
Montenegro

**Public Expenditure and
Financial Accountability Assessment**

**Public Financial Management
Performance Report**

July 2009

Table of Contents

Summary assessment	1
(i) Integrated assessment of PFM performance.....	1
(ii) Assessment of the impact of PFM weaknesses	3
(iii) Prospects for reform planning and implementation	4
1. Introduction	5
2. Country background information	7
2.1. Description of country economic situation	7
2.2. Description of budgetary outcomes	10
2.3. Description of the legal and institutional framework for PFM	13
3. Assessment of the PFM systems, processes and institutions	14
3.1. Budget credibility.....	14
3.2. Comprehensiveness and transparency.....	16
3.3. Policy-based budgeting	27
3.4. Predictability and control in budget execution.....	29
3.5. Accounting, recording and reporting	44
3.6. External scrutiny and audit.....	48
3.7. Donor practices	53
4. Government reform process.....	56
Annex 1: Performance Indicators Summary	58
Annex 2: PEFA Team	61
Annex 3: Sources of Information	63

Abbreviations

AGA	Autonomous Government Agency
BF	State / Budget Fund
CEF	Center of Excellence in Finance, Slovenia
CFAA	Country Financial Accountability Assessment
CHU	Central Harmonization Unit
COFOG	Classification of the functions of the government
DBB	Direct Budget Beneficiary
EAR	European Agency for Reconstruction
EBF	Extra-Budgetary Fund
EC	European Commission
EUROSAI	European Organization of Supreme Audit Institutions
FDI	Foreign Direct Investment
FMC	Financial Management and Control
GDP	Gross Domestic Product
GFS	Government Financial Statistics
GOM	Government of Montenegro
GTZ	German Technical Cooperation
IA	Internal Audit
IBB	In-direct Budget Beneficiary
IFI	International Financial Institution
IIA	Institute of Internal Auditors
IMF	International Monetary Fund
INTOSAI	International Organization of Supreme Audit Institutions
IPA	Instrument for Pre-Accession Assistance
IPSAS	International Auditing and Assurance Standards Board
IPSAS	International Public Sector Accounting Standards
MES	Ministry of Education and Science
MIPD	Multi-Annual Indicative Planning Document
MOE	Ministry of Education
MOF	Ministry of Finance
NGO	Non-Governmental Organization
NPI	National Program for Integration to the European Union
PE	Public Enterprise
PEFA	Public Expenditure and Financial Accountability
PEIR	Public Expenditure and Institutional Review
PFM	Public Financial Management
PFM-PR	Public Financial Management Performance Report
PI	Performance Indicator
PIFC	Public Internal Financial Control
PPL	Public Procurement Law
SAA	Stabilization and Association Agreement
SAI	State Audit Institution
SN	Sub-National
SOE	State-Owned Enterprise
UNDP	United Nations Development Program
USAID	United States Agency for International Development
USD	United States Dollars
VAT	Value Added Tax
WB	World Bank

Overview of the indicator set

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

Summary assessment

(i) Integrated assessment of PFM performance

Credibility of the budget (PI-1 to PI-4)

The government's actual expenditures and revenues have differed considerably from the initially approved budgets over the three years, 2005-2007. This was demonstrated by the significant annual revisions including in 2008. However, the main reason underpinning the budgets' unpredictability was higher than anticipated economic growth driven largely by unprecedented and increasing levels of FDI and domestic credit expansion resulting in better than expected revenues and surpluses. Government's use of the large surplus in 2007 was partly in line with its stated objectives of reducing debt stock including debts to individuals and institutions inherited from Montenegro's partition from the Former Yugoslavia, including frozen deposit accounts¹ and restitution claims for confiscated land². However, a large surplus also led government to increase current costs³ and introduce tax cuts both of which may be difficult to reverse in the event of an economic slowdown and decreased fiscal performance. Finally, the value of the budget formulation and monitoring process is also undermined by poor "downstream" PFM issues including predictability and control in budget execution, financial reporting and external audit and scrutiny.

Comprehensiveness and Transparency (PI-5 to PI-10)

Budget classification is quite good based as it is on administrative, economic and functional classification using GFS and COFOG standards. Similarly, the comprehensiveness and transparency of budget information is also good including aspects relating to inter-government fiscal relations and public accessibility. However, comprehensiveness is undermined by two main factors: there is no system presently in place to monitor aggregate fiscal risks from AGAs and PEs at a consolidated level; and there is no system presently in place for collecting financial information in respect of in-kind donor-funded projects.

Policy-based budgeting (PI-11 and PI-12)

The annual budget calendar is clear and appears to be respected. However, the budget circular issued to spending units currently lacked budget ceilings to help spending units frame their budget requests.

By contrast, multi-year fiscal planning, expenditure and budgeting are weak. Sector strategies exist for some sectors but costing is often incomplete. At the aggregate level, although there are three-year rolling estimates, projections do not include functional or organizational estimates and thus there is no direct and transparent links between these estimates and both the annual budget and sector allocations. Finally, many investment decisions have weak links to sector strategies and their recurrent cost implications may be unidentified or unreliable.

¹ Three types of frozen foreign exchange savings were identified whose repayment is regulated under three different laws using the same model (savings with resident banks, non-resident banks and pyramidal banks). Payment for these debts was legislated in 2003, 2006 and 2008. The total debt stock is estimated at more than EUR 130 millions, payments for 2009, 2010 and 2011 are estimated at 0.4% , 0.38% and 0.36% of GDP

² Total liability is difficult to establish. In June 2008, outstanding liability was estimated at EUR 127 millions

³ In 2007, wages increased by more than 25% in nominal terms.

Predictability and control in Budget execution (PI-13 to PI-21)

Budget execution with respect to revenue collection is good in terms of clarity of tax laws, registration of tax payers, tax administration procedures, remittances of tax collections to Treasury, transparency of information, application of penalties, and tax appeals. In addition, cash and debt management is good having benefited from considerable technical assistance and operating within strict operational rules, guidelines and limits. However, budget execution with respect to controls over expenditures is less satisfactory, particularly given the absence of commitment controls, the absence of organization-specific operational procedures which should work in addition to the general PFM body of rules and regulations, and the weaknesses in the internal audit function. Positive improvements in procurement have been reported, in particular with regard to the legal framework and the organizational structure of the system; however, there are concerns about the institutional capacity of the contracting authorities, the robustness of the data provided by the contracting authorities and the private sector's full confidence in the remedy process.

