

The Government of Montenegro (GoM) has prioritized the process of European integration as the basis of its principal strategic political and economic development framework. Progress in the EU integration process resulted in Candidate Country status for Montenegro (as of December 17, 2010). In the **Opinion on the membership applications by Montenegro**⁷ the EC concluded that Montenegro is ready to become a candidate country to EU membership recognizing results and achievements and highlighting additional reform priorities. The current Government, led by Prime-minister Igor Lukšić elected on 29 December 2010, is putting high priority of further reforms and the accession to the EU.

Economic growth and challenges

The growth of Montenegro's economy from 2008 was significant, mainly due to large FDI inflows into the tourism sector, real estate and banking. This, initial economic boom was replaced with decline across all macroeconomic parameters in the second half of 2009. The first signs of the global economic crisis started in the beginning of 2009 due to decreased investments in (coastal) real estate and tourism; most of capital assets were already privatized and stock market was recording downfall trends. The economic and financial challenges have different social effects, including the reduction of production and consequently layoff of employees. The Government has initiated a programme for stimulating employment through loans at favourable rates to citizens/businesses. This concentrates in the north as sharp regional disparities exist.

Local governance legal framework

The key laws for local governance legislative framework have been adopted: **the Law on Local Self-governments**⁸ and the **Law on Local Self-government financing**⁹, **the Capital City Law**¹⁰, **the Gender Equality Law**¹¹. In addition, the country adopted the Strategy for Regional Development and consequently, the Law on Regional

⁶ EC "Montenegro 2008 Progress Report"; SEC(2008) 2696; Brussels, 2008

⁷ <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/10/552&format=HTML&aged=0&language=EN&guiLanguage=en>

⁸ Law on Local Self Governments ⁸ ("Off. Gazette of RMN", No. 42/03, 28/04, 75/05, 13/06, "Off. Gazette of MN", No. 88/09 of 31 December 2009) and correction from the Parliament of Montenegro Service, "Off. Gazette of MN", No. 3/10 of 19 January 2010

⁹ "The Law on Local Self Government Financing"; "Official Gazette of the Republic of Montenegro", No. 42/03 and 44/03 (correction) and "Official Gazette of Montenegro", No. 5/08 and 74/2010.

¹⁰ Law on capital city (Official Gazette no. 65/05)

¹¹ Gender Equality Law (Official Gazette no. 46/07)

Development. In addition, the new policy framework for reform of public administration was established, through the adoption of AURUM - the Strategy for Public Administration Reform 2011-2016. Professional advancement of municipal employees is defined in the National Training Strategy for Local Governments. More details on the legal and policy framework for development of good local governance are provided in the following parts of this document.

2.2. Functioning of local self-governments in Montenegro

The Law on Local Self-Governments

The Law on Local Self Government (LoLSG)¹² defines the framework for functioning of local self-government units in Montenegro. However, the Law was revised, with the changes taking effect as of the beginning of 2010; hence, an update on this is required.

Municipal functions: original and delegated and entrusted

The revision of the Law did not bring about significant changes in the functions of local self-governments. Namely, municipalities perform functions of direct and common interest to the local population, further divided in the original¹³ (affairs of primary jurisdiction) and delegated and entrusted functions¹⁴. Some of the functions are very explicitly defined; some others have quite a generic definition, which leaves room for flexibility and local self-initiative. In addition, there are some functions that are in essence shared between the local self-government units and the central level government (e.g. in the area of education and primary health).

The functions of local self-government units are:

Affairs of primary jurisdiction

Affairs of primary jurisdiction: the LoLSG (Articles 29-37) *provides an exhaustive overview of the affairs of primary jurisdictions (original functions)* that a local self-government unit is performing through its bodies and in line with the Constitution and the Law. In general, municipal authorities could be divided into regulatory, administrative, investment and service delivery. The Articles 31, 32, 33 and 34, combined with the other provisions concerning the functions and related authorities, ensure a clear legal frame on what are and how ought to be carried on the “exclusive” functions of municipalities and who is accountable for.

Delegated and entrusted affairs

Delegated and entrusted affairs (both mandatory and non-mandatory): the LoLSG, in the **Articles 38 and 39**, defines ***delegated and entrusted affairs*** of municipalities. The basic principle for delegating/ entrusting function is a more efficient and streamlined realization of the rights and obligations of citizens and fulfilling their needs of direct interest for life and work. Functions could be delegated to municipalities by appropriate laws/ legal provisions. In addition, the Article 39 defines that “municipality conducts affairs delegated to it in the fields of education, primary health care, social and child welfare, employment and in other fields of immediate interest to the local population, in accordance with a special law.

Municipal bodies: Municipal council and President of Municipality

The Law defines municipal bodies, Municipal Council (representative body) and President of Municipality (executive body). The Council delivers the regulations, strategies, plans and program documents. With the latest changes, Municipal Council appoints and removes President of Municipality. This is, however, the major change as previously Mayors (Presidents of Municipalities) were directly elected for a five-year term, while only qualified majority of voters from respective municipality was granted right for an early recall of a mayor. Still, the revised Law kept the provision for citizens

¹² (“Off. Gazette of RMN”, No. 42/03, 28/04, 75/05, 13/06, “Off. Gazette of MN”, No. 88/09 of 31 December 2009) and correction from the Parliament of Montenegro Service, “Off. Gazette of MN”, No. 3/10 of 19 January 2010

¹³ The Law on Local Self-Governments, Articles 29-37

¹⁴ The LLSG, Articles 38 and 39- vested by law or delegated by means of the Government’s regulations

Presidents of Municipalities are elected by the Councils

to initiate recall of a mayor; the recall procedure may be initiated by at least 20% of voters of the municipality¹⁵

Chief Administration

The Mayor is the carrier of executive power in municipality and has wide ranging authority; s/he proposes the delivery of municipal regulations, in charge of their implementation, and carries out the inspection of local government work. The Mayor appoints the Chief Administrator, with the responsibility to manage and coordinate the work of local government/ administrative bodies (secretariats, offices, directorates, etc.). The heads of the local government bodies (secretariats, bureaus etc.) are appointed by the Chief Administrator, sometimes with approval of the mayor and sometimes independently. The Administrator also determines the internal organization and systematization of bodies and services in the Municipality. Lastly, the Chief Administrator supervises the legality and appropriateness of the work of the Communal Police (who ensures communal order in relation to communal activities such as parking, disposal of waste, water supply, sewage etc.).

Municipal administrative bodies established according to the directions of Chief Administrator

The LLSG¹⁶ defines administrative bodies (secretariats, offices, directorates, etc.), which should be established according to the direction of the Chief Administrator and exist to perform the administrative affairs and functions of the municipality. The Mayor also has the authority to establish special agencies to perform affairs that require specific expert and technical knowledge and autonomy in their work. The heads of the local administrative bodies decide on the selection and the position of the employees and about work-stream organization in local government body. Employees at the municipal level perform their duties in accordance with the systematization of job descriptions and tasks that are (in the majority of municipalities) decided upon by the Chief Administrator.

Public services established by the Municipal Council

Public services are established by the Municipal Council for the provision of communal services such as water supply, waste management, sewage, and public traffic. The Council can also establish public services in the field of tourism, education, culture, social and child welfare, employment, primary health care, and in other fields, but only if vested or delegated to the local self-government by the respective Ministry or national authority. Financial resources for the delivery of public services are coming from the municipal budgets.

2.3. Financing of local self-governments in Montenegro

Fiscal decentralization

Fiscal decentralization is not only a question of transferring resources to the different levels of local government. It is also about the extent to which local governments are empowered and about how much authority and control they exercise over the use and management of devolved financial resources. Although the *general concept of fiscal decentralization covers a broad policy area, the four basic "pillars" are: 1) the assignment of expenditure responsibilities to different governance levels; 2) the assignment of tax and revenue sources to different governance levels; 3) intergovernmental fiscal transfers; and 4) sub-national borrowing.*

Law on local self-government financing was

The Government of Montenegro made significant step towards fiscal decentralization of the country with the adoption of the **Law on Local Self-government Financing**¹⁷. The Law, fully in line with the EU best practices, brought about major changes in

¹⁵ The LLSG Article 61

¹⁶ Law on Local Self Government; Part 3: Local administration and public services; Article 70 "Type of the local administrative bodies"

¹⁷ „Official Gazette MNE“, no. 42/03 i 44/03 „ Official Gazette MNE“, „, no. 5/08 and 74 /2010.

**adopted in 2003
and revised in
2007 and 2010**

intergovernmental fiscal relations. The amendments to the Law were introduced in 2007 and then in 2010, striving for additional transparency and more stable financing of local governments.

According to the Law on Local Self Government Financing¹⁸, budget revenues for local government consist of (Article 4):

**Budget revenues
for local
governments**

- 1) Original revenues (municipal own resources);
- 2) Revenues transferred by the law;
- 3) Equalization Fund; and
- 4) State Budget.

The local self-government unit are entitled to the **original public revenues** generated within its territory (Article 5); namely:

**Original public
revenues**

- Real estate tax in accordance with specific law;
- Surtax on personal income tax in accordance with this law;
- Local administrative charges, in accordance with specific law;
- Local communal charges, in accordance with specific law;
- Fee for utility equipment of constriction land, in accordance with specific law;
- Fees for the use of municipal roads, in accordance with specific law;
- Fee for environmental protection and improvement, in accordance with specific law;
- Resources from sale and rent of municipal property;
- Income from capital (interests, stakes and shares, etc.);
- Fines imposed in misdemeanour proceedings, as well as gain confiscated in that proceedings;
- Revenues from concession fee for performing communal affairs and revenues from other concession activities that a municipality concludes in compliance with law;
- Revenues collected by municipal bodies, services, and organizations through their own activities;
- Revenues from grants and subsidies; and
- Other revenues set by the law.

**Transferred
revenues**

As indicated in the Law (Article 25) municipalities in Montenegro are entitled to **transferred revenues** from taxes and fees from the central (national) budget¹⁹; specifically;

- Revenue from personal income tax;
- Revenue from tax on real estate transfer;
- Revenue from concessions and other fees for using natural resources awarded by the State;
- Revenue from annual fees for the registration of motor vehicles, tractors and trailers;

Revenue from fees for use of motor vehicles and their trailers (eco-fee), which shall be paid upon the registration.

The part III of the Law, Financial equalization of municipalities, in the Article 29 defines the mechanism for fiscal equalization through the establishment of the **Equalization**

¹⁸ "The Law on Local Self Government Financing"; "Official Gazette of the Republic of Montenegro", No. 42/03 and 44/03 (correction) and "Official Gazette of Montenegro", No. 5/08 and 74/2010.

¹⁹ Article 25 of the Law on Local Government Financing.

Equalization fund

Fund²⁰. The Law envisages that the resources from the Fund are to be distributed to municipalities which average fiscal capacities per capita in three previous fiscal years are lower than an average fiscal capacity per year of all municipalities for the same period (Article 30).

In order to monitor development of the system and especially in order to provide the equity, efficiency and transparency of the system of fiscal equalization of municipalities, the Law provides for the establishment of the Commission for Monitoring Development of the System of Fiscal Equalization of Municipalities.

Conditional grants from the state budget

The part IV ***Conditional grants from the state budget*** introduces an opportunity for financing of local investment projects, which are of local self-governments' special interest. The Government on the basis of a proposal made by the Ministry of Finance decides on the allocation of the conditional grants.

Fiscal decentralization in Montenegro remains work in progress

However, fiscal decentralization in Montenegro remains a work in progress. A clear definition of municipalities' tasks/ responsibilities ("expenditure assignments") is obviously a crucial first step in fiscal decentralization. But there are also further issues regarding the revenues and expenditures of municipalities such as consolidation of revenues, an objective system for establishing and allocating grants, and municipal property rights and assets.

²⁰ Article 29, paragraph 2: "The resources for the Fund are provided from the following revenues: Personal income tax to the amount of 11% of revenues collected on that basis; Tax on real estate transfer to the amount of 10 % of revenues collected on that basis; Tax for use of motor vehicles, crafts, aircrafts and aero jets to the amount of 100% of revenues collected on that basis and Concession fees from games of chance in the amount of 40% of the revenues collected on that basis.

3. Budget preparation and planning practices in Montenegro

Budget preparation and planning is one of the most critical phases of the budget cycle in which local governments are supposed to project their activities for the next fiscal year.

Two main goals in planning and preparing budgets

There are two main goals within this phase:

- (a) determine the magnitude of budget revenues (from different sources),
- (b) plan and develop list of expenditures (corresponding to the planned programs and activities) through a complex participatory and pro-active cooperation and communication process with beneficiaries.

The Secretariats for municipal finances and specifically the Office for budget planning have a critical role in this process in each municipality as providers of necessary expertise, technical assistance to the budgetary users/ beneficiaries, and as facilitator in the negotiation process through which priorities are set and final version of the budget are approved and adopted.

Three main phases

Overall, there are three main phases of budget preparation²¹: i) Preparing revenue (income) forecasts; ii) Collecting requests from the budgetary units (direct beneficiaries) and reviewing the requests and merging them into the budget and iii) Conduct the public hearings on the budget proposal.

1. Preparing revenue forecasts

1. Preparing revenue (income) forecasts

Budget preparation is revenue driven, as spending must be adjusted to the volume of resources that are available. Usual practice is that each of the major revenues is forecasted separately, like taxes on sales, property sales, and alike. Smaller sources, on the other hand, are usually aggregated, and then estimated based on data from previous years ("historical data")²².

Methods for budget forecasts

Budget revenues could be forecast using four methods²³:

- 1. Experts judgment:** based on the expert knowledge of experienced budget professionals, with profound inside knowledge about the whole budget process.
- 2. Deterministic method:** based on simple mathematical formulas finds its place for forecasting some groups of budget revenues, such as for example property taxes (multiply the value of municipal property with the current tax rate)
- 3. Time series analyses:** is based on trends from the previous periods assuming that the dynamics of certain parameters will continue changing in course of time- example projecting certain types of revenues, like local fines, fees, licenses, etc.
- 4. Econometric or casual models:** is taking into account that certain phenomena (dependent variables) are changing in the time perspective as well as under the influence of other factors (independent variables)- example: projecting the revenues coming from sales taxes and lining them with the rate of employment.

The budget revenue forecasting process is organized around expert's judgment,

²¹ Case Studies in Public Budgeting and Financial Management; Second Edition, Revised and Expanded edited by Aman Khan and W. Bartley Hildreth, Marcel Dekker, NY, 2007

²² Ibidem

²³ Local Government Budgeting A Managerial Approach by Gerasimos A. Gianakis and Clifford P. McCue, Praeger Publishers, London, 1999

Revenue planning in Montenegro's municipalities

although some of the municipalities are using partially each of the described methods. Experiences and qualified staff in municipal financial/ budget departments analyse all budget data from the previous years in order to determine budget revenue items²⁴ that were most stable in the past, since they represent the basis for projections. However, municipalities experienced difficulties to forecast shared and transferred revenues (e.g. equalization funds, etc.).

In addition to experts' judgments in revenues projections, municipalities are using measures of economic policy of Montenegro, as the Ministry of Finance creates an initial revenue evaluation forecast for the budget year and for subsequent years. Some of the elements indicators are rates of gross domestic product growth; price growth; nominal growth of budget revenues, etc.

2. Collecting and evaluating spending requests

Expenditures forecasts

Expenditures Forecasts: Municipalities in Montenegro have similar paths in expenditure forecasting, deriving from the Law on budget. Budgetary users (beneficiaries) prepare spending requests and submit them to municipal financial departments/ budget offices. These requests are then adjusted to the framework set by the projected revenues. In the final stage these requests are merged into the budget draft document, which is then submitted to the public (for the public hearing process) and to the municipal council (for final adoption).

What are expenditures?

Expenditures consist of²⁵:

1. Current expenses, such as outlays for employees, goods and services, interest payments, subsidies, budgetary transfers to other levels of government, social transfers, and other expenses,
2. Outflows for purchase of fixed assets,
3. Outflows for purchase of financial assets, such as given loans and securities,
4. Repayment of principal on borrowing.

All the expenditures requests are calculated in the classification system

Allocation of revenues is successful if we have a well-planned inflow of revenues and expenditures planned in this way.

All the expenditure requests from the direct and indirect budget beneficiaries are calculated using the codes in the classification systems by the finance departments. This enables responsible officers (The Secretary for Finance; The Head of Budget) and the finance department to compare total expenditure request to total anticipated revenues. Based on established criteria, the level and quality of service required from the direct and indirect budget users (relative to the services of local governments as a whole), the final proposals for allocations are made for each of the budgetary users. The final decisions, however, are usually made by the presidents of municipalities (elected officials).

3. Preparing the balanced budget

Balancing the budget

After the final decision on budgetary allocations, the Secretaries for municipal finances have the necessary information to compile a balanced budget. Balanced because some proposals were cut, some were reduced, some were able to generate revenues sufficient to offset the cost and some revenues were increased to offset

²⁴ The analysis showed that the estimation of revenues is structured around different revenue sources; specifically, revenues based on fees; revenues based on contributions; revenues based on other revenues sources; equalization funds, etc.

²⁵ Case Studies in Public Budgeting and Financial Management; Second Edition, Revised and Expanded edited by Aman Khan and W. Bartley Hildreth, Marcel Dekker, NY, 2007

these costs. In the long run the municipality can only spend what it has. Since the demand for continuous outstrips the supply of funds, choices have to be made and a balance struck between raising revenue and cutting costs. Together with the prepared balanced budget, the presentation should be prepared for the citizens (public hearings- reference to citizens participation) and for the municipal council.

3.1. Findings and challenges from budget preparation and planning in Montenegro

Overall, municipalities in Montenegro expressed opinion that they have sufficient capacities for preparation of budgets: the Heads of the Financial Departments (Secretaries for Finances) and the Chiefs of the Budget and Treasury Units are in majority of cases experienced professionals, capable to prepare budgets fully in compliance with the Law on Budget and other key national policies. However, brief assessment showed that, even though the planning is usually done by experienced individuals, planning is done without considering broader context, opportunities, challenges, and future developments.

Some of the key findings and issues related to planning of budgets are presented below:

Lack of data-collection practice

- ***Lack of appropriate data to enable accurate planning:*** municipal employees emphasized that data (information and indicators) are collected and used mainly for budgeting purposes: each department is trying to present as reliable data as possible, since it determines the amount of money allocated for it. Some of municipal representatives underlined that budgeting is done “mainly intuitively, without reliable data”, hence, municipalities are performing (almost as a practice) budgetary rebalances.

Municipalities in Montenegro do not have central and unified database; there is a lack of exchange of information and data between different municipal departments, as well as between municipalities and national institutions with sub-offices at the municipal level (such as the offices of national employment service and the social welfare centres, for example).

Planning and collection of local revenues

- ***Need to improve planning and collecting of local revenues:*** majority of municipalities in Montenegro takes a “passive approach” as the basis for revenues planning. This in practice means that the local revenues are calculated on the basis of the actual amount of revenues raised in the previous years, increased for a certain percentage.

However, majority of municipalities do not consider the option to expand tax-basis through more active approach to collecting revenues.

This is the case with the collection of immovable property tax, as one of the key financial resources. Municipalities rely on the database of the national cadastre office, which does not have up-to-date information. This is further complicated by the fact that the significant percentage of the immovable property is not transferred to the actual owners (due to customary law, unresolved inheritances, etc.).

In addition, municipal leaderships use often “populist policy” justifying low percentage of the property tax collection by the fact that the majority of taxpayers in their respective municipalities live close to or even below to the poverty line. Increased level of tax collection would make this situation even more difficult. This is certainly one of the main obstacles for sustainable development of municipalities. Therefore, there is a need to enhance “administrative capacity in the area of tax-collection, raise

awareness about the importance of respecting the rules of taxation and to show clear political will to keep a consistent tax policy at the local level. It is necessary to define new mechanisms to strengthen the capacity of local inspection, but certain models of the passive system of payment of certain fees, fines and the like²⁶.

Need to introduce more systematic approach in defining expenditures: municipalities in Montenegro in general have sufficient capacities to prepare, analyse and finalize projections of expenditure.

However, the main challenge in defining expenditures is to ensure realistic inputs from direct and indirect budgetary users. As expressed by municipal finance departments, in majority of cases received projections are based on unrealistic calculations: direct and indirect budgetary users don't have well-established planning practice, hence, they use the approved amounts from the previous years, increased for certain percentage.

The assessment showed that municipal finance secretariats/ budget units don't use transparent and participatory process to make final adjustments of the proposed expenditures from the budgetary users. Most of the time, the decision is made on an ad-hoc basis, without sound justifications.

In addition to this, a brief assessment of the current situation in municipalities in Montenegro showed that administration is fragmented, and coordination mechanisms are generally inadequate to overcome parochial bureaucratic interests. Municipal employees are mainly concerned with their own tasks and responsibilities, and in general they have rather limited knowledge on activities in other departments. This affects to a large degree exchange of information and coordination of policies and activities; including preparation of budget.

Need to improve municipal property management practices: current practices in management of property need urgent changes; some of the key identified problems are with:

- registration of municipal property- currently there is no information on municipal property available;
- perception of municipal property: property is perceived in majority of cases as an original revenue source and majority of municipalities consider options to sell property without thinking about broader perspective;
- utilization of property: general lack of idea how to maximize benefits from available property.

More strategic approach to property management in all municipalities in Montenegro has to be introduced, with the overall objective how to boost profit and benefits from the existing property.

Insufficient citizen participation in preparation of municipal budgets: municipal administrations including municipal finance secretariats/ budget units are more bureaucratic than managerial in orientation. Municipal employees execute orders, which in general relate to administrative measures and processes for preparation of budgets (and on more general level, the whole municipal service delivery system is based on similar premises).

²⁶ Government of Montenegro: "STRATEGY OF PUBLIC ADMINISTRATION REFORM IN MONTENEGRO 2011-2016 "AURUM"; Podgorica, March 2011.

Namely, the review showed that the municipal finance secretariats and its units (as in general municipal administration are not accustomed to considering the citizens as the key stakeholders who are entitled to influence the budget and budget preparation process. Citizens' participation in preparation of budgets was assessed as the weakest point of civic participation and it represents the greatest cause of citizen dissatisfaction with local governments. Municipalities organize public hearings and presentations of budgets; however, there is almost no interest and the turn-out is rather low.

Forms of citizen participation have been classified, according to their intensity and legal impact, into four main groups²⁷:

- **the right to direct participation in decision-making** (forms of direct democracy, i.e. direct citizen participation in decision-making, such as: assemblies of all citizens, referenda, public or citizen initiatives and forms of local community government);
- **the right to make proposals and public criticism** (forms of citizen participation in proposing decisions and criticizing the work of representative bodies, such as: citizens' meetings, petitions and/or individual proposals, complaints and requests);
- **the right to consultation** (forms of citizen participation in establishing priorities of a local community, such as: panels and other types of political consultations, public debates, consultations via electronic media and the Internet, participation in the work of service user councils and other advisory bodies); and
- **the right to information** (forms of exercising the citizens' right to be provided with the information on activities, plans and intentions of representative bodies, situation in a local community and other information of public concern).

On the citizens' side, the prevailing opinion is that transparency and accountability in preparation and appraisal of municipal budgets are missing: municipal officials organize public hearings without genuine interest and commitment to change anything in already set budgets, hence, the impact of public hearings on the content of the budget is non-existent. In addition, municipalities never report to citizens on the progress in implementation of the budget and on the achieved results.

3.2. Key recommendations

Increase capacities for data collection and analysis

Increase capacities to collect and analyse data: It is not feasible to address all the problems related to data-collection within a framework of one project; however, it will be recommended to start with some of the most obvious and most disturbing problems. Therefore, the recommendations are twofold: focused on immediate problems, at the same providing the basis for more comprehensive follow-up approach to improve data-collection, monitoring and evaluation and policymaking in Montenegro.

Training programme

Design and implement training on collection and use of data in budget preparation (planning): the target group for this training should be municipal officials and top-level managers (mayors, deputy mayors, chiefs of administrations, heads of secretariats for finances, etc.). This could be a basic training, emphasizing importance of data collection and analysis for the policy and decision makers at the local level, especially during the budget planning and preparation phase.

²⁷ Adjusted based on "CITIZEN PARTICIPATION AT THE LOCAL LEVEL- Analysis of the legal framework and policies in Serbia and other European countries" (Research of the current situation), SCTM, 2006

Central database in pilot municipalities	<i>Explore opportunities to support establishment of a central database in pilot municipalities:</i> in order to further facilitate evidence-based policy making, it could be innovative (and useful) to consider establishment of a central database in pilot municipalities in Montenegro ²⁸ . The central database could be located at the Mayor's offices or if established, at the offices for local economic development. ²⁹
Capacity development program will comprise of	Improvement of budget planning practices (revenues and expenditures planning): it is recommended that the program include a well-balanced combination of training, on-the-spot mentoring and study visits.
Trainings	The training should build on the results of the training on data-collection and analysis and include more focused approach to budget planning (revenues and expenditures planning). Especially important will be to include representatives of direct budget users in the training, so as to ensure common understanding of all stakeholders in the process.
On-the-job trainings	It is recommended to provide coaching support through a direct, on-the job assistance. The most effective way is to facilitate horizontal peer-to-peer knowledge sharing, by using experienced and highly qualified experts and professionals from Montenegro (e.g. the data-base of immovable properties established in Bar municipality, experience from Tivat in data-collection, experience from Andrijevica in budget-planning, etc.).
Workshops and round-table discussion	Part of the capacity development program should be workshops, round-table and panel discussions, where different aspects of the budget planning processes, setting priorities, and implementation will be discussed. Subjects of the workshops will be defined in close cooperation with the key partners, the Ministry of Finance and the Union of Municipalities (some subjects that emerged during the assessment are: The Law on Local Governments Financing and its impact on sustainable municipal finances; Municipal finances in the times of financial crisis, etc.)
Study tours	The assessment confirmed that study tours should be part of the capacity development program, with purpose to expose professionals from Montenegro to the EU best practices in budgeting.
Increase collection of revenues	Assist municipalities to increase collection of revenues: in order to increase collection of revenues, it is recommended to have a two-fold action: a) to increase the tax basis and b) to increase efficiency and effectiveness in tax collection.
Increase tax-basis	It is recommended to assist municipalities in their efforts to increase the efficiency of tax administration, especially in regard to collection of public revenues. The first step could be the establishment of an adequate and up-to date data-base with information and records of all taxpayers from the respective municipality (in accordance with the Law on Tax Administration). This needs to include registration of immovable property in municipalities; hence, coordination in data-collection and communication for the establishment of a comprehensive and up-to-date base between municipalities and the Directorate for property (the Cadastre Office) needs to be established.
Increase efficiency and effectiveness in tax collection	In parallel with this, municipalities have to work on strengthening capacities of the employees in these departments, by addressing identified capacity gaps through a demand-driven capacity development program.

²⁸ Possible solution could be to organize this activity together with UNICEF and install DevInfo data-base; of course, it should expand and include other indicators non- traditional DevInfo indicators

²⁹ Municipalities could have different proposals, depending on existing structure, available capacities and/or political decisions..

Possible topics for improvement of tax management

Some of the already identified topics are: Introduction to Taxation and Tax Reform; Market Value-Based Taxation of Immovable Property; Personal Income Taxation; VAT; the Legal framework (the Law on Tax Administration, the Law on local self-governments financing, etc.); Tax Auditing: Basics and Advanced Level; Change Management in Tax Administration.

It is important to highlight that the assessment revealed results and progress of some municipalities in establishment of efficient and effective municipal tax administration; these examples are municipalities Bar, Tivat, Kotor, Danilovgrad and Herceg-Novi, hence, the employees from these municipalities could be the resource basis for support to other municipalities.

Increase citizens participation

Facilitate citizens participation in preparation and appraisal of municipal budgets: municipal officials (mayors, councillors) are representatives of citizens in their respective municipalities. It is the obligation of the municipal officials to constantly bear in mind that they represent the citizens living in the municipality, and that they should consider their interests and the general interests of the municipality in making decisions. Municipal staff is paid from public money and their role is to ensure that the local administration works properly and that the citizens are satisfied with its work.

The Council of Europe Committee of Ministers expressed the very same view in 1981 (1 Recommendation No. R (81) 18 concerning participation at municipal level) by stating that it is "necessary to strengthen representative democracy at the local level by bringing decision-making as close as possible to the citizens and involving citizens more directly in the management of the affairs of their community while safeguarding efficiency in the conduct of local affairs".

Therefore, first step should be to *facilitate better understanding of citizen participation* and benefits from citizen participation at local level (*awareness raising* on citizen participation). Municipal leaders need to organize regular, quarterly meetings to present budget balance and results achieved so far; at the same time, they need to report on priorities recognized by the citizens and supported through the budget.

At the same time, based on current situation and capacity level in different municipalities in Montenegro, activities could be initiated to *establish more permanent and functioning communication* with citizens on implementation of budgets; therefore, it could be necessary to consider innovative approaches by introducing IT/ SMS techniques in informing citizens on budget balance/ status, etc..

Next to these two activities, citizen participation should be mainstreamed through other activities; e.g. preparation of municipal strategic/ development plans that should promote an outward approach among elected representatives and municipal staff.

4. Budget implementation, reporting and revisions

Funds are activated and spent

Execution of the budget is a phase where budget funds are finally activated and are being spent in the course of the implementation of the activities anticipated by the adopted budget. In this sense, execution of the budget can be considered a simple continuation of the budget planning process, and therefore, the manner in which this phase is carried out largely depends on the quality of work invested in the planning phase.

Stages in budget execution

Budget execution is carried out through the following stages:

- Allotment of appropriations and transfer of budget funds to budget beneficiaries (transferring financial assets to their accounts): after the budget is adopted in accordance with the relevant legal regulations, the transfer of financial assets to beneficiaries follows (in accordance with the defined procedure), usually in respective parts - appropriations for certain periods (monthly or every three months).
- Undertaking commitments (ordering goods and services and/or awarding contracts): budget beneficiaries engage in payment obligations that come into effect when the contracting parties fulfil the terms of the contract.
- Managing commitments: keeping track of commitments that are entered in this process, both of those that are made through appropriate legal means (signed contracts, dispatched orders, and the like), and those that by their nature arise by confirmation.
- Receiving goods and services and verifying receipt: suppliers have delivered goods and services to budget beneficiaries, in accordance with the appropriate procedure, confirmed by the appropriate department and authorized persons.
- Payment: funds are transferred to suppliers, for performed services and delivered goods.

Budget execution comprise of

Budget spending

and

Budget monitoring

During the budget execution, participants in the budget process are faced with a number of problems; namely, there is always a risk that discrepancies might appear between some of the parameters on which the projected budget is based and the projected values. This can include changes of macroeconomic indicators (inflation, GDP growth, foreign trade exchange, etc.) and changes of the indicators at the local level (economic activities in local communities, efficiency in applying economic policy measures, etc.). Possible discrepancies of this type require a prompt response that will keep the budget process in projected margins, and what is most important - in balance.

Bearing this in mind, the budget execution at the local level in Montenegro will be analysed through two pillars: **Budget spending and Budget monitoring (Internal control, budget accounting and auditing)**.

4.1. Budget spending system:

Three elements of the budget spending system

As indicated in the policy and legal documents, the budget spending system in Montenegro operates through its key elements: i) allocations of funds (appropriations); ii) public procurement system and iii) treasury and cash management system.

Allocations of funds

The adopted budget is political approval for municipal authorities and budgetary users to spend determined amounts; however, the assumption is that the planned income of

1. Allocation of funds resources is achieved while at the same time expenses remain on the planned level. Funds are usually allotted for a year³⁰; however, practical budget implementation implies continual adjustment of financial plans to ensure budget balance.

Since revenues are not collected evenly throughout the year, budget managers should always monitor their inflow, in order to be able to allocate funds to beneficiaries in due time.

Imbalances... *Imbalances may be caused by different reasons³²:*

- Budget indiscipline. Beneficiaries enter into commitments that exceed their adopted budget, piling up overdue bills.

- "Special agreements" In countries in transition it is not an uncommon practice to use the so-called "special agreements" for payments outside budget appropriations. They are usually registered on special accounts, evading control and audit procedures.

- Poor preparation of the budget. Also, deficit often appears due to mistakes in budget planning, when actual needs for funds for specific purposes are simply overlooked.

- Political reasons. Political reasons may have an impact on overstepping budget limits when, for example, certain municipal political entities manage to impose their requirements through legal procedures, irrespective of existing budget limits.

Reactions to deficit *Reactions to budget deficits*

Amendments: formal instruments in order to secure that the budget remains in balance, through legal processes that approve all the discrepancies between the planned and actual amounts spent.

Budget Sequestration³² / Rescission³³: the reduction of the budget applied when revenues won't suffice to cover all the planned expenditures.

Line item control: budget beneficiaries are obliged to adhere to them strictly in the process of budgetary spending.

Public procurement

2. Public procurement Public procurement is a process where goods and services are provided for the needs of the public sector (state on different levels). Procedures used in this process must provide equal terms for all the suppliers and minimize the possibility of corruption.

