



# **City of Labin, Croatia**

## **Report on Public Expenditure and Financial Accountability (PEFA)**

(May 30, 2014)



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**FISCAL YEAR**

January 1 – December 31

**EXCHANGE RATE**

(28 May 2014)

Euro (€) 1 = 7.59715 Croatian Kuna (HRK)

**WEIGHTS AND MEASURES**

Decimal Metric System

# ABBREVIATIONS

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AGA - Autonomous Government Agency

ASSC - Areas of Special State Concern

CG – Central Government

CHU – Central Harmonization Unit

COFOG - Classification of the Functions of Government

EB – Extra budgetary

EU – European Union

FINA Finance Agency

FMIS – Financial Management Information System

GFS – Government Financial Statistics

GDP – Gross Domestic Product

HRK – *Hrvatska Kuna* (Croatian Kuna)

HLG – high level of government

IA – Internal Audit

IPSAS – International Public Sector Accounting Standards

IMF – International Monetary Fund

LG – Local Government

LGU – Local Government Units

NB – National Bank

OG - Official Gazette

PBZ - *Privredna Banka Zagreb*,

PD - Public Companies

PFM – Public Financial Management

PEFA - Public Expenditure and Financial Accountability

SAFE - Strengthening Accountability and the Fiduciary Environment

SAO – State Audit Office

SDDS - Special Data Dissemination Standard

SECO Swiss State Secretariat for the Economic Affairs

SN – Subnational

SPI – *Sustav poslovnih informacija* (Business information system)

TA - Tax Administration

VAT – Value Added Tax

# PREFACE

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The present report for the city of Labin was prepared by the PEFA assessment team for Local Government (LG) in Croatia, composed of three experts, the team leader, Giovanni Caprio, the senior PFM expert John Wiggins and one local PFM expert, Anto Bajo. The project officially started on March 17<sup>th</sup>, 2014 and the field work ended on April 2<sup>nd</sup>, 2014. The present version of the report includes all the comments of the city of Labin and comments provided by the PEFA Secretariat.

The present report is structured as follows:

A Summary Assessment;

Section 1: Introduction

Section 2: Background information on the city of Labin

Section 3: Evaluation of PFM Systems, Processes and Institutions

Section 4: Reform Process

Annexes

The team members wish to express their appreciation to the city Administration of Labin, and in particular to the Mayor, Mr. Tulio Demetlika, and also to the World Bank, the European Union and the Swiss Cooperation (SECO) for the opportunity to conduct this assessment and for making it possible to accomplish the work within an extremely tight timeline.

We are particularly grateful to Mr. Dario Runtic, the Advisor of the Association of Cities of the Republic of Croatia who coordinated the assignment for his guidance and support.

May 30, 2014

# Summary assessment

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## **i) Integrated assessment of PFM performance**

### **Predictability from higher levels of Government**

Overall transfers to Labin from higher levels of Governments were close to Budget during 2011-13. But the amounts provided by the central government under different headings differed substantially from Budget, so the fact that the totals were close to Budget owed more to chance than to any deliberate attempt to compensate for lower receipts under one head by higher receipts. Receipts from overall transfers were spread evenly through the year.

### **Credibility of the budget**

The low stock of expenditure arrears and the appropriate monitoring of the latter are important elements that confirm the City's ability to live within its means. In addition, the relatively low variances in expenditure composition as well as the absence of actual expenditure charged to the contingency vote are evidence of its ability to stick to its priorities even when revenue falls short, as it did as a result of lower receipts of the main revenues for which the City is responsible.

### **Comprehensiveness and transparency**

The classification system used for budget formulation, execution and reporting is consistent with international standards. In addition the information included in budget documentation as submitted to the Council is comprehensive (fulfilling 7 of the 9 information benchmarks required by the methodology). Moreover there are no extra-budgetary operations and fiscal reports include income/expenditure information on the small number of donor-funded projects. Also and as far as transparency is concerned, the public has a very good access to key fiscal information. On the other hand, however, the city has not made an overall assessment of the fiscal risks posed by the utility companies which it owns and which are responsible for the delivery of important public services.

### **Policy-based budgeting**

The budget preparation process in the city of Labin is satisfactory. If the earlier stages of the calendar have been subject to delays, the instructions to the city's entities include ceilings approved by the Mayor. In addition the last three budgets have been approved by the Council before the beginning of the fiscal year.

Detailed projections of budgeted activities are prepared each year for a 3-year period, but firm links between the multi-year estimates and the subsequent budget ceilings for particular activities have not yet been established in many cases.

Plans for the development of programmes where activities have a steady pattern allow fully for both capital and current costs. These are not sector strategies but they cover well over 25 per cent of the Budget. The execution year by year of the existing Development Plan is not costed. In addition investment planning is rather uncertain because of the unpredictability of the revenue streams required to finance it. That means that linkages between investment budgets and forward expenditure estimates are weak.

### **Predictability and control in budget execution**

#### *a) Taxpayer obligation, taxpayer registration & collection of tax payments*

In Labin, taxes on the consumption of beverages, on holiday houses and business names are simple, and the legislation and administrative procedures are clear. Taxpayers know what their liabilities are. But these taxes account for only a small part of the City's revenue. The legislation and procedures governing the payment of the community fees charged on new developments and the annual utility fees charged on all properties, which are relatively more important, are also clear and well understood. Information on tax liabilities and administrative procedures is readily available at City offices and county offices of Tax Administration although no specific taxpayer education has been provided. Appeals against community and utility fees can only be made to the Administrative Court.

The property data base has been carefully prepared by the City Administration but has no links to other data bases of the Tax Administration. Overall penalties for non-compliance are ineffective.

Tax arrears represent on average about one-third of collections (2011-2013) and collection ratio are below 60%. As far as transfers of tax collections, the majority of the revenue dependent on Labin's own decisions is paid immediately into the City's Single Treasury Account. Complete reconciliation of the position of individual fee payers with the City's Treasury records is carried out twice a year.

#### *b) Cash flow forecast, cash balances and debt management*

In Labin, a cash flow forecast is prepared for the fiscal year and updated daily on the basis of actual cash inflows and outflows. In practice, budget entities within the city are provided with reliable information for one or two months in advance. In-year adjustments to budget allocations are rare. They are carried out in a transparent and predictable way.



Labin has no foreign debt. The domestic debt records of the city are complete, updated and reconciled quarterly. Domestic debt data are considered of good quality and the corresponding debt reports are comprehensive and elaborated quarterly. Labin's contracting of loans and issuance of guarantees are made against transparent criteria and fiscal targets, and always approved by a single responsible government entity.

The city of Labin has one bank account in HRK (with one sub-account in Euro) only, held at *Privredna Bank of Zagreb* a private commercial bank. Every day the city receives a print out from the bank with the balance available.

*c) Payroll controls and controls for non-salary expenditures*

Payroll controls are fairly effective. Although there are no direct links between personnel records and the payroll, there is full documentation of the way changes in personnel records are reflected in the payroll in practice. According to the City Administration there have not been any retroactive adjustments to the pay of individuals. All changes in the two databases always leave a clear audit trail. The payroll is small, and subject to close supervision; no errors have been detected in recent general financial audits.

Internal controls for non-salary expenditures are effective. In practice, controls are effective in preventing new commitments from being undertaken before the availability of finance has been assured. Other internal control rules and procedures are generally understood and observed.

*d) Procurement system*

The procurement system in Labin meets the standards of the EU acquis. The legal and regulatory framework used is transparent and comprehensive. Open competitive procurement is the default method of procurement. The public has easy access to complete, reliable and timely procurement information, and there is an independent administrative complaints system.

*e) Internal audit*

Internal audit in Labin is effective. It meets professional standards, is operational for all city's entity and focuses on systemic issues. The audited entities receive the audit report with the Ministry of Finance and State Audit Office being informed. The response to internal audit findings by the city management is effective.

## **Accounting, recording and reporting**

Account reconciliation is regular and timely and information on all resources received by service delivery units is available. In-year budget reporting is of fair quality but timely. Annual financial statements are complete and submitted within the required timescale to the City Council and the State Audit Office. In addition, national accepted accounting standards are applied for the statements.

## External Scrutiny and audit

Overall external audit is of good quality, focusing on significant and systemic issues and adhering to auditing standards; however external audit is not a yearly exercise. In addition the city council carries out a thorough examination of the budget proposals as well as reviewing relevant audit reports.

## Donors

The city of Labin receives no budget support. Information from the two donors concerned (the EU and the Veneto region of Italy) has been included in Budget Estimates and out-turn statements. In Labin national (Croatian) procedures are followed for procurement and payment, but special donor requirements apply to reporting and audit.

## ii) Implications for budgetary outcome

Aggregate fiscal discipline is very well evidenced by the absence of expenditure arrears as well as of extra-budgetary operations. It is also evidenced by the good quality of debt data recording and reporting, and by well controlled systems for contracting loans (made against transparent criteria and fiscal targets). The operation of satisfactory aggregate fiscal discipline is also confirmed (but to a lesser extent) by aggregate expenditure out-turn comparing fairly well to the original approved budget (2011-2013) and by the good quality and timeliness of in-year budget reporting. Overall aggregate fiscal discipline remains strong in Labin despite the revenue out-turn persistently falling short of the original approved budget (2011-2013).

The extent of sub-national government responsibilities in Croatia is limited, with the central government retaining most of the responsibility for financing health and education services. Within this framework the strategic allocations of resources in Labin is confirmed by the relatively small changes in the mix of expenditure as between Budget and out-turn. In addition budget classifications consistent with international standards, the comprehensiveness of the budget documentation submitted to the city council, a good budget preparation process and good legislative (by the city council) scrutiny of the draft budget law are all elements supporting the strategic character of the process of allocating resources.

Overall, the good systems of public procurement, internal and external audit and the effective scrutiny of audit reports by the city council are all elements providing evidence of the delivery of efficient services to the city community. However, the unpredictability of some major revenue streams, and their earmarking for

particular purposes which may not represent the most immediate priorities, are obstacles to medium-term fiscal planning, and so to the best provision of services

The above three budgetary objectives, aggregate fiscal discipline, the strategic allocation of resources and the delivery of efficient services are positively influenced by the integrity of fiscal information. In fact the reconciliation of account is regular and timely, in-year budget execution is closely tracked, and full annual financial statements are produced within a very short timescale.

**Overall, the city of Labin has strong PFM systems with good performance. There are some areas needing improvement, such as the significant differences between revenue out-turn and budgeted revenue and the absence of costed sector strategies. The City Administration has shown its determination to further improve the performance of existing systems wherever possible.**

### **iii) Prospect for reforms**

Reforms are taken seriously in the city of Labin. In 2007-2008, a detailed development strategy for the city was elaborated<sup>1</sup>. The strategy lays down for a 10-year period what the priority areas are and how the interventions should take place. This long-term vision of development goals is supplemented by successive three-year budget plans covering programmes and projects. With Croatia now a member of the EU (as from July 1, 2013), prospects for public finance management reforms have further improved, while EU membership should over time make available new sources of finance to support the development of the City's services.

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<sup>1</sup>The Town of Labin, *Integral Development Project of the Town of Labin* (2008-2018)

PEFA PERFORMANCE INDICATORS (2012)<sup>2</sup>

<b>A. PFM OUT-TURNS: Credibility of the budget</b>		<b>Score</b>
HLG-1	Predictability of transfers from Higher Level of Government	<b>NR</b>
PI-1	Aggregate expenditure out-turn compared to original approved budget	<b>C</b>
PI-2	Composition of expenditure out-turn compared to original approved budget	<b>B+</b>
PI-3	Aggregate revenue out-turn compared to original approved budget	<b>D</b>
PI-4	Stock and monitoring of expenditure payment arrears	<b>A</b>
<b>B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency</b>		<b>Score</b>
PI-5	Classification of the budget	<b>A</b>
PI-6	Comprehensiveness of information included in budget documentation	<b>A</b>
PI-7	Extent of unreported government operations	<b>A</b>
PI-8	Transparency of Inter-Governmental Fiscal Relations	<b>NA</b>
PI-9	Oversight of aggregate fiscal risk from other public sector entities	<b>C</b>
PI-10	Public Access to key fiscal information	<b>A</b>
<b>C. BUDGET CYCLE</b>		<b>Score</b>
<b>C (i) Policy-Based Budgeting</b>		
PI-11	Orderliness and participation in the annual budget process	<b>B</b>
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	<b>D+</b>
<b>C (ii) Predictability &amp; Control in Budget Execution</b>		
PI-13	Transparency of taxpayer obligations and liabilities	<b>B</b>
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	<b>D+</b>
PI-15	Effectiveness in collection of tax payments	<b>D+</b>
PI-16	Predictability in the availability of funds for commitment of expenditures	<b>C+</b>
PI-17	Recording and management of cash balances, debt and guarantees	<b>A</b>
PI-18	Effectiveness of payroll controls	<b>C+</b>
PI-19	Competition, value for money and controls in procurement	<b>A</b>
PI-20	Effectiveness of internal controls for non-salary expenditures	<b>B+</b>
PI-21	Effectiveness of internal audit	<b>A</b>
<b>C (iii) Accounting, Recording and Reporting</b>		
PI-22	Timeliness and regularity of accounts reconciliation	<b>A</b>
PI-23	Availability of information on resources received by service delivery units	<b>A</b>
PI-24	Quality and timeliness of in-year budget reports	<b>C+</b>
PI-25	Quality and timeliness of annual financial statements	<b>C+</b>
<b>C (iv) External Scrutiny and Audit</b>		
PI-26	Scope, nature and follow-up of external audit	<b>D+</b>
PI-27	Legislative scrutiny of the annual budget law	<b>B+</b>
PI-28	Legislative scrutiny of external audit reports	<b>A</b>
<b>D. DONOR PRACTICES</b>		<b>Score</b>
D-1	Predictability of Direct Budget Support	<b>NA</b>
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	<b>A</b>
D-3	Proportion of aid that is managed by use of national procedures	<b>C</b>

<sup>2</sup> Scoring is assigned based on best international practices and corresponds to a scale of four (4) points: A (best performance) to D, with the possibility of intermediate scoring (+)

# 1. Introduction

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## Background and objectives

The Association of Cities of the Republic of Croatia has applied for technical support from the World Bank in order to carry out a Public Expenditure and Financial Accountability (PEFA) assessment of Local Governments in Croatia. Funding was granted from the “*Strengthening Accountability and the Fiduciary Environment*” (SAFE) Trust Fund, administered by the World Bank on behalf of the European Commission and the Swiss State Secretariat for the Economic Affairs (SECO) and the project was executed by the Association of Cities of the Republic of Croatia and covered the evaluation of the cities of Labin, Crikvenica, Koprivnica and Sisak.

The State Audit Office in their reports have regularly emphasized the existence of a number of irregularities in the financial operations of local government and often given a qualified opinion on the financial operations of local governments. The Association of the Cities felt that the local government should carry out a PEFA assessment in order to objectively determine the performance in public finance management of local governments according to internationally accepted standards, assess who is responsible for such performance (local government, legislative framework, intergovernmental relations, or something else) and establish procedures for removing the causes of such operations.

Cities were selected using four criteria:

1. Two "small town" and two county headquarters (one of which is less than 35,000 inhabitants , and the other more than 35,000 )
2. Two cities have to be engaged in the activities of the first phase of decentralization (took responsibilities for decentralized function of schools, and fire brigades) and two cities engaged in the activities of the first and second phase of decentralization (took over responsibilities for funding schools, fire brigades plus roads maintenance and construction)
3. Two cities that are based on the Adria coast, and two continental cities
4. Two cities from the regions with an average economic activity (from Primorsko-Goranska county and from Koprivnica-Krizevci county), a city from the region with significant economic activity (from Istria county) and one city from region with weak economic activity (from Sisak-Moslavina county)

The specific PEFA assessment of the city of Labin is part of this initiative.

The current report will be used to advise the city government and the State government on key challenges in the PFM sphere and provide a basis for developing policy and administrative reforms to overcome these challenges.

Assuming that part of the problem in financial transactions relates to the legal framework and the relationship with the central government, based on the PEFA assessment, the Association of the Cities intends to prepare a summary of common problems and a proposal for addressing the problems and dealing with them (amending laws and regulations, changing proposal process, etc.). Recommendations will be made to ministries and administrative state legislative bodies, and meetings/workshops structured around the PFM practice will be organized by the Association of Cities.

### **Overall process and process at the city level**

The overall evaluation process started with a one-day PEFA workshop in Zagreb on March 20<sup>th</sup>, 2014. The workshop covered methodological issues on evaluations at the SN level and included group works. About 30 participants from following entities were present:

#### **Institutions:**

Ministry of Finance (Central harmonization unit, State treasury)  
Economics Institute Zagreb  
GONG<sup>3</sup>  
State Audit Office  
Swiss Embassy  
World Bank  
Parliamentary Committee for Local Government  
Ministry of Administration (deputy minister)  
Transparency International  
Ministry of Regional Development and EU Funds

#### **Cities:**

Crikvenica  
Labin  
Sisak  
Koprivnica  
Kutina  
Vinkovci  
Virovitica

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<sup>3</sup> Gong is civic "watchdog organization". Started with election monitoring in 1998 and now does advocacy and research

The PEFA team was composed of Giovanni Caprio (team leader), John Wiggins, senior PFM expert and Anto Bajo, senior PFM expert (local). The field work for the latter (as well as for the city of Labin) took place in the period of March 17<sup>th</sup> through April 2<sup>nd</sup>, 2014.

## **Methodology**

The 3 experts have carried out the PEFA evaluation of the city of Labin following strictly the structure, methodology, and guidelines of documents elaborated by the PEFA secretariat: *the PEFA Public Financial Management (PFM) Performance Measurement Framework (PMF)* of January 2011 and the *Guidelines for the application of the PEFA Framework at the Sub National Government level* (updated January 2013). In addition the experts have also consulted the *PEFA Field guide* (May 2012)<sup>4</sup> extensively.

In the report, the experts have evidenced the scores. They have also specified, in annex the information sources and documentation used to support the analysis.

## **Stakeholders' participation and quality Control**

The Office of the World Bank in Zagreb has monitored the field work carried out by the experts but has not participated in the exercise. The Advisor of the Association of Cities of the Republic of Croatia, Mr Dario Runtic, participated in the first day of meetings in Labin on March 26<sup>th</sup>, 2014.

Quality control was carried out by the Association of Cities of the Republic of Croatia, the World Bank and the PEFA Secretariat in Washington DC. The city of Labin reviewed the draft report and checked the accuracy of the information used.

## **Scope**

The present PEFA evaluation covers the total expenditures of the city of Labin. These expenditures amounted to 59.7 million HRK in 2012 and 67.0 million HRK in 2013 respectively.