Accounting, Recording and Reporting (PI-22 to PI-25)

Accounting, including reconciliation of bank accounts and suspense accounts, is good and there are no material concerns regarding data accuracy. Timeliness of submission of financial statements is also good with statements being consistently produced by end-July. However, financial reporting could be considerably improved by producing budget revenue and execution reports in sufficient detail so as to enable a detailed comparison of budget outturn with the original budget, and producing annual financial statements in accordance with consistently applied and recognized public sector accounting standards.

External Scrutiny and Audit (PI-26 to PI-28)

External scrutiny and audit is weak. Significant strides have been made to improve the external audit function with the constitution of the State Audit Institution (SAI) in 2004 and the recruitment of a small cadre of auditors who have passed an internally-administered professional examination. However, the audit methodology requires elaboration and clarifications and the cadre of audit staff is small and thus audit coverage is also small. With the available limited resources, the SAI performs as well as could reasonably be expected but it does require considerable further strengthening. Procedurally, external scrutiny is good in that the Parliamentary Committee on Economy, Finance and Budget receives and is substantially afforded the opportunity to scrutinize the annual budget law as well as external audit reports. However, the committee appears very under-staffed and thus unable to perform its role in as detailed a manner as it would like or could reasonably be expected of it.

Donor assistance (D1 to D3)

Donor practice regarding donor-financed government-executed projects is good in terms of providing financial information for budgeting and reporting purposes. This is primarily because budget spending units may only spend funds if such projects are included within the Annual Budget and thus there is a considerable incentive to donors to provide such information⁴. However, the picture is very different for donor-financed donor-executed (in-kind) projects; the government receives very little financial information from donors and thus donor behavior undermines budget and reporting comprehensiveness. To address this, the government is currently formulating amendments to the Budget Law which would require Budget users to collect information on in-kind donations for inclusion in the Budget. Finally, the majority of

⁴ Montenegro receives no direct budget support.

aid including government-executed aid is managed in accordance with donor procedures rather than national procedures.

(ii) Assessment of the impact of PFM weaknesses

PFM systems have three objectives: macro-fiscal discipline, strategic allocation of resources, and operational or technical efficiency. These three objectives are linked: fiscal discipline is the basis without which neither a strategic allocation of resources nor operational efficiency is possible. The impact of the weaknesses of the Montenegrin PFM system in terms of these three objectives is as follows.

Macro-fiscal discipline

The significant in-year revisions to recent years' annual budgets driven largely by unprecedented levels of FDI may have created structural rigidities, particularly for wages. There is thus an increased likelihood of budget deficits in the event of an economic slowdown despite the flexible use of the capital budget as a fiscal buffer. The absence of a consolidated reporting and monitoring of fiscal risks arising from AGAs and PEs increases the risks that activities in those organizations may create fiscal risks for the government without reference to the government's targets. The limited integration of the medium-term fiscal estimates with sector policies and the annual budget formulation process can lead to unsustainable policies or an unsustainable fiscal framework. The poor internal control and internal audit framework coupled with the absence of commitment controls may lead to increased expenditures and thus increase the pressure for deficits, arrears and debts. The absence of a robust and recognized public sector financial reporting framework may result in fiscal risks going unreported with implications for decisions about fiscal sustainability and affordability of government policy. The limited capacities of the SAI and of Parliament properly to perform their roles as independent scrutinizer of government fiscal policy and its implementation reduce the incentives on government properly to consider these issues.

Strategic allocation of resources

The inaccuracy of the government's budget estimates may have created financing expectations that may go unfulfilled in the event of an economic slowdown and thus jeopardize implementation of key policies. Incomplete information about recurrent spending implications of capital projects adversely affects the efficiency of strategic planning against government priorities. The limited integration of the medium-term fiscal estimates with sector policies and the annual budget formulation process could undermine allocative decisions because the timespan of an annual budget is too short to introduce significant changes in expenditure allocations, so that costs of new policy initiative may be systematically undermined. The underdeveloped internal control and internal audit framework increases the risk of unauthorized and fraudulent payments, and therefore may result in patterns of resource utilization that differs significantly from intended allocations. The limited capacities of the SAI and Parliament properly to perform their roles reduce the incentives on government to execute the budget in line with its intended policies.

Operational efficiency

The significant in-year revisions to recent years' annual budgets particularly for wages may have had or lead to a significant impact on the efficiency of resources, particularly personnel, used at the service delivery level. The absence of a consolidated reporting of fiscal risks arising from AGAs and PEs weakens the capacity of local communities and interest groups to exercise any scrutiny on such issues. The limited integration of the medium-term fiscal estimates with sector policies and the annual budget formulation process may lead to inadequate planning of the recurrent costs of investment decisions and of the funding for multi-year procurement, and

to spending concentration in the last months of the year. Poor quality procurement data systems as well as an insufficiently independent procurement complaints system is likely to lead to less than properly competitive procurement practices and thus is likely to limit the efficiency of government programs by increasing the costs of goods or leading to the supply of goods of inadequate quality. The poor internal control and internal audit framework increases the opportunity for corrupt practices, leakages and patronage. The absence of a robust and recognized public sector financial reporting framework reduces the availability of evidence that is required for effective audit and oversight of the use of funds and could provide further opportunities for the use of resources in an unintended manner. The limited capacities of the SAI and of Parliament properly to perform their roles reduce the extent to which government is held accountable for efficient and rule-based management of resources, without which the value of services is likely to be diminished. In addition, inadequate audit means that the accounting and use of funds is not subject to detailed review and verification.