The public procurement cycle includes the following basic phases:

Phases in the procurement cycle

- determining the needs of beneficiaries and preparing projects;
- defining the public procurement procedure: Law on Public Procurement in Montenegro defines different tender procedures (open, limited and restricted) depending on the type and the scope of procurement;
- tendering process (in line with the Law).

Treasury

3. Treasury The Law on local self-governments financing³⁴ provides for the establishment of a consolidated treasury account, which should serve for all payments. Hence, the Treasury

³⁰ This means that any amount of appropriations that hasn't been spent by the budget beneficiary by the end of a current fiscal (budget) year can no longer be spent, and the authority given for it expires.

³¹ Reinventing Budgeting: The Impact of Third Way Modernization on Local Government Budgeting by W. B. Seal and Amanda Ball, Elsevier, 2008

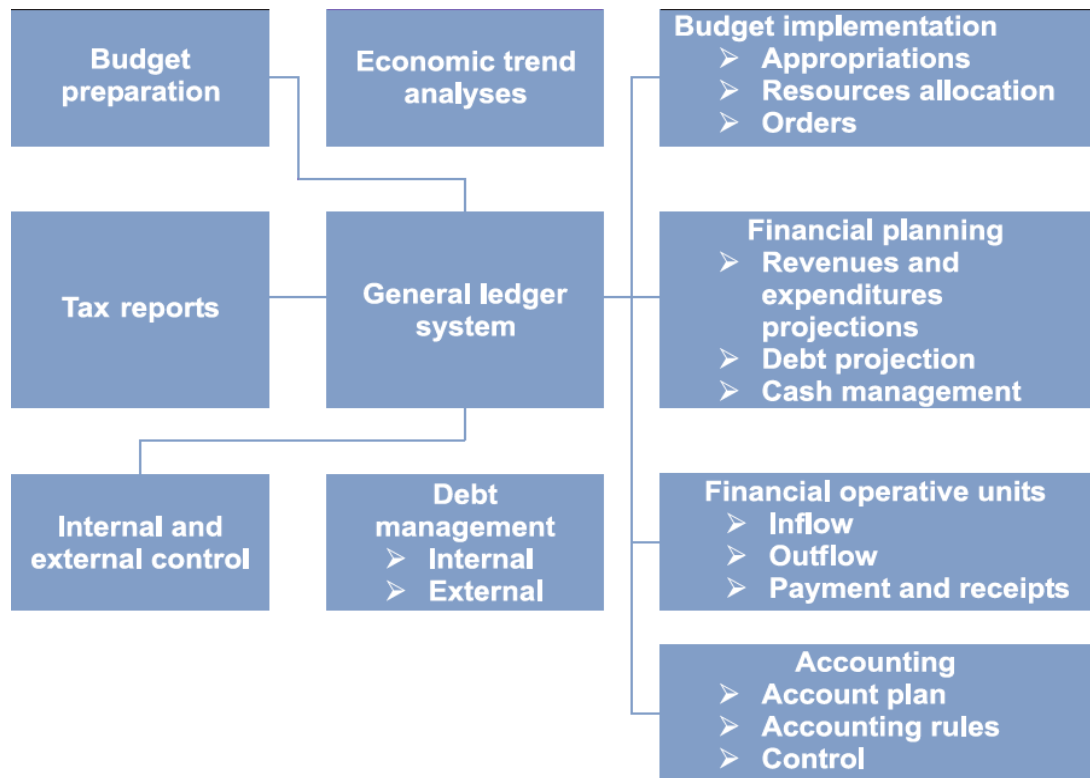
³² Sequestration -In law, temporary judicial measure of appropriating disputed items from the hands of litigants and handing them to a sequestrator for safekeeping, until the final decision is made regarding the rightful owner. Source: Vukasin Stanojevic, English-Serbian Business Glossary, Prometej, Novi Sad, 1998.

³³ Rescission -Right of one party to cancel contractual relations.

has a key role in the financial management of public finances;

Graph 3: Basic functions of the treasury

Functions of the treasury



As indicated further in the Law (Article 67) "local administration body in charge of finance activities shall perform the treasury duties by executing the following functions". These functions are specified as follows: 1) Financial planning; 2) Cash management; 3) Expenditures control; 4) Debt management; 5) Budget accountability and reporting and 6) Managing financial information system.

4.2. Audit and financial reporting

Financial reporting

The Law on budget provides a framework on reporting

The Law on Budget³⁵ provides the framework for financial reporting; specifically, it emphasizes that the Ministry of Finance is in charge to define reporting framework, by prescribing budget accounting procedures, submission of reports on the usage of budget funds, and the manner of recording receipts, expenditures, commitments, concessions, capital projects and programme budget. In addition, the Ministry is authorized to issue special orders for submission of financial reports to the spending units and municipalities.

The Law on Local Self-Governments Financing stipulates that the budget accountability and reporting is one of the functions of treasury³⁶. The Law also defines submission of the final budget statement to the Municipal Assembly.

³⁴ The Law on Local Self Governments Financing

³⁵ Article 47, The Budget Law (OGRM 40/01, 44/01, 71/05, OGM, 12/07 of 14 December 2007, 73/08 of 2 December 2008, 53/09 of 7 August 2009

³⁶ The Law on Local Self Governments Financing, Article 47, Treasury Activities - Budget accountability and reporting, which

Basic elements of financial reports

At a minimum the report should contain:³⁷

- # The budgeted amount
- # The amount spent for the month
- # The amount spent for the year to date
- # The budget amount remaining for the year to date
- # The percent of the budget spent year to date
- # The amount spent last year to date on the given line item
- # The percentage difference in last years expenditures and the current year

The framework for financial reporting at the local level

It is important to highlight that the financial reporting practice in municipalities in Montenegro is defined by the Ordinance on Reporting, which implies preparation of the Statement of Cash Flows - Economic and functional classification, Report on Outstanding Obligations and the Report on the Consolidated Public Spending). In addition, municipalities prepare and submit to the Ministry of Finance: Reports on Planned and Executed Income (POP), Reports on Planned and Executed Expenditures (PIR), Report on Budget Indebtedness (BUZ) and Report on Outstanding Obligations (NEO)

The bases for the Ordinance on Reporting are the Regulations on Uniform Classification of Budget Accounts of the Republic, Extra-budgetary Funds and Budgets of Municipalities³⁸ and on the Regulation on the preparation, compilation and submission of financial statements on budgets of the extra-budgetary funds and local government units³⁹.

Internal control, budget accounting and auditing

The Law on Budget defines the framework for internal control

The Law on Budget highlights that the responsibility for accounting and internal control of transactions related to receipts, commitments and expenditures of spending units and sub-units rests with the budget executors (including municipalities)⁴⁰. This provision clearly separates the responsibilities of the budgetary users (municipalities) to utilize approved and allocated funds for implementation of its activities from the central (financial) management system⁴¹.

The Ministry of Finance (MoF) plays the key role in defining the accounting procedures and internal control mechanisms of the budgetary users⁴².

Complementary to this, the Law on Public Internal Financial Control System⁴³ provides rather detailed framework for internal control and auditing of the budgetary users,

includes: Accounting activities for payment processing and inflow registration, maintaining daybook, ledger book, and selected accessory books for all inflows and outflows, and international donations and other types of support; Financial reporting and Accounting methodology, which includes maintenance of the classification system, prescribing rules for budget accounting, and prescribing requirements for internal and external reporting.

³⁷ INTERNATIONAL FINANCIAL REPORTING STANDARDS DESK REFERENCE Overview, Guide, and Dictionary by Dr. Roger Hussey and Dr. Audra Ong; published by: Published by John Wiley & Sons, Inc., Hoboken, New Jersey, 2005

³⁸ "Regulations on Uniform Classification of Accounts for the Republic, budgets of extra-budgetary funds and budgets of municipalities"; "Official Gazette of Montenegro" no. 35/05, 37/05 and 81/05

³⁹ "Regulation on the preparation, compilation and submission of financial statements on budgets of the extra-budgetary funds and local government units"; Official Gazette of Montenegro no. 03/06).

⁴⁰ The Law on Budget, Part VI: Internal control, budget accounting and auditing,

⁴¹ Article 44 the Law on budget

⁴² The MoF prescribes budget accounting procedures, submission of reports on the usage of budget funds, and the manner of recording receipts, expenditures, commitments, concessions, capital projects and programme budget

including municipalities. The focus of the audit is on financial and compliance issues; precisely, internal audit shall help the entity in achieving its goals by applying a systematic and disciplinary approach in evaluating operation of the entity involving risk analysis, assessment of the financial management and control system and recommendations for its improvement. The Law also provides for the establishment of an independent internal audit within the budget executers.

Definition of auditing...

Auditing is a systematic examination of resource utilization concluding in a written report; this is a test of management's internal accounting controls intended to⁴⁴:

- Determine whether financial statements fairly present the financial position and results of operations.
- Test whether transactions have been legally performed.
- Identify areas for possible improvements in accounting practices and procedures.
- Ascertain whether transactions have been recorded accurately and consistently.
- Ascertain the stewardship of officials responsible for governmental resources.

The Supreme Audit Institution

Municipalities in Montenegro are experienced in terms of auditing; the Supreme Audit Institution audited most of them. In addition, and all of them organize audit by external and independent auditors.

4.3. Findings and challenges related to budget implementation, reporting and revisions in Montenegro

The following needs (and challenges) related to budget implementation, reporting and budgetary revisions were identified:

Improve functioning of municipal treasury

Need to strengthen functioning of treasury: in order to achieve efficient function of financial planning, management resources and efficient management of budget accounting, municipalities in Montenegro have established a Treasury, within the Secretariat for Economy and Finance. In some municipalities Treasure department perform better than in the other; therefore, it is recommend analyzing best practices and promoting activities that will enhance capacities of weaker treasury departments.

One of the key issues in functioning of treasury in all municipalities was how to deal with the management of cash funds.

Improvement of budget monitoring system

Need to support establishment of a budget monitoring system: Significant deviations from the anticipated spending pattern signals pending difficulties for the municipality; however, timely identification of problems can reduce any negative impact on the overall budget. Therefore, there is a need for municipalities to establish day-to-day monitoring of expenditures, which should enable decision-makers to monitoring if any department exhibits a rate of spending above the projections. In addition, the system should provide specific information regarding costs and possible reasons for the variance from the budget. Some examples from advanced municipalities in this regard could be presented to others.

Improvement of internal control framework

Need to enhance internal control framework: municipalities in Montenegro need to work on establishment and strengthening of a mechanism for internal control and monitoring of utilization of resources by the budgetary users and different municipal departments. This is required by the legislation, particularly the Law on Local Self

⁴³ Law on Public Internal Financial Control System, Official Gazette of Montenegro 73/08T

⁴⁴ INTERNATIONAL FINANCIAL REPORTING STANDARDS DESK REFERENCE Overview, Guide, and Dictionary by Dr. Roger Hussey and Dr. Audra Ong; published by: Published by John Wiley & Sons, Inc., Hoboken, New Jersey, 2005

Government Financing, the Instructions of the Functioning of Treasury and other national and local documents.

Financial reporting at the local level needs to be improved

Need to improve quality and transparency in the reporting practice: The budget should serve as a source of information for everyone concerned, as the information contained in the budget is the most important evidence for the performance of local governments. Therefore, the budget is the heart of municipal resource administration, but the reporting system is central to the efficient, transparent and accountable budget-implementation process, and at the final instance.

In all municipalities in Montenegro the Secretariat for Local Finances (including its sub-units, the Treasury and Budget) has developed system of projecting and reporting actual expenditures. As described in some of the best examples from Montenegro, municipalities are preparing a report of expenditures whereby they are comparing actual expenses with the budget lines as approved. This is essentially a part of the municipal accounting system, as the practice is that the structure of this report corresponds to the budget classification structure used in the budget document.

However, there are number of challenges related to financial reporting in Montenegro: the reports need to be synchronized and prepared on a regular basis (ideally on a monthly basis) and be publically available. This will enable to make assessments on the operational efficiency of municipalities and to analyse level and quality of services provided by municipalities (e.g. quality of services against payment for services).

Finally, the reporting format, given by the Law, needs to be simplified and adjusted for wider public information, to enable citizens to get a clear overview about implemented activities and assess the level of services provided by municipalities.

4.4. Key recommendations

The following needs (and challenges) related to budget implementation, reporting and budgetary revisions were identified:

Improve functioning of municipal treasuries-

- **Improve functioning and strengthen the role of municipal treasury departments:** in order to improve functioning of municipal Treasury departments, it is recommended to organize and deliver two types of activities. First, it is recommended to organize at least once a year a workshop, with participation of all heads/ employees of the respective municipal Treasuries, together with the Ministry of Finance. These workshops should serve as platforms for sharing peer-to-peer experience; horizontal learning and opportunity to raise questions and concerns to the relevant institutions.

Annual workshops

In parallel, it is recommended to prepare and deliver specific capacity development program that will address capacity gaps in functioning of municipal treasuries (some of already identified topics could be: cash management, financial reporting and monitoring; operational procedures etc.)

Trainings...

Monitoring system for budget execution including proposal for corrective actions

- **Design and implement budget monitoring system:** It is recommended to work on development of a sound budget monitoring system that will promote the principles of "using budget as a control instrument". It is important to understand and distinguish between both types of monitoring (administration control) that are available, specifically: a priori control and ex post monitoring. The monitoring system should include proposal for corrective actions (e.g. transferring funds from another activity within the allowed borders, revising the work plan, reducing the future expenditures, or in more extreme cases, curtailing expenditures not essential to maintaining the most critical services).

However, comprehensive and well-established monitoring system is not currently present among municipalities in Montenegro. Therefore, it is recommended to propose and pilot monitoring system in some municipalities that expressed willingness and commitment to implement it.

***Introduce
internal
control
measures***

- ***Strengthening of internal control framework:*** this is closely linked with the development of a monitoring system; hence, in order to ensure more efficient utilization of (already scarce) resources, firm internal control framework needs to be in place. It is recommended to review more substantively current practices in internal control, propose changes and support implementation of a sound internal control mechanism that will include all budgetary users at the local level.

After the formal agreement and establishment of the internal control framework, it is recommended to provide technical assistance and strengthen the system in pilot municipalities. Experience from the pilot municipalities could be replicated in other municipalities in Montenegro.

Furthermore, establishment of municipal internal control framework could be an excellent opportunity for inter-municipal cooperation. Namely, only larger municipalities are formally obliged to establish internal control framework (select and nominate employees for this task). These municipalities could provide services within the internal control framework to all other, smaller and under capacitated municipalities, through the pay-for-services arrangement.

***More
transparency
in the
reporting
practices***

- ***Support quality and transparency in the reporting practice:*** it is recommended to improve financial reporting, with an objective to increase transparency and accountability and public participation in local decision-making processes. Specifically, reports should assist in fulfilling the duty of the local government units to be publicly accountable and should enable users to assess that accountability and to evaluate the operating results of the local government units for the year (and, year on year). Finally, financial reporting will enable users to assess the level of services provided by the municipality. Therefore, reporting formats for wider publishing/public should be simplified, by extracting only the key information from the existing reports. At the same time, it is recommended for municipalities to start working more actively in sharing the financial reports to the citizens (e.g. using internet sites and using other IT tools)

5. Capital budgeting in Montenegro

A multi-year financial plan for capital projects

A capital budget is a multi-year financial plan for the construction or acquisition of capital projects/ investments. The **capital budget is distinguished from an operating budget.** An operating budget normally provides for the day to day expenditures of a municipality for items such as salaries, wages, benefits, heat, hydro, maintenance of buildings and infrastructure, etc., whereas the capital budget plans for the acquisition or rehabilitation of capital assets. This is emphasized in the Montenegrin Law on budget, which defines the **operating budget** as the “plan intended for funding or improvement of regular business activities, as well as for recurring expenditures related to one fiscal year”⁴⁵. The **capital budget** is defined as the plan related to the period up to or exceeding one year which increases the value of non-financial assets and covers the acquisition of infrastructure of general significance, local infrastructure, building structures, land and equipment⁴⁶;

Operating vs. Capital budgets

The Law on budget highlighted the difference between the capital investments and other expenditures presented in the operating (current) budgets.

The following characteristics make them unique:

- Individual investments are costly.
- The cost of a particular project could involve millions of euros.
- Investments benefit current and future generations.
- Planning, design, and construction of major investments take several fiscal years to complete (operating expenses are depleted in a single fiscal year).
- The nature of capital investments is inevitably linked with the capital programming and budgeting process. Therefore, it is envisaged that municipalities establish a five-year Multi-annual Investment Plan (MIP)⁴⁷. The MIP should define capital requirements, capital procurement, priorities of the environmental impacts, and the impact on the Budget, financial resources and justification for each project from the Plan.

The first year of the MIP is referred to as the “capital budget” and is usually approved in conjunction with the annual operating budget.

Demand for improvement of basic infrastructure in Montenegro

Capital budgeting is a very important planning tool for municipalities as it allows them to provide for the necessary infrastructure to maintain or enhance future service levels. Through capital budgeting, municipalities can plan future operating budget expenditure, debt repayment and potential reserve fund needs in order to manage the financial position of a municipality over a five to ten-year period.

Currently, the vast majority of municipalities in Montenegro are concerned with the improvement, repair and replacement of the basic infrastructure and the issue how to ensure financial resources for these investments.

The application of the capital budgeting process is directly tied with the preparation of the strategic development plan for the local community, or more precisely it represents a direct continuation of this process. One of the most important final

⁴⁵ The Law on Budget; OGRM 40/01, 44/01, 71/05, OGM, 12/07 of 14 December 2007, 73/08 of 2 December 2008, 53/09 of 7 August 2009)

⁴⁶ Ibidem- the Law on Budget

⁴⁷ Article 37 of the Law on Local Government Financing

Capital budgets must be linked with municipal strategic plans

results of the strategic planning process is the prepared list of potential local community projects that need to be implemented in the future period. The preparation of capital budget is the key (initial) part of strategic plan implementation process, where the local community resources get allocated for a long-term period.

The capital budget preparation process consists out of three phases:

Three-phased approach to preparation of capital budgets

- Evaluation and selection of proposed projects: a municipality, like any investor, needs to carefully select priority projects including funding options. In municipal practice, different (quite simple to very complex) methods and techniques for evaluation and selection of priorities could be applied⁴⁸.
- Estimation and projection of needed resources for realization of chosen programs for the future period: this component implies detailed project design (including pre-feasibility and feasibility studies, environmental impact assessment, cost-benefit analysis and costing of the project)
- The selection of an optimal method for project financing and the evaluation of its effect on the current budget.

5.1. Findings and challenges related to capital budgeting in Montenegro

All municipalities in Montenegro have prepared and adopted capital budgets, following the priorities set in the Perennial Capital Investment Plans.

However, capital budgeting (including strategic planning, prioritization, funding and implementation, monitoring and evaluation of projects) represent particular challenge for all municipalities in Montenegro.

Lack of strategic planning approach

- **Need to improve strategic and investment planning practices in all municipalities in Montenegro:** Even though municipalities in Montenegro have developed and adopted some kind of strategic and investment plans, there is a general lack of capacities in all municipalities to plan strategically and develop strategic plans. However, this will become even greater problem with the actual implementation of the Law on Regional Development and its provisions⁴⁹.

Strategic planning in the previous period was additionally discredited as some of the funds that were allocated to municipalities based on their close relations with the central government⁵⁰. In addition, monitoring of implementation progress is never done on a systematic basis; finally, the progress is not reported to the citizens.

⁴⁸ Two different types of evaluation criteria are usually used: static (based on specific indicators that are generated from information on project cash flows, Statement of income and Cash flow tables and the Balance Sheet, in so called "representative" year of a project life time) and dynamic (based on two key indicators of business performance: liquidity and profitability of the project evaluation).

⁴⁹ Article 7 of the Law defines Strategic document as the key document for sustainable and balanced development of municipalities; at the same time Article 25 provides limited period of time for preparation of municipal strategic plans.

⁵⁰ reference to "Capacity Assessment of Municipalities in Montenegro for the absorption of IPA funds", UNDP Montenegro, 2010; report prepared by Tomislav Novovic

Strategic priorities are not reflected in local budgets

There is rather weak connection between the priorities identified in the strategic documents and the budgeting/ budgetary process. Namely, municipal plans are more presentational rather than really operational documents and the required funding exceeds in majority of cases available resources⁵¹.

Partnerships with other actors for development of municipal investment/ strategic plans were not perceived as the priority among the majority of municipalities⁵²; none of the municipalities has specifically addressed the issue of gender equality or needs of the most vulnerable groups in their strategic/ investment documents.

National and regional development priorities are not reflected in the local strategic plans

- **Need to strengthen the links between capital investment projects and the national and regional development plans and priorities:** in majority of cases, municipal planning process is still perceived as a closed process characterized by a lack of vision as to the vertical and horizontal links within the overall national planning process. Brief analysis of the available strategic and investment documents and interviews showed that only 14% of municipalities established links with the national development plans/ priorities; 58% of municipalities have partially used national development framework, while municipalities (42%) were either not using the national development documents (31%) or are vaguely familiar with the national development priorities (13%)⁵³. This is to some extent understandable since the Government has not yet taken any serious steps to clarify how exactly the municipal plans will be integrated in the national development plans and regional development priorities.

Inter-municipal cooperation could be an option for further development of infrastructure in Montenegro

- **Need to explore opportunities and benefits from inter-municipal cooperation:** In order to deal with the rising scales of production and mobility and with growing market pressures, municipalities in the EU started using inter-municipal cooperation broadly⁵⁴. Inter-municipal cooperation took a wide variety of forms and shapes: from single purpose to multipurpose; from mutual consultation to joint operation of inter-municipal agencies, involving small and large numbers of municipalities and including different territorial scales, sometimes involving private sector organisations and upper level government⁵⁵. Unlike EU countries, in Montenegro the use of Inter-municipal cooperation is not something that had a long or intense history, even though Montenegrin legal framework provided ground for cooperation and association between local authorities⁵⁶. However, municipalities in Montenegro have limited interest in inter-municipal cooperation (including planning and inter-municipal projects).

They are also little motivated and insufficiently prepared to engage in regional partnerships among themselves and with NGOs and the private sector. Their

⁵¹ The survey showed that only 22% of municipalities indicated that the budgets will be source of funding for priorities; international funds have been mentioned in 38%; support from the Government constitutes 32%, while other sources have been mentioned in 8%, from "Capacity Assessment of Municipalities in Montenegro for the absorption of IPA funds" by Tomislav Novovic, 2010

⁵² Ibid.

⁵³ Ibid.

⁵⁴ In some European countries inter-municipal cooperation is a phenomenon (nearly) as old as the municipality itself. In France, the first councils established by local government to administer communal services date from the end of the nineteenth century; in the Netherlands, the 1851 Municipal Act already contained a provision for cooperation between municipalities "in communal affairs, interests, installations and works", but implementation was very limited .

⁵⁵ Inter-municipal cooperation in Europe 12-36 (2007), Edited by Rudie Hulst and Andr'e van Montfortand, Springer, The Netherlands

⁵⁶ The Law on Local Self Governments, XIII COOPERATION AND ASSOCIATION OF LOCAL SELF-GOVERNMENTS; The Freedom of Association of Local Self-governments- Articles 127-137.

attention is essentially focused on their municipality and they thus miss opportunities to find common solutions and funding to solve complex capital investments and infrastructure problems.

Different forms of inter-municipal cooperation

The form of inter-municipal cooperation ultimately agreed upon municipalities depends on the purpose of the cooperation and existing capacities. Based on best practices, there are several models of organizational framework for inter-municipal cooperation:

- Joint-service Provision;
- Joint Administration;
- Joint Planning and Development;
- Purchase of Services;
- Joint Funding of Investments;
- Exchange of Experience;
- Creation of a new tier of government;
- Multiple modalities⁵⁷.

Small municipalities from Montenegro appear to understand and participate even less in inter-municipal cooperation⁵⁸. This is paradoxical since the smaller and the least developed is a municipality the more it has to gain from the process of regional development planning.

Need to enhance capacities for implementation of capital investment projects: the capacities for implementation of capital budgets (and consequent capital investment projects) is ***highly differentiated*** depending on the size of the municipality, its financial profile, the existence of the specialized departments or units dealing with development activities, urbanization and experience in projects.

Implementation of capital investment projects is still challenging for all municipalities in Montenegro

Municipalities have limited capacities for project development: the recent call for proposals within the grant scheme of the EC project "Support to Local Governments Reform⁵⁹" and the grant opportunities within the EC Cross-Border Cooperation showed that there are certain capacities, but further efforts are required especially when it comes to the large scale investment projects. Municipalities do not have sufficient understanding of the project development cycle and its stages⁶⁰.

In terms of project implementation, the assessment revealed that project capacity

⁵⁷ Joining Forces and Resources for Sustainable Development- Cooperation among Municipalities – A Guide for Practitioners, by Holger Osterrieder and the team of authors; UNDP, Bratislava 2006

⁵⁸ Small municipalities constituted 70% of those that were not ready for regional development partnerships, as highlighted in the survey performed by UNDP Montenegro (reference to T. Novovic "Capacity Assessment of Municipalities in Montenegro for the absorption of IPA funds", UNDP Montenegro, 2010)

⁵⁹ In the first call for proposals within the framework of the project *Support to Local Governments Reform*, seven out of twelve municipalities were awarded grants for funding small scale projects; however, this percentage is more disturbing with the CBC projects

⁶⁰ Starting from Pre-feasibility and Feasibility studies, Environmental Impact Assessment, Preliminary Design, Tender documents, Tendering procedure and contacting and Monitoring and evaluation

There are funding opportunities but limited knowledge exists at the local level

is concentrated in a limited number of municipalities, larger ones, relatively developed and urbanized, where a relatively active NGO sector exists, with PCM experience and successfully applied partnership principle. Small and rural municipalities in Montenegro have fewer capacities, have less own resources and have less access to financing for municipal investment projects than the more developed municipalities of the country.

In addition, municipalities have limited understanding of the International Financing Institutions and IPA funding mechanisms⁶¹.

5.2. Recommendations related to capital budgeting in Montenegro

In order to achieve balanced and sustainable socio-economic development in Montenegro, the strategic/ investment planning capacities among municipalities need to be addressed urgently.

In order to address issue of strategic and investment planning capacities, the following activities are suggested:

Strategic planning as prerequisite for development of capital budget

Recommendations related to the needs to improve strategic and investment planning practices in all municipalities in Montenegro: in this report we will not evaluate previous experiences in strategic planning among municipalities in Montenegro. Still, based on best practices the most appropriate approach for strategic planning is so-called "***simple strategic planning***", which ensures that the most important *positive externalities, synergies and complementarities are determined, evaluated and acted upon.*

Simple strategic planning model

A simple strategic planning development framework involves the rational use of existing and future resources to facilitate longer-term goals and objectives. It involves the generation of projects and interventions based upon extensive surveys of the national and regional strategic priorities, economic and social dynamics, trends and potentials of the region, the existing and planned programmes in all relevant municipality and central government departments, and the opportunities and threats. When citizen participation in local public affairs and developmental processes and extensive consultation with external public-private bodies is the norm, it is possible to generate ideas as well as ensure final ownership of any project or intervention that is implemented.

Team involved in strategic planning needs to take the lead in generating and packaging interventions and projects, hence, to assess each according to impact, sustainability, external effect, opportunity, costs, and so on. This can be done very simply through basic cost-benefit analysis and other standard techniques.

⁶¹ Municipalities in general are receiving limited information on IPA funding framework and opportunities from Montenegro showed that municipalities receive little (76%) or no information (24%) on IPA funds and opportunities. Challenges are faced in all examined areas: IPA financial opportunities (76%); IPA Procedures (92%); EU financing (84%) and on EU procedures (100%).

The main sources of information are: media (29%); the Government of Montenegro and the Union of Municipalities (26%); the EC delegation (16%) and other sources (29%). While in general the municipalities do not consider the lack of information as an obstacle to access pre-accession funds, most of them point to the need for information on the procedures and mechanisms of operation of the IPA. There are many documents available at the moment, but it seems that this has created lots of confusion in terms of "what is the most relevant for municipalities- ref to Novovic- "Capacity Assessment for Absorption of IPA funds"

Basic local economic models could be routinely used to assess the fiscal implications of each project. A list of key interventions and projects starts to emerge after a certain period of time.

An iterative process is generally used, with several rounds of consultation and feedback with the community in order to ensure consistency, quality and final ownership. This process also, importantly, ***underpins local democracy*** since it ensures that citizens' needs and views are reflected in strategic plans, interventions and projects, but without the dangers that come when some (usually powerful) members of the community circumvent the democratic process and propose their own projects directly to funding bodies. The most sustainable core interventions and projects are then entered into the capital budgeting framework.

Recommendations related to the needs to explore opportunities and benefits from inter-municipal cooperation: The challenges imposed on Montenegro by the current territorial organization and the development differences increased the importance of inter-municipal cooperation. This is particularly important for smaller and underdeveloped municipalities, as this will enable them to ensure investments for essential infrastructure in a cost-effective manner and to access the credit market in the form of pooled financing. Furthermore, the Government of Montenegro is currently working on the Strategy for Inter-municipal Cooperation in Montenegro.

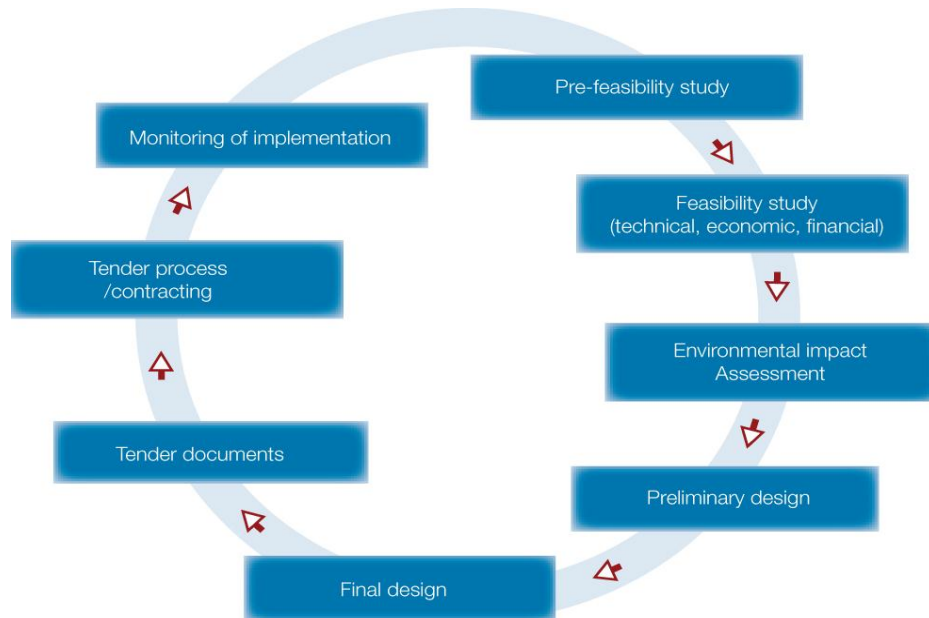
Therefore, in order to facilitate inter-municipal cooperation in Montenegro it is recommended to start with pilot intervention and explore opportunities, which should be innovative and focused on certain, very specific area (such as inter-municipal infrastructure projects, support to budget planning, shared administration of local taxes, inter-municipal development entities or alike). The success in implementation of inter-municipal cooperation could be achieved through balanced combination of persuasion (promotion of successful stories in implementation of IMC and opportunities), incentives (such as small grants mechanism for IMC partnerships as already done in some other countries from the region) and legal requirements (e.g. implementation of the EU accession action plan; implementation of the national PAR strategy, etc.).

Recommendations related to the needs to enhance capacities for implementation of capital investment projects: in order to address issue of project capacities, the following activities are suggested:

Training programme to enhance project implementation skills: it is recommended to develop a comprehensive capacity development programme that could enable municipalities to identify municipal needs, participate in EU and other funding programmes, plan and manage capital/ investment budgets (and specific project budgets) and implement projects effectively. Selection of participants should be well-planned and should include Mayors and Chief Administrators (some topics), Secretariats for finances (and budget units), municipal staff in charge of project activities.

Development of capacities for preparation of strategic project pipelines it is recommended to work with municipalities in Montenegro to better understand project development cycle and its core elements. Specifically, the focus should be on preparation of *Pre-feasibility studies* (preliminary assessment of the technical and economic viability of a proposed projects); *Feasibility studies* (a document that

verifies whether the proposed project is well founded and is likely to meet the needs of its intended target groups/ beneficiaries); *Environmental Impact Assessment* (assessment of the possible positive or negative impact that a proposed project may have on the environment, together consisting of the natural, social and economic aspects) and the *Preparation of the tender dossier*⁶².



Support to establishment sound and transparent process for prioritization of projects (in line with the strategic plans): Process of planning and prioritizing capital infrastructure projects has to further empower the concept of strategic planning, citizen participation and accountability. Therefore, it is recommended to work on a transparent mechanism for identification of projects priorities for municipalities, clearly related to strategic plan and socio-economic development.