In 2012 total Labin expenditures represented 0.26% of total Local Government expenditures in Croatia and 0.04% of total consolidated General Government expenditures. Labin revenues represented 0.269% of total Local Government revenues in Croatia and 0.046% of total consolidated General Government revenues.

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<sup>4</sup>All the 3 documents are accessible on the website of the PEFA Secretariat [www.pefa.org](http://www.pefa.org).

**Table 1.1: Labin Total Expenditures (Absolute and relative)**

HRK millions

	Labin (1)	Local Government (2)	General Government (3)	Labin (1) As Percentage of (2)	Labin (1) As Percentage of (3)
2012	59,7	22 800,00	144 600,0	0,26%	0,04%
2013	67.0	--	--	--	--

Source: Ministry of Finance, Economic and Fiscal Policy Guidelines 2012-16; Calculations by the PEFA team from data of the Ministry of Finance of Croatia and the city of Labin. Data for 2013 are not available

**Table 1.2: Labin Total Revenue (Absolute and relative)**

HRK millions

	Labin (1)	Local Government (2)	General Government (3)	Labin (1) As Percentage of (2)	Labin (1) As Percentage of (3)
2012	59,7	22 900,00	133 200,0	0,269%	0,046%
2013	67.0	--	--	--	--

Source: Ministry of Finance, Economic and Fiscal Policy Guidelines 2012-16; Calculations by the PEFA team from data of the Ministry of Finance of Croatia and the city of Labin. Data for 2013 are not available



## 2. City background information

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### 2.1 Economic Context

Croatia<sup>5</sup> is a small country in south central Europe, with a population (2012) of 4.29 million, which has declined by about 2 per cent during the last decade. The country is divided into a flatter inland section south east of the capital, Zagreb, and the Istria peninsula and a long coastline stretch of the Adriatic Sea, with numerous islands. Industry and agriculture are mainly in the inland section, while tourism dominates activity in the coastal areas. GDP per head was about 10,500 Euro (78,500 HRK) in 2012. In recent years an annual deficit on visible trade of about 14 per cent of GDP has been largely offset by net receipts on services (largely tourism) leaving a current account deficit of about one per cent of GDP. During this period the exchange rate between the Euro and the Croatian Kuna (HRK) has been broadly steady at about 7.5 HRK to the Euro.

Croatia has been severely affected by the global recession which began in 2008. Real GDP fell by nearly 7 per cent in 2009, and the economy has contracted further in each subsequent year. In 2013 GDP was about 11 per cent lower than in 2008, and the IMF forecast a further small decline in 2014. Despite considerable efforts at fiscal consolidation, the fiscal deficit has remained obstinately high, increasing from a budgeted 3.5 per cent of GDP for 2013 to an out-turn of 5.5 per cent; the deterioration reflected the lower volume of economic activity and the requirement to meet the debts of public institutions in the health and financial sectors. The hope had been that economic activity would be stimulated by Croatia's accession to the European Union in mid-2013, particularly through inward investment flows, but these have yet to materialise. Meanwhile Croatia is paying its share of EU revenues, but the details of the EU regional and social programmes which should over time more than offset Croatia's contributions to the EU Budget have yet to be settled. The following table summarises main economic developments 2010-13.

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<sup>5</sup> Refer to Annex, map 5.1

**Table 2.1 Economic Developments 2010-13**

Year	2010	2011	2012	2013
GDP (Euro millions)	44,864	44,896	44,625	46,693
Change in real GDP (%)	-1.4	0.0	-2.0	- 0.6
Inflation (average % change in CPI)	1.0	2.3	3.4	2.4
Trade Balance (Euro million)	-5,991	-6,360	-6,329	-6,461
Current Balance (Euro million)	-582	-437	-591	-528
Domestic investment (% of GDP)	24.3	23.3	23.0	23.5
Unemployment (% labour force)	12.2	13.7	14.2	14.0

Sources: IMF Staff Report 12/302 and Ministry of Finance Economic and Fiscal Policy Guidelines 2012-16, adjusted roughly to reflect staff statement at the end of 2014 Article IV Consultations (Figures need revision)

## 2.2 Central and Local Government Finance<sup>6</sup>

Croatia's General Government expenditure amounted to 43.8 per cent of GDP in 2012. Direct expenditure by the central government accounted for 82.8 per cent of the general government total, while local governments accounted for 15.8 per cent. The balance was expenditure of government-owned companies and other institutions, mainly for the provision of roads, water and environmental protection. General government revenue and expenditure is summarised in the following table.

**Table 2.2: General Government Revenue and Expenditure 2012**

	Central Government (HRK billion)	Extra-Budgetary (HRK billion)	Local Government (HRK billion)	Consolidated General Govt (HRK billion)	CG as % of GDP	EB as % of GDP	LG as % of GDP	Consol % of GDP
Total revenue	109.8	5.0	22.9	133.2	33.3	1.5	6.9	40.3
Current expenditure	118.7	3.9	19.3	137.4	36.3	1.2	5.8	43.8
Capital expenditure	1.1	2.7	3.5	7.3	0.3	0.8	1.1	2.2
Total expenditure	119.8	6.6	22.8	144.6	33.3	2.0	6.9	43.8
Fiscal Balance	-10.0	-1.5	0.1	-11.4	-3.0	-0.5	0.0	-3.5

Source: Ministry of Finance, Economic and Fiscal Policy Guidelines 2012-16

<sup>6</sup> Refer also to Annex 1

Central government revenue is dominated by indirect taxes and social contributions, which accounted for 53.2 billion HRK and 37.8 billion HRK respectively of total revenues of 109.8 billion HRK in 2012. Total revenue from income tax amounted to about 9.0 billion HRK, of which nearly 90 per cent accrued to local government. Although personal income tax is progressive, with a rate of 40 per cent charged on taxable incomes over 8,800HRK per month, the amounts of the personal allowances for each family member (and in particular the increasing amounts of child allowances as the number of children increases) result in a relatively low overall yield by comparison with social security contributions where such exemptions do not apply. The largest central government expenditure is on pensions and social benefits, where the budget was 38.3 billion HRK for 2013. The other major expenditures on services were 19.7 billion HRK on health care and 11.0 billion on education. The following table shows the trend in the central government fiscal balance for 2010-13.

**Table2.3: Consolidated Central Government Fiscal Balance**

HRK billion

	2010	2011	2012	2013
<b>TOTAL REVENUE</b>	<b>111.1</b>	<b>110.8</b>	<b>113.2</b>	<b>111.0</b>
- Current Revenue	110.8	110.4	112.9	110.7
- Capital Receipts	0.3	0.4	0.3	0.3
<b>TOTAL EXPENDITURE</b>	<b>125.6</b>	<b>126.2</b>	<b>124.3</b>	<b>129.0</b>
Current expenditure	122.6	122.4	120.9	125.3
Of which:				
- Interest	6.6	7.4	8.7	10.0
Capital expenditures)	3.0	3.8	3.4	3.7
<b>AGGREGATE DEFICIT</b>	<b>14.5</b>	<b>15.4</b>	<b>11.1</b>	<b>18.0</b>
As % of GDP	4.4	4.6	3.4	5.4
<b>General Government Debt as % of GDP</b>	<b>42.2</b>	<b>47.2</b>	<b>53.7</b>	<b>56.6</b>
<b>Gen. Govt Guarantees as % of GDP</b>	<b>18.2</b>	<b>17.9</b>	<b>15.2</b>	<b>15.2</b>
- Gen Govt Foreign Debt as % of GDP		16.0	19.1	23.2
- Gen Govt Domestic Debt as % of GDP		31.3	34.7	33.4

Sources: SDDS Tables, Ministry of Finance Economic and Fiscal Policy Guidelines, 2012-16

## Local Government

As Table 2.2 above shows, local government accounts for about 17 per cent of General Government revenue, and about 16 per cent of expenditure. Although local government thus accounts for only a relatively small proportion of general government revenue and expenditure, it is nonetheless very fragmented. The country is divided into 20 Counties, 126 cities and 429 municipalities, plus the capital city, Zagreb, which has the status of both a city and a county. 50 per cent of all local government units (LGUs) have populations less than 3,000, and 80 per cent less than 7,000. Municipalities have only very limited administrative functions. The functions of cities and counties may overlap, but no group of LGUs

is hierarchically superior to another. Counties are normally responsible for secondary education and health care facilities, economic development and the main transport infrastructure, while cities are responsible for primary education facilities, fire service, utility services (the services are usually provided by local government-owned companies), local road maintenance and public lighting, housing and physical planning, pre-school education and social welfare. Apart from pre-school education, the salaries of people employed in the health and education services remain a charge on the central government. A much higher proportion of local government expenditure is for capital projects than is the case for the central government.

Arrangements for financing local government are very complex. According to the SDDS Tables covering the 53 largest local government units (LGUs) (Zagreb, 20 counties and the 32 largest cities) which together account for about two thirds of total local government revenue and expenditure, LGUs received 15.0 billion HRK current revenue in 2012, made up of 8.6 billion HRK from income tax, 2.5 billion HRK from administrative fees, 1.8 billion HRK from grants (mainly from central government), 0.9 billion from their own property revenue, 0.4 billion from tax on property sales, 0.8 billion from various small taxes, and 0.4 billion from other miscellaneous sources. They also received 0.3 billion HRK from sales of assets.

Only about 40 per cent of total revenue is under the control of the LGUs concerned. The 5 per cent tax on sales of property is collected by the central government Tax Administration (TA), with 40 per cent of the revenue going to the LGU concerned, and 60 per cent retained by central government. Income tax is collected by TA at centrally determined rates and almost all the revenue is then distributed to LGUs on the basis of various formulae. In 2012 the law on Financing LGUs provided for cities and municipalities to receive 56.5 per cent of receipts from their residents, and counties to receive 16 per cent. Cities taking responsibility for decentralised functions could receive up to a further 12 per cent (the amount depending on which responsibilities had been taken by each LGU), while 15.5 per cent was reserved to finance resource equalisation payments, mainly to LGUs in Areas of Special State Concern (ASSC – mainly places affected by the war in the 1990s), in hill and mountain areas and on the Adriatic islands. Thus the amount available for equalising the resources available to poorer LGUs in order to ensure at least a minimum level of service is limited by the yield from time to time of income tax rather than being dependent on any objective measure of need. The only income tax revenues dependent on LGU decisions were the yield of the surtax an LGU can impose as a percentage of the basic income taxes paid by its residents. Municipalities may impose a surtax of up to 10 per cent and cities up to 12 per cent; if a city's population exceeds 30,000 up to 15 per cent, and for Zagreb up to 30 per cent. In practice few LGUs charge the maximum (Zagreb, with the highest rate, charges 18 per cent).

The only tax revenues wholly dependent on LGU decisions are those arising from three small taxes: 3 per cent on sales of drinks by catering establishments, up to 15 HRK per square metre per year for holiday houses, and up to 2000 HRK per year for registered business names. An LGU can decide to collect these revenues itself, or can contract out collection to the county office of TA for a commission of

5 per cent. Even where an LGU has a relatively large number of taxable holiday houses, the yield of these three taxes would amount to only about 5 per cent of total revenue, while the yield of the surtax might amount to a further 5 per cent of revenue for LGUs levying it at 10 per cent of basic tax payments. Administrative fees (the community fee charged on new developments and the annual utility fee) are determined by the LGUs, but the yields are earmarked for investing and maintaining the infrastructure.

Aggregate current and capital expenditure by the 53 largest authorities during the period 2008-13 is shown in the following Table.

**Table 2.4: Gross current and Capital Expenditure of Largest LGUs**

	2008	2009	2010	2011	2012	2013
Total current expenditure	13.7	14.0	13.1	12.7	13.3	10.9
Total capital expenditure	4.2	3.2	2.6	2.1	1.7	1.5

HRK billion

Source: SDDS Tables

As Table 2.4 shows, total current expenditure remained fairly flat from the beginning of the recession in 2008, until it fell back sharply in 2013, while capital expenditure has declined every year since 2008. These trends are the result of declining receipts of community fees and government grants earmarked for capital expenditure, while the fall in current expenditure in 2013 seems likely to be a reaction to the prolonged squeeze on tax revenues as GDP continued to contract.

The broad functional distribution of LGU expenditure in 2012 (current and capital combined) as between different functions and different types of LGU is shown in the following Table.

**Table 2.5: Functional allocation of 2012 expenditure, by type of LGU**

HRK billion

		Total	Counties (except Zagreb)	Municipalities	Cities	Zagreb
	Population (million)	4.3	3,5	1.2	2.2	0.8
01	General Public Services	4.3	0,8	1.2	2.2	1.0
02	Defence	0,0	0,0	0,0	0,0	0,0
03	Public Order and Safety	0,6	0,0	0,1	0,4	0,1
04	Economic Affairs	3.3	0,4	0,6	1,2	1,1
05	Environmental Protection	0,7	0,1	0,2	0,4	0,0
06	Housing	4,1	0,1	0,8	1,6	1,6
07	Health	0,7	0,5	0,0	0,0	0,2
08	Recreation and Culture	2,5	0,2	0,2	1,3	0,8
09	Education	4.1	1,2	0,3	1,3	1,3
10	Social Protection	1,5	0,4	0,2	0,4	0,5
	<b>Total</b>	<b>22.8</b>	<b>3,7</b>	<b>3,6</b>	<b>8,8</b>	<b>6,6</b>

Source: Ministry of finance RC, 2014

As Table 2.5 shows total LGU expenditure per head of population in 2012 was about 5,300 HRK. General Public services (administrative costs) accounted for about 20-25 per cent of expenditure at county and city level, while for municipalities and Zagreb the percentages were 33 per cent and 15 per cent respectively. About 1,000 HRK per head was spent by counties with education and health the largest amounts. Municipalities spent about 3,000 HRK per head, with housing and economic affairs the largest items. Cities accounted for the largest overall share of expenditure, with the largest expenditures on housing, recreation and culture, economic affairs (including infrastructure) and education; per head of population total expenditure was about 4,000 HRK. Zagreb, which also bears the costs of being the capital city, spent about 8,000 HRK per head, with priorities similar to those of the cities.

## Labin Revenue and Expenditure

**Table 2.6: Labin Revenue 2011-13**

HRK thousands

	2011	2012	2013
<b>Total revenue determined by central government</b>	<b>33,484.2</b>	<b>31,839.5</b>	<b>35,099.8</b>
of which Share of income tax	17,689.0	19,233.6	21,311.2
Share of tax on property sales	1,327.3	1,562.0	2,081.9
Payments for decentralised services	9,344.4	8,869.1	8,716.6
Other central government grants	5,123.5	2,174.8	2,990.7
<b>Total current revenue determined by City</b>	<b>27,153.8</b>	<b>26,459.0</b>	<b>32,509.8</b>
of which Yield of Surtax on income tax	1929.7	2,051.4	2,263.2
Holiday homes tax	427.6	436.8	422.5
Tax on consumption of beverages	723.5	782.5	1,090.1
Tax on business names	1,001.4	993.1	994.7
Misc. administrative revenue	2,991.4	4,132.8	6796.9
Utility fees	7,076.0	7,424.0	8,279.2
Community fees	5,929.9	3,378.4	2,551.1
Revenue from property holdings	5,374.5	5,301.6	6,824.9
Other fees, fines and charges	977.5	911.3	2,200.6
Donations (domestic)	320.8	548.2	488.8
External grants	401.5	498.9	597.8
Proceeds of asset sales	2,578.6	4,408.7	1,402.2
<b>Total revenues</b>	<b>62,496.3</b>	<b>61,660.3</b>	<b>69,011.8</b>

Source: Labin Administrative Budget and Finance Department

**Table 2.7: Labin: Economic Classification of Expenditure 2011-13**

HRK thousands

	2011	2012	2013
<b>Total Current Expenditure</b>	<b>49,898.9</b>	<b>49,866.7</b>	<b>58,573.8</b>
of which Wages and salaries	17,143.3	17,172.1	18,254.6
Goods and services	19,259.7	20,387.4	26,666.1
Subsidies	290.5	156.5	513.0
Social grants	3,351.4	3,472.2	3,990.0
Grants to other General Government	185.9	330.1	768.1
Interest payments	1,076.2	1,129.3	809.5
Other expenditure	8,591.9	7,219.1	7,572.4
<b>Gross investment in fixed assets</b>	<b>10,224.2</b>	<b>9,305.8</b>	<b>8,483.4</b>
<b>Total Current and Capital Expenditure</b>	<b>60,123.1</b>	<b>59,670.6</b>	<b>67,057.1</b>
<b>Net fiscal Balance (Surplus)</b>	<b>2,373.2</b>	<b>1,989.7</b>	<b>1,954.7</b>

Source: Labin, Administrative Budget and Finance Dept.

**Table 2.8: Labin Actual Budgetary Allocations 2011-13 (Out-turns)**

HRK thousands/% of total

I. MAIN SUB-FUNCTIONS	2011	%	2012		2013	%
General Public Services	10,427.4	17	10,894.6	18	10,856.7	18
Public Order and Safety	4,758.2	8	4,958.7	8	5,044.9	8
Economic Affairs	8,304.1	14	9,414.8	16	8,203.0	13
Environmental Protection	8,515.3	14	7,265.1	12	6,454.4	11
Housing	3,926.4	7	5,078.1	9	5,587.2	9
Health	482.2		378.5	1	712.2	1
Sport, Recreation & Culture	9,378.1	16	7,064.0	12	9,011.7	14
Education	11,602.7	19	11,588.5	19	17,914.6	20
Social Protection*	2,728.6	5	3,028.3	5	3,272.5	5
<b>TOTAL ALL SECTORS</b>	<b>60,123.1</b>	<b>100</b>	<b>59,670.5</b>	<b>100</b>	<b>67,057.1</b>	<b>100</b>

Sources: Administrative Department for Finance and Budget, Labin. Figures include interest and external grants.

Only 9 of the COFOG main functions appear, because LGUs have no role in national defence. The table shows that the functional allocation of expenditure is broadly stable from year to year, with Economic Affairs, Housing and Sport and Recreation showing the greatest variability from year to year. Labin's expenditure per head of its 11,650 population is thus running at about 6,000 HRK per year, rather higher than the average city expenditure of 3,700 HRK calculated for 2011. This in part reflects the fact that Labin provides education and fire services for



neighbouring municipalities, which count as part of its budget expenditure (and for which they pay as part of Labin's revenue from other government sources).

### **The development strategy of the City of Labin**

The project "Overall Development of Labin" represents the development strategy of the City from 2008 to 2018 consistently with the Regional Operational Programme (strategy) of Istria. The City Strategy is used to define the priority areas of economic development and serves as the basis for preparing projects to be submitted for financing from EU structural funds. The priority areas of the strategy are:

(i) *Encouraging economic development*, particularly of SMEs. The strategy aims to create the preconditions for investment in the economy, by encouraging the development and application of modern technologies in the context of the information society by restructuring and repositioning the tourist economy, and by developing sustainable agriculture and fishing,

(ii) *Fostering human resource development and higher social standards*. The strategy seeks to ensure full employment and a high level of health and social care, to promote human resource development through education, and to assist the development of civil society

(iii) *Promoting sustainable development*. The strategy aims to establish an integrated environmental management system, to improve the infrastructure, to progressively develop both inland and coastal areas, and to strengthen the civil protection and rescue services,

(iv) *Preserving the Istrian identity*. The strategy seeks to protect the landscape, biodiversity and cultural traditions of the area from any damage which might result from economic development.