(iii) Prospects for reform planning and implementation

Eventual membership of the EU is Montenegro's central priority. The signing of the Stabilization and Association Agreement (SAA) with the European Community in October 2007 was major step in the process and the National Program for Integration to the European Union (NPI) represents a comprehensive picture of reforms and activities that will be carried out in the first three years following the SAA. Given the EC-focused reform efforts coupled with both the size of the funds allocated by the EC to Montenegro (€ 31.4 million was allocated in 2007) and the fact that the EC's Montenegro 2007 Progress Report⁵ noted "a number of structural problems affect the performance of the public administration", there would appear to be considerable opportunities for EC-sponsored and -financed PFM reform. Montenegro applied for EU membership in December 2008.

The Government of Montenegro has a successful track record of implementing PFM reform programs including: 1) establishing the State Audit Institution, a Directorate for Public Procurement and the Commission for Supervising the Process of Public Procurement; 2) introduction of medium-term macro-fiscal framework and capital budgeting, 3) consolidation of the budgetary structure by inclusion of former extra budgetary funds into state budget, as well as by the inclusion of regulating agencies and public enterprises into the Memorandum to the Annual Budget Law, 4) initial introduction of program budgeting; and 5) Improvement of public debt management by reallocating budget surplus to debt reduction. It is likely that had there been a PEFA assessment in 2001 prior to the above-listed set of PFM reforms, the current PEFA assessment would have shown a considerable improvement in the performance of the Montenegrin PFM systems.

The Government of Montenegro has adopted some important reform strategies with the aim of further strengthening the PFM framework, including: Strategy of Public Administration Reform [2003], Strategy of Public Internal Financial Control [2007], Public Internal Financial Control Law [2008], and Strategy of Management of Public Debt [2008]. Other planned PFM reforms relate to planning of the budget, improvement of functional analysis and structure of the budget, as well as of the capital budgeting.

⁵ The European Commission Staff Working Document (Brussels, 6.11.2007 SEC(2007) 1434), Montenegro 2007 Progress Report may be found at http://ec.europa.eu/enlargement/pdf/key_documents/2007/nov/montenegro_progress_reports_en.pdf

1. Introduction

Objective of the PFM-PR

The purpose of the assessment is to provide the Montenegrin authorities with an internationally-recognized benchmark evaluation of the performance of the Montenegrin PFM systems in order that they may thereafter consider the systems' strengths and weaknesses and develop strategies to strengthen them. The assessment comes at a critical juncture. After double-digit growth in 2007, economic growth has slowed considerably. On the fiscal side, the boom contributed to fiscal surpluses which cannot be sustained in the current economic climate and additional challenges in fiscal management have emerged. The potential to contain recurrent expenditure and implement institutional reforms on the integration path will require increasing efficiency in public administration.

The management of the surge in tax and other revenues represented a special challenge for the government particularly given the significant revenues realized from the "one-off" foreign investment in privatized state-owned enterprises. The level of public debt, which had steadily decreased over the past few years will be more difficult to contain, particularly in view of the highly pro-cyclical nature of economic policies. In addition, spending by local governments and state-owned enterprises constitute growing contingent liabilities to the central government budget. Reform efforts will be required to ensure that the benefits from the boom during the years covered by this assessment are not lost as the country grapples with substantial economic and fiscal challenges that have emerged in the last year. PFM improvements now under consideration could contribute substantially in responding to those challenges.

Process of preparing the PFM-PR

A PEFA team was formed comprising both Government and development partners – see Annex 2. The Ministry of Finance, having requested that the World Bank organize the PEFA assessment, took the lead in the coordination of the PEFA assessment on behalf of the Government and in-country authorities. More specifically, Mr. Nikola Vukićević, Deputy Minister of Finance, coordinated the PEFA assessment and was assisted by Ms. Iva Vuković, Senior Advisor III in the Budget Department of the Ministry of Finance. In recognition of the Government's inexperience with the application of the PEFA framework, capacity constraints of the Government particularly in terms of time available to devote to this assessment, a local consultant, Ms. Biljana Šćekić, was engaged to assist the Government in the process.

In recognition of the considerable technical and other assistance received from various development partners to strengthen the country's PFM systems over the past few years, the Government expressed a keen desire to involve all development partners still active in PFM reform in the PEFA assessment. Representatives from these development partners were asked and confirmed their interest in the PEFA assessment. They include representatives from the Bank, International Monetary Fund (IMF), European Commission (EC), European Agency for Reconstruction (EAR), OECD SIGMA, United States Agency for International Development (USAID), German Technical Cooperation (GTZ) and the United Nations Development Program (UNDP). All development partners agreed to share their diagnostic work and contribute to the assessment. Mr. Ranjan Ganguli, Financial Management Consultant (World Bank), led and coordinated the assessment amongst the development partners and was assisted by Ms. Danijela Vukajlović-Grba, Economist (World Bank).

The concept note and both the draft and final Performance Reports were shared with and reviewed by the PEFA team. The assessment process was managed by the World Bank. The PEFA assessment involved the steps summarized in the following table.

Step	
Scoping mission	March 10-12, 2008
Concept Note *	May 2008
Data collection and self-assessment	May 2008
Review of data and self-assessment	June 2-13, 2008
Draft PEFA Performance Report *	February 2009
Workshop to discuss draft PEFA Performance Report	March 2009
Finalize PEFA Performance Report *	July 2009

* Prior to circulation of these documents, the World Bank conducted internal quality control reviews.

Methodology

The PEFA methodology is set out in the Public Finance Management Performance Measurement Framework (available, also in Russian, at <http://www.pefa.org>). It is based on 28 indicators covering a country's PFM system, and three indicators addressing the interaction of donors with a country's budget process and PFM system. PEFA assessments provide cross-country comparable indications of the effectiveness of PFM systems, and of their improvements over time. They do not provide, however, for an analysis of the causes of existing weaknesses. It should be emphasized that PEFA is an essentially backward-looking process, based on evidence about actual public sector financial management over the last 2-3 years.

Each indicator is scored on a scale from A to D. The bases for these ratings are the minimum requirements set out in the methodology. Many indicators include two or more dimensions, which are "added up" using PEFA-specific methods M1 or M2. For method M1 the weakest link is decisive, i.e. the overall rating is based on the dimension with the lowest score. For M2 an average of the sub-ratings is used to arrive at the score for the overall indicator (see the PEFA Framework, "Scoring Methodology").