Possible scenario could be:

- *establish selection and evaluation criteria for identification of priorities*; for example impact on socio-economic and overall local development in municipality and in the region, target groups, number of direct and indirect beneficiaries, time-frame and cost-effectiveness, short, mid and long term-impact, environmental protection, gender sensitivity, sustainability, etc.
- *organize discussions on identified priorities*: in order to mobilize local resources, to ensure commitment and local ownership of the process and consequently long term impact on municipal and regional strategic priorities, discussion and consultations with local stakeholders in each municipality should be organized.
- *selection of possible projects and preparation of project pipelines*.
- fundraising.

Recommendations aimed to enhance capacities of municipalities to better understand and approach IPA funds/ EC funding opportunities:

There is an urgent need to work with municipalities and provide basic trainings/ ensure regular info of the EU funding opportunities (especially in light of the

⁶² http://ec.europa.eu/europeaid/work/procedures/implementation/practical_guide/index_en.htm

recent candidate status for Montenegro), priorities and measures, eligible institutions and types of projects that can be financed, explain application forms, implementation mechanisms, as well as best practices and useful tips from the experience.

6. Fiscal equalization system in Montenegro

Availability and collection of resources can be different among municipalities: some municipalities are functioning in relative wealth, while the other are facing limited resources even for provision of basic services to the citizens.

Therefore, this is usually an alert to the national governments to introduce measures to counter-balance these, often significant differences. As seen in practice, there are several reasons that justify fiscal equalization and transfers from the central budget to local self-government units: (i) to equalize vertically (improve revenue adequacy); (ii) to equalize horizontally (inter-jurisdictional redistribution); (iii) to correct for inter-jurisdictional spill overs (externalities); and (iv) to correct for major administrative weaknesses and streamline bureaucracy⁶³.

The equalization transfer requires a standard for distribution (that is, criteria that determine the share received by a municipality) and a mechanism for appropriating funds into the distribution formula. Experience showed that there are several desirable features for a equalization system.

In general, the equalization system should be⁶⁴:

- a) transparent and objective, so that municipalities will know and trust the equalization system functions;
- b) formula-driven, so that transfers can be removed from political bargaining between the central and local governments;
- c) stable, so that municipalities will be able to predict their budget constraint;
- d) meaningful, so that the sums received do improve the fiscal condition of the localities; and
- e) revenue-stimulative, so that funds received do not dampen the incentive for localities to generate revenue from their indigenous resources⁶⁵

6.1. Equalization system in Montenegro

Inherited inequalities, poor physical and weak social infrastructure of smaller municipalities combined with the territorial organization of Montenegro, caused continues social and economic decline of some municipalities in Montenegro.

In order to ensure financial equalization or balance, the Law on Local Self-Government Financing envisaged establishment of the Equalisation Fund⁶⁶ (EF). Based on the Law on local governments financing, the Equalisation Fund in Montenegro was designed with a limited function to support municipalities with a weak fiscal capacity (but it does not affect the fiscal resources of the wealthier municipalities). Fiscal capacity, as stated in the Law, should be determined through

⁶³ Intergovernmental Fiscal Transfers: Concepts, International Practice, and Policy Issues by Larry Schroeder, Syracuse University, and Paul Smoke, New York University (from the book Intergovernmental Fiscal Transfers in Asia: Current Practice and Challenges for the Future, Edited by: Paul Smoke and Yun-Hwan Kim), ADB, 2003

⁶⁴ "Local Budgeting" edited by Anwar Shah, the World Bank Publications, Public Sector Governance and Accountability Series, 2007

⁶⁵ "Fiscal Federalism and Incentives in a Russian Region" by Alexeev, Michael, and Galina Kurlyandskaya. 2003. Journal of Comparative Economics 31: 20–33

⁶⁶ Article 29, Law on Local Self Government Financing

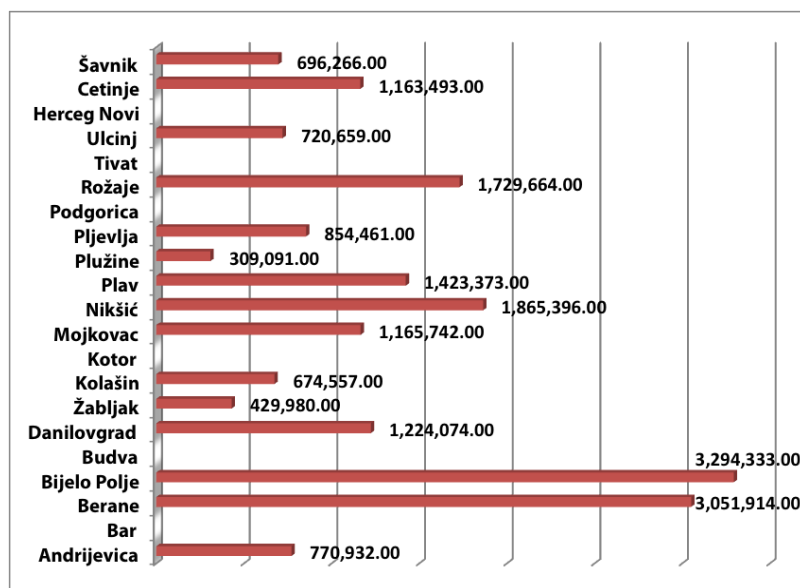


assessment of total local fiscal incomes which municipalities can realize from its own resources and transferred state revenues". In addition, the Law states that the local fiscal incomes from its own resources include: municipal taxes, charges and fees, except of the fee for utility equipment of the construction land.

The Law defines that the municipalities with the lower fiscal capacities⁶⁷ than the average within a three-year period, are eligible to benefit from the EF.

However, the Ministry of Finance remains responsible to provide more details for determining indicators relevant for determining fiscal capacities. The actual allocation of the resources is done following the proportion between the fiscal capacity (60%) and on the budgetary needs (40%)⁶⁸.

The revenues assigned to the EF⁶⁹ are parts of the personal income tax, tax on real estate transfer tax for use of motor vehicles, crafts, aircrafts and aero jets and concession fees from games of chance.



In order to further contribute to the development of the fiscal equalization system in Montenegro, the Law on Local Finance provides for the establishment of a Commission for Monitoring Development of the System of Fiscal Equalization of Municipalities. The Commission comprises of seven members (5 nominated by the Union of Municipalities; 1 by the Ministry of Finance and one by the ministry in charge

⁶⁷ In the Article 30, Paragraph 2, the fiscal capacity of municipality is to be determined through assessment of total local fiscal incomes which municipalities can realize from its own resources and transferred state revenues.

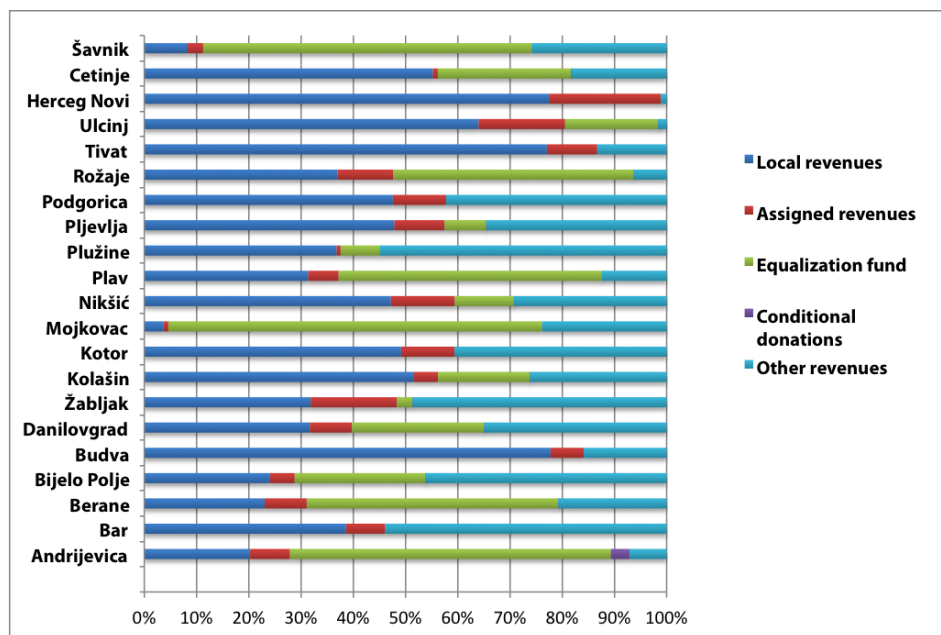
⁶⁸ Article 31, Law on Local Self Governments Financing

⁶⁹ Article 29 Fund's means shall be provided from following revenues: - Personal income tax to the amount of 11% of revenues collected on that basis; - Tax on real estate transfer to the amount of 10 % of revenues collected on that basis; - Tax for use of motor vehicles, crafts, aircrafts and aero jets to the amount of 100% of revenues collected on that basis; - Concession fees from games of chance in the amount of 40% of the revenues collected on that basis.

of local governance affairs) and its role is to monitor development of the system of fiscal equalization of municipalities, focusing on the equity, efficiency and transparency⁷⁰.

6.2. Findings related to fiscal equalization system

For some municipalities in Montenegro, transfers from the Equalization Fund represent the vast part of their budgets (e.g. 70 per cent for Andrijevica, and about 60 per cent for Berane, Mojkovac and Plav).



The assessment was primarily focused on the municipal (“client”) side of the equalization system. Practically, it was assessed and analysed whether municipalities understand functioning of the equalization system (including eligibility criteria and distribution formula and indexes), if there is sufficient degree of transparency and predictability, and the role of the Ministry of Finance and the Commission for Fiscal Equalization in the decision making process.

The analysis of the fiscal equalization system in Montenegro showed some disadvantages, such as that the wealthier municipalities are not participating in the scheme even though equalization problems are as much related to relative fiscal wealth as to relative fiscal poverty.

In addition, the nature of resources assigned to the Equalization Fund is inevitably linked to high degree of unpredictability, which brings additional difficulties in the planning processes at the local level (important budget item for the poorer municipalities is hard to predict, which introduces an element of uncertainty into budget planning).

Municipalities in Montenegro expressed concerns regarding the functioning of the Equalization Fund. Specifically, municipalities- recipients of the Fund conveyed high degree of discontent with the distribution formula, as some of the key indicators were not considered. Other municipalities that are not receiving funds are dissatisfied as they are not properly and timely informed about distribution formula, allocation and utilisation of funds. At the same time, the unpredictability of the funds earmarked for

⁷⁰ Article 35, Paragraph 2 provides detailed description of the tasks of the Committee

each municipality remains of the key issues.

The Commission for Monitoring Development of the System of Fiscal Equalization of Municipalities was established and it comprises of high professionals from municipalities and from the Ministry of Finance. However, the role of the Commission has to be re-enforced, especially in terms of its opinion and suggestions. Therefore, capacity development of the members of the Commission, in terms of policy and decision making as well as for monitoring of equalisation system needs to be reinforced.

In order to address some of these shortcomings, the Government of Montenegro/ the Ministry of Finance, with the technical assistance provided by the Council of Europe, is working on re-defining criteria and introducing new indicators for distribution of the resources from the Equalization Fund. This is work in progress and the by-laws will be finalized soon.

6.3. Recommendations related to fiscal equalization system in Montenegro

In order to support the Government and municipalities in Montenegro to establish more transparent and predictable fiscal equalization system, the following key recommendations are proposed:

Prepare an overview of best practices and models for fiscal equalization: it is recommended to prepare an overview of successful models (and lessons learned) in application of different fiscal equalization systems. The review of best practices should include assessment of impact of different models on local governance development and on quality and sustainability of municipal services.

This will enable the Government of Montenegro/ the Ministry of Finance and municipalities to adopt criteria and indicators that will adequately address current situation and financial needs in Montenegro.

Support preparation of the analysis of fiscal capacities of municipalities: as indicated in the previous paragraphs, the Law on Local Self-government Financing envisaged that the access to the Equalisation Fund should be granted to municipalities with lower fiscal capacity.

In addition, the Law states that the Ministry of Finance shall prescribe in details a manner of determine of the fiscal capacities of municipalities. Therefore, it is recommended to provide technical assistance to the Ministry of Finance to carry out an in-depth analysis and prepare a study on fiscal capacities of municipalities in Montenegro. The analysis should consider different indicators (e.g. total revenue/ tax basis vs. collected taxes and revenues, for example) for determining fiscal capacities. At the same time, it is recommended to carry out the analysis of local self-government expenses, which should enable to assess the actual relationship between the revenues and expenditures in light of expenditure assignments (competences) of local self-government units.

Organize and deliver trainings to municipalities on fiscal equalization system: in order to improve understanding and increase capacities for budget planning at the local level, there is a need to develop a training course on fiscal equalization. The content of the course and learning materials should be based on the criteria for the assessment of fiscal capacities and should reflect adopted principles for fiscal equalization. In addition, it should provide an overview of international experiences in

fiscal equalization, principles and benefits.

The recommended, primary, target group for the trainings should be senior level municipal officials (mayors/ presidents of municipalities, heads of administrations, and heads of local finance units); in addition, the training should be offered to mid-level managers (especially employees active in preparation/ planning of municipal budgets).

Provide support to enhance capacities for the members of the Commission for Monitoring Development of the System of Fiscal Equalization: capacity development of the Commission needs to be considered holistically, taking into consideration both individual and organizational needs required for their functioning. It is recommended to provide advisory support to the members of the Commission on number of specific topics arising from the new equalization framework (e.g. indicators, assessment of fiscal capacity, introduction of international best practices, etc.).

In addition, it is recommended to prepare and publicize reports from each of the meeting sessions of the Commission and share it with other municipalities.

Organize a study tour and facilitate exchange experience: it is recommended to organize a study tour based on the specific interests and needs of the members of the Commission and municipalities EF users, centred on the EU best practices in the area of fiscal equalization will be organized. The purpose of the study tours will be to facilitate horizontal learning process through exposure to the EU models and best practices in fiscal decentralization and specifically fiscal equalization.

Enhance cooperation and coordination among the key partners for the reform of public finance system in Montenegro: it is highly recommended to support better and sustainable coordination among the Government, Union of Municipalities, and local self-government units. Thus, policy-making process in this area has to involve all the key actors and prevent any (internal/ external) conflicts or inconsistencies. This is an issue in the Montenegro's policy-making cycle, particularly when it comes to the relationship between the Law on Financing of Local Self-Governments and other substantive law (e.g. Temporary Residence Tax Act and Tourist Organisations Act).

Therefore, some of the initial activities in this respect is to prepare regular notes and highlight different aspects of budgeting process, starting with preparation, coordination, and execution/ implementation, accounting and reporting in a form that can be easily transform into a policy document. In terms of improved coordination, the Project Board could be the initial step; therefore, continuous support and development of capacities of the members of the Project Board is recommended.

7. Financing of municipal infrastructure: municipal borrowing, municipal bonds and debt management

7.1.1. Municipal borrowings in Montenegro

Public policies and decisions on capital investments are among the most important (in terms of long term influence and the actual impact) that local governments can make. In the previous period, capital investments were financed on a pay-as-you-go basis (from current revenues), instead of a pay-as-you-use basis (borrowing). The reason was that infrastructure investments were financed either by direct subsidies from the central government or from the municipality's current revenues.

However, following the underinvestment of the 1990s and the decentralization of various responsibilities to local governments in Montenegro, it is no longer possible to finance the necessary infrastructure investments on a pay-as-you-go basis. Therefore, local governments in Montenegro are increasingly forced to raise revenues from their own resources and to access domestic and international financial markets.

The Montenegrin laws provided an enabling environment for municipal borrowings. Namely, the general framework is defined by the Law on Securities⁷¹, which highlighted that "the issuer of securities may be a municipality from Montenegro", while the Law on Budget⁷², stated that the "local self-government units may take long-term borrowings and issue guarantees with the prior consent of the Government", at the same time defining that the Government may take into consideration the overall macro-economic situation while issuing the consent on these requests.

The system for municipal borrowings is more specifically described in the Law on Local Self Governments Financing (Chapter VI, Articles 60-65). The Law is in line with the European Charter, by stating "a municipality may be indebted by issuing securities or taking out loans". The Law clearly delineates between the **short-term** (intended for satisfying short-term needs for liquidity, while the principal repayment schedule should not exceed 12 months- Article 61) **and long-term loans** (Article 62 defines it as "any credit where the principal repayment schedule extends beyond 12 months"). At the same time, the Law sets the borrowing limits- "a municipality may be indebted in a such way that the total payments of principal and interest, payments under a leasing contract, repayment of obligations for prior period and any other obligations that have the character of the debt may not exceed 10% of the realized current income in a year preceding the year of borrowing, with the previous approval of the Government".

7.1.2. Issuing of municipal bonds in Montenegro

What is a municipal bond?

A municipal bond is a loan that enables a municipality to borrow money from bond-buyers. Issuing of municipal bonds is a more flexible financing mechanism. Municipalities routinely raise needed capital by selling/ issuing bonds for periods as brief as a few days to as long as 30 or 40 years. A municipality (the issuer) enters into a legal agreement to compensate the lender (the bondholder) through periodic interest

⁷¹ Government of Montenegro - Law on Securities, Official Gazette of Montenegro, No. 59/00, 10/01, 28/06), Article 6

⁷² Article 40, the Law on Budget

payments in the form of coupons; and to repay the original sum (the principal) in full on a stipulated date, which is known as the bond's "maturity date"⁷³.

MUNICIPAL BONDS: Advantages and disadvantages

Advantages of municipal bonds

- Competition among investors can reduce interest rates
- Municipality builds a direct relationship with investors
- With timely repayment, municipality builds a public record of creditworthiness
- Detailed public disclosure of municipality financial condition promotes transparent municipal management
- The amount of bonds issued is limited only by law and investor perception of municipal creditworthiness

Disadvantages of municipal bonds

- Credit rating and other issuance expenses can be substantial, especially for a small bond issue
- Bond issues are not suitable for small borrowings
- Detailed financial disclosure requires time of municipal staff
- From start to finish, the preparation of a bond issue can take considerable amount of time

The subject of municipal bonds is coming to the public attention as one of the options for financing public infrastructure, as municipalities in Montenegro need to explore, facilitate, and support new financing mechanisms.

How to finance municipal infrastructure projects?

The basic legal provisions that enable municipalities to issue municipal bonds are **incorporated in the Montenegrin legal system**. As indicated in the national legislature, municipalities in Montenegro are authorised to issue/ offer bonds through public and private offers.

Issuing of bonds

The primary legislation⁷⁴ defines standard procedures for issuing of municipal bonds. More specifically, the Rules on Prescribing Conditions for Issuance, Registering and Trading with short-term Debt Securities⁷⁵ is the main by-law that could be applied to municipal bonds trading. In addition other key elements of the legal framework are, the Instructions for Creation of Special List for Trading by Republic of Montenegro Bonds and Local Self-governance Bonds⁷⁶ and Rules on Contents, Deadlines and Manner of Publishing Financial Reports of Issuers of Securities⁷⁷.

Public and private offers

On the basis of such Rules, the Securities Commission has started with the intense implementation causing a large number of sanctions to be imposed on issuers that did not comply with the reporting obligation within the deadlines prescribed by these Rules. These activities have resulted in increase in discipline of the market players and

⁷³ Thau Annette: "The Bond Book : Everything Investors Need to Know About Treasuries, Municipals, GNMA's, Corporates, Zeros, Bond Funds, Money Market Funds, and More", third edition, McGraw-Hill Professional, 2004

⁷⁴ LAW ON SECURITIES- Official Gazette of Montenegro, No. 59/00, 10/01, 28/06; By-law on Securities Trading Supervision ("Off. Gazette of the RMne", nu. 28/07); By-law of the Security Commission's Rules of Registering and Keeping of Records of Securities Issuers (Off. Gazette RMne nu. 6/01, 57/01); By-law on Content of the Prospectus for the Public Invitation for Emission of Owners and Long-term Debt Securities and the Rules on Prescribing Conditions for Issuance, Registering and Trading with short-term Debt Securities (Off. Gazette nu. 34/07).

⁷⁵ Rules on Prescribing Conditions for Issuance, Registering and Trading with short-term Debt Securities (Off. Gazette no. 34/07)

⁷⁶ Instructions for Creation of Special List for Trading by Republic of Montenegro Bonds and Local Self-governance Bonds- Off. Gazette no.07/07

⁷⁷ Rules on Contents, Deadlines and Manner of Publishing Financial Reports of Issuers of Securities "Official Gazette of Montenegro", No. 20/09, 18/10

The legal framework permits issuing of municipal bonds

the development of the public information booklet containing over 8,000 pages on financial reports and it is subjected to regular update contributing to the greater information provisioning on the market players.

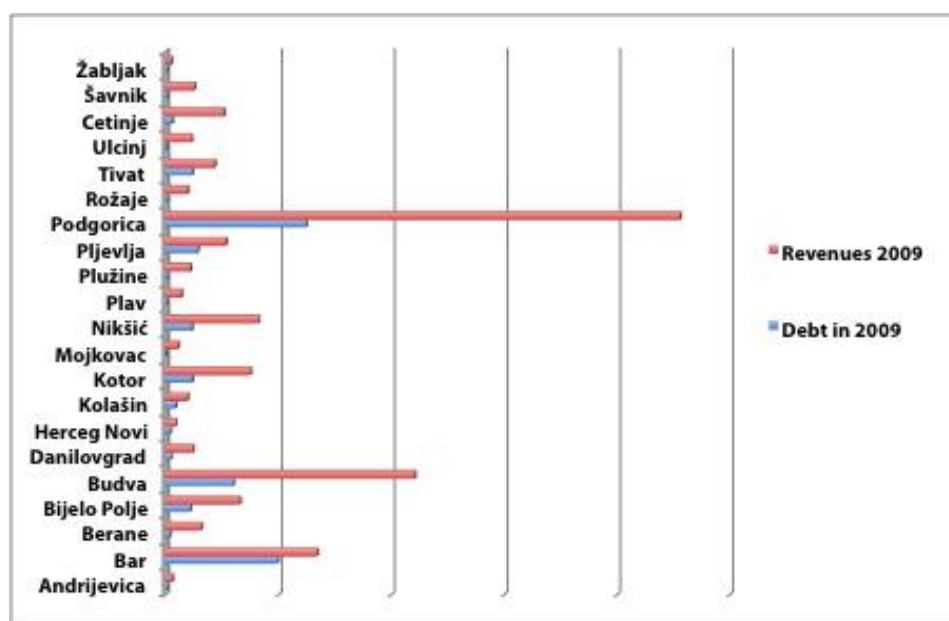
Still, this mechanism is new to Montenegro and should rapidly be clarified and brought to the attention of all concerned – municipalities, investors, those who mediate or regulate and the public. Development of a functioning municipal bonds market is a part of a broader development of the capital market/ securities market in Montenegro, which is not at the full speed.

7.2.1. Findings from analysis of municipal borrowings in Montenegro

The ability and the attitude of local governments in Montenegro towards borrowing have evolved, resulting in considerable increase in borrowings in the last few years. Compliance with the legal norms and a favourable rating at a bank are necessary but not sufficient conditions for a municipality to incur debt.

Namely, the legal restrictions imposed on local government borrowing are in line with international practice, but they do not seem to work in Montenegro.

Municipal revenues and debts in 2009⁷⁸



For instance, the limits set by Article 64 (1) of the Law on Local Self Governments, “A municipality may be indebted in a such way that the total payments of principal and interest, payments under a leasing contract, repayment of obligations for prior period and any other obligations that have the character of the debt may not exceed 10% of the realized current income in a year preceding the year of borrowing, with the previous approval of the Government”, are violated by some municipalities.

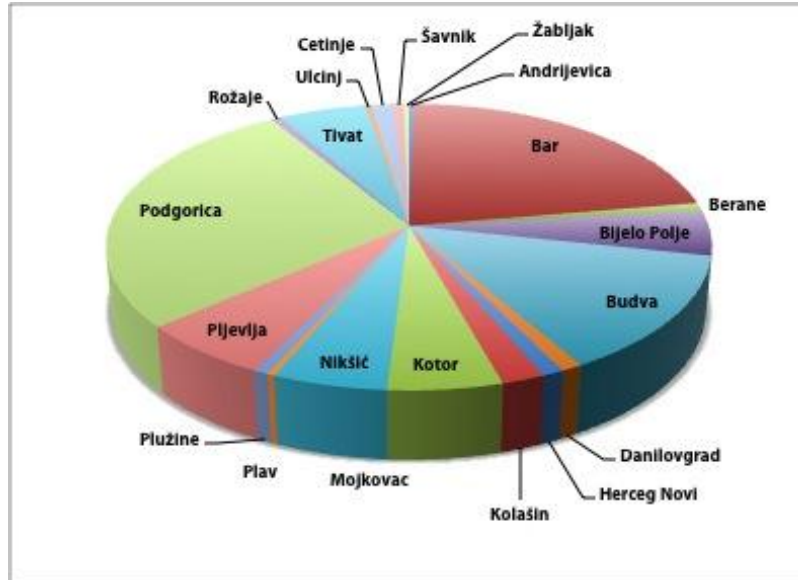
The sudden growth of the real estate prices and inflow of capital (mainly from the Russian investors) caused an enormous raise in revenues in almost all municipalities. Unfortunately, majority of municipalities used this data as a basis for planning, and consequently for borrowing, assuming that this trend will continue. However, the economic crisis caused the investment to shrink even less than in the pre-boom

⁷⁸ Ministry of Finance of Montenegro, Official data

period. But, debts remained there.

This situation is further exacerbated by the fact that majority of municipalities in overstuffed; hence, municipalities need to take commercial credits to pay severances to redundant employees.

Municipal debts in Montenegro (2009)⁷⁹



The assessment showed that in Montenegro, the municipal credit market is characterized by:

- A lack of adequately prepared municipal development strategies and long-term investment plans;
- Lack of and poorly prepared projects. Often projects are oversized as a result of poor assessment of the costs and benefits of the investment program. Furthermore there is reluctance for cooperation in-between municipalities for financing and operating projects which in many cases would result in economies of scale.
- Lack of technical and administrative capacity to access credits and manage debt, especially with smaller and underdeveloped municipalities;
- Increased and politically based intergovernmental transfers through non-transparent mechanisms (eg. Directorate for public works, etc.) to some municipalities without taking strategic approach

7.2.2. Findings and challenges related to municipal bonds in Montenegro

Municipal bond market initiated

Municipal bond market in Montenegro brings number of controversies: according to some authors, the whole strategy for the establishment of a municipal bond market was deceptive, leading into de-facto its non-existence⁸⁰. The Primer market is under the control of the Fund for development and investments; which in its portfolio has number of other bonds and securities (e.g. from the Fund for restitution; the old currency savings securities; securities issued by the Ministry of Finance of Montenegro, etc.). The secondary market is not functional.

Secondary market is not

⁷⁹ Ministry of Finance, statistics for 2009

⁸⁰ Policy and Legal Advice Center report on comparative analysis of financial markets in the Western Balkan region

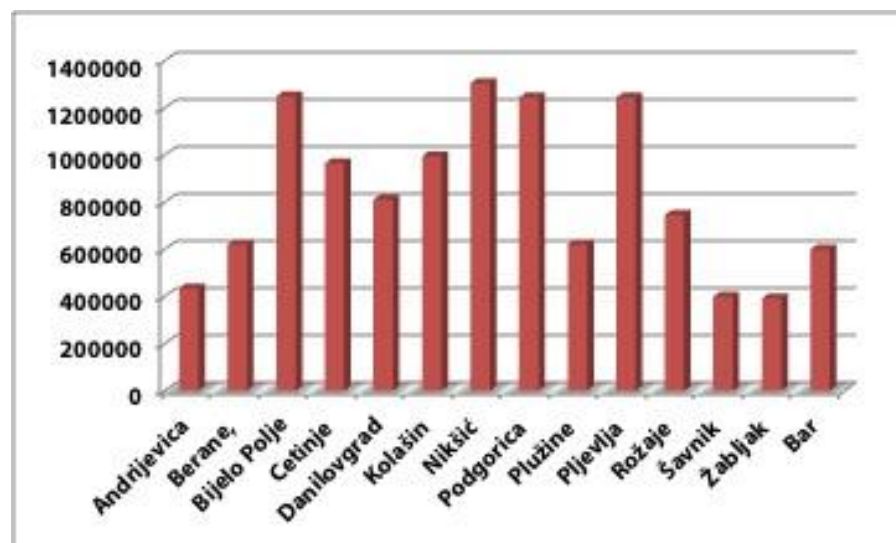
functional

Hence, after the initial work on establishment of municipal bonds market in Montenegro there is a need for further development and improvements. The main challenges for the establishment of functional municipal bonds market are those related to human resources and to the establishment of secondary market. Municipal employees have limited knowledge and understanding of general aspects of municipal bonds and the opportunities arising from the functional municipal bonds market. All municipalities in Montenegro are facing difficulties with preparation of document for issuing of municipal bonds; municipal creditworthiness is at a low level and needs to be addressed. As indicated in the previous table, already issued municipal bonds were sold to already familiar buyer, the Fund for development and investments, resulting in non-existence of the real, secondary bonds market.

Need for further development

Key problem is the lack of capacity for issuing of bonds

Municipalities issuers of municipal bonds⁸¹



The whole mechanism and the concept are relatively new to municipalities and should be clarified and brought to the attention of all concerned – municipalities, investors, those who mediate or regulate and the public. Development of a functioning municipal bonds market should be considered as a part of a broader development of the capital market/ securities market in Montenegro. Especially important will be further development of the secondary market, and open trade with municipal bonds.

Municipalities in Montenegro need to work on the preparation of mature, full-fledged capital investment projects that could be financed through issuing of municipal bonds. One of the main preconditions for the issuing of municipal bonds is financial reporting, especially municipal balance sheets.

⁸¹ The Fund for Development, Montenegro, 2009

7.3.1. Recommendations for improvement capacities for municipal borrowing and debt management

Enhance capacities among municipalities for management of debt: municipalities in Montenegro need an urgent development of capacities for debt management; this should include understanding how to plan and pay the interest and principal payments on existing debt, and how to plan for incurrence of new debt at a level which will optimize borrowing costs and not impair the financial position of the municipality.

The initial step will be to organize a capacity development program (trainings) for all municipalities on debt management, reflecting on the following topics:

Best practices and lessons learned in municipal borrowing: Experience from Montenegro showed that the current situation with the debts of municipalities is disturbing and it is becoming a systemic problem. Therefore, municipalities need to start working urgently on management of debts and to link borrowings only with solving of strategic issues.

Changes in the system of borrowings and the future developments: Municipalities in Montenegro experienced unrealistically high prices of real estate and privatization. However, this was rather short-term push: this is depleted as the proceeds of selling real estate and privatization are depleted.

Still, municipalities in Montenegro could expect some positive changes, through conditional grants provided by the European Union that may become increasingly important, especially for infrastructure investments and structural adjustments linked with the accession to the EU.

Management of municipal property: one of the key challenges of all municipalities is how to manage property with the maximum profit.

Risks assessment for borrowings: since lenders are financial institutions more accustomed to risk management, it is the borrowers - municipalities need to pay more attention to the risks and eventual consequences on their future finances. Therefore, this should be part of the capacity development programme.

Improve municipal property management practices: it is recommended that municipalities work on an accurate system for registration and keeping records of property owned by municipalities and public enterprises founded by the respective municipalities (communal property and property belonging to public companies). The software application developed in the municipality of Bar could be a good solution for other municipalities in Montenegro. At the same time, experienced staff from Bar could support other municipalities in these efforts.

In parallel with this, municipalities have to work on development of capacities to better grasp complex issue of management of property. Trainings on topics such as legal framework (Montenegro Property Law, Law on Construction Land, Law on Basic property relations and other by-laws adopted pursuant to these regulations), optimization of municipal property, etc. should be included.

Support municipalities to improve creditworthiness: Creditworthiness is a municipal capacity to repay debts on time, and in full. In order to improve their creditworthiness, municipalities have to manage finances in a way to generate a steady operating surplus equal to at least 5% of their recurring operating expenses every year (operating surplus equals recurring operating revenues minus recurring operating

expenses).

Investors look to credit rating agencies for an assessment of a municipality's credit worthiness. A number of **key indicators** are used to assess a municipality's ability to service debt. Some of the most commonly used indicators are:

- i) Debt per capita
- ii) Debt charges per capita
- iii) Debt charges as a percentage of revenue
- iv) Debt charges as a percentage of the municipal levy
- v) Debt to assessment ratio
- vi) Debt charges to tax rate ratio
- vii) Annual increase in debt in relation to: inflation, population, assessment growth and operating revenue

These indicators are reviewed on their own merit, and in relation to other municipalities, to derive the municipality's credit worthiness (the potential risk of the municipality not meeting debt payment obligations). Determination of credit worthiness is reflected by the interest rate at which the investor is willing to lend his money. The ability to repay debt and a sound financial position lowers the overall risk to an investor, and therefore, lowers the interest rate required by the investor. In theory, the ultimate debt capacity of a municipality is the point at which no investor will make money available to the municipality at any rate of interest.