The main long-term goals of the city are:

1. To achieve a developed economy based on industrial and tourist activities with higher added value,
2. To develop human resources so as to support overall socio-economic development and high social standards; and
3. To preserve the environment, and the natural, historical and cultural heritage.

The strategy includes a list of major projects, an action plan for the development of different economic sectors, a review of possible funding sources and a statement setting out how the plan will be implemented. The strategy also includes an overview of key personnel and their role in implementing it. Following the adoption of the strategy, the City has established medium term budgetary priorities up to 2016, and will continue to adapt them as necessary so as to achieve its objectives.

## 2.3 Description of the legal and institutional framework for PFM

### a) Legal framework

The system of financial management at the local level is essentially determined by the *Budget Act (Official Gazette 87/08 and 136/12)* which governs the planning, development, adoption and implementation of the budget; asset and debt management; contracting of debt and issue of guarantees at state and local level; budgetary relations in the public sector; accounting, budgetary control and other issues related to the management of public finance. The Government's Economic and Fiscal Policy Guidelines issued each year set the framework for the budgets of local government units (LGUs) for the next three years. The annual Law on Execution of the Budget determines the limits on borrowing and the amounts of state aid allocated to local governments. *Rules of Procedure of borrowing and consent of the local ( regional ) self-government (OG 55 / 09 and 139 /10)* defines in detail the procedure for granting approval for local government borrowing, mandatory documentation, and reporting on government issued guarantees and approvals.

*The Fiscal Responsibility Act (OG 139/ 10, 19 /14)* establishes rules limiting spending by LGUs (as well as by all central government institutions), reasserts their responsibility for the legal, functional and purposeful use of budgetary resources, and strengthens the system of control and supervision in order to ensure responsible fiscal behaviour. LGUs must comply with the Fiscal Responsibility Act, which obliges all heads of central and local government operations (including mayors of cities and municipalities) to sign an annual statement attesting prudent use and management of budgetary resources

*Regulations on the Budget Ledger (OG 114/2010 and 31/ 2011)* define the bookkeeping documents, business records, bookkeeping organization, and content of the Chart of Accounts. This regulation prescribes budget classification by economic, functional, organizational categories, and by programs and projects. It also requires LGUs to identify the source of funding for each operation. The strategic planning process prescribed by the Budget Act requires LGUs according to programs linked to their long term development strategies. *The Regulations on Financial Reporting in OFB (OG 32/11)* establish the form and content of LGU financial statements and the deadlines for their submission.

*The Law on Financing Local and regional self-government (OG 117 /93, 69/97 , 33 / 00 , 73 / 00 , 127 / 00 , 59 / 01 , 107 / 01 , 117 / 01 , 150 / 02 , 147 / 03 , 132 / 06 , 26 / 07 , 73 / 08 , 25/12 )* regulates the sources (own revenues, shared taxes, grants from central and other local governments) and uses of funds by LGUs (counties, municipalities, cities ). *The Utility Services Act (OG 36/95, 70/97, 128/99, 57 / 00 , 129 / 00 , 59 / 01 , 26 / 03 , 82 / 04 , 110 / 04 , 178 / 04 , 38 / 09 , 79 / 09 , 153 / 09 , 49 / 11 , 84/11 , 90/11 , 144/12 , 94 /13 , 153/13 )* defines the performance and financing of utility services provided to households and

businesses, and also the construction and maintenance of the infrastructure in the area of each LGU.

*Regulations on Budgetary Control (OG 71/13)* regulate the objectives, scope and content of budgetary surveillance and inspection, and the arrangements for its implementation. *The Law on Internal Financial Control (OG 141 / 06)* establishes the system of internal financial control in the public sector, including both financial management and control and also internal audit. The Act establishes the methodology, standards, relationships and responsibilities and authority of the Ministry of Finance and other bodies in the implementation of the system of internal financial control in the public sector. An *Ordinance of the Minister of Finance (OG 96 /2013)* sets the framework for the establishment and operation an independent audit function directly responsible to each budget head, including arrangements for quality assurance of internal audit activities

*The Law on Civil Servants and Employees in Local and Regional Self-Government (OG 86/08, 61/11)* regulates the appointment, rights, duties and responsibilities of officers and employees in administrative departments and agencies of local (and regional ) self-government .The *Law on Salaries in local and regional self-government (OG 28/10)* lays down the criteria for determining the salary and benefits of county prefects, city and municipal mayors and their deputies, as well as the salaries of officers and employees in the administrative departments and offices of local and regional governments

*The Public Procurement Act (OG 90/11, 83/13, 143/13, 13/14)* regulates the planning and execution of public procurement throughout the public sector, including different types of contract which may be used in different circumstances to acquire goods, works or services, legal protection in connection with such activities and the jurisdiction of the State Commission body responsible for dealing with complaints about the operation of the public procurement system. The *Decree on the Supervision of the implementation of the Public Procurement Act (OG 10/12)* regulates the powers of the central state administration body responsible for public procurement system (Ministry of Economy), other matters related to supervision of the implementation of the Public Procurement Act, and the enactment of subordinate legislation in the area of public procurement. *Regulations on the list of entities bound to the Public Procurement Act (OG 19 /12)* specifies the list of contracting authorities subject to the Act (OG 90 /11)

*The Act on Financial Transactions and Settlements not involving bankruptcy (OG 35/14, 108/12, 144/12, 81/13, 112/13)* regulates the business environment, including setting deadlines for the fulfilment of financial obligations and the legal consequences of delay. These obligations are defined as the principal amount that should have been paid within the period provided by law or contract, including taxes and other compulsory payments specified in the bill or other appropriate request for payment

*The Law on Public Private Partnerships (OG 78 /12)* determines how such partnerships are to be established, implemented and monitored. *Concessions Act (Official Gazette 143 /12)* regulates the procedures for granting concessions (for

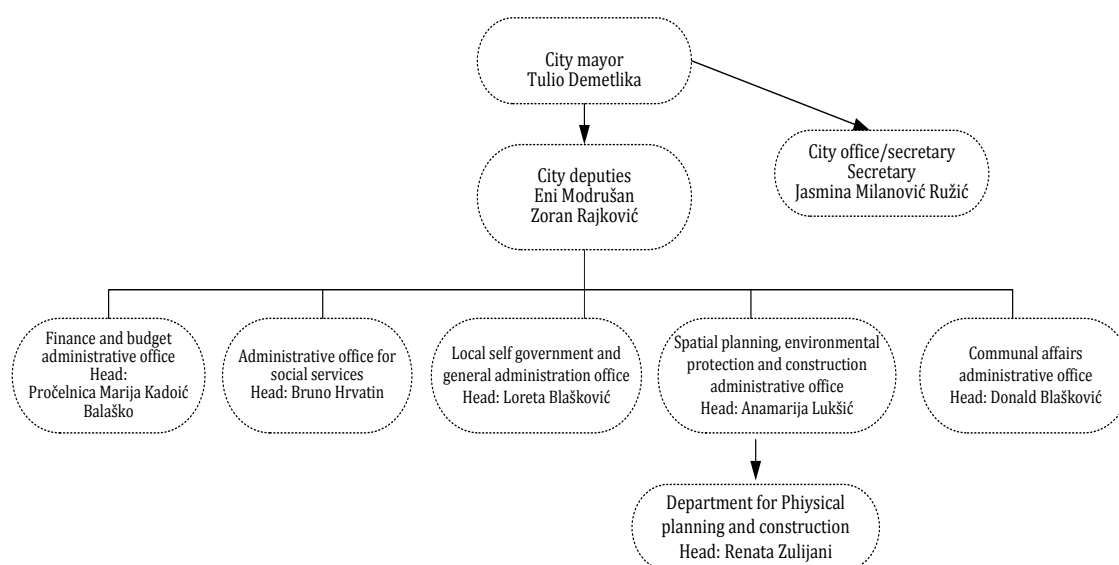
the provision of particular services, or the exploitation of particular public assets), including the concession agreement, the termination of the concession, and arrangements to ensure fairness in its operation.

## b) Institutional framework

The Labin City administration consist of an administrative office and five administrative departments: (1) finance and budget, (2) social activities (3) local self-government and general affairs, (4) spatial planning, environmental protection and construction, and (5) utility services affairs). The City Administration, in addition to its responsibilities for local government activities, also carries out central government functions (elementary education and fire service) which have been transferred to the City

*The City Office* carries out most of the administrative tasks related to the activities and responsibilities of the elected Council, including the preparation of decisions and the organization and recording of its decisions. The Office prepares documents, drafts and proposed regulations, monitors their implementation and gives opinions on materials submitted to the Council and working groups. Preparation of the City's annual Procurement Plan is carried out by the Office, which also supervises compliance with public procurement legislation. Internal audit is part of the Office, which is also responsible for submitting projects for EU funding

### City of Labin - Internal organisational structure



*The Administrative Department for Finance and Budget* is responsible for preparation of the annual budget and longer term fiscal planning. It manages the City's Single Treasury Account through which all the City's payments and receipts

flow, and is responsible for accounting, financial reporting and debt management. It also operates the payroll through which all employees of the City and its budget users are paid.

*The Department of Social Services* manages the City's pre-school and elementary education functions, its program of scholarships at secondary and tertiary education level, and also cultural activities and sports.

*The Department of Self-Government and General Affairs* monitors the living standards of the City's population and takes steps to meet the social and welfare needs of older and disadvantaged people. It also contributes to action to improve public health, and provides 700,000 HRK a year towards health care for which Istria County is primarily responsible.

The Department also encourages the participation of citizens in decision-making about local affairs, coordinates the activities of the program committees of the local (neighbourhood) councils, and records and promotes the work of NGOs and other civil society organizations. The Department is responsible for the personnel function within the City's administration, and for safety at work. The Department also co-ordinates public procurement activities

*The Department of Planning, Environment and Construction* is responsible for spatial and urban planning, protection and improvement of the environment, protection of air and water, protection of cultural property, supervision of the construction of buildings, and construction and maintenance of the City's infrastructure. The Department prepares capital investment projects, ensures the implementation of spatial planning documents, issues regulations concerning water supply and manages property owned by the City. The Department's Division of Physical Planning and Construction is responsible for issuing regulations to implement the zoning plan.

*The Department of Utility Services* is responsible for the maintenance of public and green space, cleanliness, playgrounds, streets, beaches and harbour facilities, and manages the contracts placed with the contractors who carry out these tasks. Its Interior Division looks after the maintenance of municipal infrastructure, unclassified roads, parking lots and street lighting. The Department approves the amounts of utility charges, and controls the use of public land.

Labin funds nine budget users: two council members in receipt of salaries and seven other budget users (two schools, volunteer fire department, kindergarten, Open University, the City Library and Sports Federation). The City owns 100 % of four utility companies (1 May - communal activity, water supply, Labinapartments - property management and Labin 2000 - construction, real estate and marketing). The city has minority stakes in 10 companies. The annual reports of companies 'majority owned by the City are submitted to and discussed by the City Council. The reports of companies in which the city has minority holdings are usually sent when requested, and the information is in any case publicly available.

The 2013 Budget provided finance for 40 programs and 116 subprograms.

### *City Council and Mayor*

*The role and conduct of the Mayor* are regulated by the Law on Local and Regional Self-Government, the Charter of the City of Labin, the Ordinance on the internal order of the City Administration and other regulations. In practice the Mayor enjoys a wide measure of discretion in managing the City and its staff, with little interference from the Ministry of Public Administration. The Mayor represents the city and is the holder of the executive power. The term of office is four years. The Mayor is responsible for putting forward the draft budget, and for the subsequent budget execution; for managing real estate and movable property rights owned by the City in accordance with the law and the Articles of Association; and for managing the revenues and expenditures of the City. The Mayor may decide on the acquisition of movable and immovable property of the City whose individual value does not exceed 0.5 % the amount of the City's revenue (excluding receipts from borrowing) the previous year. The Mayor puts forward Internal Rules and Regulations for governing bodies of the City, appoints and dismisses the heads of the administrative Departments, and also the internal auditor. The Mayor makes proposals for the development of the City including the Physical Plan and any necessary subsequent amendments, taking into account the views of businesses and persons concerned.

*The City Council* is the representative body which consists of 17 councillors elected at the regular election on 19 May 2013 for a term of four years. The City Council has a president and two vice-presidents (chosen from their ranks). Within the framework of the State Constitution and the laws applicable to LGUs, the Council determines its own rules of procedure for the conduct of business. The Council has established three permanent Commissions (dealing with awards, petitions, and minority affairs) and 10 Standing Committees covering the different functions of the City. Their main task is to prepare proposals on specific issues to be submitted to the Council. The Youth Council operates as an advisory body to the elected Council. The annual budget prepared by the Mayor requires the approval of the City Council, and the Council has the power to reject the Mayor's proposals if they take insufficient account of its views. However, in practice the Labin Council has always approved the budget following detailed discussions with the Mayor, in the course of which some amendments may be made to the original proposals.

The city of Labin is divided into seven local areas (Labin gornji, Labindonij, Kature, Vinez, Kapelica, Ripenda, Rabac), each of which elects a neighbourhood council. These local councils have 4-7 members elected for four year terms, who participate in decision-making on matters of concern to their areas, including preparation of relevant sections of the City budget. They have some limited funds available from the City budget, but they do not have independent bank accounts, and all expenditure arising from their operations is paid directly from the City's Single Treasury Account.

### **c) Municipality special PFM features**

In 2013, the city introduced a treasury system based on the SPI information system used by about 160 LGUs in Croatia. The system operates through a centralized treasury and all spending comes out of a single treasury account, which is held in a commercial bank. The Treasury system is linked to other electronic systems covering payroll and procurement. The development of these systems has considerably improved financial management, as well as contributing to greater transparency, where according to studies by the Institute of Public Finance the City compares particularly well with other comparable LGUs.

## Section 3: Evaluation of PFM systems, processes and institutions

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### HLG-1 Predictability of transfer from Higher Level of Government

*(i) Annual deviation of actual total HLG transfers from the original total estimated amount provided by HLG to the SN entity for inclusion in the latter's budget*

The budgeted and actual total amounts of payments to Labin from central government and other LGUs in respect of the services the City provides is shown in the following Table.

**Table3.1: Budgeted and actual receipts from central government and other levels of government 2011-13**

HRK thousands

	2011		2012		2013	
	Budget	Out-turn	Budget	Out-turn	Budget	Out-turn
Total receipts	34,531.5	33,484.2	33,200.5	31,839.5	38,481.9	35,109.9
<b>Out-turn as % of original budget</b>		<b>97%</b>		<b>95.9%</b>		<b>91.2%</b>

Source: Labin Administrative Department for Finance and Budget

*ii) Annual variance between actual and estimated transfers of earmarked grants*

The budget estimate and out-turn figures for each of the streams of revenue Labin received from central government, counties and municipalities for the provision of services for the period 2011-13 are shown in the following table. The rating should be calculated by reference to the sum of the differences between the actual out-turn for each element of earmarked revenue and the budgeted amount adjusted for the overall difference between budget and out-turn. This PEFA dimension should be calculated by reference to the functional destination of each earmarked revenue stream (with the total unearmarked receipts counted as one revenue stream). In the event it proved impossible to obtain consistent data in the detail PEFA requires, so the variance has been calculated by reference only to the separate streams of revenue without regard to their functional destination..



**Table3.2: Budgeted and Actual Revenue Streams from Central and other Local Governments for the Provision of Services**

2011	Budget (1)	Budget x Out-turn % (97.0) (2)	Out-turn (3)	Difference between (3) and (2) (4)
.Share of income tax	17,536.6		17,689.0	
.Share of tax on property sales	1,600.0		1,327.3	
Total un-earmarked receipts	19,136.6	18,562.5	19,016.3	453.8
.Central Government payments for decentralized services	6,443.2	6,249.7	6,362.2	112.5
.Earmarked CG grants	1,884.9	1,828.4	2,194.6	366.2
.Payments from county	363.0	352.1	209.6	142.5
.Payments from municipalities	2,833.0	2,748.0	2,772.6	24.6
.Other receipts from CG	3,870.8	3,754.7	2,928.9	825.8
Total	34,531.5		33,484.2	1,925.4
Column (4) as % of Column (3)				5.7%
<b>2012</b>		95.9% of Col (1)		
.Share of income tax	18,858.6		19,233.6	
.Share of tax on property sales	1,600.0		1,562.0	
Total un-earmarked revenue	20,458.6	19,619.8	20,795.6	1,175.8
.CG payments for decentralized services	6,029.3	5,782.1	6,023.4	241.3
.Earmarked CG grants	2,593.1	2,486.8	1,667.3	819.5
.Payments from county	238.6	228.6	83.3	144.9
.Payments from municipalities	2,940.1	2,819.6	2,762.4	57.2
.Other receipts from CG	940.8	901.5	507.5	394.0
Total	33,200.5		31,839.5	2,832.7
Column (4) as % of Column (3)				8.9%
<b>2013</b>		91.2% of Col (1)		
Share of income tax	20,901.7		21,311.2	
Share of tax on property sales	1,700.0		2,081.9	
Total un-earmarked revenue	22,601.7	20,612.7	23,393.1	2,780.4
CG payments for decentralized services	5,674.6	5,175.2	5,657.7	482.5
Earmarked CG grants	3,378.4	3,081.1	2,149.8	931.3
Payments from county	201.3	183.6	190.7	7.1
Payments from municipalities	3,130.4	2,854.9	2,868.3	13.4
Other receipts from CG	3,495.5	3,187.4	840.2	2,347.2
Total	38,481.9		35,109.9	6,561.9
Column (4) as % of Column (3)				18.7%

Source: LabinAdministrative Department for Finance and Budget.

The variance percentages were 5.7 per cent, 8.9 per cent and 18.7 per cent for the three years 2011-13. If this information were considered sufficient for scoring dimension (ii), the result would be C, since the variance exceeded 10 per cent in only one of the three years.

*iii) In-year timeliness of transfers from HLG (compliance with timetables for in-year distribution of disbursements agreed within one month of the start of the SN fiscal year*

Tax receipts are shared out by FINA (the Government Agency which receives all central government revenue) as they are received from taxpayers. Other payments for decentralized services are paid monthly. Thus most of Labin's receipts are distributed evenly through the year.