The main sources of information that have been used for this PEFA assessment are: (a) government self-assessment material; (b) official GOM reports and data; (c) external evaluations and reports (WB, IMF, EU); and (d) interviews with users and providers of PFM information and other stakeholders (government officials, representatives of development partner organizations, representatives of selected NGOs, professional advisers on aspects of the Montenegrin tax and legal systems). To the extent possible the consultants have sought to triangulate information.

Scope of the assessment

The PEFA assessment focuses primarily on the national level of a country's PFM system. At the national level, it seeks to cover the entire PFM system, including cross-cutting and overall issues, the revenue side, budget cycle from planning through execution to control and auditing; and the interaction of development partners with the PFM system. Notwithstanding the above, a few of the indicators are designed to probe into how the national level interacts with sub-national governments and with public service providers at the local level. Finally, this PEFA assessment is based on the data available as at the time of the main data collection visit in May 2008 and focuses on the three year period 2005, 2006 and 2007.

2. Country background information

2.1. Description of country economic situation

Country context⁶

Montenegro is a small, open, middle-income economy. Total GDP is approximately \$3.8 billion. GDP per capita of just above \$6,000 is comparable to or higher than other Western Balkan countries. Still, per capita incomes remain well below recent EU members except for Bulgaria and Romania.

Economic Indicators 2007

Population (thousands)	626
GDP per capita (USD)	6,137
Unemployment rate (%)	11.9
Inflation (%)	7.7
Fiscal revenue/ GDP	46.0
Fiscal balance/ GDP	5.5
Public debt/ GDP	27.0
Trade (GNFS)/ GDP	107.0
FDI/ GDP	36.0
Current Account/ GDP	34.0

In 2007, Montenegro was one of the world's fastest growing non-oil economies. The country reaped the benefits from its comprehensive, pre-independence reform agenda. The implementation of a privatization and structural-reform agenda, the provision of a low-tax, pro-business environment, and a clearly defined European perspective instilled sufficient post-referendum confidence for a surge in pent-up investment. Foreign direct investments, equivalent to 40 percent of GDP, stimulated domestic demand and economic growth; real GDP is estimated to have grown at double-digit rates in 2007. Commercial banks supported these activities with very large increases in credit to the economy (with 12-month growth rates exceeding 180 percent in 2007). These helped to finance higher imports of goods and services (85 percent of GDP), leading to a rapid widening in the current-account deficit (40 percent of GDP). The economic dynamism, exceeding all (published) projections, resulted in buoyant fiscal revenues and—with effective control over public expenditures in 2007—a very substantial overall surplus. This outcome reflected increased investors' confidence and the belief that the country was on the right track, en route to becoming a full member of the European Union (EU) in the foreseeable future.

The post-independence economic boom was fueled by very large—and, to a considerable extent, unsustainable—external capital inflows. Apart from tourism receipts and foreign acquisitions of companies, banks, and shares in publicly traded enterprises, more than one-third capital inflows consisted of elements that are unsustainable—in particular, purchases of (coastal) real estate by foreigners (20 percent of GDP in 2007) and external bank borrowing (20 percent of GDP). With a coastline of 293 kilometers, the supply of beachfront property is by definition finite, implying that purchases of coastal real estate by non-residents (which represented more than one-half of total FDI in 2006 and 2007) cannot be maintained at the current level. Similarly, domestic banks will not be able to lend to the private sector as aggressively as they did during the period 2006–07. Credit to the economy had grown at unprecedented rates and, in 2007, considerably faster than deposits, necessitating increased foreign borrowing by domestic banks abroad. In response, the Central Bank of Montenegro adopted measures, with noticeable success, to strengthen prudential ratios and decelerate the

⁶ This section is based in large extent on the Montenegro Public Expenditure and Institutional Review draft as of August 18, 2008

rates of private-sector credit growth. Lower deposit growth rates, decreased demand for credits, and the effects from the international financial crisis will further restrict the inflow of external bank credit. On the demand side, rising inflation rates (for factors other than energy and food prices) and a widening current-account deficit have highlighted existing absorption constraints caused by external demand stimuli in this magnitude.

With Government increasingly relying on imports as a source of fiscal revenue, the underlying tax regime adds an additional element of pro-cyclicality. Like many other countries in Southeastern Europe, Montenegro has been aggressively reducing its direct tax rates, having introduced a flat tax for corporate income of 9 percent—with the personal income tax rate to be reduced to the same level by 2010. Government eliminated capital gains taxation and kept social contributions at a minimum, which has been very beneficial in terms of enhancing the relative attractiveness of Montenegro as site for (foreign) direct investments. However, the flat tax removed automatic stabilizers from the tax system, thereby adding elements of pro-cyclicality. These low tax rates have made the budget more susceptible to external demand shocks and increased its reliance on imports as a source of fiscal revenues. This is an especially significant factor as lower capital inflows will lead to an almost corresponding reduction in imports and, in turn, considerably lower tax revenues than during the current boom period. Subsequently, Montenegro's policymakers need to base decisions on permanent spending obligations on its "structural" tax base, that is, tax revenues net of influences from temporary and unsustainable external demand stimuli.

Given its 1999 decision to adopt the Deutsche Mark (subsequently the Euro), Montenegro's only policy instrument of macroeconomic management is fiscal policy. As such, fiscal policy will have to play a double function in ensuring continued macroeconomic stability and advancing Government's socio-economic development (and politico-economic integration) objectives. With the tax regime and external bank credits both being strongly pro-cyclical in their impacts on the economy, the medium-term fiscal program needs to be designed with the objective of including counter-cyclical elements and enabling the implementation of critical public investments. The capital budget needs to be increased to reverse decades of negligence of public infrastructure, increase total factor productivity, and crowd in private-sector investments. This, in turn, requires that the Ministry of Finance create sufficient fiscal space in future budgets to ensure, with private-sector co-financing, the ultimate realization of the large-scale, high-impact public investment currently envisaged. To do this, **Government needs to strictly control current spending.** In recognition of this, and notwithstanding the fact that the country does not formally participate in the Stability and Growth pact, the Government informally shadows the so-called Maastricht or convergence criteria which requires fiscal deficits ceilings to be no more than 3% of GDP and public debt to be no more than 60%.