All activities planned within the framework of the project are aimed to build a strong financial profile for municipality and to practice financial transparency. Therefore, implementation of this project will address the creditworthiness of municipalities; however, separate activities aimed at increase of creditworthiness will not be implemented.

7.3.2. Recommendations for development of capacities for issuing of municipal bonds in Montenegro

Recommendations and priorities in the forthcoming period in regard to development of capacities for issuing of municipal bonds in Montenegro are:

Analysis of the current situation related to municipal bonds in Montenegro and recommendations for the next steps: there is a need to carry out a comprehensive review and analysis of the municipal bonds market in Montenegro. This analysis should verify whether the bond market in Montenegro is well founded and is likely to meet the needs of municipalities/ beneficiaries. This analysis will serve as the policy paper for planning in this area, providing operational details (such as number and nature of municipalities, volume of debt raised, etc.), and the context, conditions and constraints for such a market.

The analysis will take into consideration the legal framework that regulates issuing of municipal bonds. Recommendations will be on the removal of obstacles and introduction of needed changes that will create enabling environment for issuing of municipal bonds and for development of secondary market of bonds in Montenegro.

The actual process of analysis should be participatory, ensuring consultations with the Securities Commission, Stock Exchange, National Bank and Ministry of Finance, as

***Expenditure
forecasting***

well as municipalities themselves.

Prepare a user-friendly Handbook for issuing of municipal bonds: Following the analysis and reflecting on experience from the selected municipalities, as well as international best practices, a user-friendly Handbook for issuing of municipal bonds needs to be prepared.

The Handbook has to provide a brief introduction to the purpose of the municipal bonds and the key principles for issuing, legal requirements (national and municipal level), the process of issuing of municipal bonds (work plan, activities, tasks), the types of indicators, evaluation, monitoring and reporting process. In addition, the Handbook has to include templates as required by the national level framework (submission to the Ministry of Finance, opening of the emission account at the Central registry for securities, etc.).

Develop training programme on issuing of municipal bonds: as indicated in the previous paragraphs, the initial work on issuing of municipal bonds was done and the first series were released. However, the opportunities from municipal bonds remained at the rudimentary level, with the Fund for Development being the only buyer.

During the assessment, all municipalities expressed interest to learn more about municipal bonds, opportunities and challenges as well as about how to release them. Therefore, one of the priorities should be to develop a training programme that will present framework for issuing of municipal bonds in Montenegro, through step-by-step approach. At the same time, the training programme should involve some of already experienced citizens and municipalities from the region that have been successful in issuing of bonds. This will ensure exchange of experience and horizontal learning from experienced peers.

It is recommended to have two-days training. The target audience should be municipal officials and public enterprises in charge of infrastructure maintenance.

ANNEX 1: Review of municipalities

Municipality ANDRIJEVICA



Demographic data

Area: **283** Km² (rank: 17)

Population: **5,785** (rank: 18)

Density: 20 Inh/km² (rank 17)



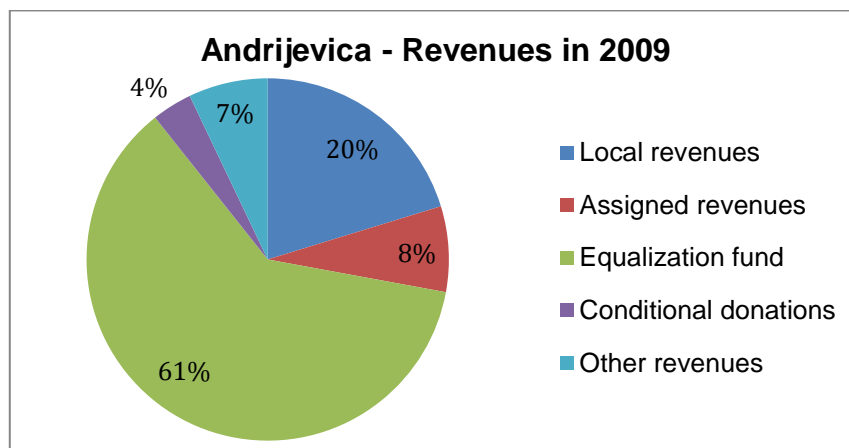
Municipal administration

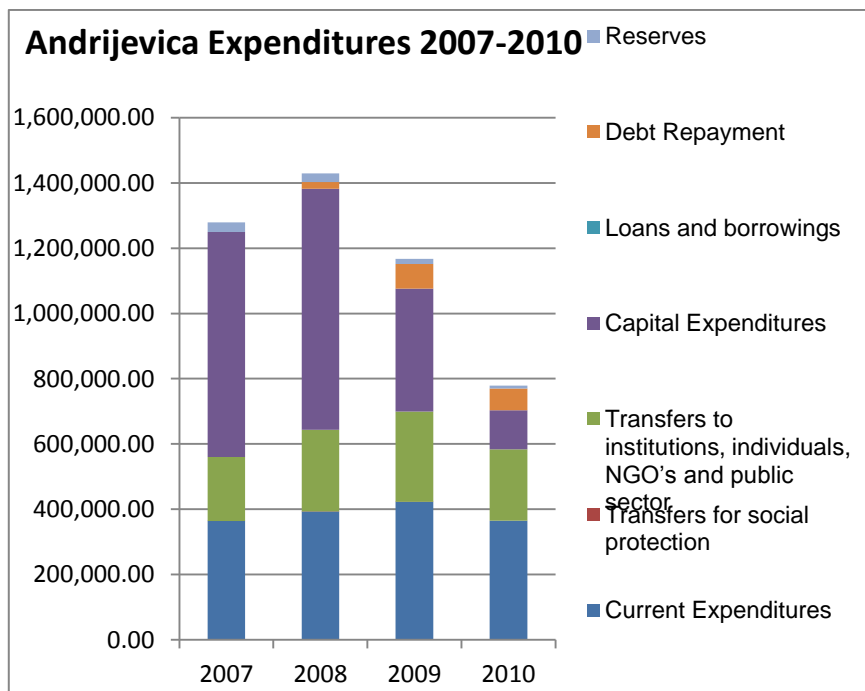
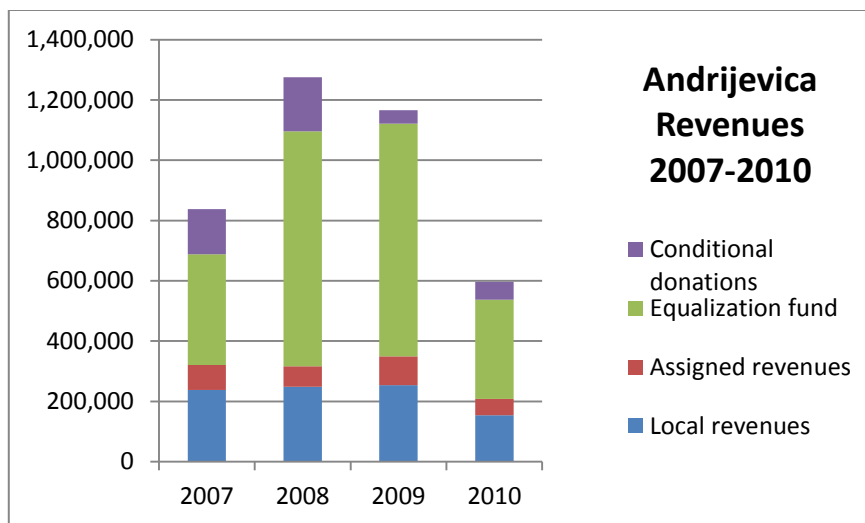
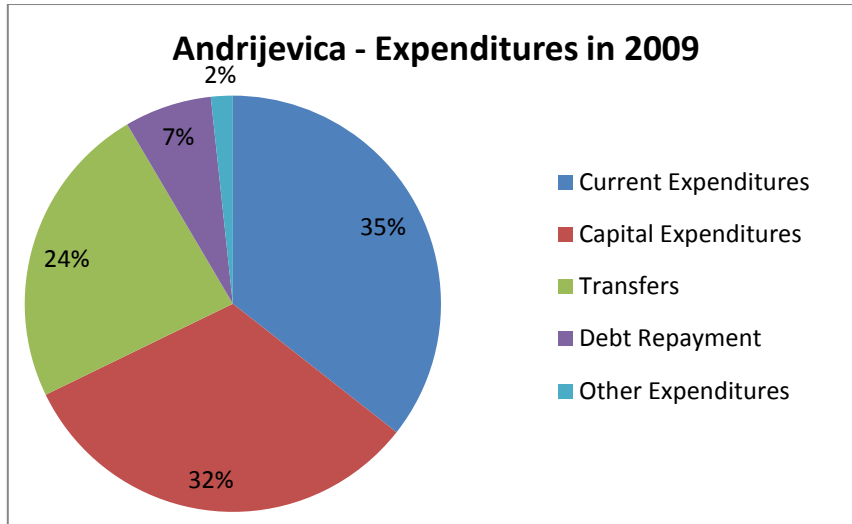
Municipality	Local administration	Public institutions	Public enterprises
Andrijevica	28	10	36

Municipal financial units

Municipality	Number of employed in the Secretariat for municipal finance		Number of employed in the tax departments	
	Male	Female	Male	Female
Andrijevica	1	1	2	2

Budgetary and financial information





Municipality BAR



Demographic data

Area: **598** Km² (rank: 9)

Population: **40,037** (rank: 4)

Density: 67 Inh/km² (rank 7)

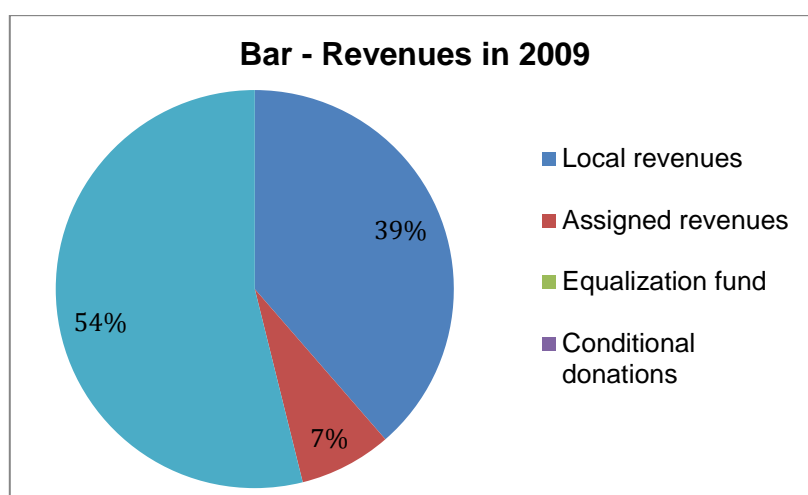
Municipal administration

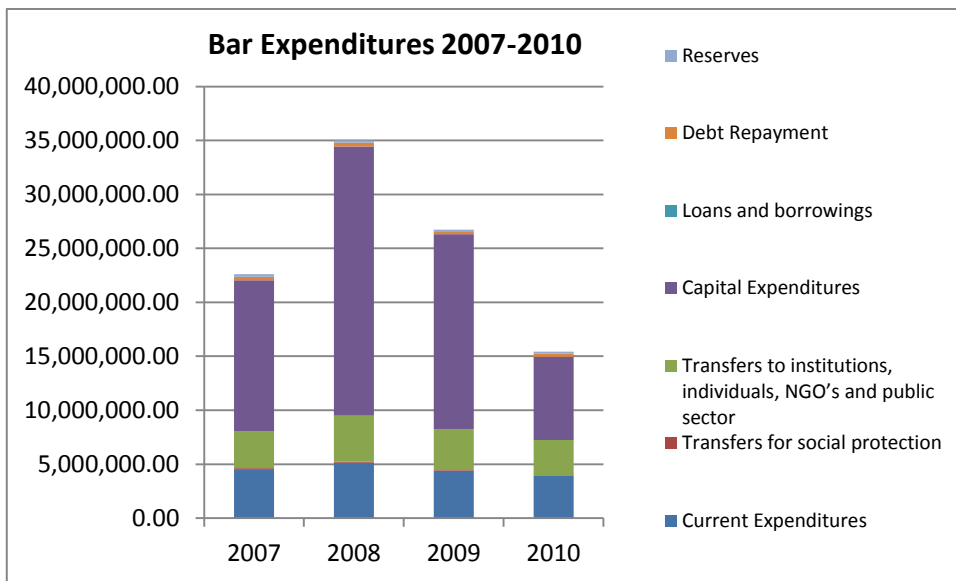
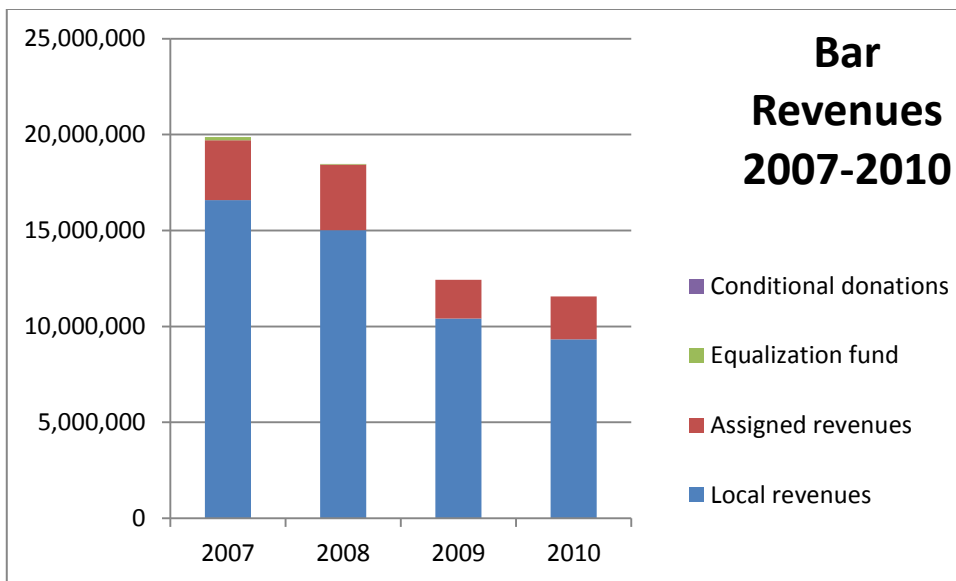
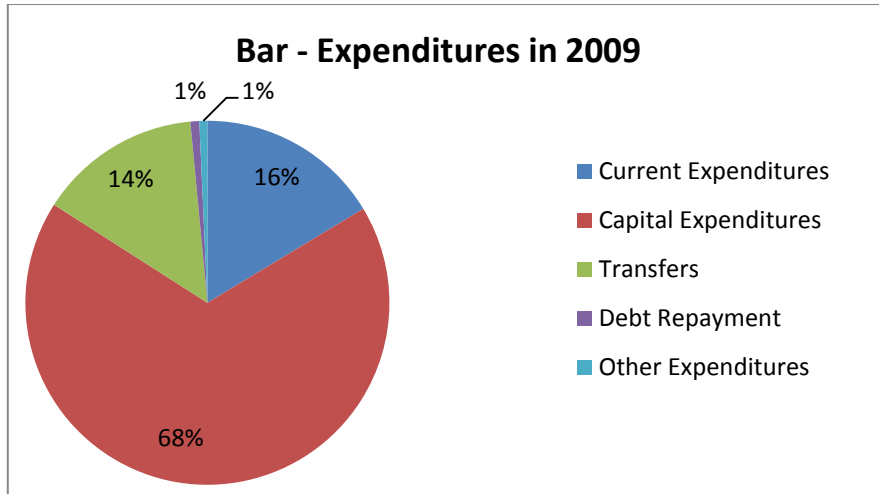
Municipality	Local administration	Public institutions	Public enterprises
Bar	287		509

Municipal financial units

Municipality	Number of employed in the Secretariat for municipal finance		Number of employed in the tax departments	
	Male	Female	Male	Female
Bar	1	9	12	21

Budgetary and financial information





Municipality BERANE



Demographic data

Area: **717** Km² (rank: 8)

Population: **35,068** (rank: 6)

Density: 49 Inh/km² (rank 10)



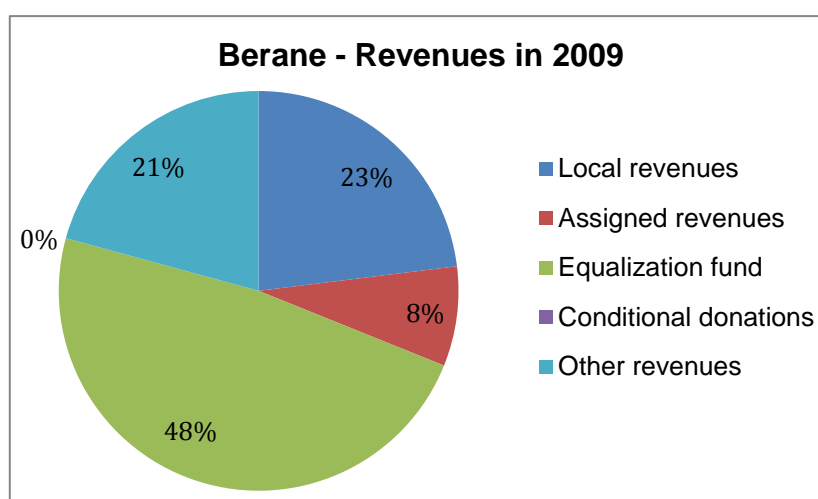
Municipal administration

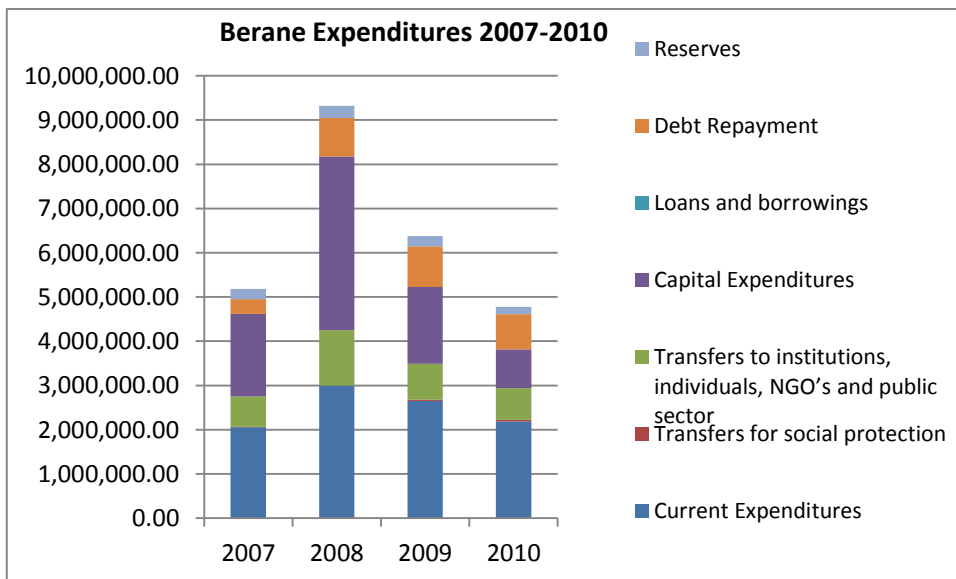
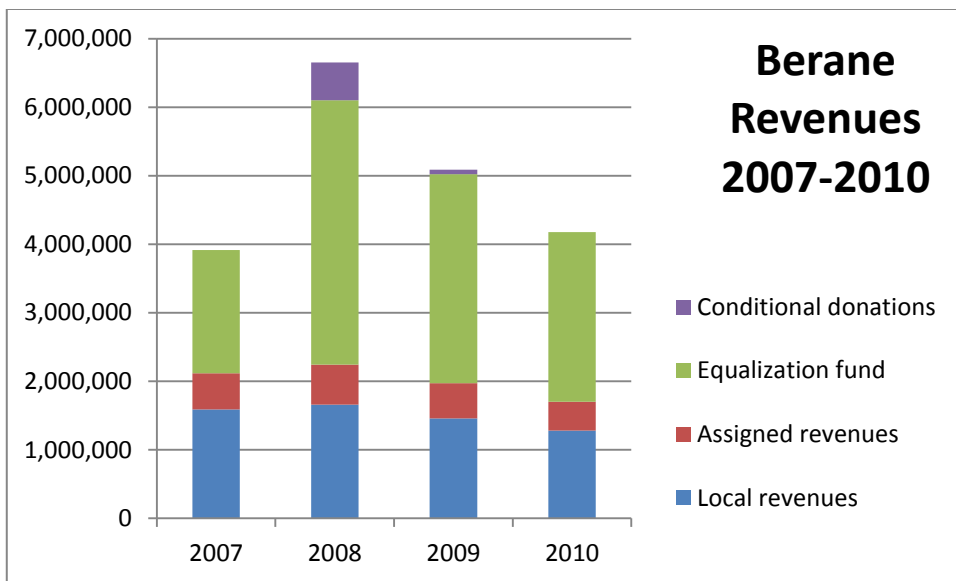
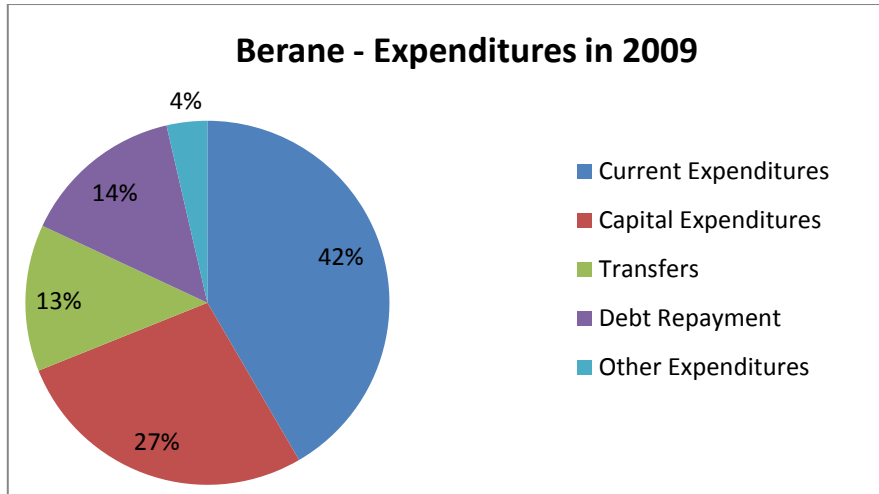
Municipality	Local administration	Public institutions	Public enterprises
Berane	352	58	279

Municipal financial units

Municipality	Number of employed in the Secretariat for municipal finance		Number of employed in the tax departments	
	Male	Female	Male	Female
Berane	2	5	15	11

Budgetary and financial information





Municipality BIJELO POLJE



Demographic data

Area: **924** Km² (rank: 4)

Population: **50,284** (rank: 3)

Density: 54 Inh/km² (rank 8)



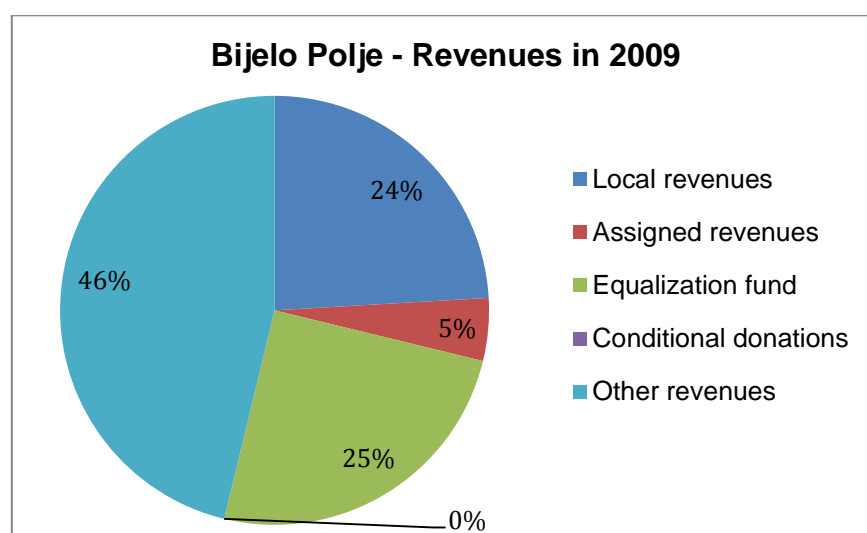
Municipal administration

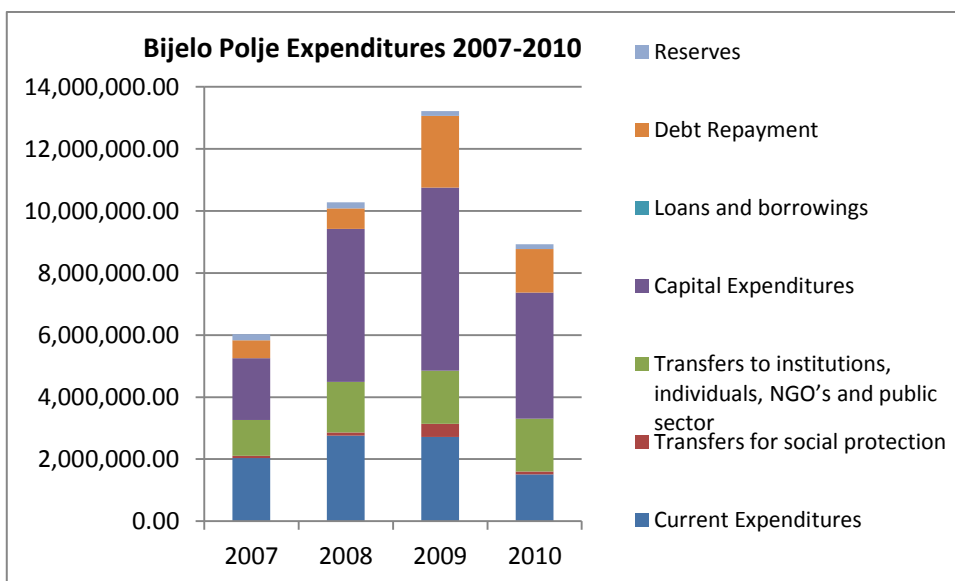
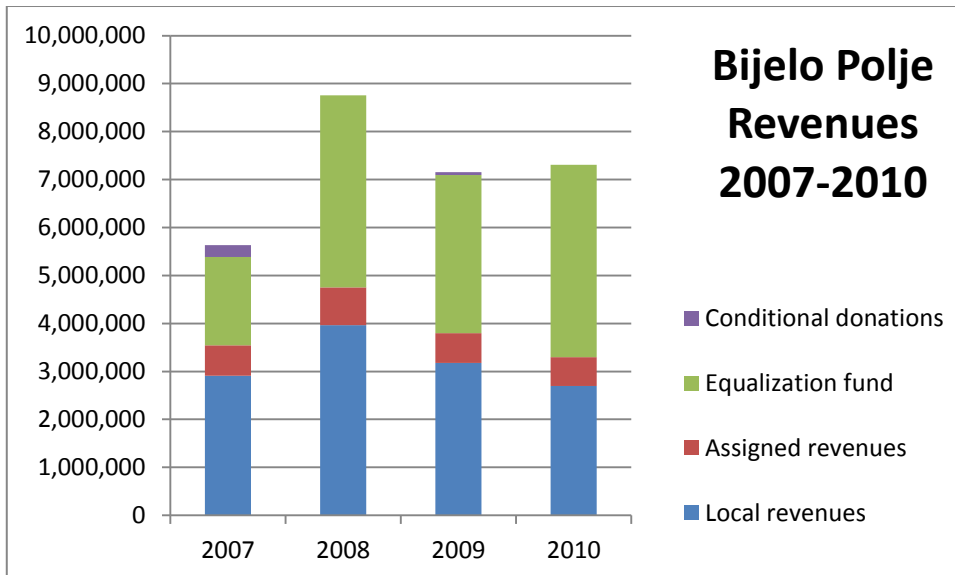
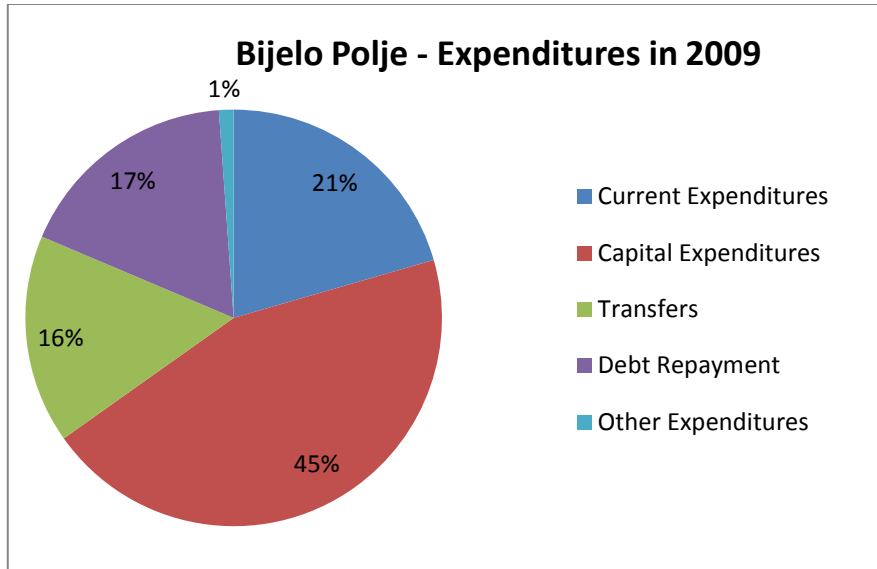
Municipality	Local administration	Public institutions	Public enterprises
Bijelo Polje	348	49	

Municipal financial units

Municipality	Number of employed in the Secretariat for municipal finance		Number of employed in the tax departments	
	Male	Female	Male	Female
Bijelo Polje	11	20	31	22

Budgetary and financial information





Municipality BUDVA



Demographic data

Area: **122** Km² (rank: 20)

Population: **15,909** (rank: 13)

Density: 130 Inh/km² (rank 3)



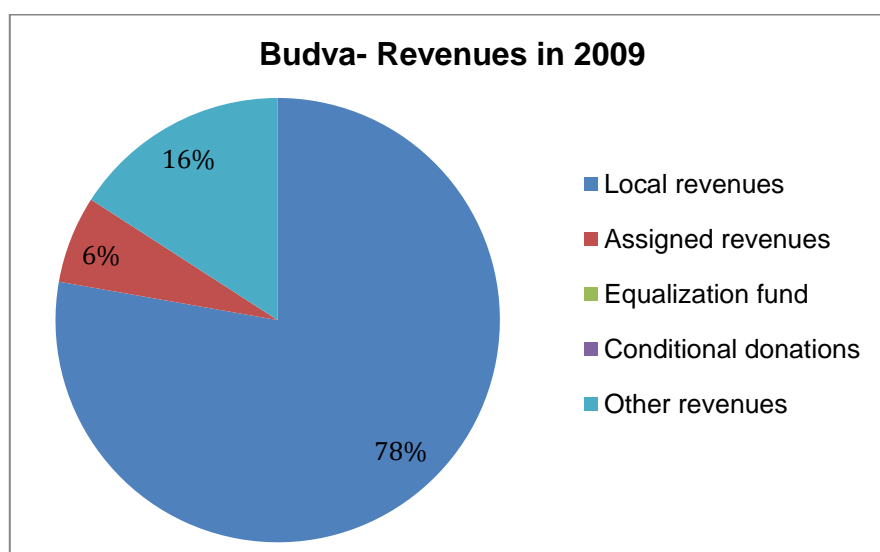
Municipal administration:

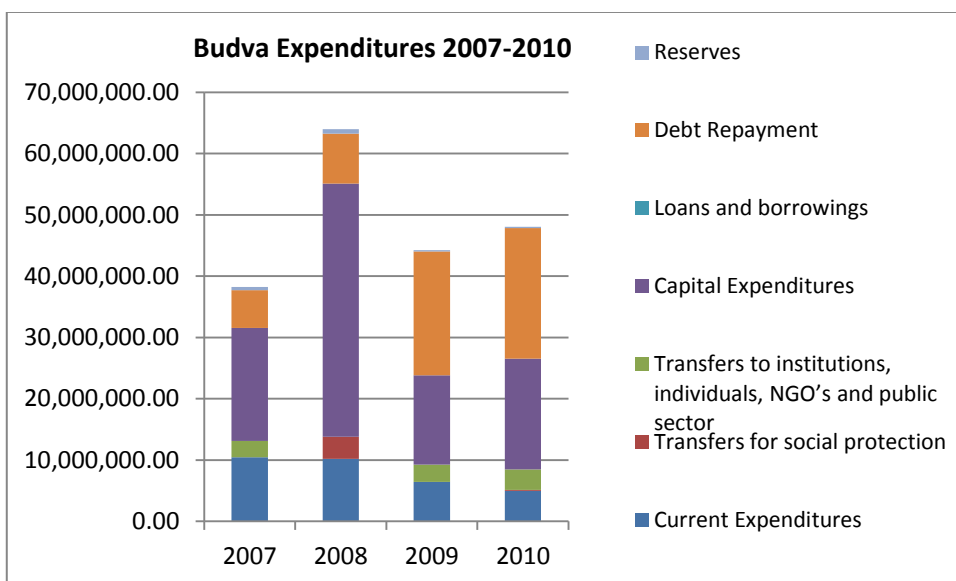
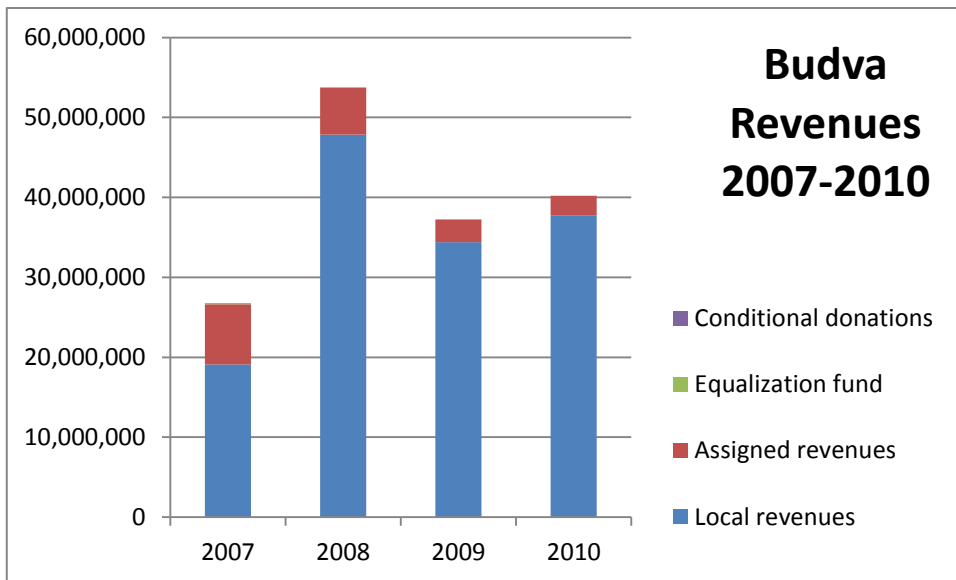
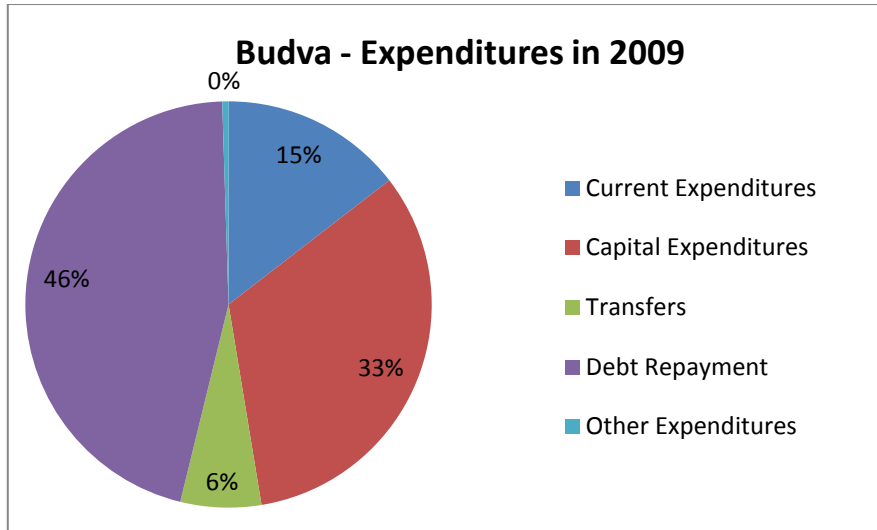
Municipality	Local administration	Public institutions	Public enterprises
Budva	373	106	457

Municipal financial units

Municipality	Number of employed in the Secretariat for municipal finance		Number of employed in the tax departments	
	Male	Female	Male	Female
Budva			14	23

Budgetary and financial information





Municipality DANILOVGRAD



Demographic data

Area: **501** Km² (rank: 11)

Population: **16,523** (rank: 12)

Density: 33 Inh/km² (rank 12)

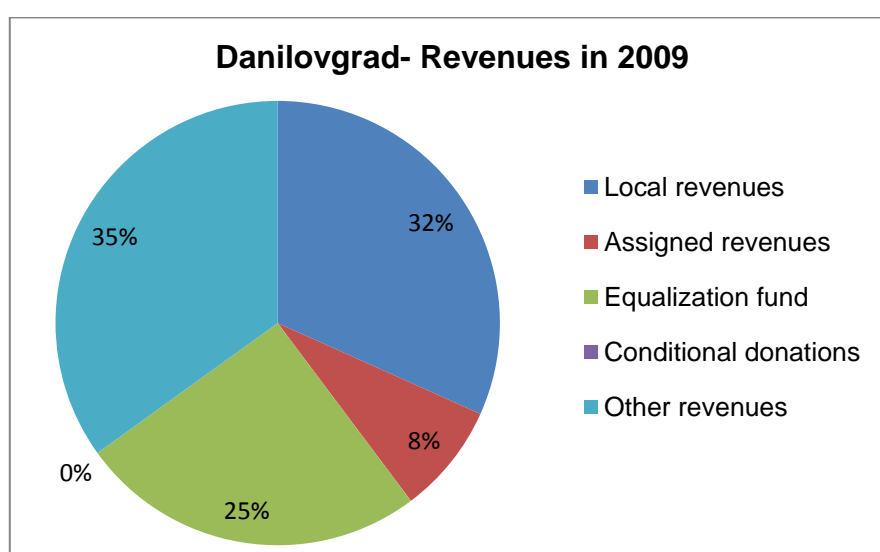
Municipal administration

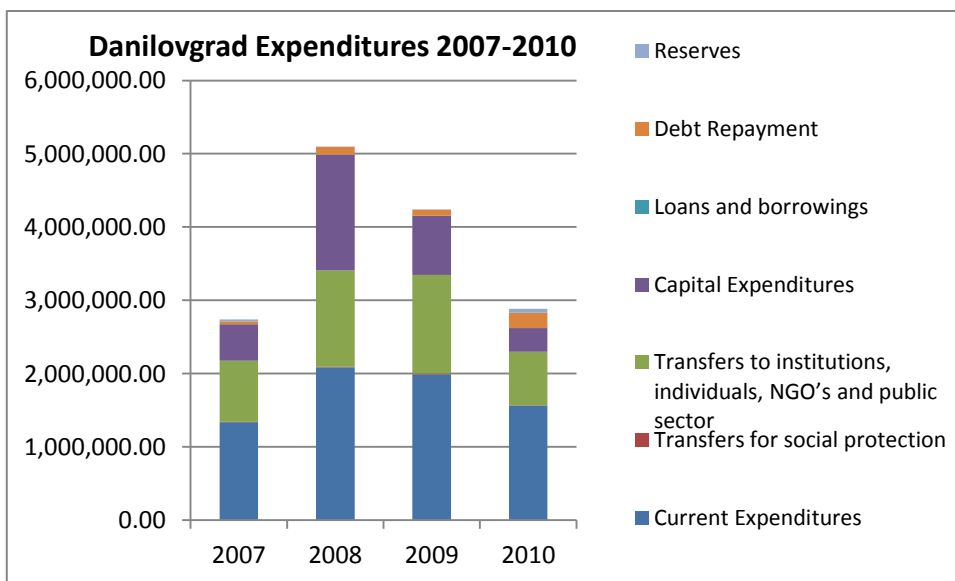
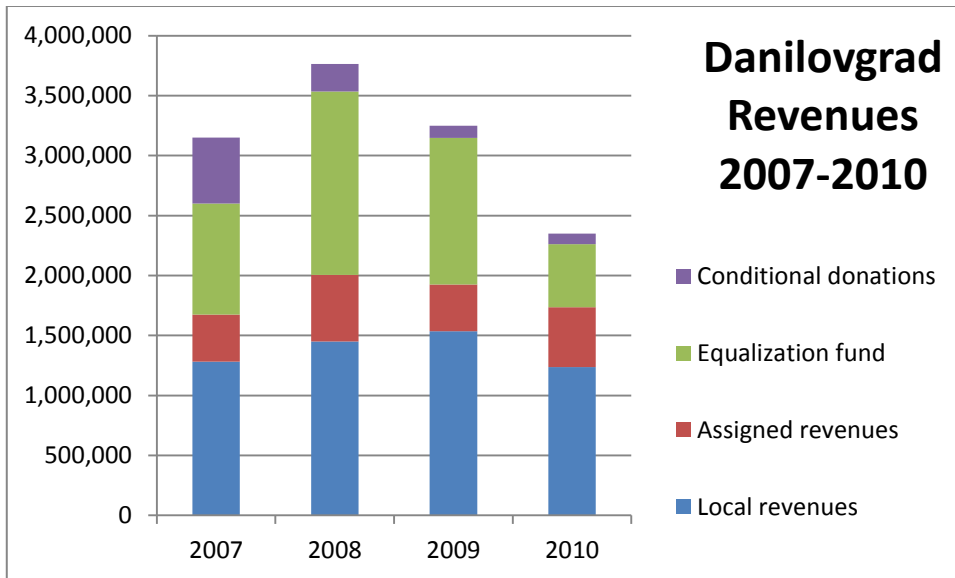
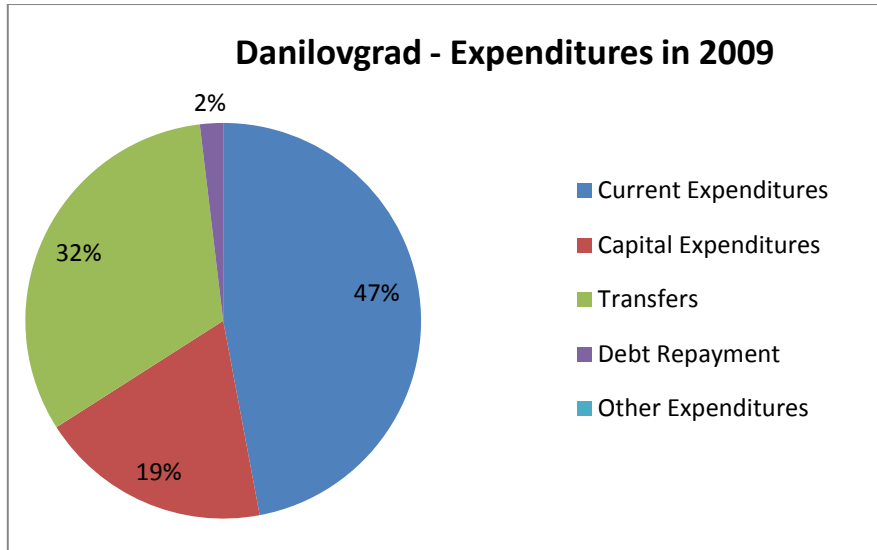
Municipality	Local administration	Public institutions	Public enterprises
Danilovgrad	117	36	112

Municipal financial units

Municipality	Number of employed in the Secretariat for municipal finance		Number of employed in the tax departments	
	Male	Female	Male	Female
Danilovgrad	1	7	4	3

Budgetary and financial information:





Municipality ŽABLJAK



Demographic data

Area: **445** Km² (rank: 13)

Population: **4,204** (rank: 20)

Density: 9 Inh/km² (rank 19)

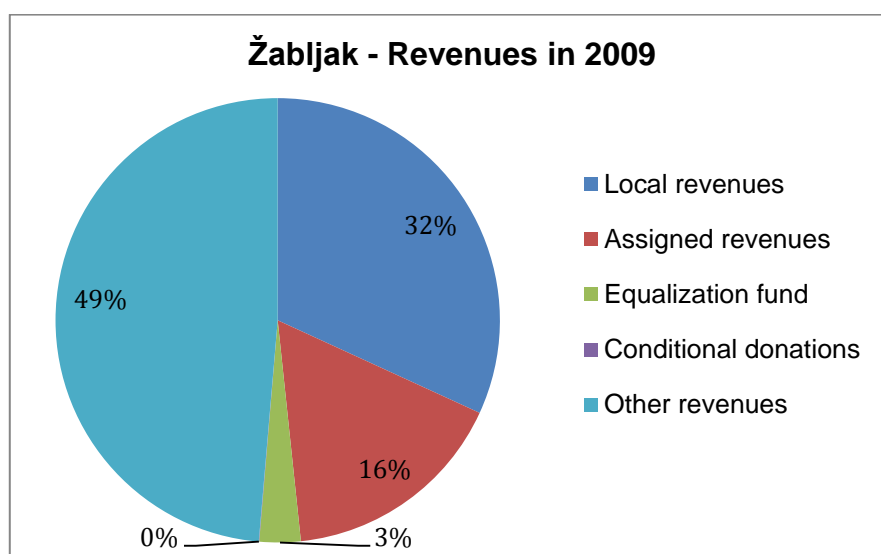
Municipal administration

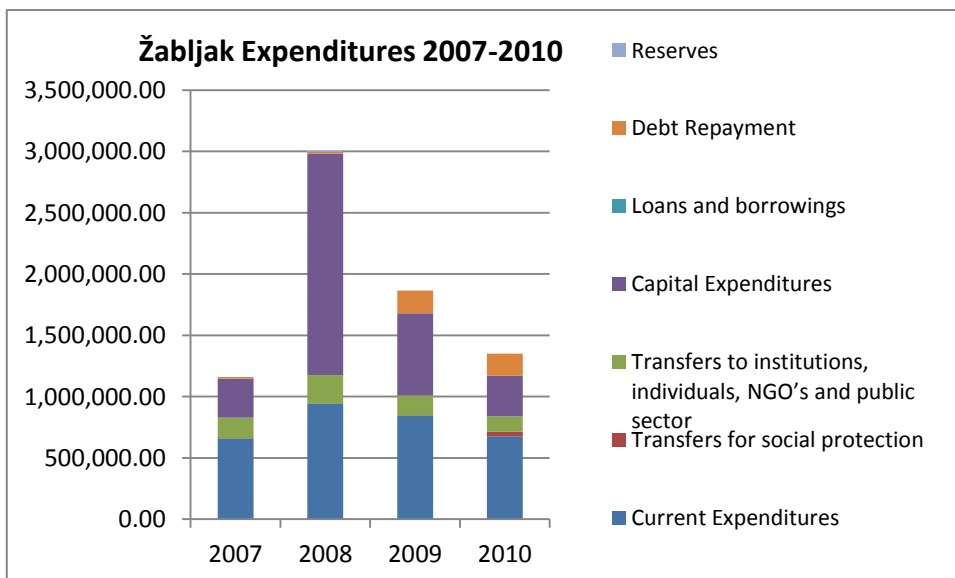
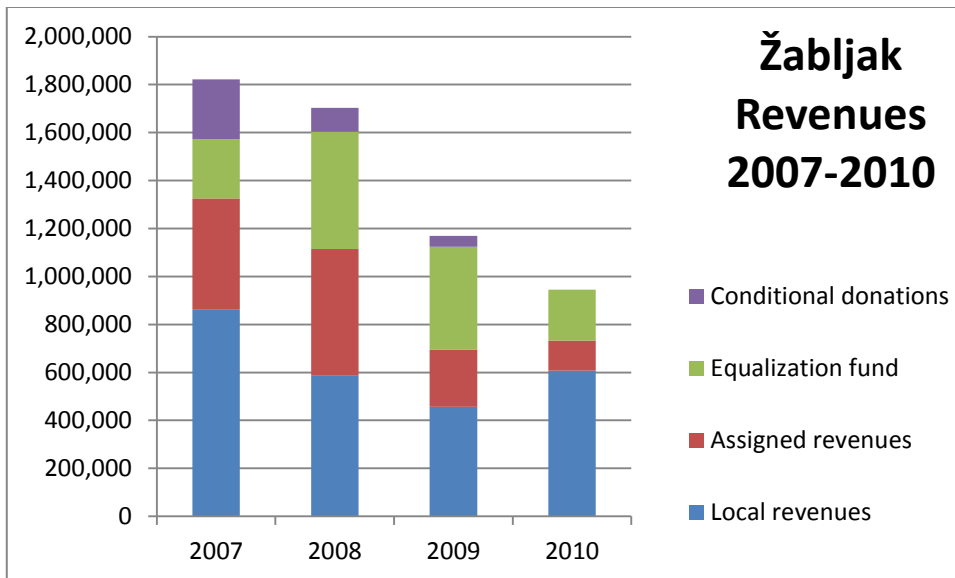
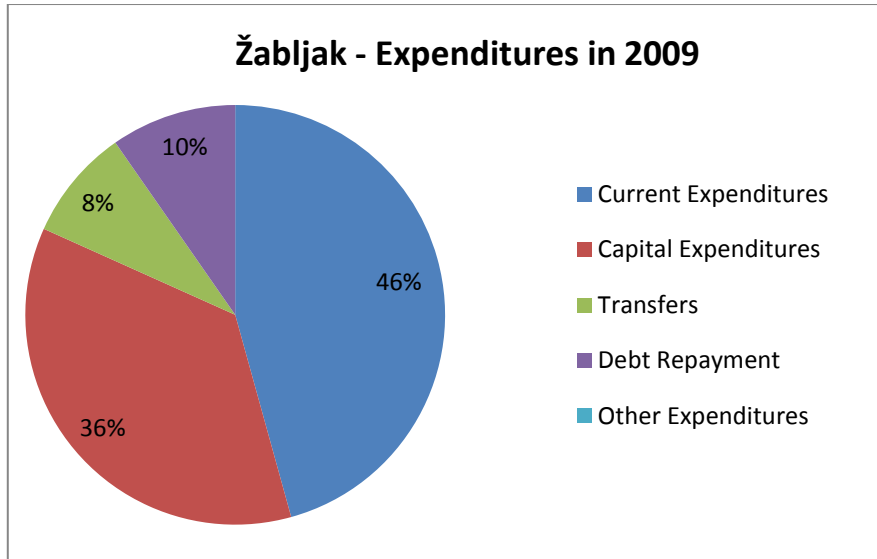
<i>Municipality</i>	<i>Local administration</i>	<i>Public institutions</i>	<i>Public enterprises</i>
Žabljak	62	12	40

Municipal financial units

<i>Municipality</i>	<i>Number of employed in the Secretariat for municipal finance</i>		<i>Number of employed in the tax departments</i>	
	<i>Male</i>	<i>Female</i>	<i>Male</i>	<i>Female</i>
Žabljak	3	3	2	1

Budgetary and financial information





Municipality KOLAŠIN



Demographic data

Area: **897** Km² (rank: 6)

Population: **9,949** (rank: 17)

Density: 10 Inh/km² (rank 18)



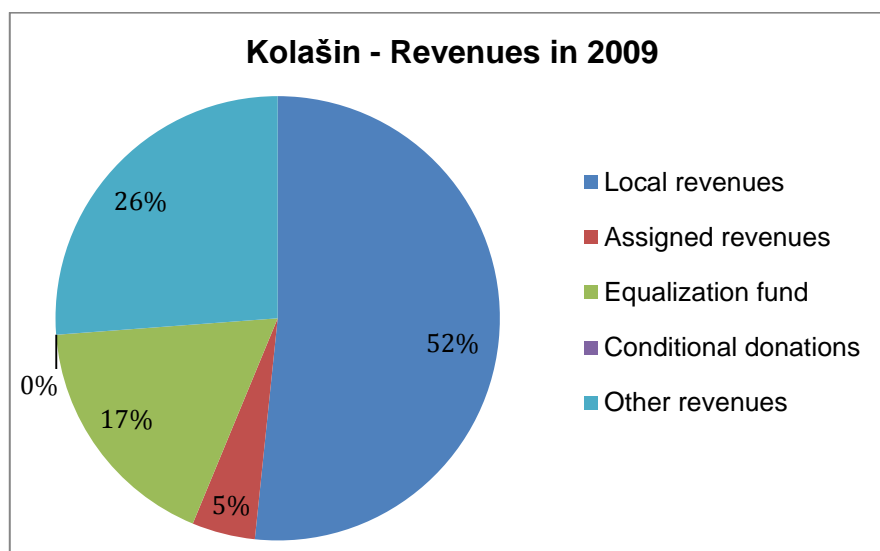
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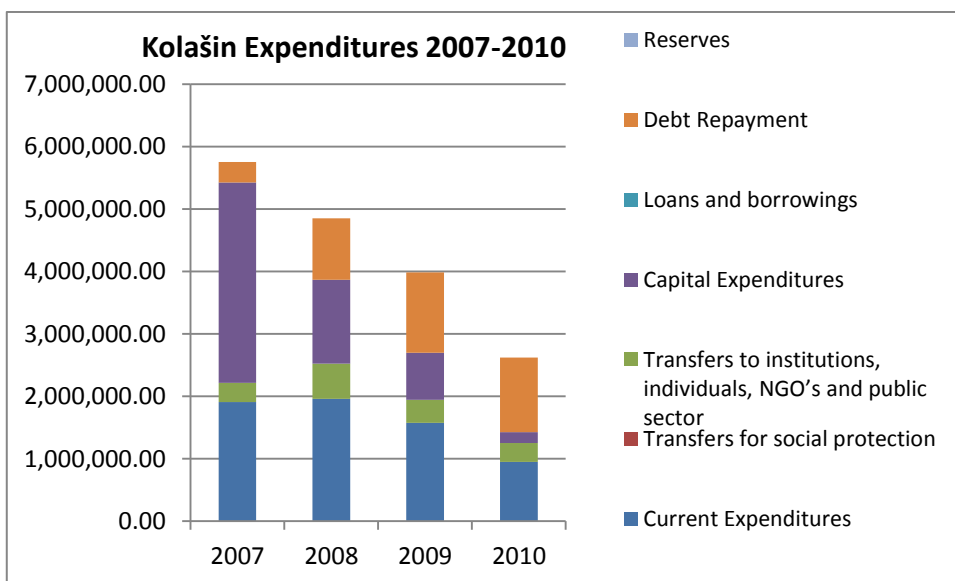
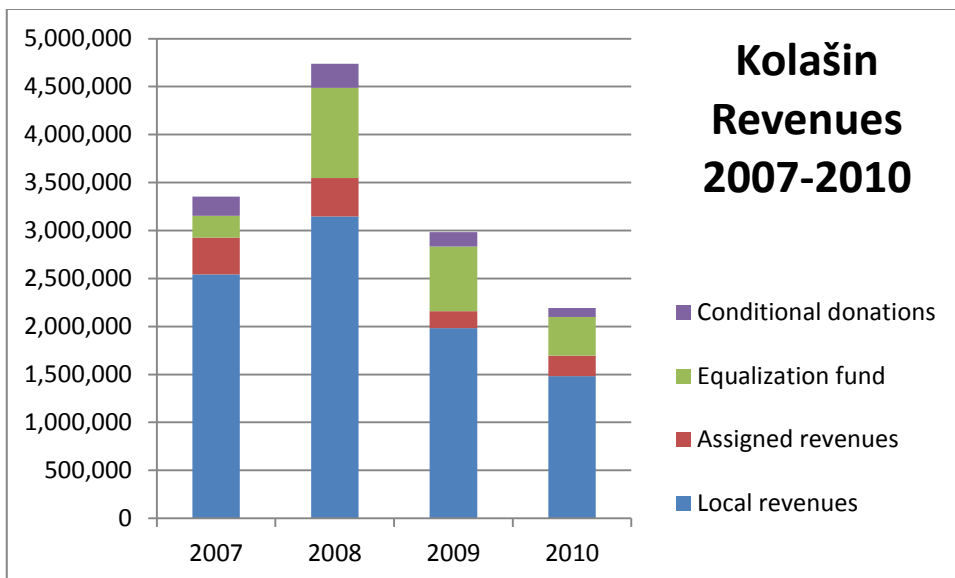
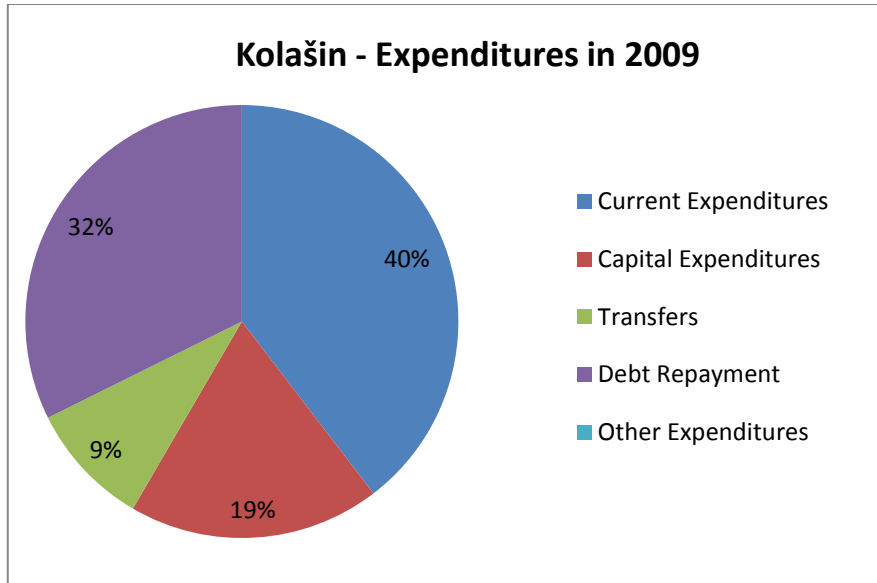
Municipality	Local administration	Public institutions	Public enterprises
Kolašin	183	41	74

Municipal financial units

Municipality	Number of employed in the Secretariat for municipal finance		Number of employed in the tax departments	
	Male	Female	Male	Female
Kolašin	8	5	14	8

Budgetary and financial information





Municipality KOTOR



Demographic data

Area: 335 Km² (rank: 16)

Population: 22,947 (rank: 8)

Density: 68 Inh/km² (rank 6)



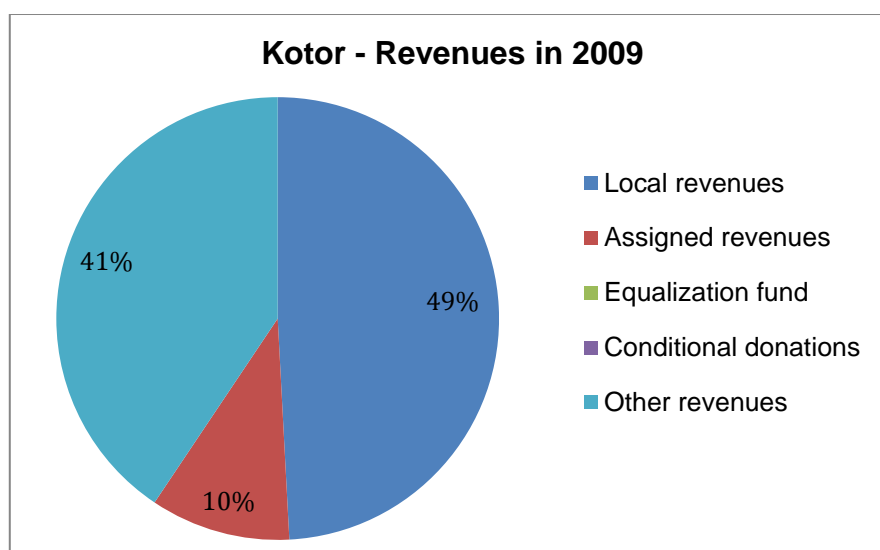
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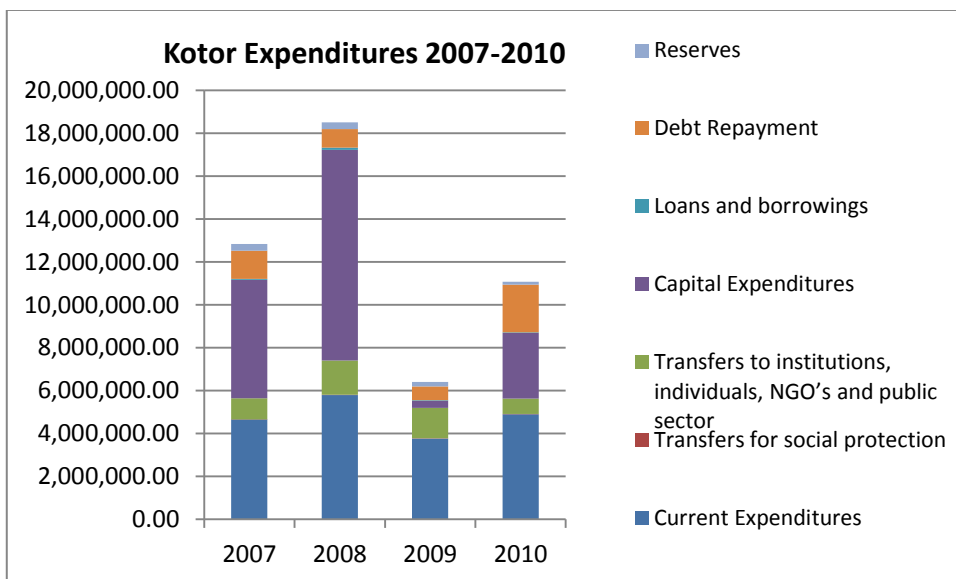
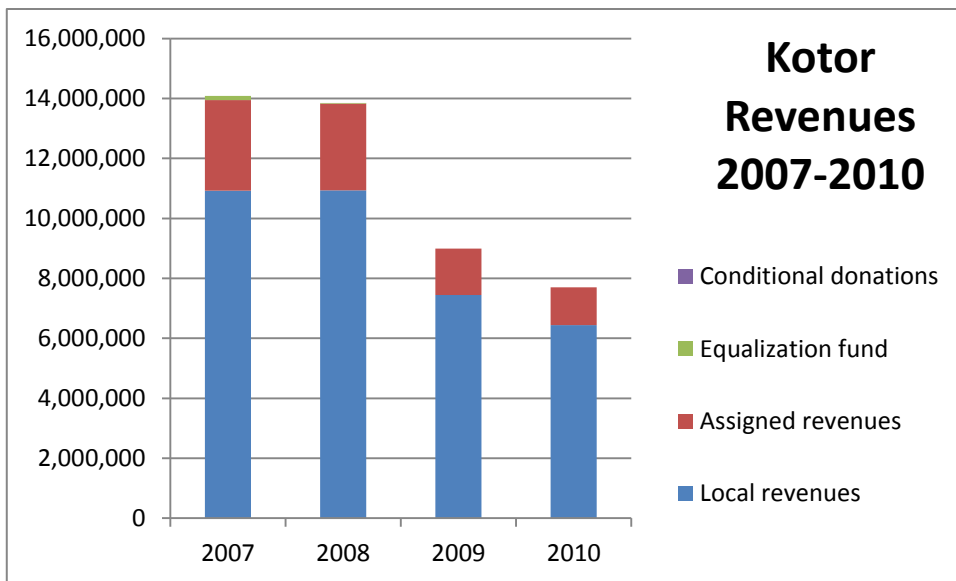
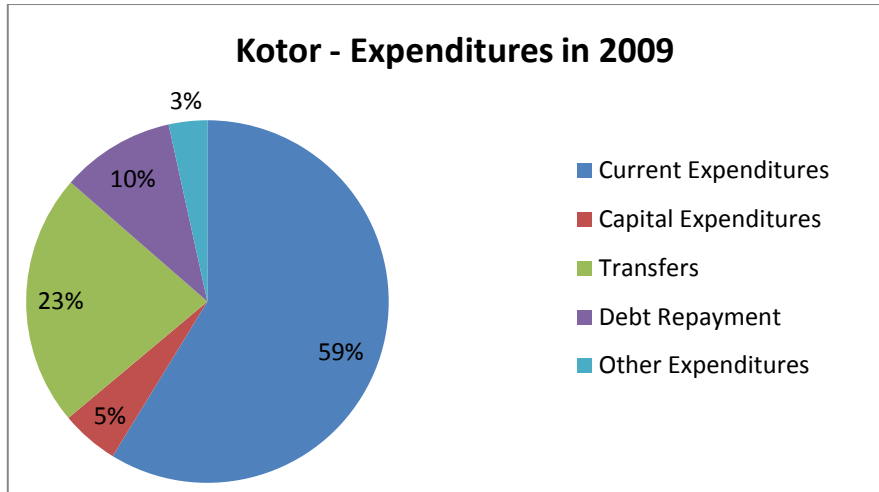
Municipality	Local administration	Public institutions	Public enterprises
Kotor	163	35	240

Municipal financial units

Municipality	Number of employed in the Secretariat for municipal finance		Number of employed in the tax departments	
	Male	Female	Male	Female
Kotor	4	18	3	9

Budgetary and financial information:





Municipality MOJKOVAC



Demographic data

Area: **367** Km² (rank: 15)

Population: **10,006** (rank: 16)

Density: 27 Inh/km² (rank 15)