Indicator	Score	Explanation
<b>HLG-1 Predictability of Transfers from Higher Level of Government</b>	<b>NR</b>	<b>Scoring method M1</b>
i) Annual deviation of actual total HLG transfers from the original total estimated amount provided by HLG to the City for inclusion in the latter's budget	A	Transfers from Central and other Governments fell short of budget by more than 5 per cent in only one of the last three years
ii) Annual variance between actual and estimated of earmarked grants	NR	Variance in receipts of different grant streams exceeded 10 per cent in only one of the last three years. But because information could not be obtained about the functional destination of earmarked receipts, dimension cannot be scored.
iii) In-year timeliness of transfers from HLG (compliance with timetables for in-year distribution of disbursements agreed within one month of the start of the City EFY	A	Receipts are spread evenly through the year.

### Subsection 3.1: Budget Credibility

#### PI-1 Aggregate expenditure out-turn in comparison with the original approved budget

*(i) Difference between actual primary expenditure and originally-budgeted primary expenditure*

The following table shows budgeted and actual expenditure for the three years 2011-13.

**Table 3.3 Budgeted and actual expenditures (2011-2013)**

Year	2011		2012		2013	
	Budget	Out-turn	Budget	Out-turn	Budget	Out-turn
Total Current Expenditure	50,117.6	49,898.9	53,143.7	49,866.7	61,924.1	58,573.8
Total Capital Expenditure	16,937.0	10,224.2	15,805.8	9,803.8	17,244.1	8,483.4
Less Interest	1,095.0	1,076.2	1,135.9	1,129.3	979.7	809.5
Less External Grants	401.3	401.3	498.9	498.9	597.8	597.8
Total Primary Expenditure	65,558.3	58,645.6	67,314.7	58,042.3	77,590.7	65,849.8
Out-turn as % of Budget		89.5		86.2		84.9
Current Expenditure less interest and grants	48,621.3	48,421.4	51,508.9	48,238.5	60,346.6	57,366.4
Out-turn as % of Budget		99.6		93.7		95.1

HRK thousands

Source: LabinAdministrative Department for Finance and Budget

Actual total expenditure fell consistently well short of the budgeted amount, mainly due to reductions in capital expenditure resulting from revenue shortfalls.

Indicator	Score	Explanation
<b>PI-1 Aggregate expenditure out-turn compared to original approved budget</b>	<b>C</b>	<b>Scoring method M1</b>
(i) Difference between actual primary expenditure and originally-budgeted primary expenditure (debt service charges and also expenditure on projects from external financing excluded)	C	Actual primary expenditure fell more than 15 per cent short of original budget in only one of the three years 2011-13. Percentages were 89.5%, 86.2%, 84.9% respectively.

**PI-2 Composition of expenditure out-turn compared to original approved budget**

- (i) *Extent to which the variance in the composition of primary expenditure exceeded the aggregate variance (as defined in PI-1) in the past three years excluding contingency items*

The variance is calculated by adjusting the budgeted expenditure for each of the nine main (COFOG) functions by the overall percentage difference between budgeted and actual primary expenditure. The difference between the expenditure out-turn on each function and these adjusted figures is then calculated, with the variance being the sum of the absolute differences as a percentage of aggregate primary expenditure. The variance calculated in this way was 7.7 per cent for 2011, 10.8 per cent for 2012, and 8.5 per cent for 2013.

Note: Calculations deduct interest payments from General Public Services line, and external grants from Sport, Recreation and Culture.

**Table 3.4 Primary Expenditures (2011-2013)**

(HRK thousands)

	2011				2012				2013			
	Budget (1)	Budget x out-turn 89.5 % (2)	Out-turn (3)	(3) minus (2) (4)	(1)	(2) 86.2%	(3)	(4)	(1)	(2) 84.9%	(3)	(4)
General Public Services	9,927.0	8,884.7	9,351.0	466.3	10,600.7	9,137.8	9,765.3	627.5	11,549.4	9,805.4	10,247.2	441.8
Public Order and Safety	4,869.4	4,358.1	4,758.2	400.1	5,016.8	4,324.5	4,958.7	634.2	5,078.0	4,311.2	5,044.9	733.7
Economic Affairs	10,554.7	9,446.5	8,304.1	1,142.4	12,303.9	10,606.0	9,414.8	1,191.2	10,472.5	8,891.2	8,964.5	73.3
Environmental Protection	9,192.0	8,226.8	8,515.3	288.5	7,549.0	6,507.2	7,265.1	757.9	8,413.1	7,142.7	6,454.4	688.3
Housing	5,022.0	4,494.7	3926.4	568.3	7,136.0	6,151.2	5,078.1	1,073.1	8,105.2	6,881.3	5,587.2	1,,294.1
Health	550.0	492.2	482.2	10.0	450.0	387.9	378.5	9.4	773.0	656.3	712.2	55.9
Sport, Recreation, Culture	10,637.6	9,520.7	8,976.8	543.8	8,599.3	7,412.6	6,565.1	847.5	10,430.7	8,855.7	8,413.9	441.8
Education	11,755.7	10,521.4	11,602.7	1,081.3	12,574.5	10,839.2	11,588.5	749.3	19,373.5	16,448.1	17,914.6	1,466.5
Social Protection	3,050.0	2,729.7	2,728.6	1.1	3,084.5	2,658.8	3,028.3	364.5	3,395.2	2,882.5	3,272.5	390.0
Total	65,558.3		58,645.6	4,501.8	67,314.7		58,042.3	6,256.6	77,590.7		65,849.8	5,585.4
Additional Variance as % of out-turn				7.7%				10.8%				8.5%

Source: LabinAdministrative Department for Finance and Budget; figures exclude debt interest and external grants

*(ii) The average amount of expenditure charged to the contingency vote over the last three years*

Article 56(4) of the State Budget Law restricts the amount of any Contingency Reserve to 0.5 per cent of revenues excluding capital receipts. Labindid not have any such reserve during the period 2011-13.

Indicator	Score	Explanation
<b>PI-2 Deviations in composition of expenditure out-turn compared to the original approved budget</b>	<b>B+</b>	<b>Scoring method M1</b>
(i) Degree to which the variation in composition of primary expenditure has exceeded the global deviation in primary expenditure (as defined in PI-1) in the past three years	B	The variance in the composition of primary expenditure exceeded 10 per cent of the expenditure out-turn in only one of the three years.
(ii) The average amount of expenditure charged to the contingency vote over the last three years	A	No expenditure was charged to a Contingency Reserve during 2011-13.

**PI-3 Aggregate domestic revenue out-turn compared to original approved budget**

*(i) Actual domestic revenue compared to domestic revenue in the originally approved budget*

This Indicator is rated by reference to the difference between budgeted own revenue and actual out-turn. The calculations are shown in the following table.

**Table3.5: Own revenue out-turn compared with original budget, 2011-13**

	HRK thousands					
	2011		2012		2013	
	Budget	Out-turn	Budget	Out-turn	Budget	Out-turn
Total current revenue	63,108.0	59,917.7	63,181.3	57,251.6	74,811.0	67,608.8
Less Receipts from General Govt. (HLG-1)	34,531.5	33,484.2	33,200.5	31,839.5	38,481.9	35,109.9
Less External Grants	401.3	401.3	498.9	498.9	597.8	597.8
Own current revenue	28,175.2	26,032.2	29,481.9	24,913.2	35,731.3	31,901.1
Current revenue out-turn as % of original budget		92.4%		84.5%		89.3%
Receipts from asset sales	5,548.0	2,573.6	8,035.0	4,408.7	6,792.0	1,402.2
Total own revenue	33,723.2	28,605.6	37,516.9	29,321.9	42,523.3	33,303.3
<b>Total own revenue as % of original budget</b>		<b>84.8%</b>		<b>78.2%</b>		<b>78.3%</b>

Source: LabinAdministrative Department for Finance and Budget

Indicator	Score	Explanation
<b>PI-3 Deviations in aggregate revenue out-turn compared with the original approved budget</b>	<b>D</b>	<b>M1 Scoring Method</b>
(i) Real collection of domestic income in comparison with estimates in the original approved budget	D	Actual revenue was 84.8%, 78.2% and 78.3% for the three years 2011-13, well below the 92% required for C.

#### PI-4 Stock and monitoring of expenditure payment arrears

The city of Labin has no liquidity issues and there are very few arrears. They were generated for technical reasons (incomplete documentation during procurement) rather than by the inability of the city to pay.

For the last three years (2011-2013), expenditures arrears as a percentage of total real expenditures were insignificant. They represented 1.2% in 2011. In 2012 and 2013 they were 0.6% and 0.5% respectively. These results are summarized below:

**Table 3.6: Arrears in Percentage (%) of total Expenditures for 2011-2013**

(In 000 of HRK and in Percent)

Year	Total Expenditures	Amount of Arrears as of December 31	Arrears as a % of total Expenditures
2013	68 828.2	328.0	0,5%
2012	59 670.5	358.9	0,6%
2011	60 123.1	707.2	1,2%

Source: Calculations by the PEFA team on data provided by the Administrative Department for Finance & Budget for 2011-2013

Data on the stock of expenditures arrears with an age profile are available daily (in real time) in the FMIS, SPI (*Sistem poslovnih informacija* or Business Information System) an integrated software covering budget planning, budget execution, payroll, payments, treasury, procurement and property registry. The SPI was introduced in 2010. The internal auditors at the city regularly follow SPI processes. In addition the company that manages SPI is Libusoft Sicom, which

has an ISO certificate of good quality<sup>7</sup>. All these elements provide evidence of the reliability of the data on expenditure arrears; furthermore the external auditors have never detected inaccuracies in the data.

*(i) Stock of expenditure payment arrears*

The stock of arrears is insignificant

*(ii) Availability of data to monitor the stock of expenditure payment arrears*

Reliable and complete data on the stock of arrears (including an age profile) is available daily

Indicator	Score	Explanation
<b>PI-4 Stock and Monitoring of expenditure payment arrears</b>	<b>A</b>	<b>M1 Scoring Method</b>
(i) Stock of expenditure payment arrears	A	Stock of arrears is below 2% in 2013
(ii) Availability of data in order to monitor the stock of expenditure payment arrears	A	The existing system allows having complete and reliable data on arrears in real time (any time during the year) with an age profile.

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<sup>7</sup>[www.spi.hr](http://www.spi.hr)



## Subsection 3.2: Comprehensiveness and Transparency

### PI-5 Classification of the Budget

*i) The classification system used to formulate, execute and report on the City budget.*

It is a legal obligation to have an organizational (administrative), economic, functional and program budget classification<sup>8</sup>. It is also a legal obligation to have a budget classification according to sources of financing and location.

In the city of Labin, for budget preparation, execution and reporting functional and sub-functional classification are used (compatible with GFS/COFOG standards. There are 9 functions and 22 sub-functions<sup>9</sup>.

Budget preparation, execution and reporting are also classified by programs and sub-programs (there are about 40 programs and over 116 sub-programs).

In addition to the functional and programme classifications described above, preparation, execution and reporting of the budget are also carried out according to the administrative and economic classifications<sup>10</sup>.

Indicator	Score	Explanation
<b>PI-5 Classification of the Budget</b>	<b>A</b>	<b>M1 Scoring method</b>
(i) The classification system used to formulate, execute and report on the central government budget.	A	The budget formulation, execution and reporting is based on administrative, economic, sub-functional classification and program classification.

<sup>8</sup>State Budget Act (Consolidated Text), 2009, Art. 21; Ordinance on Budget Accounting and Chart of Accounts (Official Gazette, no. 27/05 and 127/07)

<sup>9</sup>These functions are: 1. General public services (with 2 sub-functions); 2. Defence (does not apply at the SN level); 3. Public order and safety (with 1 sub-function); 4. Economic affairs (with 2 sub-functions); 5. Environment (with 3 sub-functions); 6. Housing (with 4 sub-functions); 7. Health (with 2 sub-functions); 8. Leisure, culture and religion (with 2 sub-functions); 9. Education (with 3 sub-functions); 10. Social Care (with 3 sub-functions); (sources: City Budget 2013, Budget execution Reports 2013).

<sup>10</sup> This is explicitly required by law (State Budget Act, 2009, Art. 10)

## PI-6 Comprehensiveness of information included in budget documentation

**TABLE 3.7: INFORMATION CONTAINED IN BUDGET DOCUMENTATION**

Documentary Requirement	Fulfilled	Document
1. Macroeconomic assumptions, including aggregate growth, inflation and exchange rate estimates, at the very least.	<b>YES</b>	This information is included in the draft budget of the city (as well as in the guidelines for budget preparation provided by the Min Fin.  (Draft budget for the city of Labin2014)
2. Fiscal deficit.	<b>NO</b>	Based on the current legislation a budget should not show a deficit from a technical point of view (State Budget Act, 2009, Art. 7). However the city is allowed to borrow (State Budget Act, 2009, Art. 86-89). The amount of the Loan in the budget corresponds to the deficit. It is considered as a receipt to the budget (State Budget Act, 2009, Art. 48) but overall this presentation of the deficit is not consistent with GFS standards.  (Draft budget for the city of Labin 2014)
3. Deficit financing	<b>YES</b>	Loans are indicated in the budget and can be identified as the amounts to finance the "fiscal deficit"  (Draft budget for the city of Labin 2014)
4. Debt stock.	<b>YES</b>	Debt stock is indicated in the budget  (Draft budget for the city of Labin 2014)
5. Financial Assets.	<b>YES</b>	Shares and equity in 10 companies as well as bank balances are indicated in budget documentation.  (Draft budget for the city of Labin 2014)
6. Results of previous budget exercise	<b>YES</b>	This information is available in the budget  (Draft budget for the city of Labin 2014)
7. Results of the current year's budget (revised)	<b>YES</b>	This information is available in the budget  (Draft budget for the city of Labin 2014)
8. Summarized budget data for both revenue and expenditure according to the main heads of the classifications used (ref. PI-5), including data for the current and previous year.	<b>NO</b>	Draft budget 2014. Summary available only in economic classifications  (Draft budget for the city of Labin 2014)
9. Explanation of the budget implications of new policy initiatives.	<b>YES</b>	This is indicated in the budget  (Draft budget for the city of Labin 2014)

*i) Share of the above listed information contained in the budgetary documentation most recently issued by the central government.*

Recent budget documentation fulfils 7 of the 9 information benchmarks

Indicator	Score	Explanation
<b>PI-6 Comprehensiveness of information included in budgetary documentation</b>	<b>A</b>	<b>M1 Scoring method</b>
(i) Proportion of information mentioned above and contained in the most recent budgetary documentation published by the central government.	A	Recent budget documentation fulfils 7 of the 9 information benchmarks

## **PI-7 Extent of unreported city operations**

*i) Level of extra-budgetary expenditure (not including projects financed by donors) that is not declared – in other words that does not appear in fiscal reports.*

The existing legislation requires that all revenue and expenditure to be included in the budget<sup>11</sup>. All revenue by education centres (PI-23) under the city's supervision are reported. There are no health centres or hospitals under the city's supervision. Overall the PEFA team has not identified any extra-budgetary operations in Labin.

*ii) Information on income and expenditure in relation to projects financed by donors included in the fiscal reports.*

The city of Labin has received grants from the Veneto Region of Italy (bordering Istria and Croatia). It has also received EU grants (Europe for Citizens, for the projects *Mining Heritage* and *Organic Production and Consumption*). These amounts are relatively small (less than Euro 200 000) and represented less than 2% (but more than 1%) of total expenditures in 2013<sup>12</sup>. For 2013 income/expenditure information on the small projects financed by these grants were included in fiscal reports.

<sup>11</sup>Refer to: State Budget Act (2009), *Universality principle*, Art. 9

<sup>12</sup> Calculations by the PEFA team based on data provided by the city of Labin: Euro 50 000 were provided by the *Regione Veneta* for a 4-year period. For the period July 2013 through September 2014 the city also received Euro 142 000 (50% of this amount was paid in 2013) from the EU. An additional amount for Euro 18 000 was received for the same period from the EU (small project on organic production and consumption).

Indicator	Score	Explanation
<b>PI-7 Extent of unreported government operations</b>	<b>A</b>	<b>M1 Scoring Method</b>
(i) Level of extra-budgetary expenditure (as distinct from that for projects financed by donors) which is not declared, in other words does not appear in fiscal reports.	A	The level of unreported extra-budgetary expenditure (other than donor funded projects) is nil.
(ii) Information on income and expenditure relating to projects financed by donors that is included in fiscal reports.	A	There are no inputs provided in-kind to Labin. Complete information on donor resources provided in cash is included in fiscal reports

### PI-8 Transparency of inter-governmental fiscal relations

The city of Labin has 7 Neighbourhood Councils, *Gornigrad, Doni-Labin, Kature, Vinez, Kapenitza, Ripenda&Rabac*. The neighbourhood councils are at first sight sub-national entities of a lower level that function with elected councils for four years (5 members that are volunteers and not paid).

The neighbourhood councils receive all their resources from the city and do not collect revenues. The transfers from the city are equally distributed to the 7 neighbourhood councils.

The neighbourhood councils do not have own budgets (they have no employees either). However they can propose to the city how the amounts of funds to be transferred to them can be spent. The city has always the last word on this budget and approves the details of spending of the neighbourhood councils.

The amounts to be spent by the neighbourhood councils are included in the budget of the city of Labin. The latter has to also approve all expenditures made by the neighbourhood councils and the city directly executes the various stages of spending (commitment, payments).

The neighbourhood councils are nothing more than departments of the city and/or deconcentrated units of the same.

- i) Transparent systems based on regulations governing horizontal allocations between sub-national governments of unconditional and conditional transfers from central government (budgeted and real allocations).NA*
- ii) Timely provision of reliable information to sub-national governments on the allocations to be made to them by Central Government for the following year.NA*

iii) Degree to which consolidated general government fiscal data (at least on income and expenditure) is collected and made available, broken down by sectoral categories.NA

Note: Consolidated general government data broken down by function covering all LGUs has only recently been collected, and has not been readily available

Indicator	Score	Explanation
<b>PI-8 Transparency of inter-governmental fiscal relations</b>	<b>NA</b>	<b>M2 Scoring Method</b>
i) Transparent systems based on regulations regarding horizontal allocation between sub-national governments of unconditional and conditional transfers from central government (budgeted and real allocations)	NA	NA
ii) Punctual provision of reliable information to sub-national governments about the allocations to be made to them by central government in the coming year	NA	NA
iii) Degree to which consolidated fiscal data are gathered and made known (at least in terms of income and expenditure) relating to general government, broken down by sectoral categories	NA	NA

### PI-9 Oversight of aggregate fiscal risk caused by other public sector entities

The city of Labin has a *People's Museum*, a *City Library Labin* and a *Fire Brigade*. These entities do not have their own budgets. They are part of the city of Labin budget, operating therefore as if they were city departments. All their expenditures (salary, operating costs, etc.) are met by the city.