Overall government reform program and system of government

Montenegro started to implement a program of structural reforms during the mid-/ late 1990s after the economic crisis and is currently harvesting the results of timely reforms.

The main elements of structural reforms were as follows: (i) bank system reform including institutional restructuring of the Central Bank of Montenegro, payment system and adoption of the Deutsche Mark and, later, Euro as its legal tender; (ii) implementation of a regime of low customs barriers; (iii) tax system reform including the introduction of the value-added tax (VAT); and (iv) resident treatment of foreign companies. The reforms mentioned created a de-facto independent Montenegro, especially in economic sense, even prior to the May 21, 2006 referendum. Montenegro quickly gained full international recognition and joined relevant international organizations, including the IMF and the World Bank Group on January 18, 2007. In October 2007 Montenegro adopted a new Constitution.

Eventual membership of the EU is Montenegro's central priority. The signing of the Stabilization and Association Agreement (SAA) with the European Community in October 2007 was major step in the process as was the signing of the Interim Agreement on free trade and Community matters which entered into force in January 2008⁷. The National Program for Integration (NPI) to the European Union represents a comprehensive picture of reforms and activities that will be carried out in the first three years following the SAA. Montenegro will annually receive financial assistance from the European Commission in the order € 30 million⁸ for transitional assistance, institution building and cross-border cooperation. The main focus areas are: public administration reform and rule of law, business environment, transport, environment, agriculture and food safety. Montenegro applied for EU membership in December 2008.

The central administration of Montenegro comprises of 13 ministries and 34 other central government bodies (administrations, directorates, and institutes), of a total of 102 Direct Budget Beneficiaries (DBB). In total there are some 382 budget beneficiaries; most are second-tier so-called "In-direct Budget Beneficiaries" (IBB) including primary schools and health care institutions. In addition, there are 21 local government administrations and five former extra-budgetary funds that were transformed to state funds. The public sector of Montenegro comprises some 44,000 civil servants of which some 39,000 are employed by central government and the rest by local self-government. Education, Health and Public Order and Safety are by far the largest employers with some 11,500, 9,000 and 9,000 employees respectively (2007). There are also a significant number of people working for public companies, notably for public utilities and the railway. Within the reform program it is envisaged to lower the number of direct budget beneficiaries and to increase the responsibility and accountability of the remaining budget beneficiaries. Public administration in Montenegro is characterized by a declared staff shortages in some administrative units and generally low number of skilled staff although the actual size of the country's public administration may be considered rather large given that in 2007 it employed 28.1% of the country's total workforce. In addition, some key state institutions (such as the Directorate for Public Procurement) and administrative units (such as the unit for public enterprises, internal audit and capital budget unit within MoF) have only been recently established.

Rationale for PFM reforms

The EC's Montenegro 2007 Progress Report⁹ noted that "a number of structural problems affect the performance of the public administration. These are due to significant gaps in the legal framework and weaknesses in the arrangements for implementing certain horizontal tasks relating, in particular, to financial and asset management (e.g. public procurement, financial control and concessions) and human resources and career management, including recruitment and conflict of interests. Much remains to be done, particularly in the areas of transparency and accountability, financial control, public procurement, budget management, management of public assets and licensing procedures. Particular attention needs to be paid to enhancing administrative capacity and law enforcement, especially as regards the fight against corruption and organized crime and protection of personal data."

The Government recognizes the importance of sound public financial management (PFM) systems both because of need to improve budget outcomes and control the economy's

⁷ The Interim Agreement will remain in force until the SAA has been ratified by every EU Member State and by Montenegro

⁸ About 0.1% of GDP

⁹ The European Commission Staff Working Document (Brussels, 6.11.2007 SEC(2007) 1434), Montenegro 2007 Progress Report may be found at http://ec.europa.eu/enlargement/pdf/key_documents/2007/nov/montenegro_progress_reports_en.pdf

slowdown as well as the importance attaching to it by the European Commission. Over the past few years the Government and other in-country authorities have received considerable analytical, technical and other assistance from various development partners to strengthen the country's PFM systems. Primarily in recognition of the growing financial and technical support that will be made available by the European Commission to further strengthen the Montenegrin PFM systems, some development partners including USAID and GTZ are currently reconsidering their engagement in Montenegro. A PEFA assessment now provides a useful measure of the state of the Montenegrin PFM systems at this stage of transition, the developments since the previous public financial management assessments including the CFAA and PEIR, and serve as a baseline to measure the impact of future PFM reform interventions however they may be supported.

2.2. Description of budgetary outcomes

Fiscal performance

The economic situation described in section 2.1 considerably affected the aggregate levels of public income and expenditures. This resulted in considerable revisions to the annual budgets and was reflected in amendments to the relevant annual budget laws including those for the most recent three fiscal years¹⁰. More specifically, central government revenues (excluding borrowings and grants) for the years 2005, 2006 and 2007 were in the order of, respectively, 29.2%, 20.5%, and 34.7% higher than originally budgeted. This was primarily as a result of increased tax receipts of which VAT constituted almost 70%, a significant proportion of which was attributable to VAT on imports. This enabled an increase in public expenditures, both current and capital expenditures, as well as repayments of debts, both foreign and domestic, thus considerably lowering the levels of public debt as a proportion in GDP. The table below presents Central Government Budget as a percentage of GDP¹¹.

Central Government Budget as a percentage of GDP (%)

	2005	2006	2007
Total Revenues and Grants	24.40	26.61	31.19
Total Revenues:	24.26	26.61	31.19
Of which: Current Revenues, comprising:	23.59	26.18	31.11
Tax revenues	21.75	23.24	27.87
Duties	0.38	0.65	0.72
Fees	0.38	0.83	0.90
Other revenues	0.81	1.16	0.76
Capital revenues	0.27	0.30	0.86
Total Expenditures and Net Lending	23.77	22.23	23.05
Total Expenditures	23.13	22.30	23.05
Of which: Current Expenditures, including:	14.04	12.20	13.94
Gross salaries	8.59	7.38	7.60
Other personnel costs	3.16	2.01	2.94

¹⁰ A budget revision for 2008 budget was also passed.