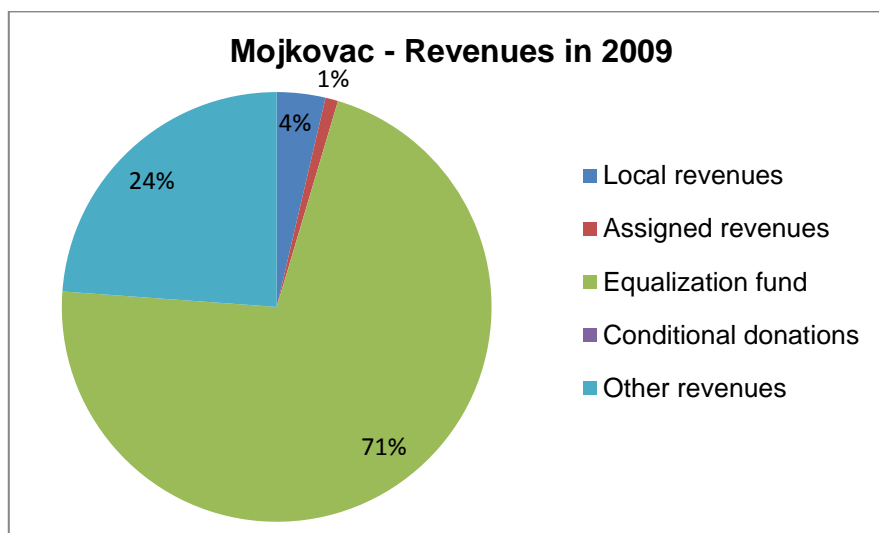
Municipal administration

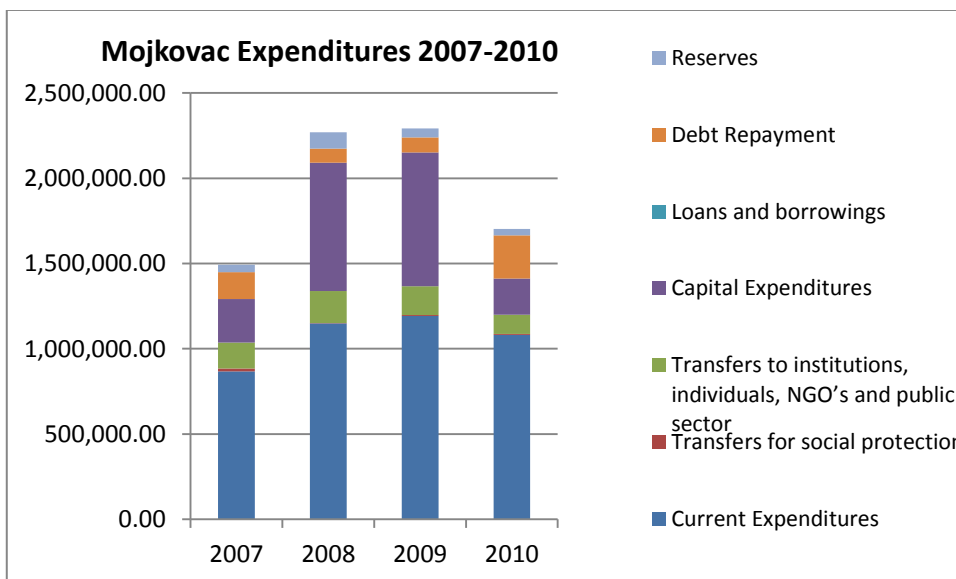
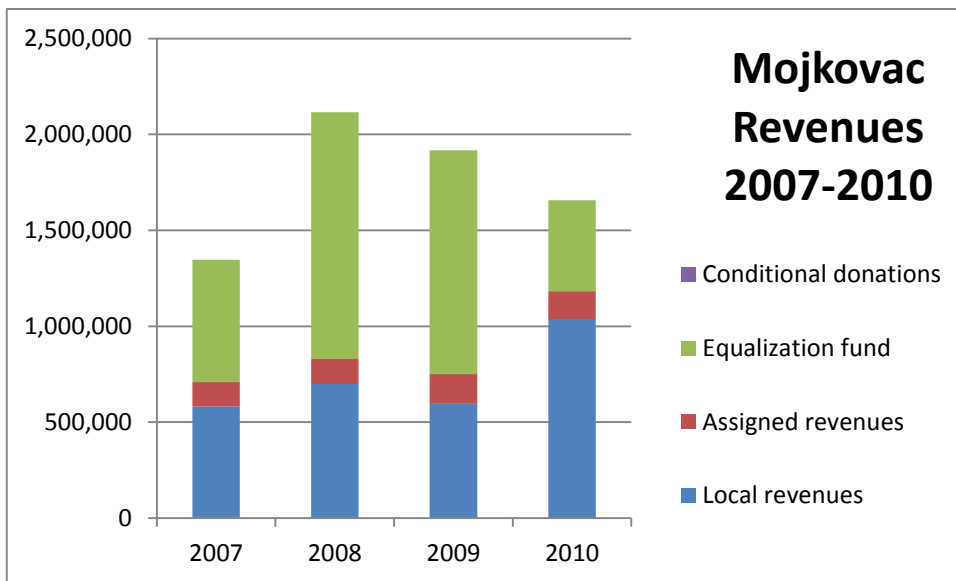
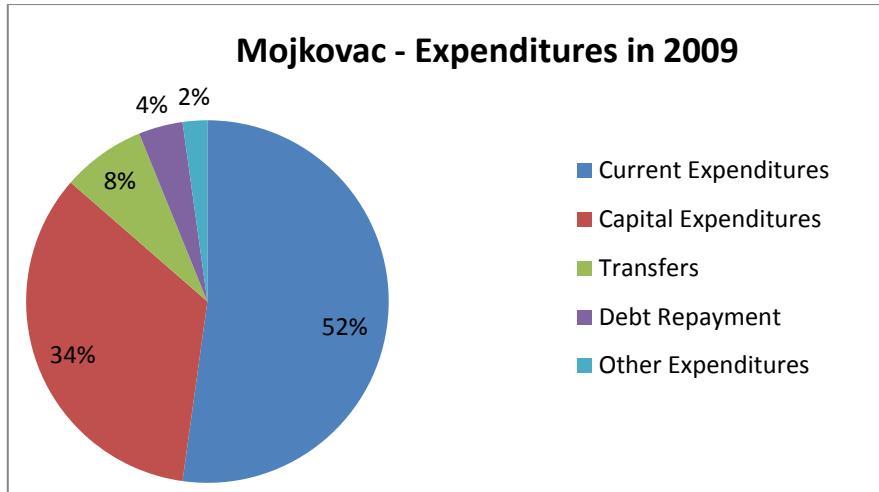
Municipality	Local administration	Public institutions	Public enterprises
Mojkovac	64	12	45

Municipal financial units

Municipality	Number of employed in the Secretariat for municipal finance		Number of employed in the tax departments	
	Male	Female	Male	Female
Mojkovac	2	1	1	3

Budgetary and financial information





Municipality NIKŠIĆ



Demographic data

Area: **2065** Km² (rank: 1)

Population: **75,282** (rank: 2)

Density: 36 Inh/km² (rank 11)



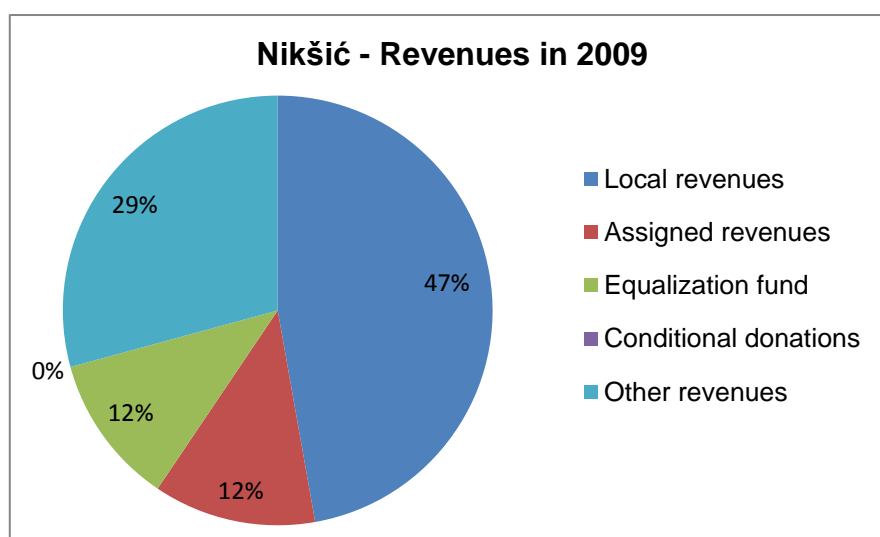
Municipal administration

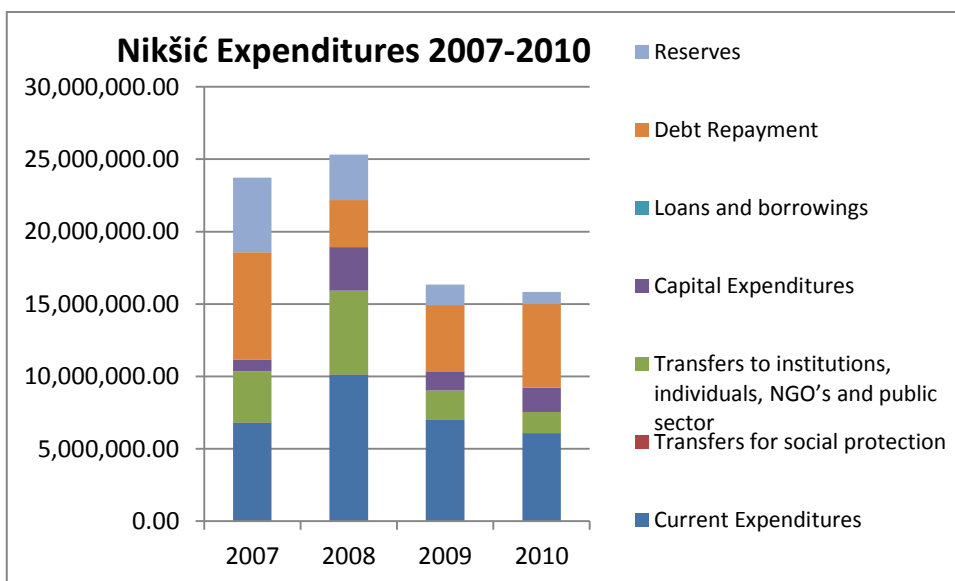
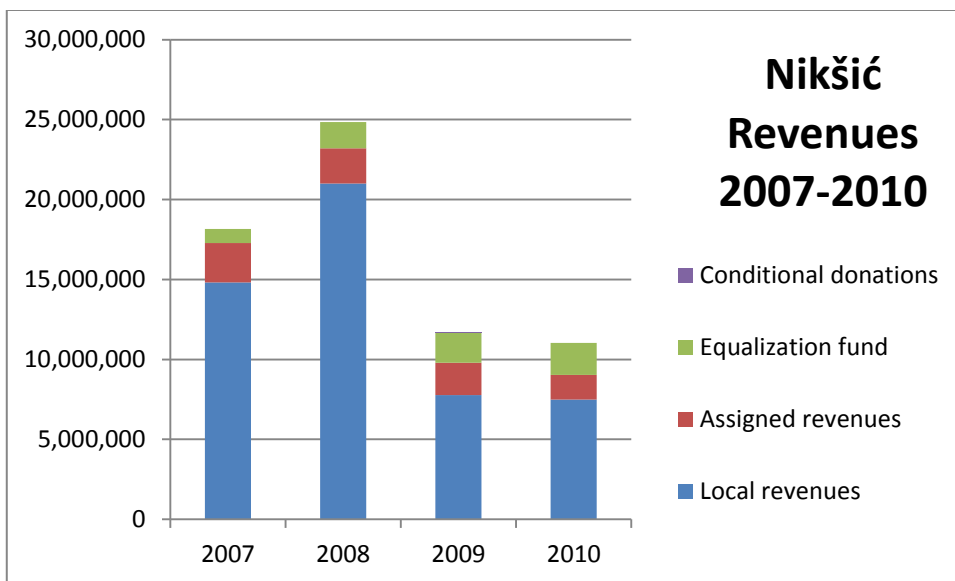
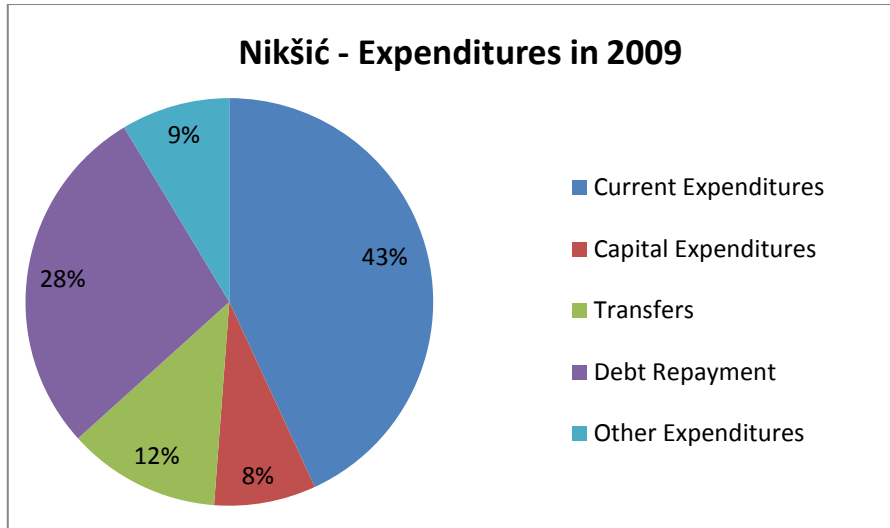
Municipality	Local administration	Public institutions	Public enterprises
Nikšić	500	122	555

Municipal financial units

Municipality	Number of employed in the Secretariat for municipal finance		Number of employed in the tax departments	
	Male	Female	Male	Female
Nikšić	14	41	10	22

Budgetary and financial information





Municipality PLAV



Demographic data

Area: **486** Km² (rank: 12)

Population: **13,805** (rank: 14)

Density: 28 Inh/km² (rank 13)

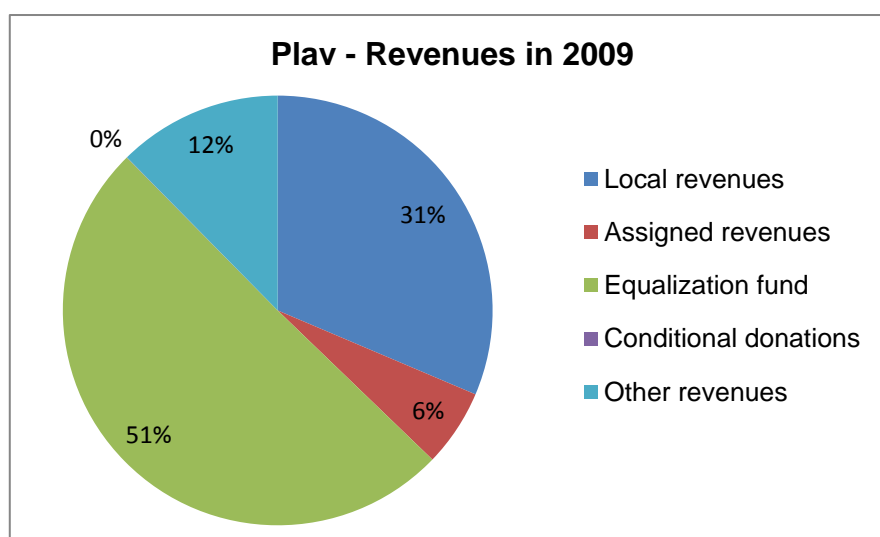
Municipal administration:

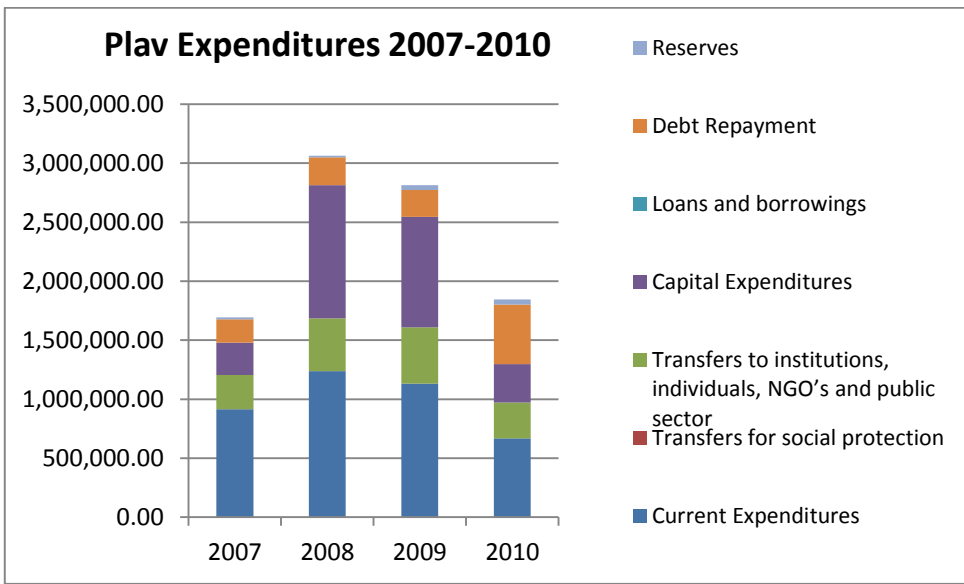
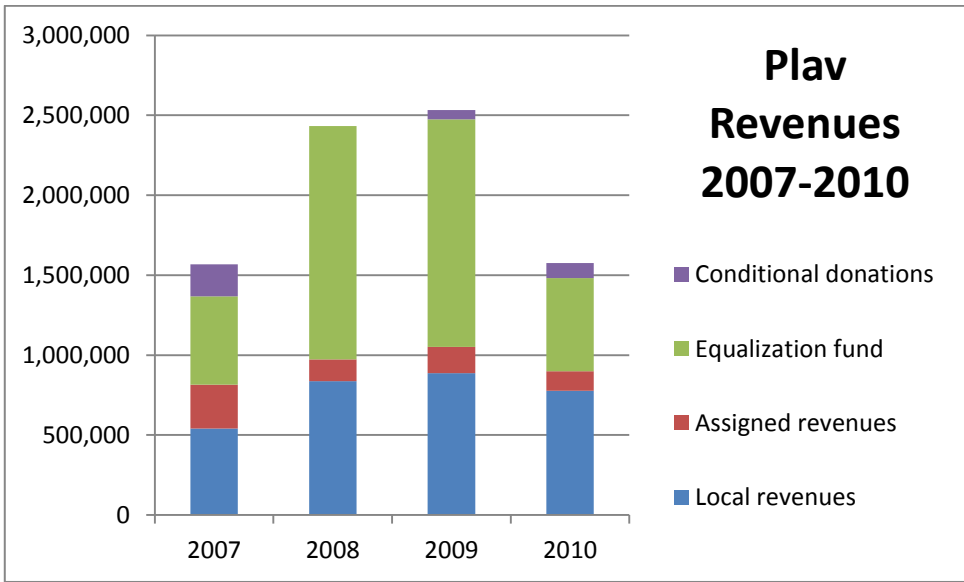
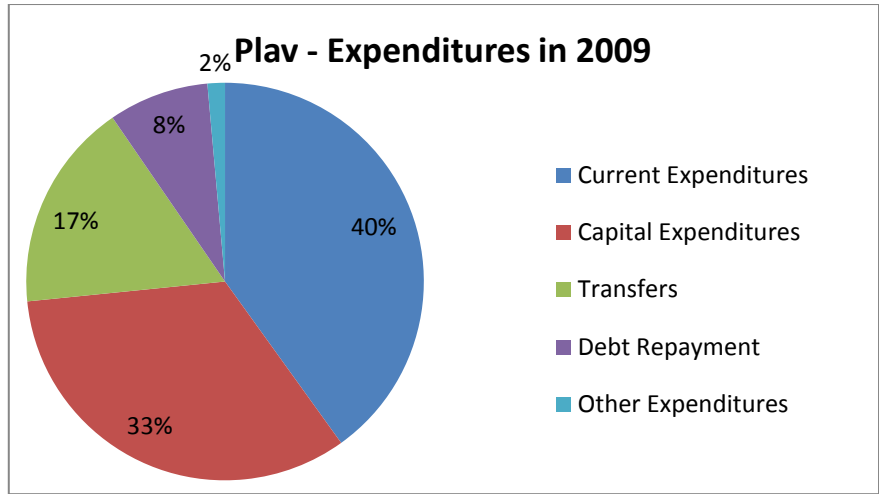
Municipality	Local administration	Public institutions	Public enterprises
Plav	119	24	77

Municipal financial units

Municipality	Number of employed in the Secretariat for municipal finance		Number of employed in the tax departments	
	Male	Female	Male	Female
Plav	3	4	12	2

Budgetary and financial information:





Municipality PLUŽINE



Demographic data

Area: **854** Km² (rank: 7)

Population: **4,274** (rank: 19)

Density: 5 Inh/km² (rank 21)

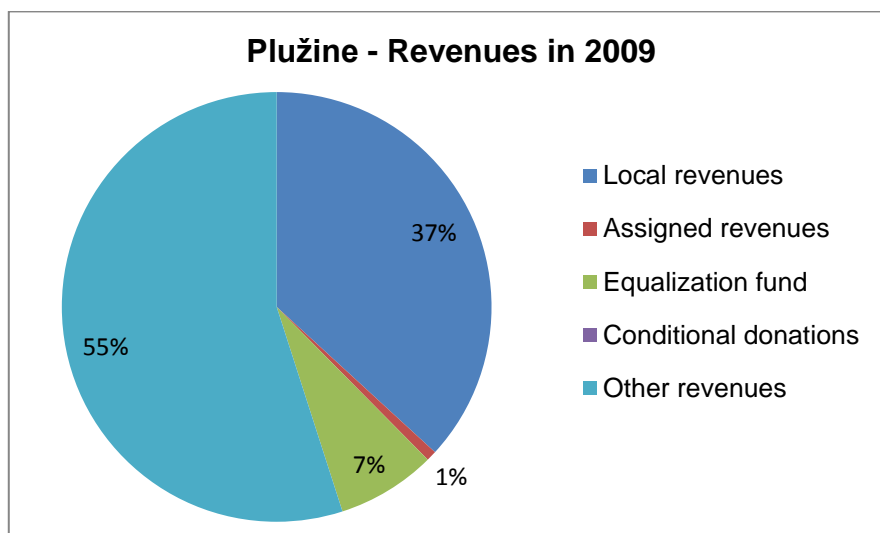
Municipal administration

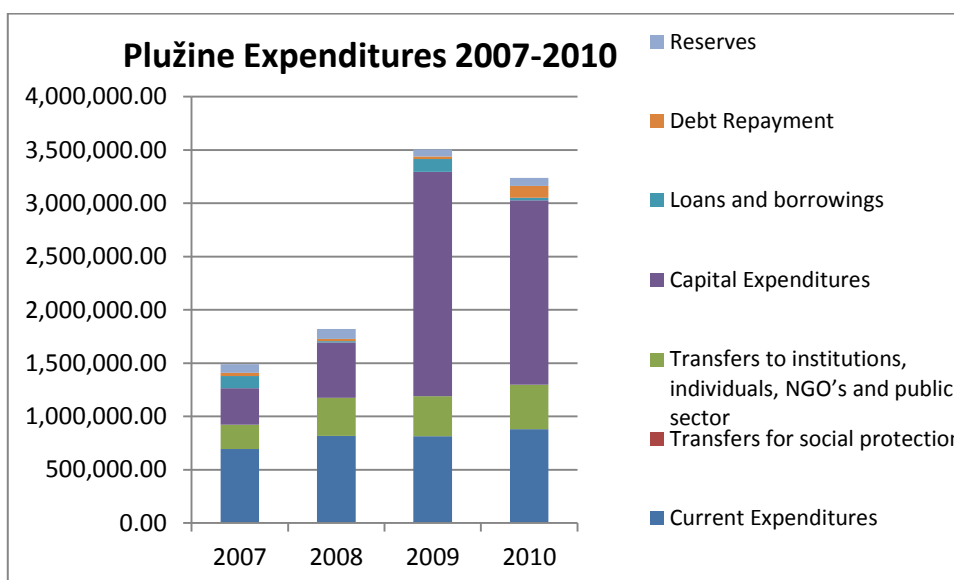
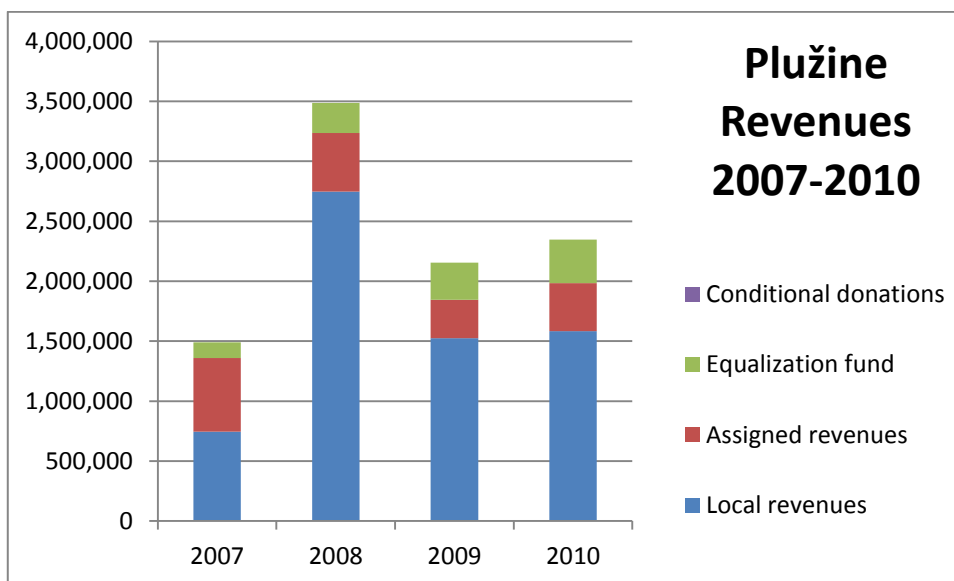
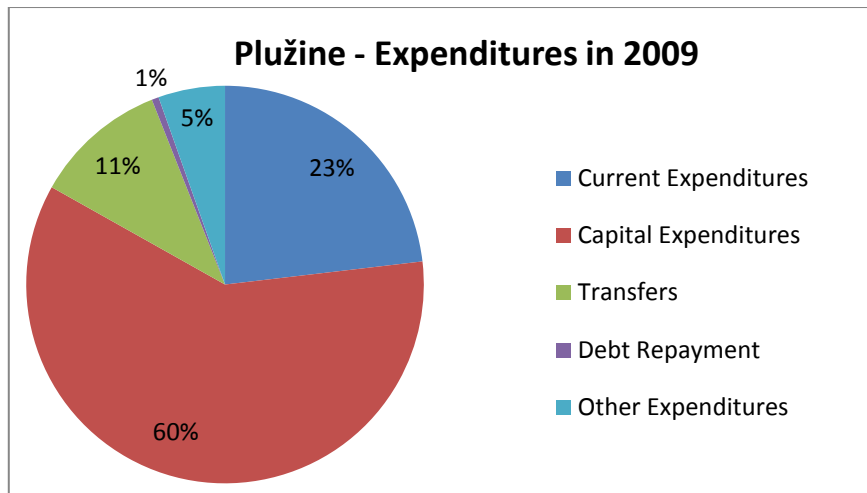
Municipality	Local administration	Public institutions	Public enterprises
Plužine	36	9	27

Municipal financial units

Municipality	Number of employed in the Secretariat for municipal finance		Number of employed in the tax departments	
	Male	Female	Male	Female
Plužine		5		4

Budgetary and financial information





Municipality PLJEVLJA



Demographic data

Area: **1,346** Km² (rank: 3)

Population: **36,918** (rank: 5)

Density: 27 Inh/km² (rank 14)



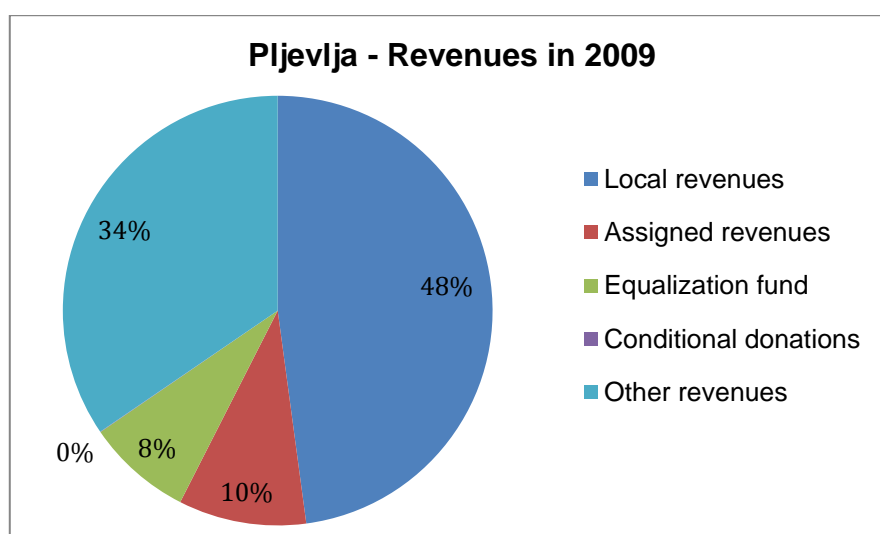
Municipal administration

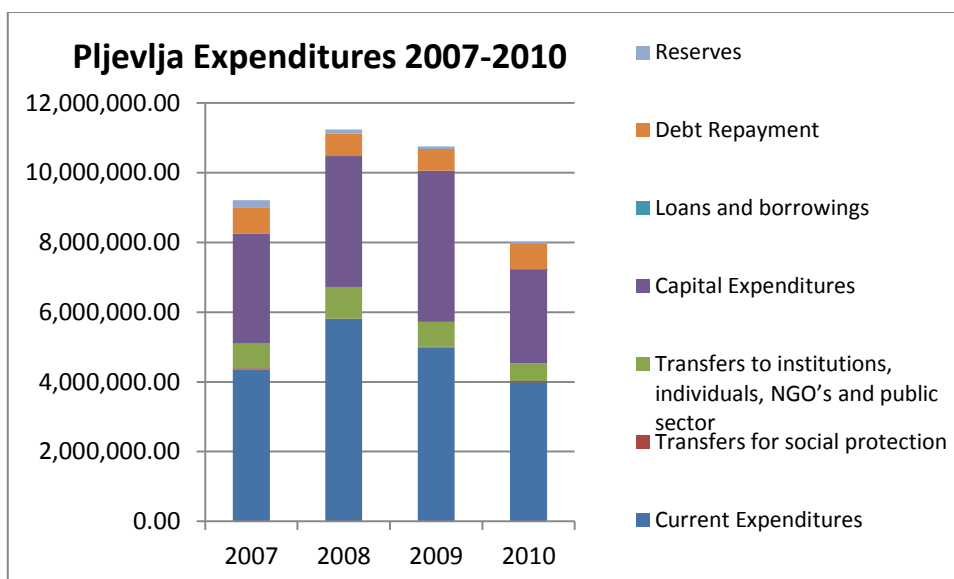
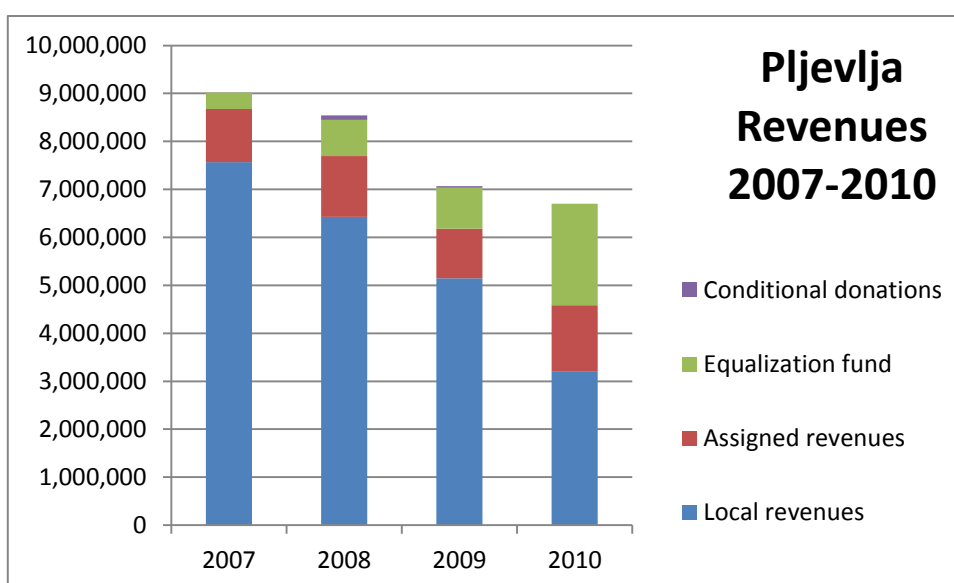
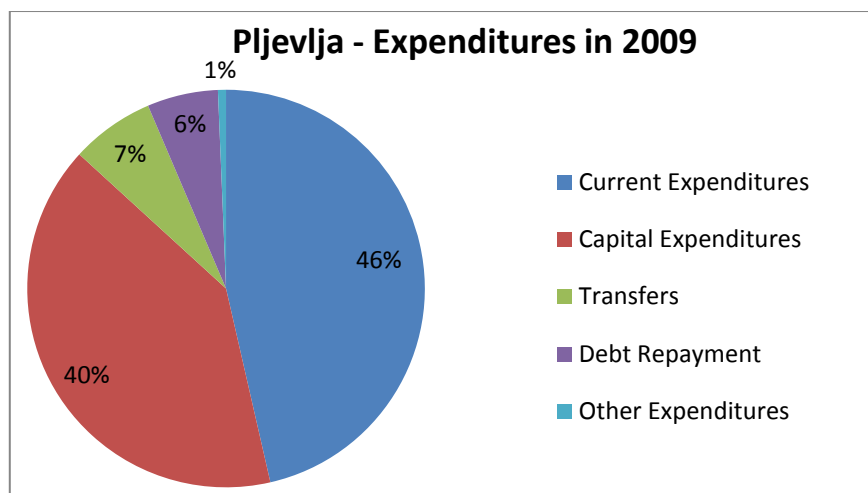
Municipality	Local administration	Public institutions	Public enterprises
Pljevlja	262	45	417