The city of Labin has shares in 6 companies. These shares were valued at: 30 million HRK on December 31, 2013:

1. *1 Maj* comunal company<sup>13</sup>, 62% owned by the city being in charge of collecting waste. On December 31, 2013, the shares were valued at HRK 6.2 million;
2. Water Supply company (*Vodovod Labin*)<sup>14</sup>, 54.4% owed by the city (the remaining shares being owned by 4 other nearby municipalities). On December 31, 2013, the shares were valued at HRK 61.8 million;

<sup>13</sup>[www.prvimaj.hr](http://www.prvimaj.hr)

<sup>14</sup>[www.vodovod-labin.hr](http://www.vodovod-labin.hr)

3. *Labin Stan* that manages private buildings (100% ownership by the city). On December 31, 2013, the shares were valued at HRK 208,949.00 ;
4. *Labin 2000* in charge of collecting parking fees and of maintaining IT infrastructure for the city (100% owned by the city). On December 31, 2013, the shares were valued at HRK 278,917.00;
5. *IVS-Istarski vodozastitni sustav* regional company in charge of protecting water sources (3.32% owned by the city). On December 31, 2013, the shares were valued at HRK 33, 200.00;
6. *Istarska Autocesta Labin* – operates Istria highway (1.57% owned by the city). On December 31, 2013, the shares were valued at HRK 291,333.00;
7. *IDA PULA*, to provide loans and to encourage entrepreneurship (4.29% owned by the city). On December 31, 2013, the shares were valued at HRK 1.5 million ;
8. *Zračna luka Pula airport*, Pula (3% owned by the city). On December 31, 2013, the shares were valued at HRK 2.5 million ;
9. *Riviera Adria*, tourism company that operates hotels (1620 shares owned by the city). On December 31, 2013, the shares were valued at HRK 21,060 ;
10. *Uljanik Pula*, shipyard (43 shares owned by the city). On December 31, 2013, the shares were valued at HRK 1 720.00 ;

It should be noted that *1May* receives subsidies from the city.

All the above mentioned companies where the city of Labin has a majority ownership forward semi - annual and annual reports to the city. The annual reports are audited and are submitted to the city council. The city does not elaborate a consolidated overview on fiscal risk (report)

*i) Degree of city monitoring of the main autonomous public organisations and state companies.*

Companies controlled by the city of Labin forward audited accounts to the city at least annually but the information is not consolidated into a single report assessing the possible fiscal risks arising from their operations.

*ii) Degree to which the city monitors the fiscal position of the sub-national governments.*

There are no sub-national governments in Labin. The dimension does not apply (NA)

Indicator	Score	Explanation
<b>PI-9 Oversight of aggregate fiscal risk caused by other public sector institutions</b>	<b>C</b>	<b>M1 Scoring Method</b>
(i) Degree to which the central government monitors the autonomous public organisms (AGAs) and public companies (EPs).	C	Companies forward audited fiscal reports to the city annually but no consolidated report is produced about the fiscal risks posed by their operations.
(ii) Degree to which the central government monitors the fiscal position of sub-national governments	NA	--

### PI-10 Public access to key fiscal information

*i) Number of the elements regarding public access to information, mentioned in table 3.8 that are used (an element can only be considered for the purposes of this evaluation if it fulfils all the requirements).*

The city makes available to the public 5 of the 6 listed types of information

**TABLE3.8: INDICATORS OF PUBLIC ACCES TO KEY FINANCIAL INFORMATION**

Key information	Situation of public access
(i) Annual budget documentation: A complete set of documents can be obtained by the public through appropriate means when it is submitted to the city legislature.	<b>YES.</b> Accessible on the city web site. For the 2014 draft budget, the whole documentation of the budget was posted on the website when submitted to the Council.  (Department for Social Affairs and local self-government, City of Labin; <a href="http://www.labin.hr">www.labin.hr</a> )
(ii) In-year budget execution reports: The reports are routinely made available to the public through appropriate means within one month of their completion.	<b>YES</b> on the city website about 10-20 days within completion  Budget Law (2009), Art 12 (3); Administrative Department for Budget and Finance, <a href="http://www.labin.hr">www.labin.hr</a> )
(iii) Year-end financial statements: The statements are made available to the public through appropriate means within six months of completed audit.	<b>NO.</b> There are no audited financial statements. Statements are published when they are finalized. The State Audit Office identifies issues to be dealt with the following year.  (Administrative Department for Budget and Finance.)
(iv) External audit reports: All reports on city consolidated operations are made available to the	<b>YES,</b> The last audit report published was for 2011. It was posted on the web site of the StateAudit O ffice

public through appropriate means within six months of completed audit.	( <a href="http://www.reviziga.hr">www.reviziga.hr</a> )
(v) Contract awards: Award of all contracts with value above approx. USD 100,000 equiv. is published at least quarterly through appropriate means.	<b>YES</b> Published on the Official Gazette and on the website of the official Gazette as soon as the official decision is made (there is a 30 day deadline for publication)  ( <a href="http://www.snpqz.hr">www.snpqz.hr</a> )
(vi) Resources available to primary service units: Information is publicized through appropriate means at least annually, or available upon request, for primary service units with city coverage (elementary schools or primary health clinics).	<b>YES</b> Resources available to the kindergarten and the 3 elementary schools in Labin (with city coverage) are available in the city budget. Resources to the primary health centre under the city coverage in Labin are also visible in the budget. Information on real resources received by these units is available in year-end budget execution reports and upon request  (City budgets 2013 and 2014, Administrative Department for Budget and Finance, <a href="http://www.labin.hr">www.labin.hr</a> )

Indicator	Score	Explanation
<b>PI-10 Public access to key fiscal information</b>	<b>A</b>	<b>M1 scoring method</b>
Number of elements listed above regarding public access to information that is fulfilled.	A	The city makes available to the public 5 of the 6 listed types of information



### Subsection 3.3: Policy-based Budgeting

#### PI-11 Orderliness and participation in the annual budget process

##### (i) Existence and observance of a fixed budget calendar

**TABLE 3.9: CALENDAR FOR THE BUDGET PREPARATION PROCESS (for 2014 budget)**

Deadline	Activity
30 June 2013	Ministry of Finance sends guidelines for preparing 2014 Budget to Local Government Units. Guidelines actually issued in late September 2013.
30 August 2013	Labin Administrative Department for Finance and Budget issues instructions to other City Depts and Budget Users. Actual Date 25 October
15 September 2013	Labin Administrative Department for Finance and Budget invites applications for subsidies from voluntary organisations (sports clubs, etc.)
15 September 2013	Budget users submit proposals to Labin Administrative Department for Finance and Budget Actual date 8 November
15 October 2013	Labin Administrative Department for Finance and Budget submits consolidated draft Budget to Mayor. Actual date 13 November
15 November 2013	Mayor submits draft Budget to City Council
24 November 2013	First reading of Budget by Council
Early December 2013	Public consultation on Budget proposals
31 December 2013	Council approves revised Budget proposals. Actual date 22 December
By 15 January 2014	Labin Administrative Department for Finance and Budgets ends approved Budget to Ministry of Finance

Source: State Budget Act, Articles 25-40; Labin Administrative Department for Finance and Budget

As indicated in the Table above, the State Budget Act prescribes a calendar which Local Government Units (LGUs) should follow in the preparation of their Budgets. However, during the current period of financial stringency following the financial crisis of 2008-09, the Ministry of Finance has itself been unable to issue its Guidelines for Budget preparation in accordance with the prescribed timescale. As a consequence LGUs have been unable to issue their Budget instructions at the time stipulated. However, Cities are relatively small organisations with few budget users, and Labin has been able in practice to produce consolidated Budget proposals by 15 November, so that discussion by the elected Council can take place in an orderly way, with sufficient time allowed for detailed amendments before the Budget is approved by 31 December.

*(ii) Guidance on the preparation of budget submissions*

The City Finance Department works closely throughout the year with the other City Departments and the main budget users (elementary schools, kindergarten, fire service, etc.). The Heads of the City Departments and of the main budget users are analogous to the Cabinet of Ministers at central government level. Thus it is possible for budget submissions to be prepared within a very short time after the issue of final instructions, which the Administrative Department for Finance and Budget agrees with the Mayor, and which contain expenditure ceilings within which all Heads of Department and budget users have to work. This process works satisfactorily despite some short timescales, and there is full communication at every stage between the Administrative Department for Finance and Budget, the Mayor and the main budget users.

*(iii) Timely approval of the budget by the Legislature*

The Council has approved the Budget in each of the last three years before 25 December.

**TABLE 3.10: DATES FOR BUDGET APPROVAL BY LEGISLATURE (2012 through 2014)**

Fiscal Year	Date of Approval
2012	21 December 2011
2013	20 December 2012
2014	22 December 2013

Source: Budget plan for 2013. <http://www.labin.hr/sites/default/files/Broj%2016%20-%20od%2023.%20prosinca%202011.pdf>, Budget plan for 2013. <http://www.labin.hr/sites/default/files/proračun%20za%202013.%20godini.pdf>, Budget plan for 2014. [http://www.labin.hr/sites/default/files/Proračun%20Grada%20Labina%20za%202014.%20godinu%20sa%20projekcijom%20za%202015.%20i%202016.%20godinu\\_0.pdf](http://www.labin.hr/sites/default/files/Proračun%20Grada%20Labina%20za%202014.%20godinu%20sa%20projekcijom%20za%202015.%20i%202016.%20godinu_0.pdf)

Indicator	Score	Explanation
<b>PI-11 Orderliness and participation in the annual budget process</b>	<b>B</b>	<b>M2 scoring method</b>
(i) Existence and observance of a fixed budgetary calendar	C	The earlier stages of the calendar have been subject to considerable delays which were outside the control of LGUs.
(ii) Directives on the preparation of budgetary documents	B	Ongoing consultations between the Finance Department, the Mayor, the City Departments and the main budget users ensure that Budget proposals can readily be produced once the final instructions, which include expenditure ceilings approved by the mayor, have been given.
(iii) Timely approval of the budget by the Council	A	The City Council has approved the next year's Budget before 25 December in each of the last three years.

## **PI-12 Multi-year perspective in fiscal planning, expenditure policy and budgeting**

### *(i) Preparation of fiscal forecasts and multi-annual functional allocations*

Article 33 of the State Budget Law requires each LGU's Finance Department to prepare a "*development programme plan*" for a three year period "*on the basis of strategic documents intended for the development of the LGU*". Article 34 requires the development programme plan to "contain goals and priorities of the development of the LGU linked with programme and organisational (i.e. administrative) classification of the budget". During 2011-13 Labin has accordingly presented figures for the two subsequent years alongside its figures for the budget year immediately ahead. Where the shape of activities in future years can be foreseen with confidence (e.g. elementary schools, kindergarten, fire service), the figures take account of the impact of investment expenditures on future current expenditure. But the unpredictability of major revenue streams, and the fact that some of them are earmarked for particular types of expenditure, makes it difficult to prepare strategic plans which remain stable from one year to the next. The comprehensive explanatory document circulated by the city to all its citizens is concerned exclusively with the budget year ahead, and makes no mention of any longer time horizon. There are no links between the multi-year estimates and the subsequent setting of annual budget ceilings – for example, many of the 2014 figures presented with the 2013 Budget bear little relation to their counterparts in the actual 2014 Budget –.

### *(ii) Scope and frequency of debt sustainability analyses*

The Ministry of Finance keeps tight control of all LGU borrowing, which in all cases (including borrowing by LGU-owned utility firms) requires the Ministry's consent. The Budget Law (OG 87/08) requires that the annual debt service payments (interest and capital repayments) on all outstanding loans remain within a limit of 20 per cent of the previous year's revenue net of capital receipts. Provided LGUs comply with this limit, it already constitutes a considerable measure of assurance that they will always be able to service their debts. Article 75(3) of the State Budget law gives the Ministry of Finance power to further restrict overall LGU borrowing by annual Law on Budget execution. For the period 2011-13 the Ministry limited total new borrowing by LGUs and their utility service companies to 2,3 (in 2011) and 2.5 (2012 and 2013) per cent of the previous year's aggregate LGU revenue excluding central government grants. Labin has two outstanding loans which together amount to less than 15 per cent of annual revenue, and on which reports are made every six months to the Council; debt service costs are not much more than one per cent of revenue. Since the City's debt is so small, this dimension is Not Applicable.

### *(iii) Existence of sectoral strategies with multi-annual determination of current expenditure and investment costs*

Labin showed that where its activities follow a relatively stable and predictable path over time, the figures in its projections of the costs of the services concerned include the ongoing current expenditures required to make use of new investments. These activities do not constitute strategies or parts of an overall strategy although they cover more than 25 per cent of the budget. Labin's Development Plan does not allocate costs over time<sup>15</sup>. It is however very detailed on potential sources of financing.

### *(iv) Links between the investments budget and future expenditure estimates*

The unpredictability of the revenues (communal fee paid in respect of new construction and central government grants) required to finance investments makes longer-term investment planning very difficult. The figures produced each year for the two years following the Budget year include the current expenditure impact of new investments included in the projection, so it is not possible to say that there is no connection between the planning of current and capital expenditure. But there are no real strategies determining future investment plans, and the unpredictability of the necessary revenues means that investment intentions have to be reformulated each year.

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<sup>15</sup> The Town of Labin, *Integral Development Project of the Town of Labin (2008-2018)* [www.labin.hr/sites/default/files/Town%20of%20Labin%20Integral%20Development%20Project\\_0.pdf](http://www.labin.hr/sites/default/files/Town%20of%20Labin%20Integral%20Development%20Project_0.pdf)

Indicator	Score	Explanation
<b>PI-12 Multi-year perspective in fiscal planning, expenditure policy and budgeting</b>	<b>D+</b>	<b>M2 scoring method</b>
(i) Multi-annual fiscal forecasts and functional allocations	C	Although detailed projections of budgeted activities are prepared each year for a three year period, firm links between multi-year estimates and subsequent budget ceilings for particular activities have not yet been established in many cases.
(ii) Scope and frequency of debt sustainability analyses	NA	Labin's total debt service costs barely exceed one per cent of revenue. There is no question of the city's debt becoming unsustainable. In this situation the dimension is Not Applicable.
(iii) Existence of sectoral strategies with cost determination	D	Plans for the development of programmes where activities have a steady pattern allow fully for both capital and current costs. But these do not constitute strategies although they cover well over 25 per cent of the Budget. The Development Plan is not costed.
(iv) Linkages between investment budgets and forward expenditure estimates	C	Investment planning is rather uncertain because of the unpredictability of the revenue streams required to finance it, although the projections produced each year are consistent as between current and capital expenditure.

### Subsection 3.4: Predictability and Control in Budget Execution

#### PI-13 Transparency of taxpayers' obligations and liabilities

This Indicator considers tax and other revenue accruing to the city where payments are compulsory, and the rates charged are not directly related to the costs of providing any service. Labin imposes a surtax of 6 per cent on the income tax payments of its residents, which is assessed by the Tax Authority (TA) and paid to the City as it is collected by the central government's Finance Agency (FINA) together with the City's share (64 per cent) of the basic income tax payments. There is also a 3 per cent tax on the consumption of beverages at catering establishments in the City, an annual charge of 2,000 HRK on each business operating in the City, and an annual tax based on the floor area of each holiday house. These tax revenues are collected by the county office of TA, and paid to the City each month. The most important own revenues are the Community fees charged in respect of new developments, and the annual utility fee charged on each property to meet the costs of upkeep of the City's infrastructure. The City directly collects these amounts.

**TABLE 3.11: OWN TAX & FEE REVENUE COLLECTION, 2013**

Taxes	Executed HRK thousands	% relative to subtotal	% relative to total
<b>Direct taxes</b>	<b>2,263.2</b>		<b>14.5%</b>
Surtax on personal income tax	2,263.2	100%	14.5%
<b>Indirect Taxes</b>	<b>2,507.3</b>		<b>16.1%</b>
Tax on consumption of beverages	1,090.1	43.5%	7.0%
Tax on holiday houses	422.5	16.9%	2.7%
Tax on business names	994.7	39.7%	6.4%
<b>Administrative fees</b>	<b>10,830.3</b>		<b>69.4%</b>
Community fees	2,551.1	23.5%	16.4%
Utility fees	8,279.2	76.5%	53.1%
<b>TOTAL OWN REVENUE</b>	<b>15,600.8</b>		<b>100 %</b>

Source: LabinAdministrative Department for Finance and Budget

#### *(i) Clarity and comprehensiveness of tax liabilities*

Surtax depends entirely on the central government for its assessment and collection, and therefore is not considered here. The taxes on the consumption of beverages, on holiday houses and business names are conceptually simple, and the legislation and administrative procedures are clear. The amounts payable are determined by objective factors, without there being scope for the exercise of discretion by officials of the TA. Thus the City, TA and taxpayers know what their liabilities are. The legislation governing the payment of the community fees in respect of new developments and the annual utility fees charged on all properties is well understood by all those concerned. The basis on which utility fees are charged is clear in principle, although there might be questions about the accuracy of measurements of particular properties, where the records are kept

by the City. There is inevitably some (but few) element(s) of negotiation concerning the amounts of the once-for-all payments of the community fees.

*(ii) Access by taxpayers to information on their tax responsibilities and administrative procedures*

The basis for the calculation of the amounts payable in respect of the different taxes and the annual utility fees is clearly stated on the accounts sent to those who are liable to pay them. Community fees are specifically calculated whenever chargeable developments are undertaken. Further information is readily available to tax and fee payers at City offices and county offices of TA, although no particular steps are taken to provide taxpayer education.

*(iii) Existence and functioning of a tax appeals mechanism*

Appeals against tax assessments are made initially to TA. If agreement is not reached, an appeal can be made to a specialised section of the Ministry of Finance. A further appeal is possible to the Administrative Court, which has a considerable backlog of undecided cases. It does not appear that the small taxes for which LGUs are responsible give rise to any significant incidence of disputes and appeals. There is provision in the law for appeals to be made against utility fees and the community fees charged on new developments to a "second instance" (i.e. after an initial appeal to the LGU making the assessment) consisting of an independent panel appointed by the county concerned, but such appeals were stated to be extremely rare. In practice LGUs are reliant on the Administrative or Bankruptcy Courts to collect unpaid fees, while those liable to pay the fees can equally appeal to the Court.