¹¹ Presentation of Central government budget in the table differs from the standard presentation that the government uses for calculating the deficit/surplus (i.e. does not contain the receipts from repayment of loans as a part of total revenues but as a part of a net lending and does not include repayments of domestic and foreign liabilities as a part of total expenditures but as a part of domestic and foreign financing). In that regard percentages from this table differ from the other percentages presented in the rest of the document.

	2005	2006	2007
Regular maintenance	0.00	0.88	0.81
Interest	1.14	1.04	1.01
Rent	0.10	0.11	0.19
Subsidies	0.35	0.28	0.51
Other outflows	0.09	0.11	0.20
Of which: Transfers to institutions, individuals, NGO and public sector	4.75	5.57	5.06
Of which: Capital Expenditures	1.48	1.47	1.85
Of which: Capital Budget	0.00	0.00	1.25
Of which: Reserves	0.96	1.27	0.43
Net Lending	0.64	-0.07	0.01
Overall balance before grants and net lending	0.44	3.89	6.81
Primary Balance	1.58	4.93	7.82
Financing	-0.44	-3.89	-6.81
Domestic Financing	-5.25	-3.67	-2.71
Foreign Financing	0.02	-0.24	-3.23
Grants	0.14	0.00	0.00
Project loans	0.18	0.42	0.08
Privatization Receipts	7.51	0.29	0.43
Increase/Decrease of Deposits	2.07	0.34	1.29
Overall Public debt	38.83	32.62	29.02
Foreign debt	28.29	23.45	18.19
Domestic debt	10.32	9.17	6.89

Source of information: Ministry of Finance, World Bank

Allocation of resources

The unexpectedly large increase in tax revenues in 2006 and 2007 resulted in changes in Government policy regarding the levels and allocation of public expenditure. Most notably, the Government cleared all budgetary arrears and reduced external debt as part of its overall strategy to reduce foreign debt levels from over 25% of GDP in 2006 to 20% of GDP by 2008. It also enabled Government to achieve its goal of decreasing the proportion of public expenditures on gross wages and salaries although the nominal value of these expenses increased significantly¹² which may have created structural rigidities that may prove difficult to unwind in the event of reduced tax revenues. In addition, the increased revenues gave the Government the means to begin to address the significant one-off fiscal exposures arising from land restitution claims (€1 billion), frozen foreign exchange savings (€135 million) and pension indexation liabilities (€100 million). The Government was also given the means of increasing capital expenditures particularly for infrastructure projects which are regarded as necessary for further economic development.

Actual budgetary allocations by sectors appear to reflect fiscal policy, particularly those relating to reforms required for EU harmonization and integration such as strengthening public administration. Defense expenditures decreased as a result of the independence and the saving was used to increase police expenditures, particularly relating to the border control. Education

¹² This increase is attributed by Government to the need to increase the motivation and compensation of public employees in order to increase their capacities. However, it is not clear that a formal needs assessment has been performed of the number and skills of staff required.

and health sector expenses increased because of the general increase in gross wages and salaries. Expenses for the Economy function increased largely as a result of rising energy prices and level of rents.

Actual Budgetary Allocations by Functional Classification

	2005		2006		2007	
	€'000	%	€'000	%	€'000	%
Total	543,421	100.0	580,055	100.0	776,249	100.0
General public services	233,768	43.0	172,838	29.8	252,528	32.5
Defence	40,611	7.5	36,817	6.3	37,179	4.8
Police	65,709	12.1	82,192	14.2	107,995	13.9
Education	84,275	15.5	88,672	15.3	116,991	15.1
Health	7,674	1.4	12,284	2.1	15,441	2.0
Social protection	44,474	8.2	106,201	18.3	119,542	15.4
Sport and culture	10,162	1.9	11,200	1.9	20,780	2.7
Environment protection	0	0.0	3,085	0.5	5,299	0.7
Economy	53,935	9.9	62,894	10.8	95,339	12.3
Other	2,813	0.5	3,872	0.7	5,156	0.7

Source of information: Ministry of Finance, World Bank

Actual Budgetary Allocations by Economic Classification

	2005		2006		2007	
	€'000	%	€'000	%	€'000	%
Total expenditures	543,420	100.0	580,056	100.0	776,252	100.0
Current expenditure	254,891	46.9	262,161	45.2	354,126	45.6
Gross wages and salaries	155,931	28.7	158,590	27.3	192,949	24.9
Other personal earning	11,264	2.1	8,165	1.4	17,242	2.2
Goods and services ¹³	42,742	7.9	43,272	7.5	74,731	9.6
Maintenance	14,646	2.7	18,845	3.2	20,641	2.7
Interest	20,615	3.8	22,367	3.9	25,543	3.3
Rent	1,811	0.3	2,430	0.4	4,795	0.6
Subsidies	6,333	1.2	6,073	1.0	13,073	1.7
Other expenditures	1,549	0.3	2,419	0.4	5,152	0.7
Social welfare transfers	34,683	6.4	38,426	6.6	44,749	5.8
Transfers to institutions	86,286	15.9	119,770	20.6	128,622	16.6
Capital expenditures	26,803	4.9	31,625	5.5	47,041	6.1
Borrowings and loans	7,455	1.4	6,693	1.2	6,017	0.8
Debt repayment	115,870	21.3	94,177	16.2	153,051	19.7
Reserves	17,432	3.2	27,204	4.7	10,845	1.4
Capital budget	0	0.0	0	0.0	31,801	4.1

Source of information: Ministry of Finance, World Bank

¹³ Data in the budget statement for 2005 are presented jointly showing both figures together, Goods & Services and Maintenance, in the total amount of Euro 57.4 million.

2.3. Description of the legal and institutional framework for PFM

The [Organic] Budget Law, which dates from 2001, together with the Treasury Regulations, which are issued in accordance with the Budget Law, governs public financial management in Montenegro. Intergovernmental fiscal relations are mainly regulated by the Law on Local Government Finance. The Budget Law is relatively general thus giving considerable authority to the Ministry of Finance and leaving great scope for further guidelines and interpretation.