Municipal financial units

Municipality	Number of employed in the Secretariat for municipal finance		Number of employed in the tax departments	
	Male	Female	Male	Female
Pljevlja	7	11	4	10

Budgetary and financial information:





Capital PODGORICA



Demographic data

Area: **1,399** Km² (rank: 2)

Population: **169,132** (rank: 1)

Density: 121 Inh/km² (rank 4)

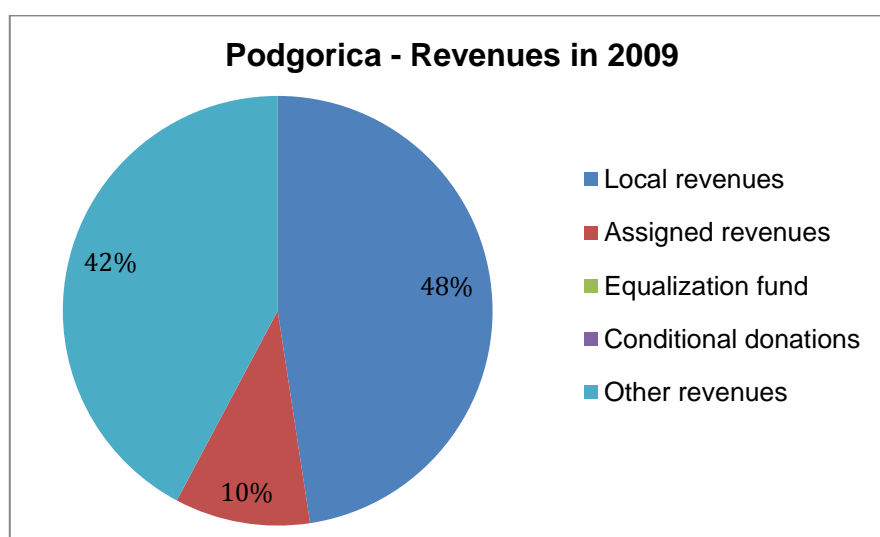
Municipal administration

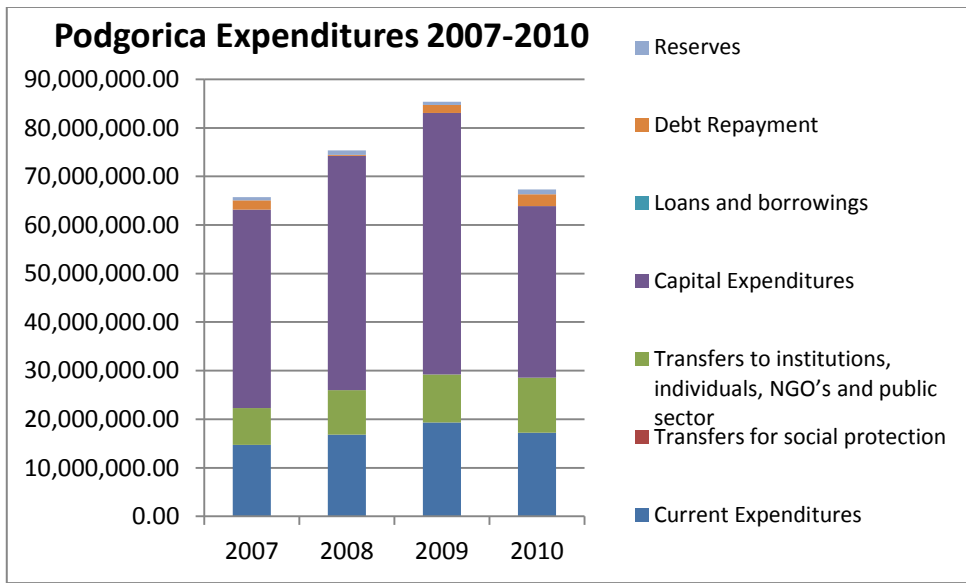
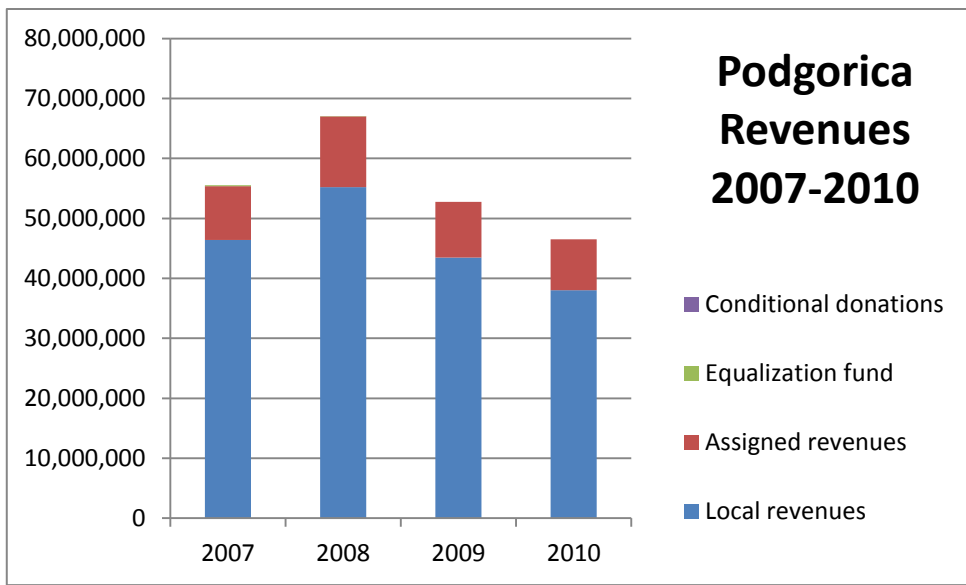
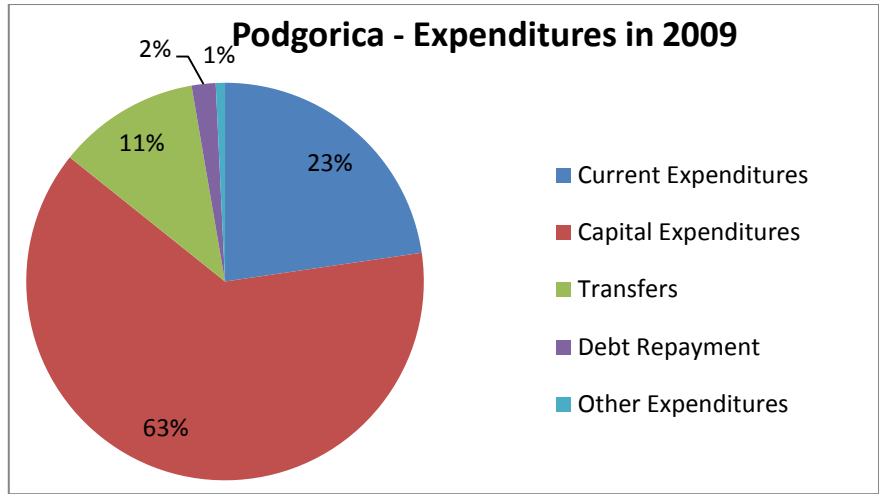
<i>Municipality</i>	<i>Local administration</i>	<i>Public institutions</i>	<i>Public enterprises</i>
Podgorica	602	188	1,371

Municipal financial units

<i>Municipality</i>	<i>Number of employed in the Secretariat for municipal finance</i>		<i>Number of employed in the tax departments</i>	
	<i>Male</i>	<i>Female</i>	<i>Male</i>	<i>Female</i>
Podgorica	6	17	14	19

Budgetary and financial information:





Municipality ROŽAJE



Demographic data

Area: 432 Km² (rank: 14)

Population: 22,693 (rank: 9)

Density: 53 Inh/km² (rank 9)

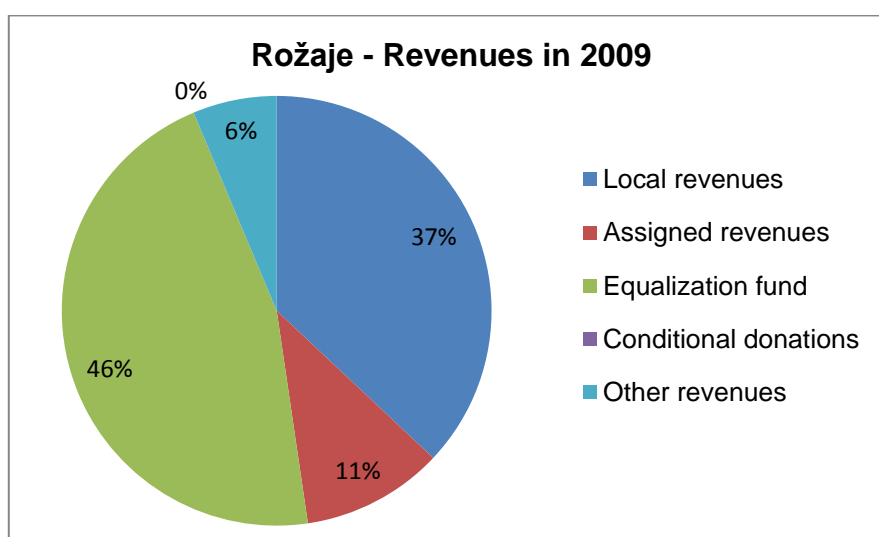
Municipal administration

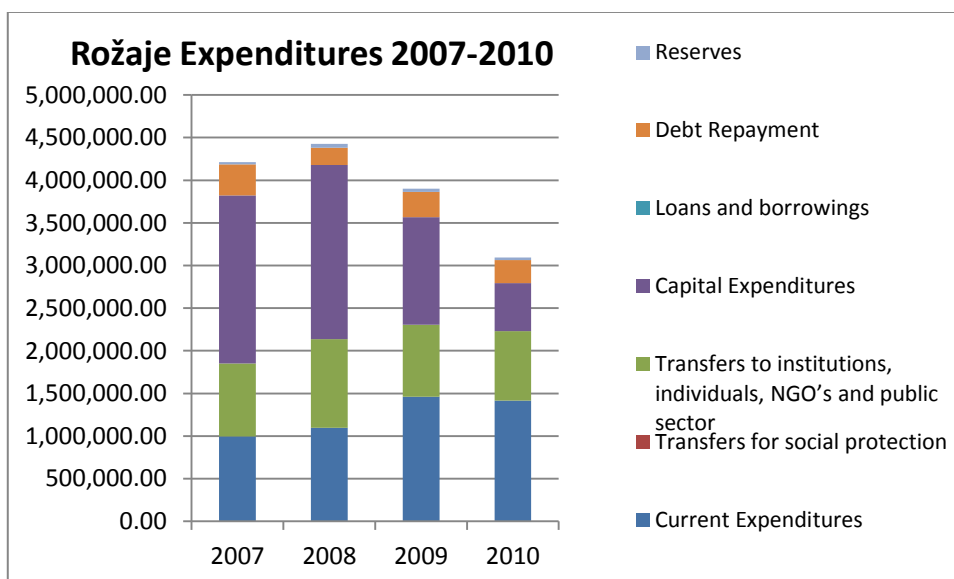
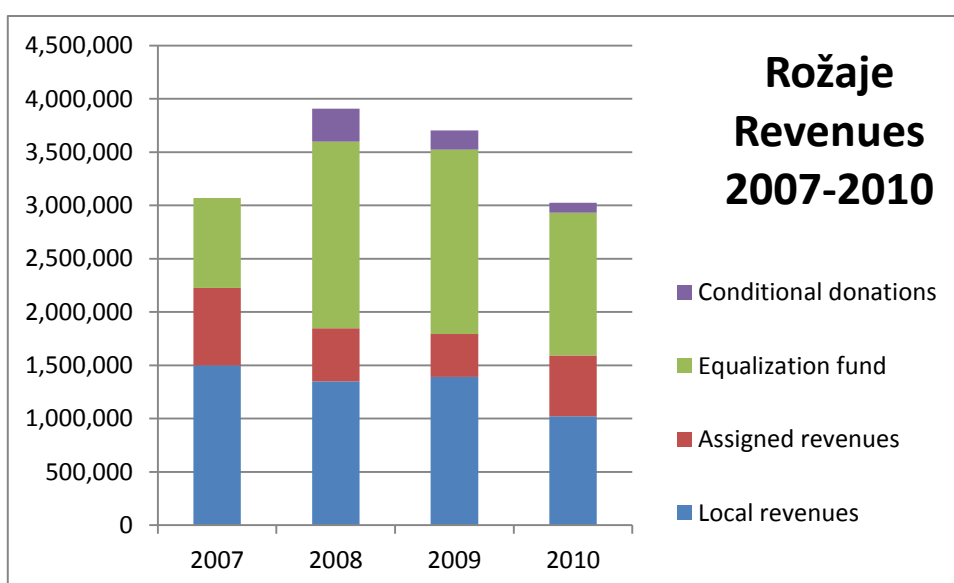
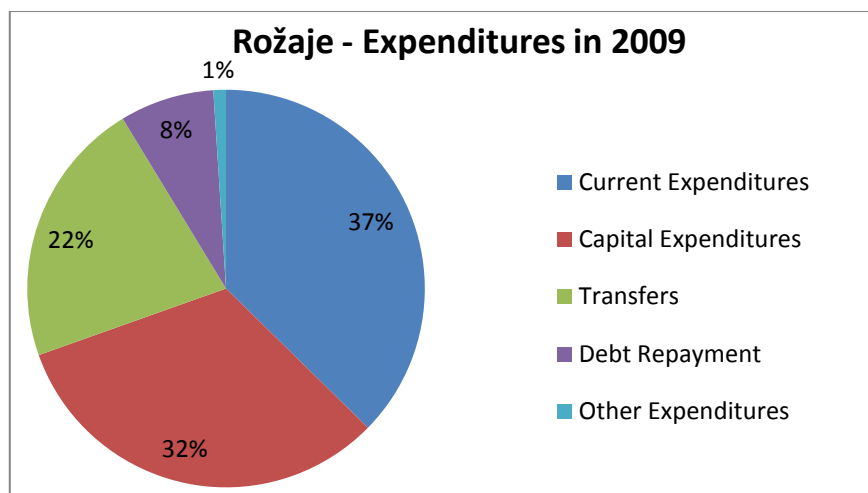
Municipality	Local administration	Public institutions	Public enterprises
Rožaje	99	24	80

Municipal financial units

Municipality	Number of employed in the Secretariat for municipal finance		Number of employed in the tax departments	
	Male	Female	Male	Female
Rožaje	5	11	7	2

Budgetary and financial information





Municipality TIVAT



Demographic data

Area: **46** Km² (rank: 21)

Population: **13,630** (rank: 15)

Density: 296 Inh/km² (rank 1)



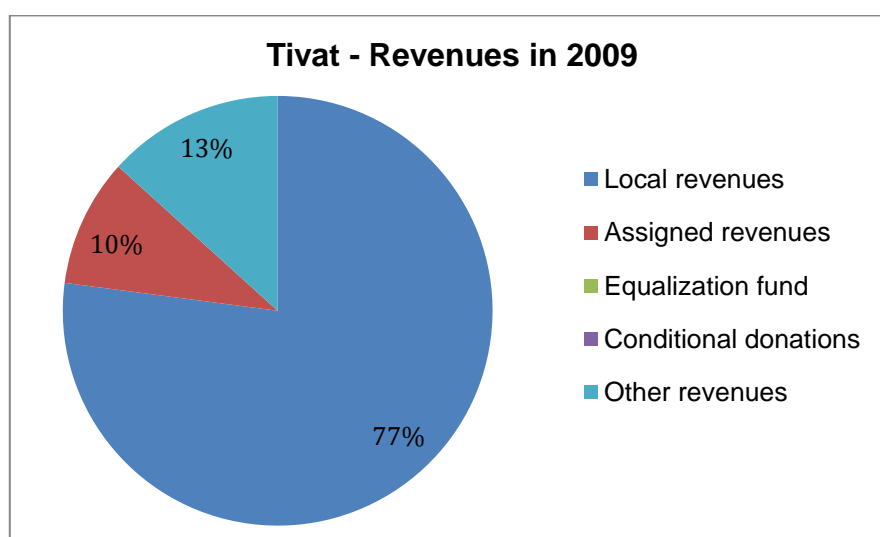
Municipal administration

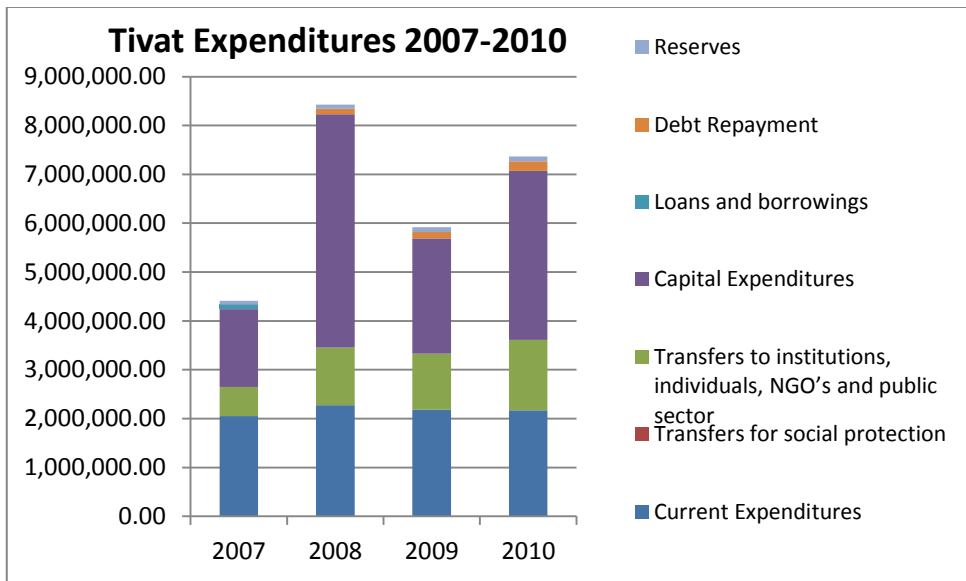
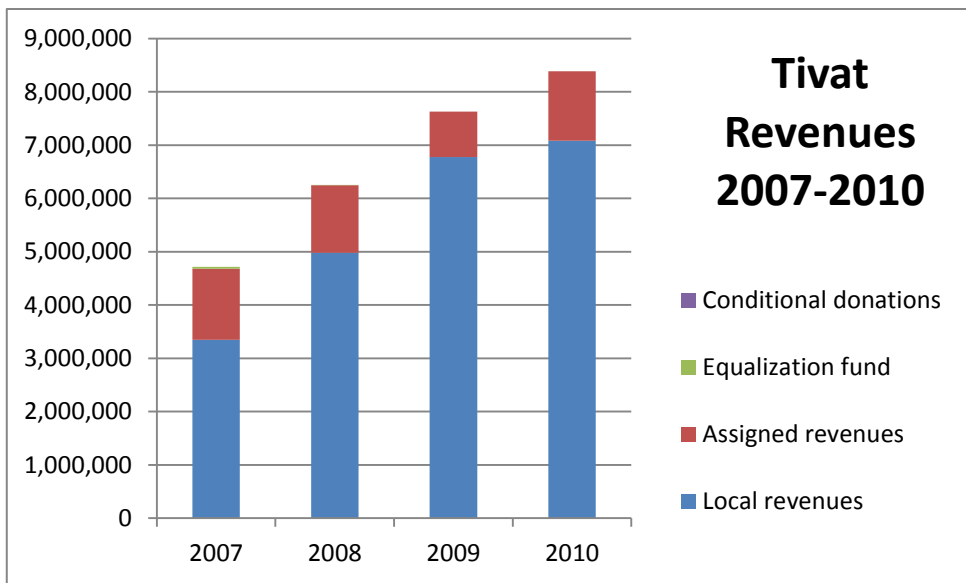
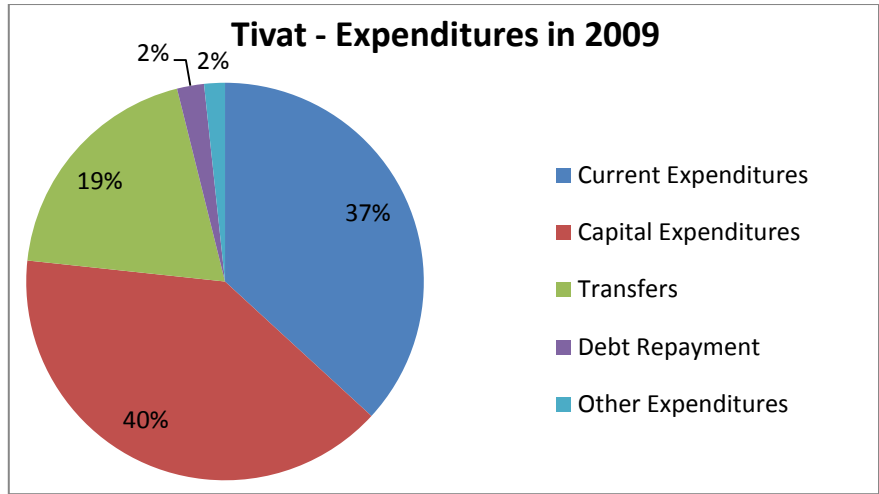
Municipality	Local administration	Public institutions	Public enterprises
Tivat	92	19	147

Municipal financial units

Municipality	Number of employed in the Secretariat for municipal finance		Number of employed in the tax departments	
	Male	Female	Male	Female
Tivat	4	11	2	

Budgetary and financial information





Municipality ULCINJ



Demographic data

Area: **255** Km² (rank: 18)

Population: **20,290** (rank: 10)

Density: 80 Inh/km² (rank 5)

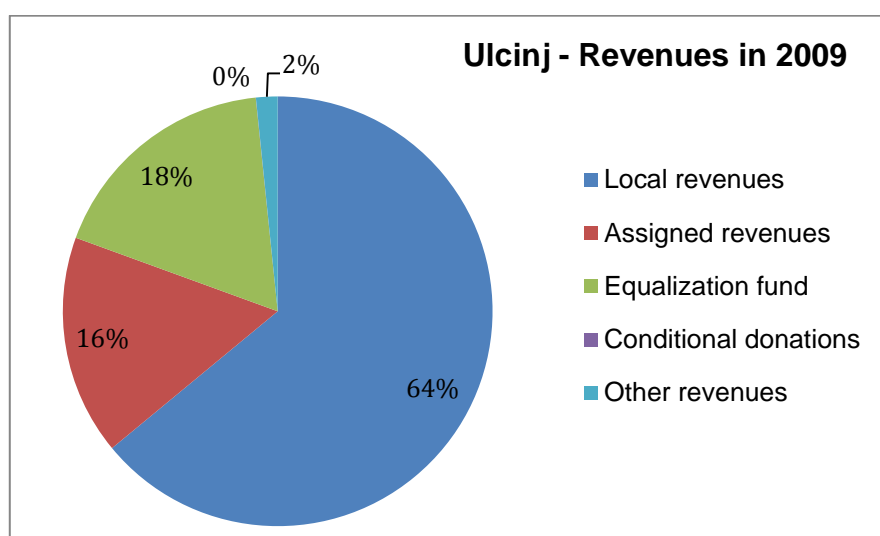
Municipal administration

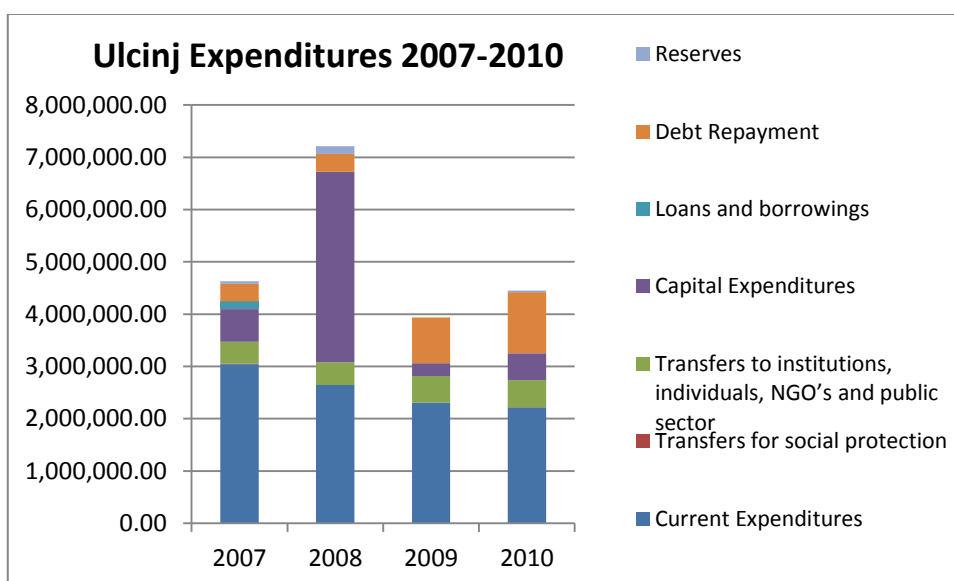
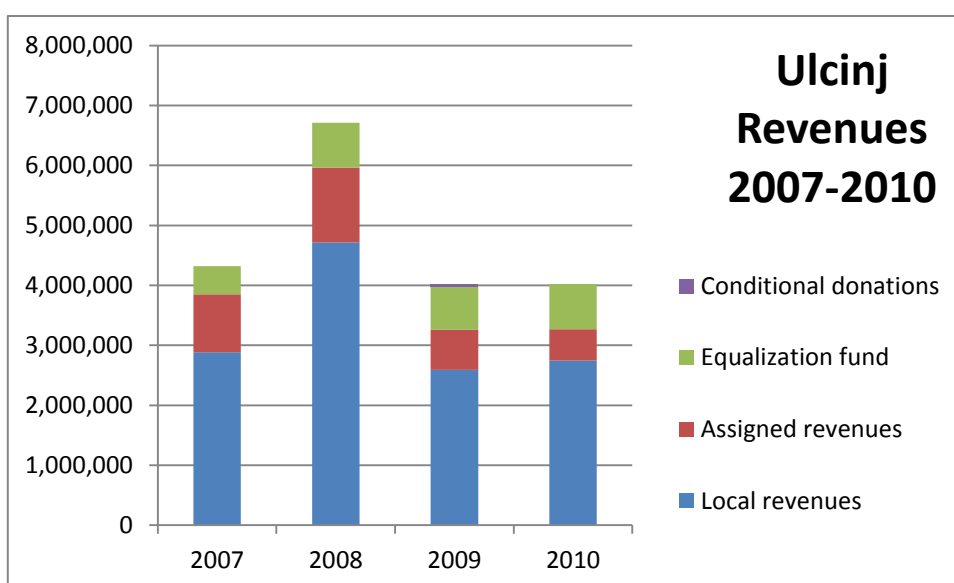
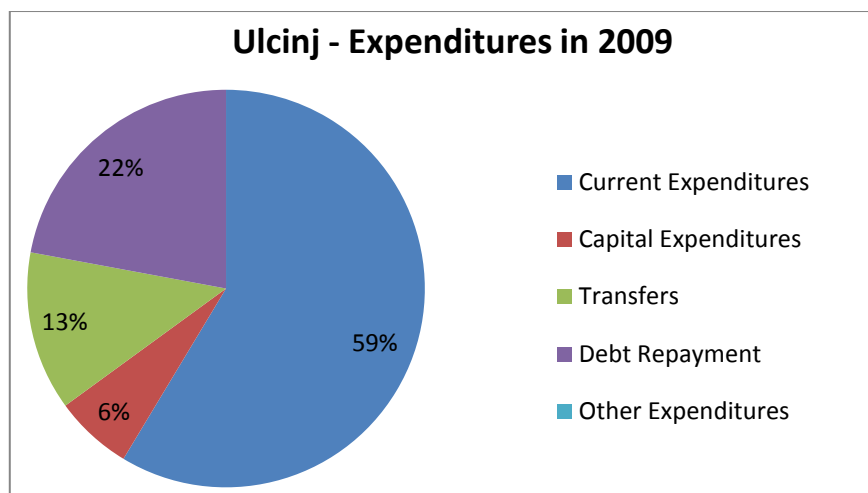
Municipality	Local administration	Public institutions	Public enterprises
Ulcinj	195		281

Municipal financial units

Municipality	Number of employed in the Secretariat for municipal finance		Number of employed in the tax departments	
	Male	Female	Male	Female
Ulcinj	17	4	7	3

Budgetary and financial information





Municipality HERCEG NOVI



Demographic data

Area: 235 Km² (rank: 19)
 Population: 33,034 (rank: 7)
 Density: 141 Inh/km² (rank 2)