Indicator	Score	Explanation
<b>PI-13 Transparency of taxpayers' obligations and liabilities</b>	<b>B</b>	<b>M2 scoring method</b>
(i) Clarity and comprehensiveness of tax liabilities	B	Liability for payment of the taxes and fees for which LGUs are responsible is clearly defined in legislation, although there may be scope for error in the measurement of chargeable areas, and there is inevitably an element of negotiation in the case of the community fees.
(ii) Access by taxpayers to information about responsibilities and administrative procedures in relation to taxes.	B	Assessments make clear the basis on which amounts owing have been calculated. Information is readily available at local offices, although there are no particular efforts directed towards education of those liable to pay.
(iii) Existence and functioning of a tax appeals mechanism.	C	A special section of the Ministry of Finance deals with tax appeals. There is provision for appeals against city community and utility fees to be made to a body appointed by the county concerned, but such appeals were stated to be extremely rare

## **PI-14 Effectiveness of measures for taxpayer registration and tax assessment**

### *(i) Controls in the taxpayer registration system*

Surtax is paid by the Government Agency FINA directly to the LGUs where taxpayers are registered. LGUs have no control over whether they receive the correct amounts, since they are told nothing about the identity of individual taxpayers. However, the incentive to misrepresent a taxpayer's residence will not be significant in Labin where the surtax is only 6 per cent. The City has the responsibility to identify businesses in its area liable to the business names and beverage consumption taxes, and also holiday houses, but collection and enforcement is in the hands of the TA which does not provide the City with a detailed account of payments by each taxpayer. Furthermore the TA stated that it did not make use of its electronic registers of those liable to other taxes in collecting the three taxes which are decided by LGUs. However, the requirement for businesses to keep electronic Fiscal Registers (important for the collection of VAT) provides the City with some measure of assurance that most amounts due from businesses will be received. Receipts of holiday houses tax will be dependent on the LGU's effectiveness in collecting the necessary information. The assessment and collection of community and utility fees depends on the completeness of the City's records and the strength of its enforcement efforts; Labin has succeeded in quadrupling its receipts from utility fees over the last decade. However, countrywide the cadastral records are considered not to be of sufficient accuracy to support the collection of a property tax based on size or value, and TA does not release information to LGUs about the details of tax receipts arising from sales of property in their areas.

### *(ii) Effectiveness of penalties for non-compliance with registration and declaration obligations*

It appears that the main focus of TA's enforcement activity is on VAT, social contributions and income taxes, with relatively little attention to the minor taxes levied on behalf of LGUs. Penalties arising from the minor taxes are not significant. Failure to register a property in respect of which utility fees should be paid incurs a penalty of only 500HKR (less than US\$100), although once such properties are identified the city makes every effort to collect the amounts owed. Enforcement of community and utility fees has to be done through the Courts without the threat of substantial further penalties becoming payable in cases of non-compliance. The city sends notices to users who do not pay the utility charge and contribution within three months, and after the notice expires the city may start foreclosure. For poor users the city provides for the utility charge and contribution to be paid from the budget, from the item social care. The city often writes off claims for utility charge as a part of bankruptcy procedure. The City's claims for charges and contributions must be secured within three years. The Office for Communal Affairs employs one person who deals with the decisions for charges and contributions. Another person, from the Budget and Finance Office, takes care of registering the payments. The payers of utility fees and



community fees levied in respect of new developments mostly accept the decisions of the city. In the case of the community fees, the city may take a charge on the property of the payer. The city has taken charges on three or four real estates to prevent the owners (debtors) from selling them and leaving the city without paying.

*(iii) Planning and control of tax auditing programmes*

Labin devotes substantial staff resources to the enforcement of community and utility fees, based on local intelligence. However, the taxes and fees for which LGUs are responsible do not involve self-assessment, so there is no question of a risk-based tax audit programme of the kind with which this dimension is concerned.

Indicator	Score	Explanation
<b>PI-14 Effectiveness of measures for taxpayer registration and tax assessment</b>	<b>D+</b>	<b>M2 scoring method</b>
(i) Application of controls in the taxpayer registration system	C	Labin devotes much effort to its property database. But there are no links with TA databases.
(ii) Effectiveness of sanctions for failure to register and declare taxes	D	Penalties for non-compliance are ineffective
(iii) Planning and control of tax audit programmes	NA	The taxes and fees imposed by Labin do not involve self-assessment.

**PI-15 Effectiveness in collection of tax payments**

*(i) The collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of fiscal year, which was collected during that fiscal year (average of the last two fiscal years)*

There are substantial arrears of the taxes and charges for which Labin is responsible. Information is available at the beginning of each year about arrears of each tax or fee (and the amounts owed by each individual taxpayer), and also about the amounts collected in the course of the year. The position is summarised in the following table.

**Table 3.12: Tax arrears and amounts collected each year, 2011-13**

Tax/Fee	Arrears at 31.12.10	Amount collected in 2011	Arrears at 31.12.11	Amount collected in 2012	Arrears at 31.12.12	Amount collected in 2013	Arrears at 31.12.13
Holiday houses	271.4	415.1	258.9	436.8	183.4	427.6	258.9
Consumption	316.6	735.2	328.2	782.5	262.3	723.5	328.2
Business names	1,109.3	1,001.4	1,201.7	993.1	1,178.2	1,001.4	1,201.7
Communal fees	1,203.9	5,929.9	1,204.6	3,378.4	2,059.8	2,551.1	1,438.1
Utility fees	1,354.4	7,076.0	1,509.8	7,424.0	1,781.3	8,279.2	1,505.3
Total	4,255.6	15,157.6	4,503.2	13,024.8	5,465.0	12,982.8	4,732.7
<b>Arrears as % of collections during year</b>			<b>29.7%</b>		<b>42.0%</b>		<b>36.5%</b>

Source: Labin Administrative Department for Finance and Budget

As the table shows, total arrears increased each year from 2010 to 2012, but there was an overall improvement in 2013. Arrears as a proportion of collections are smaller for the fees which the City itself collects than they are for the small taxes which are collected by TA. There are no specific data on the collection ratio for tax arrears. Because arrears amount to more than a third of the annual revenue flow and consistently stay at that level (2012 & 2013), this suggests that the debt collection ratio is relatively low and in any case below 60%.

*(ii) Effectiveness of the transfer of tax payments to the Treasury by the revenue administration*

All revenue is paid into the Labin's Single Treasury Account, either directly by fee payers, or monthly by TA in respect of the three small taxes. Less than 20 per cent of revenue is transferred to the Treasury on a monthly basis, with the remainder paid into the Treasury daily.

*(iii) Frequency with which the Treasury completely reconciles accounts reflecting tax assessments, payments, records of arrears and transfers to Treasury*

Labin carries out 6-monthly reconciliations of the arrears, new assessments and collections from its individual fee payers with its Treasury records within 30 days of end of the semester.

Indicator	Score	Explanation
<b>PI-15 Effectiveness of tax collection</b>	<b>D+</b>	<b>M1 scoring method</b>
(i) Collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of fiscal year, which was collected during that fiscal year (average of the last two fiscal years)	D	Arrears of the taxes and which Labin is responsible amount to more than a third of total annual receipts.
(ii) Effectiveness in the transfer of recovered taxes to the Treasury by the revenue administration	B	The majority of the revenue dependent on Labin's own decisions is paid immediately into the City's Single Treasury Account, with only the minor revenue from the small taxes received monthly from TA.
(iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and transfers to Treasury.	C	Complete reconciliation of the position of individual fee payers with the City's Treasury records is carried out every six months (within 30 days of end of the semester).

## PI- 16 Predictability in availability of funds for commitment of expenditure

### *i) Degree to which cash-flow forecasts and monitoring are carried out*

The city of Labin prepares a cash flow planning every year (at the very beginning of the year) to ensure realistic appropriation and commitment levels. The cash flow forecast is essentially based on historical information on revenue and expenditure of past years. The forecast is broken down into twelve months and is updated monthly on the basis of cash inflows and outflows.

### *ii) Reliability and time horizon of the information on maximum limits and payment commitments provided to the MDA during the year*

In most cases spending units in the city of Labin receive information to plan new expenditure commitments less than three months in advance.

### *iii) Frequency and transparency of adjustments to budgetary allocations at a level higher than city Departments.*

In 2013, there was one amended budget (supplementary budget) in Labin, which modified the original approved budget slightly<sup>16</sup>. The adjustment was predictable and it was carried out as a result of a shortfall in revenue. The

<sup>16</sup>The original approved budget for 2013 amounted to HRK 81.6 million. The adjusted budget amounted to HRK 79.9 million. Real expenditures for 2013 amounted to HRK 68.8 million.

amendments/adjustments were reviewed and approved by the City Council in full transparency<sup>17</sup>. The Mayor also made extensive use of his authority (subject to certain limitations) to reallocate up to 5 per cent of each budget line to other purposes. These were notified to the Council after the event.

Indicator	Score	Explanation
<b>PI-16 Predictability of availability of funds for commitment</b>	<b>C+</b>	<b>M1 scoring method</b>
(i) Degree to which cash flow forecasting and monitoring is carried out	A	A cash flow forecast is prepared for the fiscal year, and is updated monthly on the basis of actual cash inflows and outflows.
(ii) Reliability and time horizon of the periodic information during the year providing the managers of the City's operations with information about maximum limits for payment commitments	C	Departments are provided with reliable information for one or two months in advance.
(iii) Frequency and transparency of the adjustments made to the budgetary allocations available at a level higher than MDA administrations	A	There was one revision of the Budget in 2013. It was carried out in a transparent (predictable) way.

### PI-17 Registration and Oversight of Cash Balances, Debt and Guarantees

As of time of this assessment (March 2014) the city of Labin had two (2) domestic loans, the first one of about HRK 6.5 million with PBZ (*Privredna Banka Zagreb, Intensa san Paolo*), a private commercial bank, and a second one of about HRK 4.5 million with the same bank. Payments for the first loan have to be made during the period 2009-2020, and for the second loan during the period of 2010-2021. Debt management is carried out by the Administrative Department for Finance and Budget.

#### *i) Quality of debt data recording and reporting*

Given the limited number and amounts of loans, reconciliation as well as the update of the debt data is carried out quarterly in Labin. Bank statements are compared with the city's books. This ensures the very good quality of the debt data. It should also be pointed out that the PEFA team has not identified any issue raised by auditors that could question the quality of the debt data.

<sup>17</sup>For changes in the same group of budget items (which do not modify the total amount of the approved budget), reallocations are allowed. For all other cases City Council has to review and approve the amendments with the procedures being the same as for the original approved budget.

Four times per year the Administrative Department for Finance and Budget elaborates comprehensive reports sent to the Ministry of Finance. Twice a year the same entity elaborates comprehensive debt reports sent to the city council.

*ii) Degree of consolidation of the government's cash balance*

The city of Labin has one bank account in HRK (with one sub-account in Euro) , held at *Privredna Bank of Zagreb* a private commercial bank. This bank account is used for collecting revenues and for transfers from Central Government. It is also used for all payments. Every day the city receives a print out from the bank with the balance available. The city (Administrative Department for Finance and Budget) can also access the account electronically in real time.

*iii) Systems for contracting loans and issuance of guarantees*

The city of Labin may contract loans (as seen above) and issue guarantees. For the time being the city has not issued any guarantee. The conditions for contracting loans and issuing guarantees are indicated in the law<sup>18</sup> and are valid for all cities. In both cases the City Council has to approve the decision to borrow or to issue a guarantee. The government's approval is required on the proposal of the Minister of Finance. When contracting a loan (or giving a guarantee) the total annual liability of the city for debt service payments is limited to 20 percent of the revenues realized in the year proceeding the year in which the borrowing is made (or the guarantee is issued).

Indicator	Score	Explanation
<b>PI-17 Recording and Management of Cash balances, Debt and Guarantees</b>	<b>A</b>	<b>M2 scoring method</b>
i) Quality of the records and reports presented on debt data.	B	Domestic debt records (there is no foreign debt) are complete, updated and reconciled quarterly. Data are considered of high standard. Comprehensive management and statistical reports (covering debt service, stock and operations) are produced quarterly.
ii) Degree of consolidation of government cash balances	A	All cash balances are calculated daily
iii) Systems for contracting loans and issuance guarantees	A	Labin's contracting of loans and issuance of guarantees are made against transparent criteria and fiscal targets, and always approved by a single responsible government entity.

<sup>18</sup>State Budget Act (2009), Art 88; ; Ordinance on the borrowing procedure of local and regional self-government units and on issuing guarantees of local and regional self-government units (Official Gazette, no. 55/04)

## **PI-18 Effectiveness of payroll controls**

Labin has 48 employees in the City administration, and 118 working in the services for which it is responsible (74 in the Kindergarten, 24 in the Fire Service, 13 in cultural and adult education activities and 7 to provide out-of-hours care in elementary schools). All payments are made through an automated payroll from the City's Treasury account.

### *i) Degree of integration and reconciliation between personnel records and payroll data*

Personnel records are kept by the City's Central Administrative Office (*hrv. Ured Grada*), with all decisions on appointments and promotions approved by the Mayor. The payroll is the responsibility of the Administrative Department for Finance and Budget, with the monthly pay for each individual calculated automatically by the Libusoft IT system on the basis of input (hours worked, holidays, etc.) by the Finance and Budget Department. The basic parameters for each individual (length of service, coefficient to be applied to basic amount in the negotiated collective agreement) are taken from the personnel records. Access to the payroll system is strictly limited, and changes made to basic parameters only when authorised by the Director of the Central Administration Department. The Director of the Administrative Department for Finance and Budget reviews the payroll each month. Thus although there is no direct link between electronic personnel and payroll systems, there is full documentation of the way in which changes in personnel records are reflected in the payroll system.

### *(ii) Timeliness in the introduction of changes to the personnel records and payroll*

Changes to personnel records are notified to the Administrative Department for Finance and Budget without delay, so that correct amounts can be paid each month. There have been no recent instances of retroactive pay adjustments being required.

### *(iii) Internal control over changes to personnel records and payrolls data*

Changes to personnel records are initiated by the Head of the responsible Department, endorsed by the Central Administration Department, and approved by the Mayor. The way in which changes in personnel records are taken into account in the payroll is closely supervised by the Director of the Administrative Department for Finance and Budget. There is always a clear audit trail.

### *(iv) Existence of payroll audits to identify control weaknesses and/ or ghost workers*

There have been no audits, internal or external, specifically directed at the operation of the payroll system in the last three years. However the operation of

the payroll has been reviewed as part of the annual audit of the City's activities and Financial Statements by the State Audit Office (SAO), including the testing of some salary payments. The most recent such audit covered the year 2011. SAO reports have not included any observations about errors or weaknesses in the payroll. In addition given the small size of the City's payroll, strong supervision and control is also exerted by different parts of the City Administration.

Indicator	Score	Explanation
<b>PI-18 Effectiveness of payroll controls</b>	<b>C+</b>	<b>M1 scoring method</b>
(i) Degree of integration and reconciliation between personnel registers and payroll data	B	Although there are no direct links between personnel records and the payroll, there is full documentation of the way changes in personnel records are reflected in the payroll.
(ii) Timeliness of changes to personnel records and the payroll	A	Changes in personnel records are notified immediately to the Administrative Department for Finance and Budget. There is no record of any need for retroactive adjustments to the pay of individuals.
(iii) Internal control of changes to the staff register and payroll	A	There are firm controls over both personnel records and the payroll, and changes always leave a clear audit trail.
(iv) Payroll auditing to identify weaknesses and/ or ghost workers	C	Partial payroll audit was carried out once in the last 3 years

## PI-19 Competition, value for money and controls in procurements

### *(i) Transparency, comprehensiveness and competition in the legal and regulatory framework*

Public Procurement legislation was substantially revised in 2011 in preparation for Croatia's accession to the European Union, with some further amendments in 2013. It applies to all levels of government as well as to all companies owned by central or local government. In Labin two officials have received the necessary certification from the Ministry of Economy for preparing tender documents and supervising contract awards. One of these has the responsibility to prepare the annual Procurement Plan which is published on the City's website after the Budget has been approved. In 2013 9 of the 13 contracts above the Croatian Government's thresholds of 200,000HRK for goods and services and 500,000HRK for works were let through open competition (the EU Directive sets

much higher thresholds: 207,000 Euro for goods and services and 5.186million Euro for works); they accounted for 94 per cent of the 8 million HRK expenditure on large contracts. Labin requires at least three offers for any contract below the threshold but in excess of 20,000HRK. For 2014 the Procurement Plan provides for expenditure of 2 million HRK on works contracts, 4 million HRK on services and one million HRK on goods.

**TABLE 3.11: LEGAL AND REGULATORY FRAMEWORK FOR PROCUREMENT**

Documentary Requirement	Fulfilled	Explanation
1. Procurement legal framework is organized hierarchically and precedence is clearly established.	Yes	The Public Procurement Act and Regulations issued under it by the Ministry of Economy comprehensively cover all public procurement activities.
2. Procurement laws and regulations are freely and easily accessible to the public through appropriate means.	Yes	All relevant texts are freely available on the government website <a href="http://www.javnabava.hr/default.aspx?id=3414">http://www.javnabava.hr/default.aspx?id=3414</a>
3. The legal framework applies to all procurement undertaken using government funds.	Yes	The law applies to all procurement by central and local government, and by companies owned by central or local government.
4. The legal framework makes open competitive procurement the default method of procurement and defines clearly the situations in which other methods can be used and how this is to be justified	Yes	The law conforms to the EU directive requiring justification for the use of less competitive methods than open tender.
5. The legal framework provides for an independent, administrative procurement review process for handling procurement complaints by participants prior to contract signature.	Yes	Complaints can be made to the independent State Commission which has authority to suspend the contracting process. The Commission has hitherto given its rulings within 60 days; plans are in hand to reduce this time to 30 days.
6. The legal framework provides for public access to all of the following procurement information: <i>government procurement plans, bidding opportunities, contract awards, and data on resolution of procurement complaints.</i>	Yes	Each contracting authority must publish its procurement plans, tender opportunities and contract awards, and the Ministry of Economy maintains a central database of all this information. The State Commission's rulings are also published on its website. <a href="https://eojn.nn.hr">https://eojn.nn.hr</a>

*(ii) Use of competitive procurement methods*

The following Table summarises Labin's Procurement expenditure in 2012 and 2013.



**Table 3.12: Labin's Procurement expenditure (2012- 2013)**

HRK thousands

Procurement Type	Goods		Construction		Services		Total	
	Value	No.	Value	No.	Value	No.	Value	No.
Open Procedure	1,603.0	3	5,906.8	6			7,509.9	9
Negotiation above threshold	153.5	1	127.2	2	213.1	1	493.8	4
Total above threshold	1,756.5	4	6,034.0	8	213.1	1	8,003.7	13
Below threshold	693.4		143.7		3,649.5		4,486.7	
Framework contract	189.0		-		427.9		616.9	
<b>Total 2013</b>	<b>2,638.9</b>		<b>6,177.7</b>		<b>4,290.5</b>		<b>13,107.2</b>	
Open Procedure	-		3,327.1	5	-		3,327.1	5
Negotiation above threshold			934.1	2	93.5	1	1,027.6	3
Total above threshold	-		4,261.2	7	93.5	1	4,354.7	8
Below threshold	733.5		1,769.3		2,641.8		5,144.5	
<b>Total 2012</b>	<b>733.5</b>		<b>6,030.5</b>		<b>2,735.3</b>		<b>9,499.3</b>	

Source: City of Labin

Open competition accounts for the large majority of expenditure on contracts above the national thresholds: 93.8 per cent in 2013 and 76.4 per cent in 2012. Where for a smaller proportion of the expenditure negotiated procedures have been used, this reflected particular circumstances which justified a less competitive approach in accordance with the Procurement Law. Full information has to be provided to the Ministry of Economy in all such cases. Labin's procurement has not given rise to any recent complaints by tenderers or any intervention by the Ministry.