Recent legislative changes include the introduction of the Law Amending and Supplementing Law on Budget¹⁴ (amending the [Organic] Budget Law). With the amendments, a former Law on Public Debt became an integral part of the “organic” Law on Budget, while other changes referred to integration and transformation of the extra-budgetary funds in state funds, as well as to establishing more detailed procedure of the adoption of budgets of local self-governments and control of the spending of funds on the local level. Implementation of the Capital Budget was another new feature of the amended Law, as well as prohibition of spending by administrative units, above the amounts and for purposes different from those approved within the annual law on budget. Another change in regulation important for PFM was introduced with the adoption of the Law Amending and Supplementing Law on Financing of Local Self-Governments¹⁵. The new Law provided more quality sources of financing of the municipalities, harmonization of the regulations with European Charter on local self-Governments and additional development of criteria for allocation of funds from Equalization Fund. The Law on Internal Financial Control was promulgated in December 2008.

In addition to the legislative changes, the Government of Montenegro has adopted some important PFM reform strategies including: Strategy of Public Internal Financial Control Development [2007], and Strategy of Management of a Public Debt [2008].

The Minister of Finance oversees the implementation of the Budget System Law, which regulates budget preparation, budget execution, debt management, budget accounting and reporting through the establishment of the Treasury. The Ministry of Finance comprises nine “sectors” or units/departments and supervises twelve “administrations”, including the Tax Administration, the Customs Administration, the Administration for Properties, the Administration for Anticorruption, the Administration for the Prevention of Money Laundering (APML), Directorate for Public Procurement and the State Bureau of Statistics. Other key institutions in the Montenegrin PFM framework include: the State Audit Institution¹⁶; a Directorate for Public Procurement; and the Commission for Supervising the Process of Public Procurement.

¹⁴ Official Gazette of Montenegro, No. 104/07.

¹⁵ Official Gazette of Montenegro, No. 05/08.

¹⁶ The State Audit Institution is the given name of the Montenegrin Supreme Audit Institution.

3. Assessment of the PFM systems, processes and institutions

3.1. Budget credibility

The credibility of the budget matters to citizens, investors, and of course to all those who will implement the budget. The difference between the initially approved budget and the actual expenditures and revenues measures the budget deviation, which is a good measure of the overall performance of the PFM system at a high level.

PI 1: Aggregate expenditure out-turn compared to original approved budget

PI 1	Scoring method M1: In two of the last three years, actual expenditures deviated from original budgeted expenditures by more than 5% but less than 10%.	B
------	---	---

From 2005 to 2007, central government expenditure (excluding interest payment and debt repayment) deviated from original budgets by 5.5%, 0.3% and 8.3% respectively, resulting in a score of B. As discussed earlier in the report, the deviations can be largely ascribed to better than expected economic and fiscal performance.

Table: Central government aggregate expenditure out-turn compared to original approved budget (Euro '000)

Year	Original Budget	Actual Out-turn	Deviation, δ	Deviation, δ
2005	430,564	406,936	23,628	5.5 %
2006	464,908	463,511	1,398	0.3 %
2007	522,563	565,822	43,269	8.3 %

Source: Ministry of Finance, World Bank computations

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

PI 2	Scoring method M1: Variation in expenditure composition was less than or equal to 10% in at least two of the last three years.	C
------	---	---

For the budget to be a useful policy statement, the composition of actual expenditure should not vary considerably from the original budget. The table below shows the variance in expenditure composition of the Central government budget for 2005, 2006 and 2007. Only in 2007 was the weighted average of the variance in excess of the total deviation greater than 10%. Accordingly, PI-2 is rated C.

Table: Central government expenditure out-turn by functional classification compared to original approved budget (Euro '000)

Functional classification	2005			2006			2007		
	Original Budget	Actual Out-turn	δ	Original Budget	Actual Out-turn	δ	Original Budget	Actual Out-turn	δ
General Public Service	115,854	97,283	16.0%	46,098	56,294	22.1%	66,943	42,110	37.1%

Functional classification	2005			2006			2007		
	Original Budget	Actual Out-turn	δ	Original Budget	Actual Out-turn	δ	Original Budget	Actual Out-turn	δ
Defense	41,645	40,611	2.5%	39,500	36,817	6.8%	40,980	37,179	9.3%
Public Order and Security	64,637	65,709	1.7%	84,200	82,192	2.4%	94,990	107,995	13.7%
Education	89,091	84,275	5.4%	91,910	88,672	3.5%	103,650	116,991	12.9%
Health	13,253	7,674	42.1%	14,870	12,284	17.4%	9,390	15,441	64.4%
Social Welfare and Protection	43,303	44,474	2.7%	104,260	106,201	1.9%	116,370	119,542	2.7%
Housing and Communal Work	3,170	2,813	11.2%	4,410	3,872	12.2%	3,990	5,156	29.2%
Sport, Culture and Religion	10,168	10,162	0.1%	10,740	11,200	4.3%	14,920	20,780	39.3%
Economic work	18,221	19,412	6.5%	65,090	62,894	3.4%	68,500	95,339	39.2%
Agriculture, forestry & fishery	8,872	9,196	3.7%						
Energy	800	642	19.8%						
Mining	919	991	7.8%						
Transport	18,007	21,651	20.2%						
Environment Protection				3,830	3,085	19.5%	2,830	5,299	87.3%
Other costs	2,624	2,043	22.2%						
Total (refer to PI-1)	430,564	406,936	5.5%	464,908	463,510	0.3%	522,563	565,822	8.3%
Aggregate variation (weighted ave)			9.0%			5.7%			19.2%
Variance in excess of total deviation			3.5%			5.4%			10.9%

Source: Ministry of Finance, World Bank computations

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

PI 3	Scoring method M1: Actual domestic revenues consistently exceeded budgeted domestic revenues in each of the past three years.	A
------	--	---

As discussed elsewhere in this report, domestic revenue collections considerably outperformed expectations. In 2005, this was driven largely by unanticipated privatization receipts. In 2006 and 2007, it was driven by both VAT collections on imports as a result of significant increased foreign investments as well as Personal Income Tax (PIT) revenues resulting from the introduction of a 15% PIT flat tax rate. Excluding grants and borrowings, actual revenues exceeded budgeted revenues in 2005, 2006 and 2007 by, respectively, 29.2%, 20.5% and 34.7%. Accordingly, PI-3 is rated A.