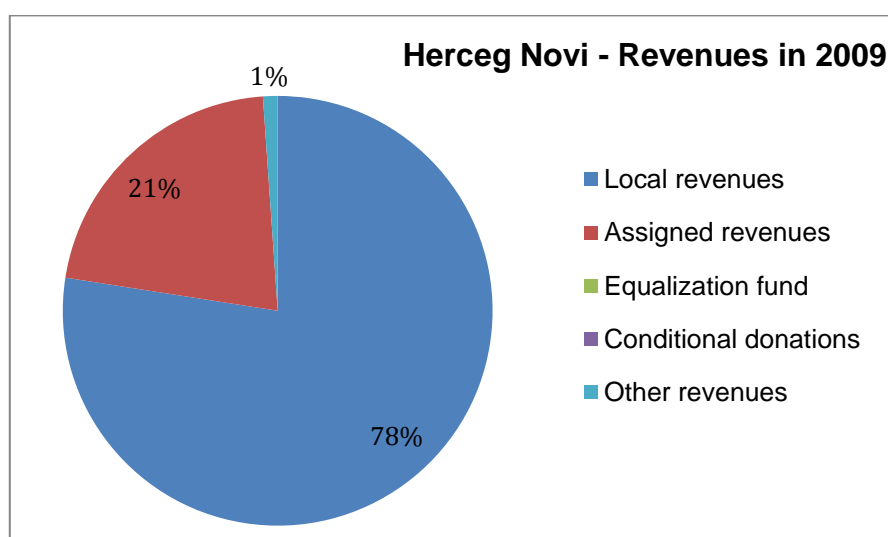
Municipal administration

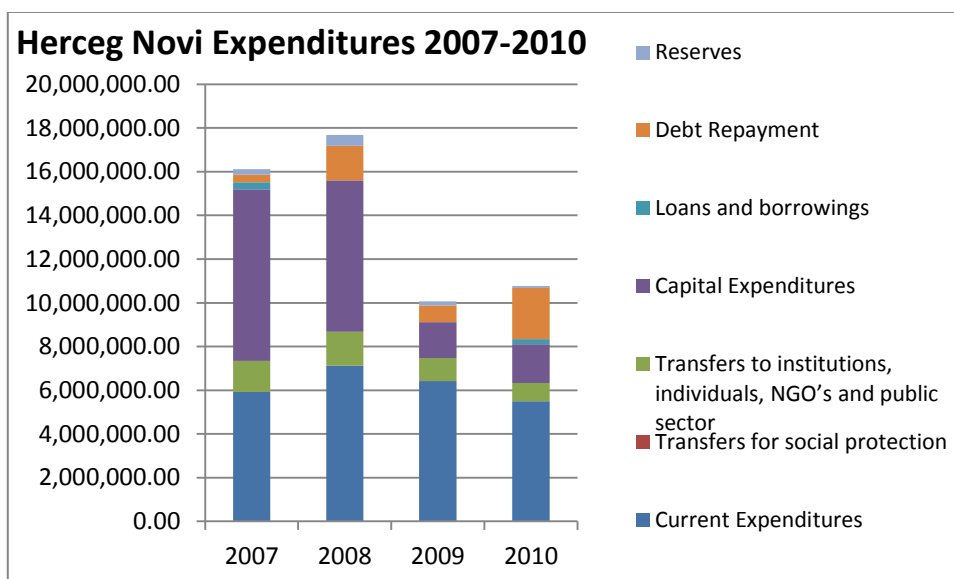
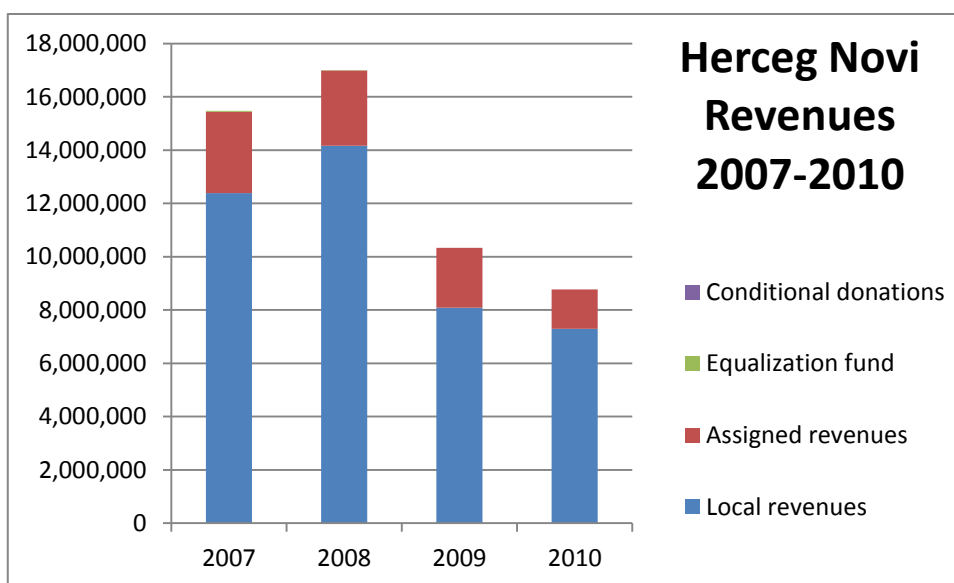
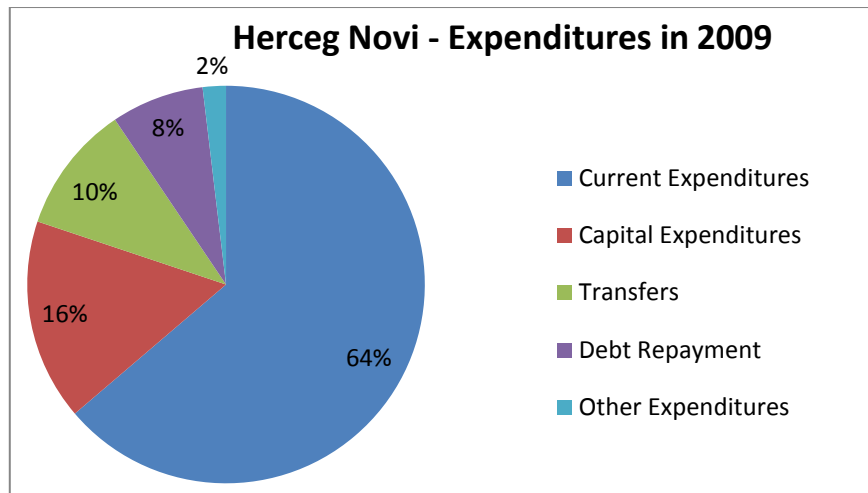
Municipality	Local administration	Public institutions	Public enterprises
Herceg Novi	202	35	171

Municipal financial units

Municipality	Number of employed in the Secretariat for municipal finance		Number of employed in the tax departments	
	Male	Female	Male	Female
Herceg Novi	2	16	2	13

Budgetary and financial information





Old Royal Capital CETINJE



Demographic data

Area: **899** Km² (rank: 5)

Population: **18,482** (rank: 11)

Density: 21 Inh/km² (rank 16)



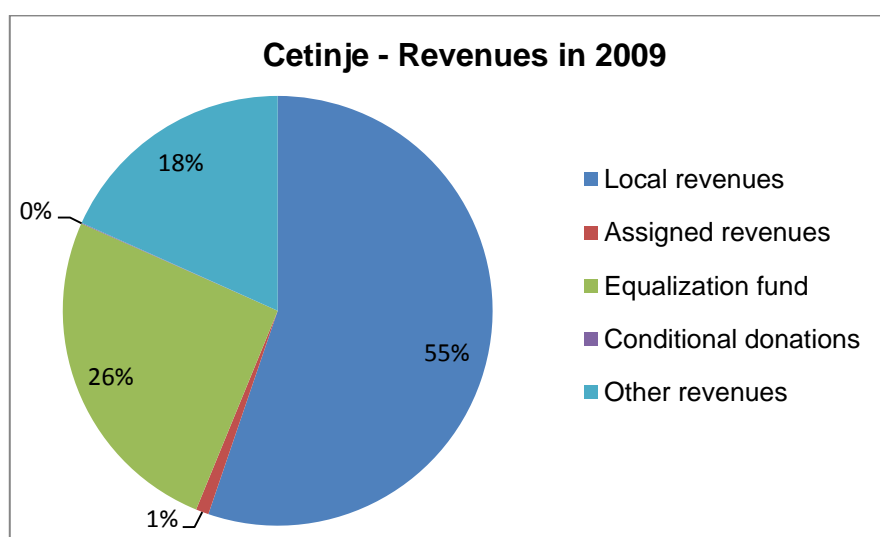
Municipal administration

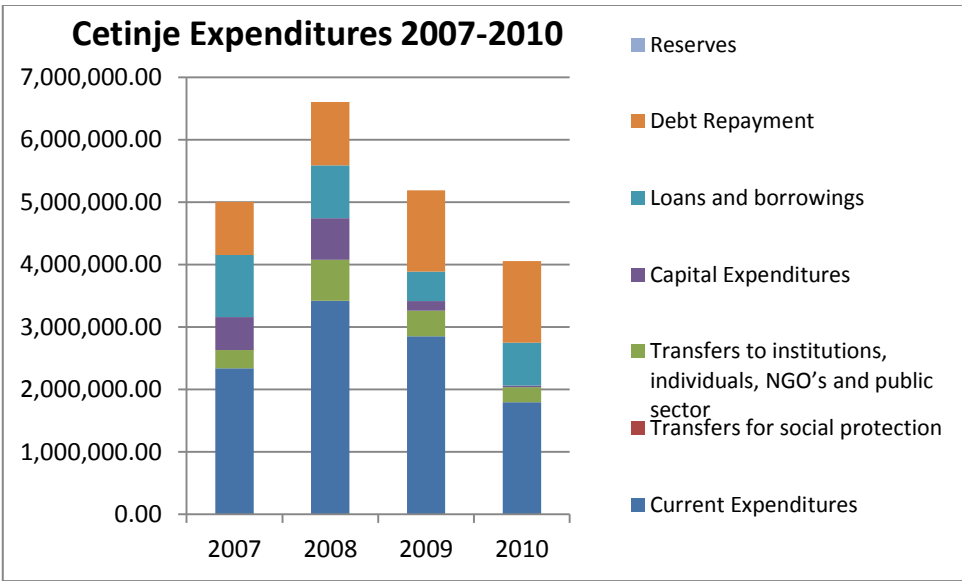
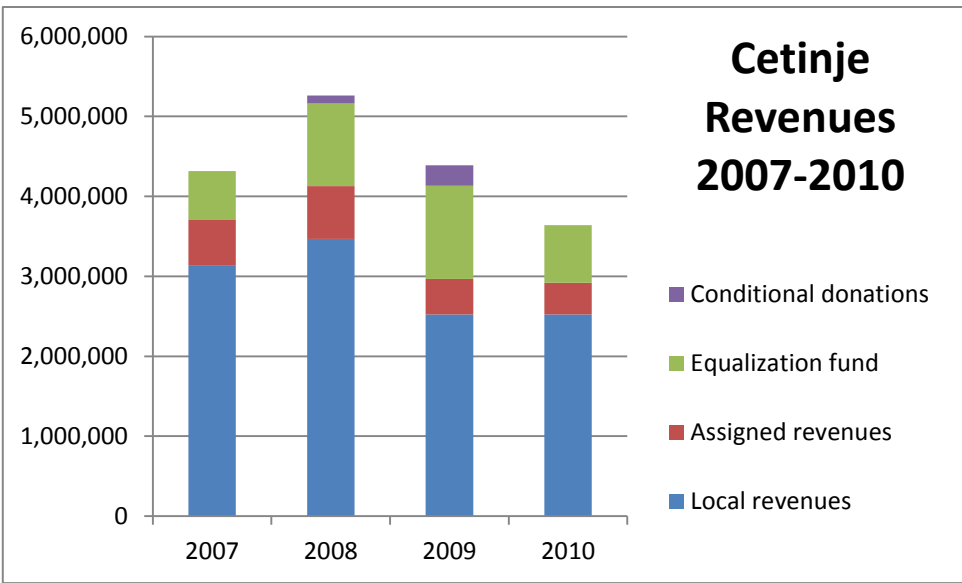
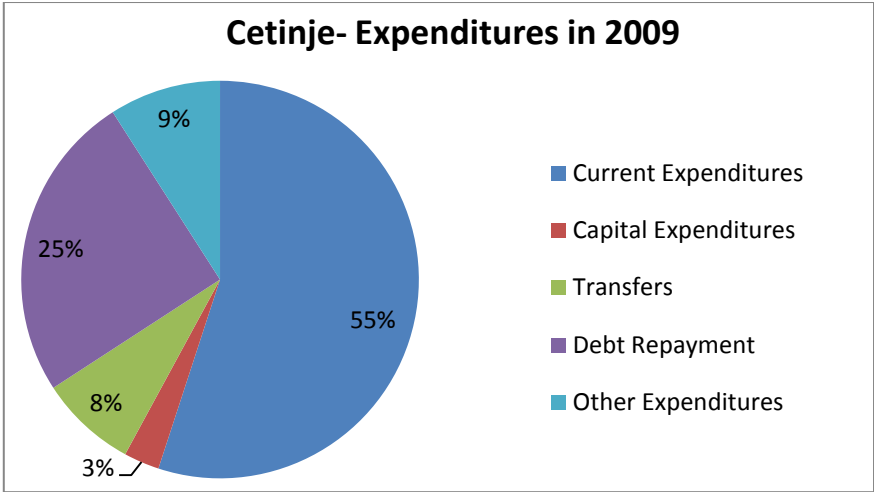
Municipality	Local administration	Public institutions	Public enterprises
Cetinje	257	13	186

Municipal financial units

Municipality	Number of employed in the Secretariat for municipal finance		Number of employed in the tax departments	
	Male	Female	Male	Female
Cetinje	2	12	3	8

Budgetary and financial information





Municipality ŠAVNIK



Demographic data

Area: 553 Km² (rank: 10)

Population: **3,280** (rank: 21)

Density: 5 Inh/km² (rank 21)

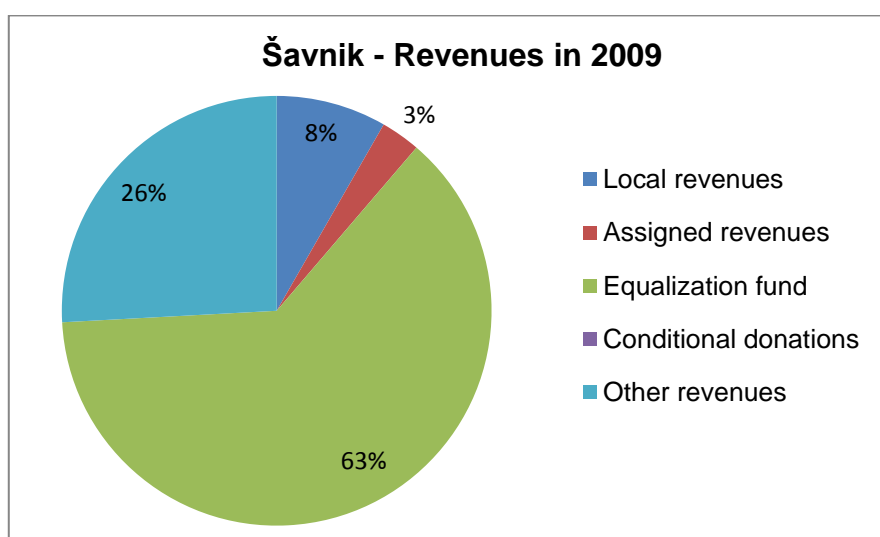
Municipal administration

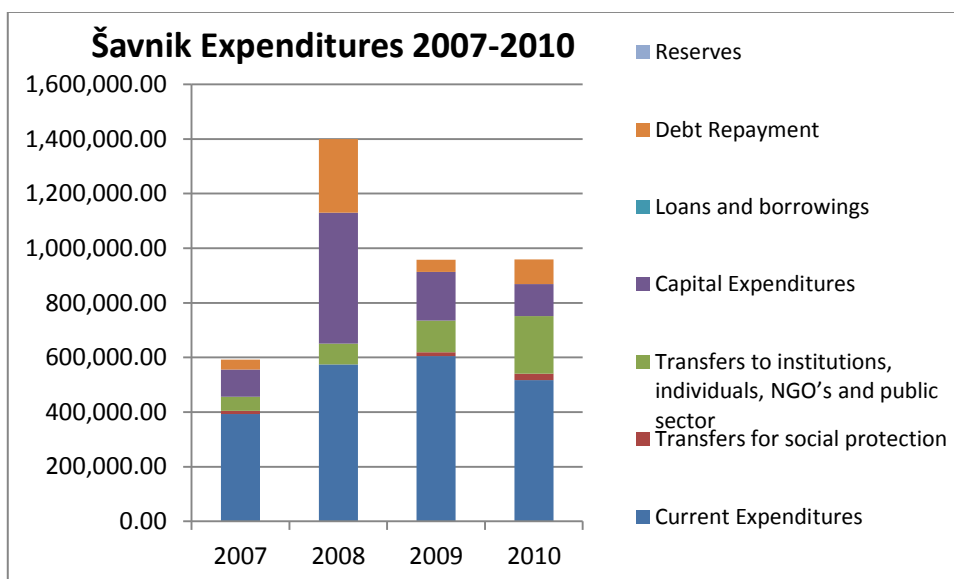
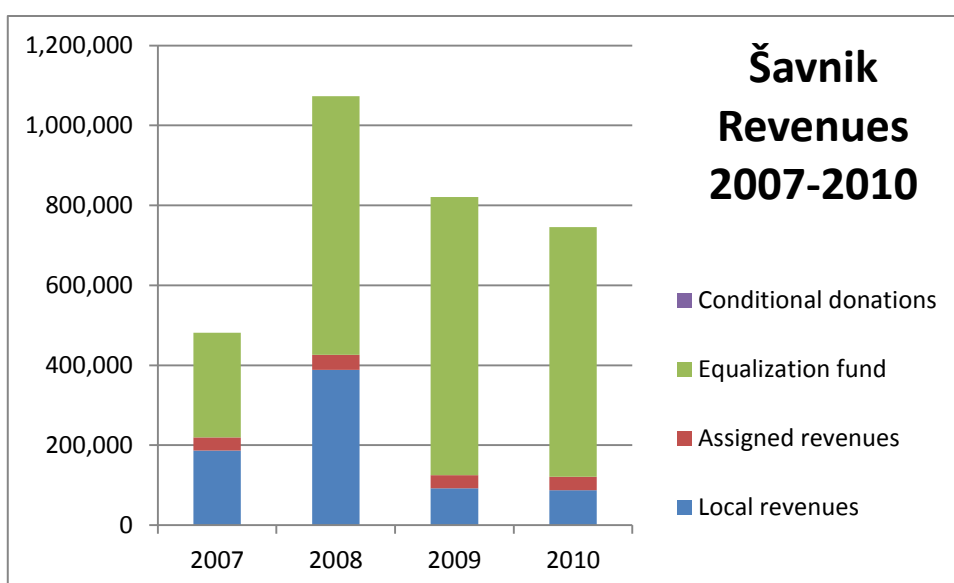
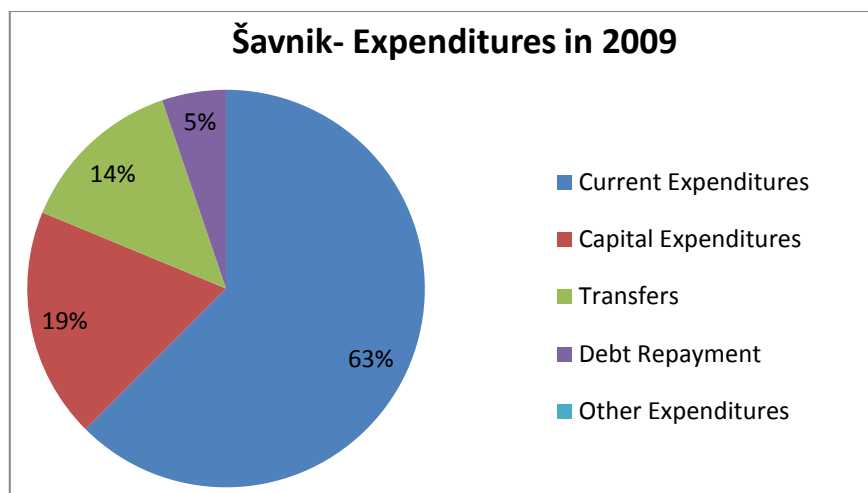
Municipality	Local administration	Public institutions	Public enterprises
Šavnik	40	8	14

Municipal financial units

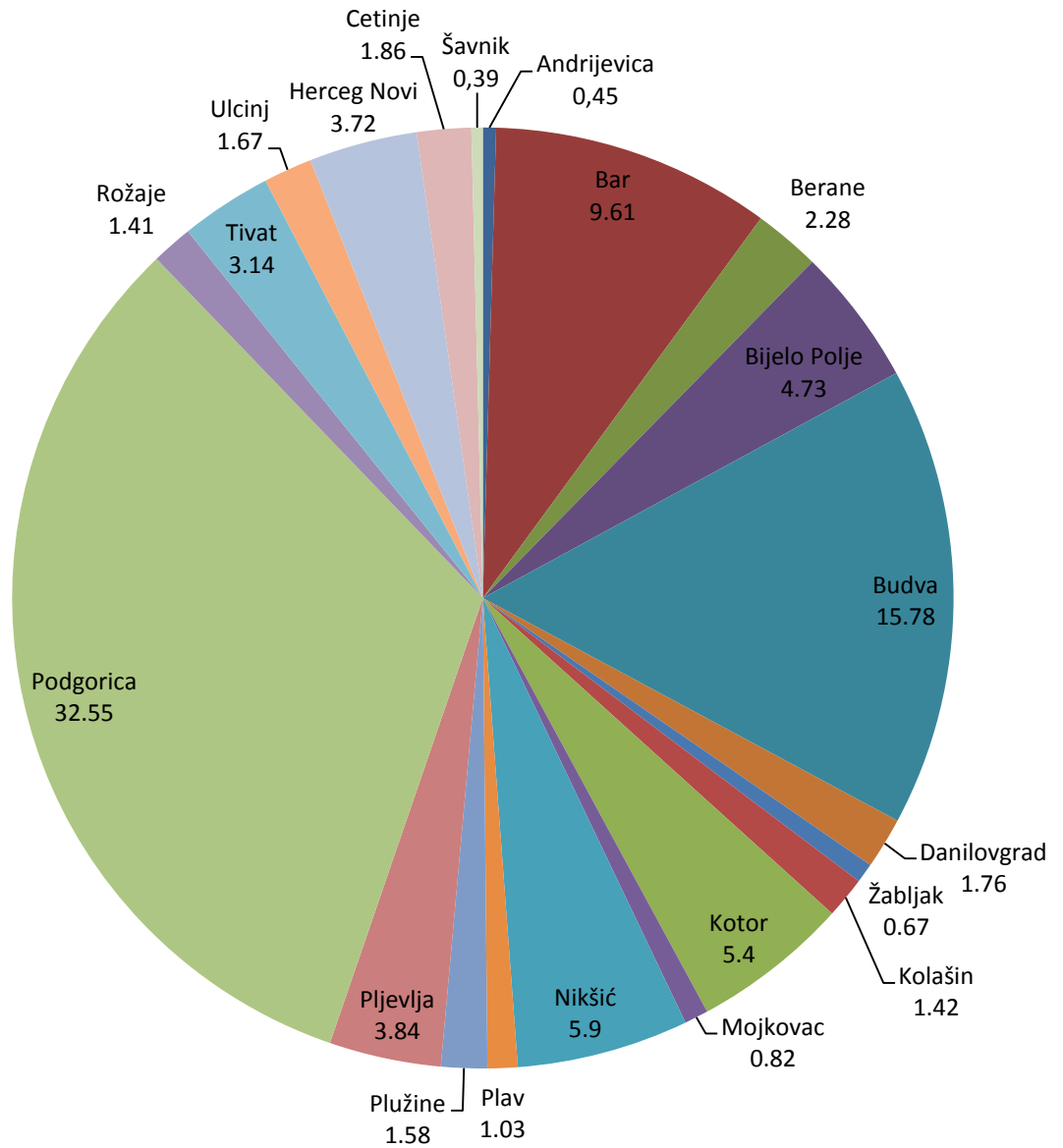
Municipality	Number of employed in the Secretariat for municipal finance		Number of employed in the tax departments	
	Male	Female	Male	Female
Šavnik				

Budgetary and financial information

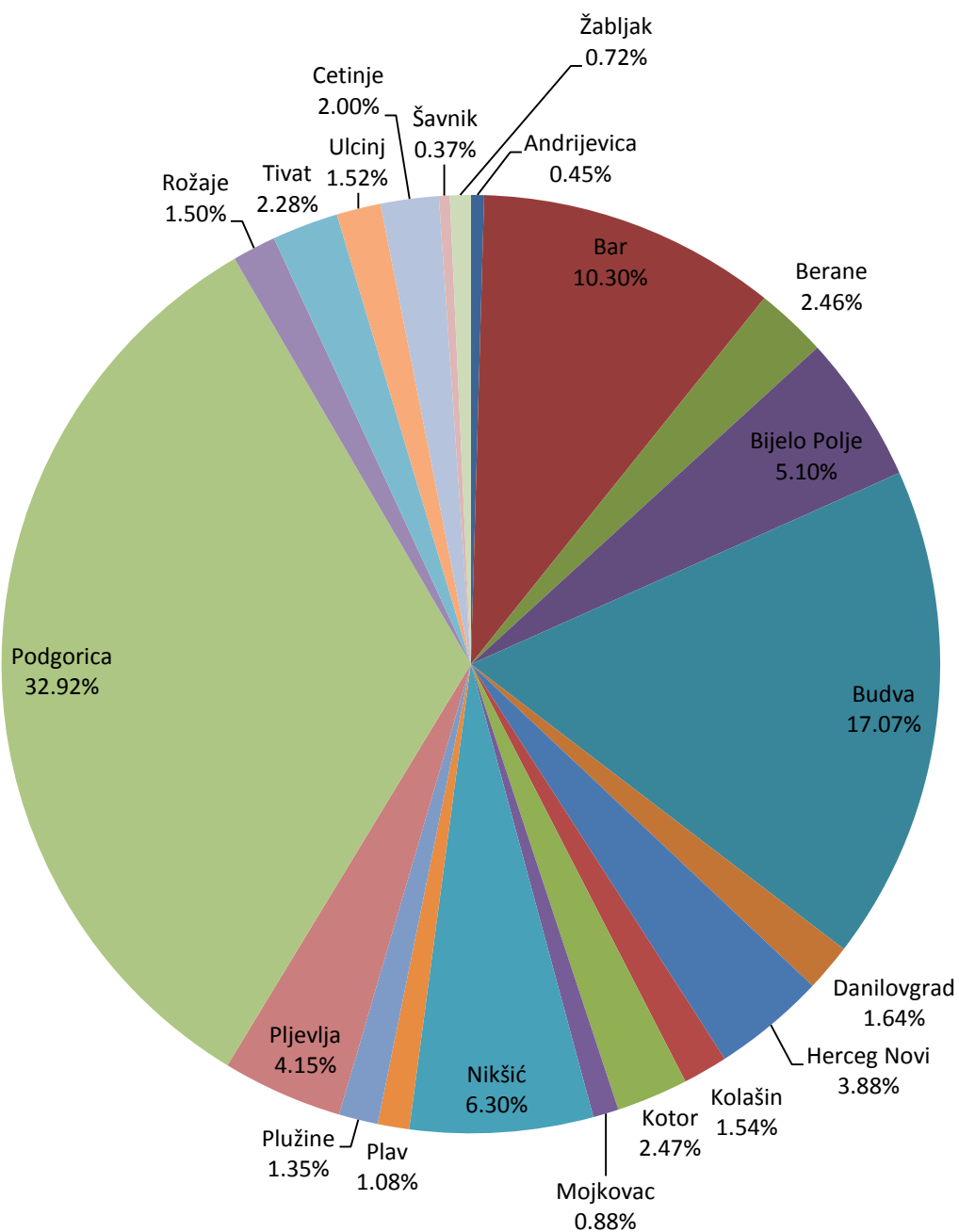




Percentage of Municipality Share in Total Municipality Revenues



Percentage of Municipality Share in Total Municipality Expenditures



ANNEX 2: List of people interviewed

Thursday, March 17, 2011

Municipality of Budva

- *Mihailo Đurović*, Secretary for Economy and Finances

Old Royal Capital Cetinje

- *Zoran Jovićević*, Secretary of Finance and Entrepreneurship Development Department
- *Valentina Vujović*, Chief of Mayor's Office
- *Matija Dautović*, Mayor's Advisor for Investment and Development

Friday, March 18, 2011

Municipality of Nikšić

- *Mitar Matijašević*, Secretary for Economy and Finances
- *Ranka Gvozdenić*, Head of Unit for Budget

Municipality of Danilovgrad

- *Branislav Đuranović*, Mayor of Danilovgrad
- *Svetozar Domazetović*, Adviser for Economy
- *Jovanka Popović*, Secretary for Economy and Finances
- *Maja Matijašević*, Chief of Mayor's Office
- *Darko Mrvaljević*, Coordinator of the Projects Management Team
- *Nataša Radulović*, Budget Adviser
- *Dragan Dragojević*, Adviser for the Investment Projects

Monday, March 21, 2011

Municipality of Kotor

- *Marija Čatović*, Mayor of Kotor
- *Ivo Mrgud*, Advisor to the Mayor for the Economic Issues
- *Branka Todorović*, Advisor to the Mayor for the International Relations
- *Nikola Banićević*, Associate in the Office of the Mayor

Municipality of Bar

- *Dragan Simović*, Deputy Mayor of Bar
- *Dejan Klikovac*, Secretary of Economy and Finance Department
- *Ljiljana Rakočević*, Assistant to the Secretary of Economy and Finance Department
- *Nevenka Plantak*, Head of Treasury Department

Tuesday, March 22, 2011

Municipality of Ulcinj

- *Arsllan Hajdinaga*, Advisor to the Mayor for the International Relations
- *Agron Ibrahim*, Head of Finance Department
- *Milla Bahra*, Finance Department
- *Samanta Gjekaj*, Finance Department

Municipality of Herceg Novi

- *Stevo Cvjetković*, Secretary of Finance Department
- *Ljiljana Lučić*, Finance Department

Wednesday, March 23, 2011

Municipality of Pljevlja

- *Milko Čolaković*, Deputy Mayor of Pljevlja
- *Božo Gospić*, Head of Local Revenues Directorate
- *Slavko Marković*, Head of Budget Department
- *Slavica Terzić*, Finance Department

Thursday, March 24, 2011

Municipality of Plužine

- *Mijuško Bajagić*, Mayor of Plužine
- *Marina Bakrač*, Advisor to the Mayor of Plužine

Municipality of Šavnik

- *Velimir Perišić*, Mayor of Šavnik
- *Vladimir Bečanović*, Secretary of Local Administration Department

Municipality of Žabljak

- *Isailo Šljivančanin*, Mayor of Žabljak
- *Radmila Vukićević*, Secretary of Economy, Finance, Administration and Social Affairs Department

Friday, March 25, 2011

Municipality of Kolašin

- *Đorđije Živković*, Deputy Mayor of Kolasin
- *Luka Medenica*, Secretary for Finances

Municipality of Mojkovac

- *Dragan Savić*, Mayor of Mojkovac
- *Radoslav Medojević*, Secretary for Finances and Economic Development
- *Vukić Fuštić*, Adviser for Finances

Monday, March 28, 2011

Municipality of Podgorica

- *Miomir Jakšić*, Secretary for Finances
- *Snezana Popović*, Head of the Budget Department

Ministry of Finance

- *Biljana Šćekić*, Deputy Minister for Customs and Taxes
- *Gordana Radović*, Adviser for Financing of Local Self-Governments

State Audit Institution

- *Milan Dabović*, Member of the Senate

Tuesday, March 29, 2011

Municipality of Rožaje

- *Nusret Kalač*, Mayor of Rožaje
- *Mevljuda Cikotić*, Secretary for Finances
- *Fikret Kuč*, Adviser for Programming

Municipality of Berane

- *Vuka Golubović*, Mayor of Berane
- *Brano Lutovac*, Secretary for Urban Planning
- *Dragana Delević*, Secretary for Finances
- *Svetlana Ojdanić*, Chief of the Treasury

Cooperative Housing Foundation Montenegro (CHF Montenegro)

- *Daliborka Savović*, Business Enabling Environment Coordinator USAID Economic Growth Project

Municipality of Andrijevica

- *Veselin Bakić*, Mayor of Andrijevica
- *Stojan Mitrović*, Secretary for Financing

Wednesday, March 30, 2011

Municipality of Plav

- *Salih Šabović*, Secretary for Finances
- *Šukrija Cikotić*, Adviser for Finances
- *Galjo Purišić*, Director of the Agency for Investments and Urbanism
- *Bisa Bašić*, Adviser for Treasury

Municipality of Bijelo Polje

- *Aleksandar Žurić*, Mayor of Bijelo Polje
- *Milorad Rmandić*, Adviser for Finances
- *Jelena Mrdak*, Adviser for Economy in the Mayor's Cabinet

Thursday, March 31, 2011

Municipality of Tivat (via telephone)

- *Zdravka Samardžić*, Secretary of the Finance and Economic Development Department

Delegation of the European Union in Montenegro

- *Pierre-Yves Bellot*, Task Manager, Operations Section

Human Resource Management Authority

- *Svetlana Vuković*, Director of the Human Resource Management Authority
- *Blaženka Dabanović*, Training and Human Resources Development Department
- *Bojana Marčetić*, Training and Human Resources Development Department

Friday, April 1, 2011

Union of Municipalities

- *Rajko Golubović*, Secretary of the Union of Municipalities
- *Žana Đukić*, Adviser for Finances of Local Self-Governments

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ANNEX 4: Budgeting cycle in Montenegro

MONTH	THE GOVERNMENT OF MONTENEGRO (NATIONAL LEVEL)	MUNICIPALITIES (LOCAL LEVEL)
<i>January/ February</i>	The Government prepares the Guidelines for development of capital budget	
<i>February</i>	The Ministry of Finance prepares and releases technical instructions for preparation of capital budget for municipalities (local self-government units) for the following fiscal year (following the Guidelines)	
<i>By 31 March</i>	The Government determines strategic priorities of economic policy for the following fiscal year (based on the proposal of the Ministry of finance)	Municipalities prepare and submit their requests for budget allocations for capital projects to the Ministry of Finance)
<i>April</i>	The Ministry of Finance prepares and submits a report on the realization of macroeconomic and fiscal policy for the current year and proposes targets and directives of fiscal policy, on the basis of which it plans the main categories of receipts and expenditures with the estimate for the following three fiscal years.	
<i>May</i>	The Ministry of Finance prepares and releases technical instructions for preparation of municipal budgets of for the following fiscal year.	
<i>End of June</i>	The Government defines the proposal law on the final account of the state budget submit it to Parliament by the end of September.	
<i>End of July</i>		Municipalities, as a part of their procedure for planning the budget, submit requests to the Ministry of Finance for allocation of budgetary funds
<i>End of September.</i>	The Government submits the Law on the final account of the state budget to the	

	Parliament	
October	The Ministry of Finance prepares the draft Law on the State Budget and submits it to the Government	
November	The Government determines the proposal of the Law on the State Budget and submits it to the Parliament	The competent municipal body prepares the draft decision on municipality budget and submit it to the Ministry of Finance for insight (by 15 November)
		The competent municipal body prepares the proposal decision on the municipal budget and submits it to the Municipal Assembly (by the end of November).
December	Adoption of the State Budget (If the state budget is not approved by December 31, the Ministry of Finance, until the budget is approved, on monthly basis, approves funds for spending units up to 1/12 (one twelfth) of actual expenditures of the previous fiscal year	