*(iii) Public access to complete, reliable and timely procurement information*

Labin's Procurement Plans, tender opportunities and contract awards are all published on the City's website. The State Commission's decisions on complaints are all published on <https://eojn.nn.hr>.

*(iv) Existence of an adequate administrative procurement complaints system*

Complaints are heard by the State Commission of nine members, five of whom must be lawyers, and all of whom must have three years' experience of public procurement. The members of the Commission are appointed by the Parliament, and have no links to the Government. Thus the Commission is entirely independent; moreover it is explicitly excluded from any involvement in the process leading to procurement award decisions. Recent experience indicates that some 30,000 contracts let each year give rise to about 2,000 complaints. Complainants must pay a fee of 3,000HRK for contracts valued up to 500,000HRK rising to 9,000HRK for contracts above 10,000,000HRK (i.e. about 0.25 per cent of the contract value). The lodging of a complaint suspends the tender process until the matter is resolved. The large majority of complaints are settled by the Commission, but about 50 per year result in further appeals to the

Administrative Court which is currently considering cases from 2011. Labin was the subject of one complaint in 2010 concerning the tender specification of heating equipment, which was rejected by the Commission.

**TABLE 3.13: COMPLAINTS SYSTEMS**

**Complaints are reviewed by a body comprised of experienced professionals, familiar with the legal framework for procurement. This body, which includes members drawn from outside government:**

(i) Is not involved in any capacity in procurement transactions or in the process leading to contract award decisions; **Yes**

(ii) Does not charge fees that prohibit access by concerned parties; **Yes** While the minimum fee of 3,000HRK may discourage complaints against the award of small value contracts, the fees are not large in relation to more substantial contracts.

(iii) Has the authority to suspend the procurement process; **Yes**

(iv) Issues decisions within the timeframe specified in the rules/regulations; **Yes**

(v) Issues decisions that are binding on both parties. **Yes**

(vi) Issues decisions within the timeframe specified in the rules, regulations; **Yes**

(vii) Issues decisions that are binding on all the parties (without precluding subsequent access to an external higher authority). **Yes**

Indicator	Score	Explanation
<b>PI-19 Competition, value for money and controls in procurements</b>	<b>A</b>	<b>M2 scoring method</b>
i) Transparency, comprehensiveness and competition in the legal and regulatory framework	A	The legal and regulatory framework meets the requirements of the EU Directive on Public Procurement. It provides for transparency, comprehensiveness and competition covering all procurement by general government and government-owned companies.
ii) Use of competitive procurement methods	A	Where contracts above Croatian thresholds have been let other than by open competition, this has been justified in accordance with the Procurement Law. Contracts above the thresholds not let by open competition have accounted for only a relatively small proportion of Labin's procurement expenditure.
(iii) Public access to complete, reliable and timely procurement information	A	There is full public access on the City website to Labin's Procurement Plans, tender opportunities and contract awards. If there had been any recent complaints, the results would have been published on the State Commission's website.
(iv) Existence of an adequate administrative procurement complaints system	A	The State Commission serves as an effective independent body charged with resolving complaints. It has authority to cancel a tender or a contract award where complaints are found to be justified.

## PI-20 Effectiveness of internal controls on non-salary expenditure

Croatia has made considerable efforts in recent years to strengthen public financial management and control. The first step was the Public Internal Financial Control (PIFC) Act 2006. Ministries and larger local government units (Zagreb, counties, cities which are county centres and cities with populations over 35,000) are required to make annual reports on the operation of their financial management and control systems and on their internal audit function. These reports are submitted in a standardised format to the Central Harmonisation Unit (CHU) of the Ministry of Finance which has the responsibility to promote better financial management throughout central and local government. The reports cover the control environment (management structure and style, existence of strategic goals, reporting arrangements, development of human resources), risk management, specific control activities, information and communication (arrangements for collecting all information needed to measure achievement of objectives) and system monitoring and assessment (including responses to internal and external audit findings and recommendations). A further report is required about the operation of internal audit. Labin is not among the LGUs required to submit these reports. The Fiscal Responsibility Act 2010 further requires all heads of operations at every level of government to submit an annual

statement confirming that funds have been used correctly and purposefully, and that the financial management and control system functions efficiently and effectively within the framework of resources defined by the budget. Heads of operations (including the Mayors of each city) make this statement on the basis of answers to detailed questions about the functioning of every aspect of budget planning, execution, accounting and reporting, and the operation of public procurement. Where weaknesses are identified a plan for their elimination is to be submitted, as well as a report on action to correct weaknesses identified the previous year. The statement should also be accompanied by an internal auditor's certificate confirming those aspects of the statement which have been the subject of internal audit examination during the year in question, together with a summary of internal audit activities and recommendations.

*i) Effectiveness of expenditure commitment controls*

Labin plans, executes, accounts for and reports its budget through the Libusoft electronic system used by many Croatian LGUs. This provides for expenditure to be tracked against the approved budget, and prevents payments from being made outside the approved plan. Public procurement contracts are registered in the system when they are signed; they would be rejected if they were not provided for in the Procurement Plan. Similarly a payment in respect of a contract which had not previously been registered would be rejected. The Administrative Department for Finance and Budget prevents any contract from being concluded until it knows that the necessary funds (usually central government grants, borrowing approvals or earmarked revenue from the communal fees paid in respect of new developments) will be available. Labin has thereby avoided incurring any significant expenditure arrears. While the system does not provide for a separate commitment control covering all current expenditure before payments are made, the safeguards which ensure that new contracts or orders are not placed unless they are consistent with the Procurement Plan, and the necessary financing has been assured, constitute effective commitment controls.

*(ii) Scope, relevance and understanding of other internal control regulations and procedures*

There are clear instructions and procedures covering all aspects of budget planning, execution, public procurement, and separation of functions as between decision-making, payment and accounting in respect of each activity. These are set out in an Internal Control rule book approved by the Mayor, and are generally understood and respected. These procedures cover the preparation of the Budget, the collection of revenues, the receipt of invoices and the verification of supporting documents, the issuing of orders and the conclusion of contracts, the checking of accounting and payment records, and the separation of functions related to procurement decisions from the subsequent verification that performance has been satisfactory. The Internal Auditor undertakes a series of ex post checks of the correctness of payments of different types, including whether they are provided for in the budget, supported by all required documentation, financed from the correct sources, correctly recorded in the accounts, and paid in time to avoid any late payment penalties.

*(iii) Degree of compliance with regulations on the processing and registration of transactions*

As noted in relation to PI-18 and PI-19, all aspects of transactions related to the payroll and public procurement are subject to rigorous and careful checks and procedures. Across the whole budget all invoices have to be certified by the responsible Department, and are only paid when signed by the Mayor or his deputy and the Director of the Administrative Department for Finance and Budget. Labin's 2010 Financial Statements were qualified by the State Audit Office (SAO) because the actual work done in respect of a continuing service contract was not separately certified every month. Procedures were strengthened in response to this. Apart from this SAO has never made any criticism of Labin's procedures in the period 2011-2013.

Indicator	Score	Explanation
<b>PI-20 Effectiveness of internal controls on non-salary expenditure</b>	<b>B+</b>	<b>M1 scoring method</b>
(i) Effectiveness of controls on expenditure commitments	B	Although there is not a separate commitment control in place across the whole budget, controls are effective in preventing new commitments from being undertaken before the availability of finance has been assured.
(ii) Scope, relevance and understanding of other internal control regulations and procedures	A	Internal control rules and procedures are generally understood and observed. Separation of duties is correctly practised and ex post facto checks are made of a sample of payments.
(iii) Degree of compliance with the regulations for processing and registering transactions.	A	Rules and procedures for registering transactions are generally observed. Procedures for the verification of invoices were strengthened following SAO criticism in relation to the audit of 2010.

**PI-21 Effectiveness of Internal Audit**

*(i) Scope and quality of internal audit function*

Internal Audit (IA) has been functioning in Labin for eight years, with the work being done by a fully qualified internal auditor. IA procedures are defined in an internal rule book approved by the Mayor. Procedures are in accordance with those of the International Institute of Internal Auditors. The auditor prepares a Strategic Plan for three years which then forms the basis for annual plans. An Annual Report is produced on the previous year's activities, which is sent to the Central Harmonization Unit (CHU) at the Ministry of Finance. The audit work extends across all the City's Departments and budget users. It focuses on the

performance of systems in ensuring that programmes are realistically planned, correctly executed, and achieve the intended results. Recent audits have concerned the handling of revenue arrears, the respect for the earmarking of particular revenues, the management of small procurements, official travel, and the provision of bursaries for high school and university students. A current audit is reviewing the enforcement of the execution of contracts.

*(ii) Frequency and distribution of reports*

The auditor aims to complete four reports a year, in addition to the preparation of strategic and annual plans, annual reports and educational work within the City's services. Reports are sent to the Head of the Department for Finance and Budget and to the Heads of the Departments concerned. They are taken into consideration by the State Audit Office in the course of its audit work on Labin. As noted above, the Annual Report on the previous year's activities is sent to the CHU at the Ministry of Finance.

*(iii) Management response to internal audit findings*

There is a constructive management response to audit findings and recommendations, with most recommendations being accepted. Changes are often made during the course of the audit although where changes in IT systems are contemplated the time-scales are inevitably longer. For example the audit of revenue arrears identified the need for a procedure to write off those arrears which are clearly uncollectable; and the audit of bursaries indicated a need to develop a programme to promote the employment of school leavers in the City. The Mayor and Heads of Department approve the action plans in response to IA reports. The Mayor, in signing the annual Statement of Fiscal Responsibility has to be able to show that proper account has been taken of IA recommendations, and this is reflected in the documentation supporting the Statement.

Indicator	Score	Explanation
<b>PI-21 Effectiveness of Internal Audit</b>	<b>A</b>	<b>M1 scoring method</b>
(i) Scope and quality of internal audit function	A	A wide range of work is undertaken in accordance with professional standards, and focused on the performance of systems.
(ii) Frequency and distribution of reports	A	Four reports are made each year, which are sent to the heads of the Departments concerned. Actions in response to recommendations are considered by the Mayor and all the Heads of Department. They are taken into consideration by the State Audit Office. The Annual Report on the previous year's activities is sent to the CHU at the Ministry of Finance.
(iii) Management response to internal audit findings	A	Most findings and recommendations are accepted. The auditor contributes to the documentation supporting the annual Statement of Fiscal Responsibility.



### Subsection 3.5: Accounting, recording and reporting

#### PI-22 Timeliness and regularity of accounts reconciliation

##### *i) Regularity of bank account reconciliations*

As seen (PI-17 ii), the city of Labin has one bank account. Reconciliation of this account takes place daily. For this exercise, bank balances forwarded by the bank are compared with the city's books.

##### *(ii) Regularity of reconciliation and clearance of suspense accounts and advances*

There were about 20 advances in 2013 and no suspense accounts in Labin. For advances reconciliation is made on a quarterly basis within the 2 weeks following the quarter. Outstanding balances are fully cleared at the end of the year (with no balances brought forward).

Indicator	Score	Explanation
<b>PI-22 Timeliness and regularity of accounts reconciliation</b>	<b>A</b>	<b>Scoring method M2</b>
(i) Frequency of reconciliation of bank accounts	A	Reconciliation of the only bank account of the city takes place daily.
(ii) Frequency of reconciliation and clearance of suspense accounts and advances	A	Reconciliation and clearance of advances take place quarterly, within 2 weeks from end of period and with no balances brought forward.

#### PI-23 Availability of information on resources received by service delivery units

##### *i) Compilation and processing of information to show the resources effectively received (in money or in kind) by the majority of front-line service delivery units (with particular focus on primary schools and primary health care clinics) in relation to the resources made available by the relevant sector or sectors, regardless of the level of government responsible for the functioning and funding of these units.*

There are no health centres under the city's supervision<sup>19</sup>. For one health centre (under the county) the city of Labin provides 700 000 HRK yearly (2011-2013). There are three (3) elementary schools that are legal entities, each one

<sup>19</sup>The City is not responsible for health care. The County is responsible for health care and for non-elementary education.



having its own budget. The city of Labin pays everything for these schools except the salary that are paid by the Central Government. Books and free meals are provided to poor families. Books are returned at the end of the year. Vouchers are also provided by the city to buy stationery and pencils.

The elementary schools are basically like departments of the city. All payments are made through the city account and are registered in the city's book and information system. The accounting on resources received by the entities is carried out at the Administrative Department for Finance and Budget. This information is available in the annual financial statements.

Indicator	Score	Explanation
<b>PI-23 Availability of information on resources received by service delivery units</b>	<b>A</b>	<b>Scoring method M1</b>
Compilation and processing of information to show the resources effectively received (in payment or in kind) by the majority of front-line service delivery units.	A	Routine data collection or accounting systems provide reliable information on resources received in cash by primary schools across the city's boundaries. The information is compiled into reports at least annually.

#### **PI-24 Quality and timeliness of in-year budget reports**

The city of Labin issues 3 types of in-year execution report:

- A monthly report Every month the Finance Department elaborates an in-year execution report to the mayor;
- A quarterly report sent to the Ministry of Finance, State Audit Institution and Financial Agency (FINA)<sup>20</sup>.
- A Semi-annual report that are sent to the Official gazette (more detailed than the monthly)

The elaboration of the quarterly and semi-annual execution reports is required by law<sup>21</sup>.

*(i) Scope of the reports in terms of coverage and compatibility with budget estimates*

<sup>20</sup>FINA is a State funded Agency, which acts as mediator between the State and SN entities. FINA is coordinated by the State and receives data on SN entities

<sup>21</sup>State Budget Act (2009), Art 91, 108 & 109

For all the 3 reports mentioned above, expenditure is captured only when it is accrued. There is no separate presentation of the extent to which it has been committed. In addition comparison to the adjusted budget is possible only for main economic and functional classifications. The semi-annual report provides more details than the 2 other reports.

*(ii) Timeliness of report presentation*

Quarterly and semi-annual in-year execution reports are finalized about 10 days after the period covered. This deadline is respected because a legal requirement<sup>22</sup>. Monthly reports are generally finalized 2 to 3 weeks after the period covered (there is no legal indication and/or obligation on the timing of issuing the reports).

*(iii) Quality of information*

Data are considered to be of very good quality and external audit never detected any inaccuracies (in the data).

Indicator	Score	Explanation
<b>PI-24 Quality and timeliness of in-year budget reports</b>	<b>C+</b>	<b>Scoring method M1</b>
(i) Scope of reports in terms of coverage and compatibility with budgetary forecasts	C	Comparison to the adjusted budget is possible only for main functional and economic headings. Expenditure is captured only at the point of accrual, and not at an earlier commitment stage.
(ii) Timeliness in the presentation of reports	A	In-year execution reports are finalized within a maximum of 20 days after the period covered.
(iii) Quality of the information	A	There are no material concerns regarding data accuracy.

<sup>22</sup> Budget Act (2009, Art. 81 (9)); for 2013, the 1 quarterly report was finalized on April 10, 2013. The Jan-June 2013 report was finalized on July 10<sup>th</sup>, 2013. The Jan-September 2013 report was finalized on October 10<sup>th</sup>, 2013 (sources: reports on budget and budget users, City of Labin, Administrative Department for Budget and Finance)

## PI-25 Quality and timeliness of annual financial statements

### (i) *Comprehensiveness of financial statements*

In conformity with the existing legislation<sup>23</sup> yearly financial statements in the city of Labin include full information on revenues and expenditure, financial assets (bank balance and shares/equity in companies) and liabilities (internal debt)

### (ii) *Timeliness in the presentation of financial statements*

For 2012 and 2013, the annual statements were sent to the State Audit Office before the end of February in the following years (the legal deadline), i.e. within 2 months from the period covered. In 2014, the 2013 annual financial statements were sent to the State Audit Office on February 26<sup>th</sup>, 2014.

### (iii) *Accounting standards used*

For the last three years (2011-2013), national accounting standards have consistently been used. These standards do not correspond to IPSAS standards..

Indicator	Score	Explanation
<b>PI-25 Quality &amp; timeliness of financial statements</b>	<b>C+</b>	<b>Scoring method M1</b>
(i) Completeness of financial statements	A	Annual Financial statements include full information on revenue, expenditure, financial assets and liabilities.
(ii) Timeliness in the presentation of financial statements	A	The last annual financial statements (2013) were submitted for external audit on February 26 <sup>th</sup> , 2014, less than 2 months after the period covered.
(iii) Accounting standards used	C	National standards (not corresponding to IPSAS) were used for the last 3 years.

<sup>23</sup> State Budget Act (2009), Art 105; Ordinance on Financial Reporting in the Budget Accounting (Official Gazette, no. 27/05 and 2/07),

## **Subsection 3.6: External Scrutiny and Audit**

### **PI-26 Scope, nature and follow-up of external audit**

The remit of the State Audit Office (SAO) covers all operations of central and local government, and all companies owned or majority controlled by bodies at any level of government. Until 2011 SAO was required to audit all 576 local government units (LGUs) every year, but it now has more flexibility in planning its work and no longer needs to audit well-managed smaller LGUs with this frequency. Zagreb, counties, county centres and cities with over 35,000 people are still audited every year. Audits have mainly focused on financial statements and compliance of LGUs with legal requirements, but SAO has recently extended its work to address aspects of performance, on which 24 auditors are engaged. Reports covering a number of LGUs have been made on the efficiency of revenue collection and the maintenance of unclassified roads. SAO has 280 staff, of whom 240 are qualified auditors; about 80 per cent of the staff work in offices of each of the counties. Audits are carried out in accordance with international (INTOSAI) standards.

SAO considers that LGU financial management has been improving: while only 3.3 percent of the reports on 2004 were unqualified, this figure rose to 21 per cent for 2011. Qualifications often related to respect for revenue earmarking restrictions and public procurement irregularities occasioned by frequent changes in legal requirements. 135 LGUs were audited in respect of 2011 and 81 for 2012; SAO plans to audit 122 LGUs for 2013, covering 70 per cent of total LGU expenditure. LGU internal audit reports are taken into consideration when SAO audits the LGUs concerned. In addition to audits of government units SAO audited 169 companies' 2012 financial statements.

#### *(i) Scope/nature of the audit carried out (including compliance with auditing standards)*

Labin's most recent annual audit concerned 2011. In addition to the review of financial performance, including both City Departments and all budget users, the audit included reviews of the robustness of control systems, respect for revenue earmarking, and respect for the rule limiting total payroll costs to 20 per cent of total expenditure. The report was qualified on account of insufficient documentation of the performance each month on contracts providing for regular monthly payments for particular services. Labin was also covered by the recent (2013) performance audit of the maintenance of unclassified roads, where LGUs have been advised to clarify and document the ownership of the roads concerned, and plan more rigorously for their maintenance. Despite the good quality of the audit work, and its compliance with legal requirements, the requirement under the current PEFA methodology for an audit every year of Financial Statements for any score higher than D means that D has to be applied in the case of Labin.

#### *(ii) Timeliness in submission of audit reports to the Legislature*

The report for 2011 was received by the City in mid-July 2012, and submitted to the Council before the end of August of the same year.

*(iii) Evidence of follow up on audit recommendations*

It was explained to the City Council that the weakness in the system which had resulted in the Qualification had already been corrected before the audit took place. The City is currently (April 2014) preparing its response to the recommendations in the recent audit of road maintenance; it expects to submit its proposals for discussion at the June 2014 Council Meeting. In this case the City's ability to implement the recommendations (see i above) will be limited by the resources available, while identifying and registering the ownership of all minor roads can only be achieved over an extended period of time. In any case there is clear evidence of effective and timely follow up.

Indicator	Score	Explanation
<b>PI-26 Scope, nature and follow-up of external audit</b>	<b>D+</b>	<b>Scoring method M1</b>
(i) Scope/nature of the audit carried out (including adherence to audit standards).	D	Audits cover aspects of performance in addition to financial and compliance audits. International standards are respected. But the absence of an audit every year of the Financial Statements prevents a higher score from being recorded.
(ii) Timeliness in the presentation of auditing reports to the Legislature	A	Audit reports are presented to the City Council within a few weeks of their receipt by the Administration.
(iii) Evidence of follow up of audit recommendations	A	The Administration addresses the recommendations, and normally implements them to the extent possible, given the resources and time required. In any case there is clear evidence of effective and timely follow up

**PI-27 Legislative scrutiny of the annual budget law**

*i) Scope of examination by the Legislature*

The Budget as submitted to the City Council by the Mayor takes into account the guidance from the Ministry of Finance on trends in the economy and prospects for revenue. Revenues and expenditures must be balanced (with authorised net additional borrowing, if any, counted as revenue for this purpose). Full information

is presented about revenue and expenditure by administrative, economic and programme (functional) classification. The Council may propose reallocations of expenditure within the given total, but cannot propose any change which would require additional borrowing (Article 38 of the State Budget Act). Although figures are presented for the two years following the Budget year, the focus of the Council's discussion is on the year immediately ahead.

*ii) Degree to which legislative procedures are recognised and respected*

The State Budget Act requires the Budget proposals for the following year to be submitted to the Council by 15 November each year. The Budget should then be approved before the end of the year. In Labin the Council has a first reading discussion of the proposals shortly after their submission. This is followed by detailed examination by the Council's Finance Committee, and by a public consultative meeting at which the proposals are presented. The Budget, subject to any revisions and reallocations arising from the Council's examination and the public consultation, is then approved at a second reading around 22 December. These arrangements are well established and have been regularly followed in recent years.

*iii) Adequacy of the time for the Legislature to provide a response to budget proposals*

The timetable allows the Council to spend up to six weeks on its examination of the Budget before final decisions are taken. In practice however the Council has at least a month for its consideration of the proposals.

*iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature*

Article 46 of the State Budget Act permits the Mayor to reallocate up to 5 per cent of each Budget line without the prior approval of the Council. Any such reallocations must be notified to the Council in the half-yearly and annual reports on Budget execution. Any more extensive reallocations require a revised Budget approved by the Council through the normal procedure. These arrangements are fully respected in Labin; in practice the Mayor makes extensive use of the power to make minor adjustments to the approved Budget.

Indicator	Score	Explanation
<b>PI-27 Legislative scrutiny of the annual budget law</b>	<b>B+</b>	<b>Scoring method M1</b>
i) Scope of examination by the Legislature	B	The Council's examination mainly focuses on the next year's revenue and expenditure. There is no scope at sub-national government level for any discussion of the appropriateness of the Government's fiscal stance, and not much attention is paid to fiscal planning in the medium term.
ii) Degree to which legislative procedures are recognised and respected	A	The arrangements for the Council's discussion of the Budget proposals are well established and regularly followed.
iii) Sufficiency of time for the Legislature to respond to the budgetary proposals.	B	The Council has at least a month to consider the Mayor's proposals.
iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature.	A	The State Budget Act sets a strict limit to the extent of reallocations which the Mayor may make without the prior approval of the Council. This is respected.

## PI-28 Legislative scrutiny of external audit reports

External audit reports are made on the affairs of small cities only intermittently. Where reports concern only the particular City or other LGU, there would not normally be any discussion in the national Parliament, although the situation might be different in the case of a performance audit report concerning a particular aspect of the affairs of a number of different LGUs. It would not be expected that the Council of a small city would establish special arrangements for the consideration of audit reports analogous to the arrangements in the national Parliament.

*(i) Timeliness in examination of the audit reports by the Legislature (reports received within the past three years).*

The annual audit report for 2011 was submitted to the Council at the end of August 2012, about six weeks after its receipt from SAO. The City Department concerned is currently preparing its response to the recent performance audit report on the maintenance of unclassified roads, which it expects to submit to the Council for its June 2014 meeting.

*(ii) Scope of the hearings carried out by the Legislature into the main findings*

Where audit criticisms, and recommendations for improvement have in the past been received from SAO, the Heads of Departments concerned have explained the circumstances and the remedial action taken. In the case of the recent report on road maintenance, the City Administration intends to seek the approval of the Council for its action plan in response to the audit recommendations.

*(iii) Issuance of recommendations by the Legislature and their implementation by the Executive*

The initiative in responding to SAO recommendations necessarily rests with the City Administration. The normal expectation in the procedures in force under the Public Internal Financial Control Act is that LGU administrations will implement audit recommendations to the extent possible. In these arrangements there is hardly room for a city Council to address separate recommendations to its Administration. In Labin the Administration's normal approach is to seek the Council's approval for the action it takes in response to audit recommendations.

Indicator	Score	Explanation
<b>PI-28 Legislative scrutiny of external audit reports</b>	<b>A</b>	<b>Scoring method M1</b>
(i) Timeliness in the examination of audit reports by the Legislature (reports received within the past three years).	A	Audit reports are submitted to the Council within a few weeks of their receipt by the Administration.
(ii) Scope of the hearings held by the Legislature into the main conclusions	A	The Council discusses the responses to audit recommendations with the City officials concerned.
(iii) Measures recommended by the Legislature and implementation of these by the Executive	A	The Administration seeks the Council's approval for the action taken in response to audit recommendations.



## Subsection 3.7: Donor Practices

### D-1 Predictability of direct budgetary support

Labin does not receive direct budgetary support from any external source. This Indicator is therefore Not Applicable.

Indicator	Score	Explanation
<b>D-1 Predictability of direct budgetary support</b>	<b>NA</b>	<b>Scoring method M1</b>
i) Annual deviation in real budgetary support with respect to that forecast by donor organisations at least six months before the Government presents its budgetary proposals to the Legislature (or other equivalent body responsible for approving the budget)	NA	Labin does not receive direct budget support from any external source.
ii) Timeliness of disbursements by donors throughout the year (fulfilment of aggregate quarterly estimates)	NA	There are no disbursements.

### D-2 Financial information provided by donors for budgeting and reporting on project and programme aid

#### *i) Comprehensiveness and timeliness of donors' budgetary estimates in relation to project support*

Labin has participated in two small EU projects. The timing of the receipts from the EU is generally determined in the agreement on each programme. The Veneto Region of Italy (bordering Istria and Croatia) has provided finance for a church restoration. The projects have been included in annual budget proposals and execution statements. Since there are only two donors, and full information is provided about the payment of assistance,

#### *ii) Frequency and coverage of the presentation of reports by donors in relation to effective resource flows for project support*

The execution of projects is essentially under the control of Labin, so the flow of information is from the City to the donor. This dimension is therefore considered to be Not Applicable.

Indicator	Score	Explanation
<b>D-2 Financial information provided by donors for budgeting and reporting on project and programme aid</b>	<b>A</b>	<b>Scoring method M1</b>
i) Comprehensiveness and timeliness of donors' budgetary estimates for project support	A	Labin has information from the two donors concerned which has enabled them to be included in Budget Estimates and out-turn statements.
ii) Frequency and coverage in the presentation of reports by donors on effective flows for project support	NA	Execution of the projects is under the City's control, and there is no question of any payments being made separately by the donors.

### D-3 Proportion of aid managed by use of national procedures

#### *i) Global proportion of aid funds to the City that are administered on the basis of national procedures*

The donor-funded projects have been subject to national procurement (now assimilated to EU standards) and payment procedures. But donors normally require separate audited reports once projects are concluded. Thus national procedures are used exclusively for procurement and payment, but donor procedures have to be followed for reporting and audit (although the expenditure is also subject to national reporting and audit). In the PEFA criteria this situation is assessed as implying that national procedures are followed for 50 per cent of the donor funds.

Indicator	Score	Explanation
<b>D-3 Proportion of aid managed by use of national procedures</b>		<b>Scoring method M1</b>
i) Proportion of aid funds for the central government that are managed in line with national procedures	C	National procedures are followed for procurement and payment, but special donor requirements apply to reporting and audit.

## **Section 4: Government reform Process**

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### **Subsection 4.1: Description of Major PFM Reforms**

In 2013, the City introduced a new treasury system based on the SPI information system. The system is based on a single treasury account located in a commercial bank into which, all the City's revenues are paid, and from which all payments are made. Thanks to the centralized system of financial management, the City is gradually developing and using other IT functionalities such as public procurement.

Along with the introduction of IT information system, there has been a continuing programme of education for all the staff of the administrative departments and other budget users. The City mayor and his associates follow and participate in the process of improving financial management. This initiative will be particularly important as the City prepares to bid for and use EU Structural Funds within the framework of its Strategy of Economic Development.

The City Administration attaches great importance to fiscal transparency. Each year the City produces a guide to its Budget proposals, in which the proposed allocation of resources to different functions during the year ahead is explained, and citizens are invited to suggest any changes they would like to see. (The documents for the 2013 and 2014 Budgets were presented to the PEFA team.). The NGO GONG in cooperation with the Association of Cities undertook a research project entitled "*Transparency and openness of local and regional government*". The survey covered all 576 LGUs. In the category of cities the City of Labin took second place.

The City invests significant funds in computerization and connecting administrative departments into a single information system which is also connected to those of local and national utility companies. In 2009, the issuance of building permits was transferred from the central government to the counties, and could be further devolved to other LGUs. The City of Labin took this responsibility which has enabled it to enhance its electronic records of land and property, and thereby strengthen its revenue collection (especially utility charges). The City Administrative Department for Communal Affairs is linked to a common data base with utility companies, including those of the national public companies Croatian Waters and Croatian Electric Power. The spatial plans approved by the City are entered into single information connected to the GIZ system established at national level by the Ministry of Physical Planning.

#### **Subsection 4.2: Institutional Factors Supporting the Planning and Implementation of Reforms**

Croatia's accession to the EU has required LGUs to take steps to strengthen their capacity to prepare projects and initiatives which can be put forward for co-financing from EU Structural Funds. Labin has accordingly played the leading role in establishing the Local Action Group (LAG) "Eastern Istria" made up of the City of Labin and the municipalities *Krsan, Pican, Rasa* and *Sv Nedjelja*, of which the Mayor of Labin is President. The objectives of the LAG are to promote sustainable development, to encourage cooperative efforts by companies in the area, to promote the area based on its traditions and cultural heritage, and to put forward projects in accordance with these objectives which will qualify for EU funding. At its meeting in March 2013 the LAG unanimously approved its Local Development Strategy.

# ANNEXES

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## Annex 1: Croatia-Profile of Sub-National Governments

### 1. Overall sub-national government structure

Articles 133-138 of the Constitution of Croatia provide for the existence of counties (regions), cities (with more than 10,000 people), municipalities and the Capital City Zagreb which is both a city and a county. Apart from Zagreb, there are two tiers of sub-national government throughout the country; every citizen belongs to a county and to a city or municipality. The powers and responsibilities of different local government units (LGUs) are defined in the Law on Local and Regional Self-Government; there is considerable overlap between the counties and the cities/municipalities, with both permitted to provide education and health services and to build and maintain infrastructure. However, cities/municipalities are not subordinate to counties; both tiers depend directly on central government. All LGUs have elected councils to which elected Mayors (Prefects in the case of counties) are responsible. Mayors are in charge of the appointment of staff, subject to some accountability to the councils. The structure of sub-national government is summarised in the following table.

**Table Annex 1: Overview of sub-national government structure in Croatia**

Government level	Corporate Body	Own political Leadership	Own Budget	Number	Average population	% of Pub. Exp.	% of Pub. Rev.	% of Exp. paid by Govt. transfers
Central Govt.	Yes	Yes	Yes	1	4.3million	84.2%	93.1%	-
Counties	Yes	Yes	Yes	20	175,000	2.6%	6.9%	59.1%
Cities	Yes	Yes	Yes	126	17,500	6.1%	for all	for all
Municipalities	Yes	Yes	Yes	429	2,800	2.5%	LGUs	LGUs
Zagreb	Yes	Yes	Yes	1	0.8million	4.6%	together	together

Source: Ministry of Finance, RC

### 2. Sub-national fiscal systems

The financing of sub-national government is regulated by the Law on Local and Regional Self-Government, most recently updated in 2012. The largest revenue stream accruing to LGUs comes from the share of income tax paid by their residents: 56.5 per cent accrues to cities and municipalities and 16 per cent to counties. Cities which take responsibilities for decentralised services (mainly elementary education and fire services) may receive up to a further 12 per cent, while 15.5 per cent is reserved for equalisation payments to poorer LGUs in remote areas or severely affected by the war in the 1990s. The next largest revenues are those from annual utility fees for the maintenance of local infrastructures which are charged by reference to the areas of properties, and the

community fees charged on new developments to meet the additional infrastructure costs. Zagreb, cities and municipalities (but not counties) may levy a surtax on the income tax paid by their residents of up to 10 per cent (municipalities), 12 per cent (cities – and 15 per cent where the population exceeds 30,000), and Zagreb 30 per cent (18 per cent is currently charged). Cities and municipalities also receive 40 per cent of the 5 per cent national tax on the transfer of properties in their area. They further receive the revenue from three small taxes on holiday houses, the consumption of beverages and an annual charge on business names operating in their areas. LGUs may also receive grants from central government Ministries for particular purposes, most frequently for the provision of education, health or transport facilities. Labin and Crikvenica, with populations of about 11,000 and important tourism activities, are smaller than the average for all cities but spend about two thirds more per head of population than the average for all cities.

### **3. Main functional responsibilities of sub-national governments**

Cities are typically responsible for the provision and maintenance of local infrastructures, sports and cultural facilities and activities, pre-school education, non-salary costs of elementary education, and fire services. (Counties have corresponding responsibilities for secondary education as well as providing some health services and co-ordinating transport infrastructures.) The main costs of education and health services – the salaries of teachers and health professionals – continue to be met by central government. The largest share of LGU expenditure is that of cities, which spend about 4,000HRK a year per head of population; counties spend only about 1,000HRK a year per head on their more limited responsibilities.

### **4. Sub-national budgetary systems**

The budgetary systems of LGUs are regulated by the same State Budget Act which applies at central government level. LGUs are required to implement a budgeting process culminating in approval by the elected council, and to follow a budget calendar similar to those operating at central government level; they must also produce execution reports on a basis comparable to those produced by central government. LGUs must present balanced budgets (although the proceeds of permitted new borrowing are treated as revenue, and the repayment of debt as expenditure). Once approved, Budgets must be reported to the Ministry of Finance, but they are not subject to approval by the Ministry. Borrowing is strictly controlled by the Ministry of Finance, and total debt of LGUs is low (about one per cent of GDP, as against about 60 per cent of GDP for the central government). LGUs generally operate a Single Treasury Account in a commercial bank of their choice. The same Public Procurement Act applies to LGUs as to central government (and also to all publicly owned companies and utilities); LGUs' procurement activities must be transparent, and in accordance with the Act, but are not subject to any requirement for prior approval by any central government body.

## Annex 2: Detailed score calculations

A. PFA RESULTS: Credibility of Budget					
Indicator/method	Score	D (i)	D (ii)	D (iii)	D (iv)
HLG-1 (M1)	NR	A	NR	A	--
PI-1 (M1)	C	C	--	--	--
PI-2 (M1)	B+	B	A	--	--
PI-3 (M1)	D	D	--	--	--
PI-4 (M1)	A	A	A	--	--
B. KEY CHARACTERISTICS OF ALL STAGES: Comprehensiveness and transparency					
PI-5 (M1)	A	A	--	--	--
PI-6 (M1)	A	A	--	--	--
PI-7 (M1)	A	A	A	--	--
PI-8 (M2)	NA	NA	NA	NA	--
PI-9 (M1)	C	C	NA	--	--
PI-10 (M1)	A	A	--	--	--
C. BUDGETARY CYCLE					
C (i) Policy-based budgeting					
PI-11 (M2)	B	C	B	A	--
PI-12 (M2)	D+	C	NA	D	C
C (ii) Predictability and control in budget execution					
PI-13 (M2)	B	B	B	B	--
PI-14 (M2)	D+	C	D	NA	--
PI-15 (M1)	D+	D	B	C	--
PI-16 (M1)	C+	A	C	A	--
PI-17 (M2)	A	B	A	A	--
PI-18 (M1)	C+	B	A	A	C
PI-19 (M2)	A	A	A	A	A
PI-20 (M1)	B+	B	A	A	--
PI-21 (M1)	A	A	A	A	--
C (iii) Accounting, recording and reporting					
PI-22 (M2)	A	A	A	--	--
PI-23 (M1)	A	A	--	--	--
PI-24 (M1)	C+	C	A	A	--
PI-25 (M1)	C+	A	A	C	--
C (iv) External scrutiny and audit					
PI-26 (M1)	D+	D	A	A	--
PI-27 (M1)	B+	B	A	B	A
PI-28 (M1)	A	A	A	A	--
D. DONOR PRACTICES					
D-1 (M1)	NA	NA	NA	--	--
D-2 (M1)	A	A	NA	--	--
D-3 (M1)	C	C	--	--	--



### Annex 3: List of contacts

Name and surname	office for:	position	contact
Tulio Demetlika		City mayor	tel + 385 52 852 078 fax 385 52 852 269 <a href="mailto:gradonacelnik@labin.hr">gradonacelnik@labin.hr</a>
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## Annex 5: Maps

### Annex 5.1: Croatia in Europe



## Annex 5.2: Istria and Labin