Table: Aggregate revenue out-turn compared to original approved Budget (in Euro '000)

	2005			2006			2007		
	Budget	Actual	δ	Budget	Actual	δ	Budget	Actual	δ
1. Current revenue	423,064	423,124	0.0%	480,105	562,698	17.2%	583,485	790,253	35.4%
2. Receipts sales of assets	6,000	136,310	2171.8%	7,000	6,288	10.2%	11,398	10,822	-5.1%
3. Net lending by	6,700	5,514	-17.7%	-14,875	-2,620	82.4%	-7	134	2014.3%

	2005			2006			2007		
	Budget	Actual	δ	Budget	Actual	δ	Budget	Actual	δ
Government									
4. Revenue from Capital	5,400	4,967	-8.0%	3,277	6,552	99.9%	0	0	N/A
Subtotal (for PI-3)	441,164	569,915	29.2%	475,507	572,918	20.5%	594,876	801,209	34.7%
5. Grants, transfers	3,691	2,500	-32.3%	5,504	44	99.2%	600	86	-85.7%
6. Borrowing & credits	53,609	12,163	-77.3%	5,108	9,045	77.1%	15,870	1,996	-87.4%
Total revenues	498,464	584,578	17.3%	486,119	582,007	19.7%	611,346	803,291	31.4%
Memo items:									
VAT	243,697	258,983	6.3%	215,117	273,157	27.0%	297,138	393,174	32.3%
PIT	71,900	67,085	-6.7%	70,376	72,494	3.0%	66,115	85,402	29.2%

Source: Ministry of Finance, World Bank computations

PI 4: Stock and monitoring of expenditure payment arrears

PI 4	Scoring method M1: (i) There is no reliable data on the stock of arrears (Not Scored) (ii) There is no reliable data on the stock of arrears. (D)	D
------	---	---

Treasury does not monitor all arrears as it can only monitor the lag between the time it receives invoices from line ministries and the time it effects payments. There is no commitment control by the Ministry of Finance, which in practice, means that a line ministry is in a position to enter into a commitment for a good or service without reference to Treasury. Treasury only becomes aware of the commitment once an invoice is transmitted to it for payment. Although arrears are unlikely in a situation of budget surplus, such possibility has arisen in the past¹⁷ with respect to heating expenses. Accordingly, for want of complete data, dimension (i) cannot be scored. In addition, and for the same reason, dimension (ii) is rated D. Finally, while not covered under the rating, the IMF notes that data on stock of local government arrears need to be strengthened.

3.2. Comprehensiveness and transparency

PI 5: Classification of the budget

PI 5	Scoring method M1: Budget formulation and execution is based on administrative, economic and main functional classification using GFS and COFOG standards.	B
------	---	---

Assessment of the annual budget law for 2008 indicates that the budget classification is consistent with GFS and COFOG standards. A recent visit by the regional IMF statistics advisor, based at the CEF in Ljubljana, confirmed that the classification is sufficient to produce fiscal statistics in accordance with the (cash-based) GFS 1986. Some further development is necessary to produce fiscal statistics that follow the format of GFS 2001, but this should not require major changes to the classification structure. Production of accrual-based statistics would, however, be a much more significant step and is not envisaged in the near future.

¹⁷ See IMF, 2006

The 2008 budget law provides a full break-down of the budget according to organizational, economic and functional classifications. For 16 spending units the budget law also provides a programmatic breakdown. The programmatic classification also facilitates a further specification of sub-functions for these spending units. Although the programs only cover 10 of about 100 spending units, these include several large units, such as the Finance Ministry, Tax and Customs administrations, the Education Ministry and several subordinate units, and the Ministry of Culture, Sport and Media.

While PI-5 covers only central government, it is worth noting that the IMF Article IV Consultation of January 2008 (IMF Country Report No. 08/48) states that “fiscal data reporting suffers from frequent re-classifications, especially, at the level of local government and social funds. The MOF has recently created a unit responsible for data collection for state-owned enterprises (SOEs), but a satisfactory compilation of the public sector fiscal balance requires significant further efforts.” This statement indicates that some government organizations have difficulties in presenting their fiscal reports in the prescribed formats. However, these problems do not seem to be linked to systemic weaknesses in the budget classification itself, as other government organizations are able to provide the required reports.

There are ongoing efforts to extend budgeting by programs to the remaining spending units. The 2009 Budget was prepared using a program structure for all spending units.

PI 6: *Comprehensiveness of information included in budget documentation*

PI 6	Scoring method M1: Recent budget documentation fulfils 5 of the 9 information benchmark criteria	B
------	---	---

The assessment examines which of nine pieces of information are included in the Budget documentation submitted to the Parliament.

Overall, the Government has made impressive strides in transparency and comprehensiveness of budget documentation available to Parliament while strengthening control over spending. For example, in the 2008 budget proposal the mid-term macroeconomic projections were improved by including the consolidated public spending for the period 2008 to 2010, as well as the projections of consolidated budget and projection of the level of deposits. In addition, Extra-Budgetary Funds (EBF) were converted into state Funds (BF)¹⁸ and reflected accordingly in the 2008 annual budget proposal¹⁹. At the same time, the Law on Financing of the Local-self-government was changed to introduce new and transparent criteria for financing through the Equalization fund as well as own sources of financing. A new regulation on preparing and submitting financial reports of independent regulatory bodies, state funds and SOEs was introduced in 2008. Within the Memorandum to Budget for 2008, formats for submissions of balance sheets by SOE were introduced, as were formats for balance sheets and financial statements of the Central bank of Montenegro and of independent regulatory agencies, together with their financial plans for the next year. Program budgeting was introduced in one more administrative unit and improved generally. For the 2009 Budget, the government adopted

¹⁸ Incomes and expenditures of three EBF were included into the consolidated account of the state Treasury, whereas budgets of the State Pension Fund and Health Fund became a part of the State Budget.

¹⁹ [Organic] Budget Law, Article 3. Official Gazette of Montenegro

program budgeting for all remaining administrative units, for which the regulation was not adopted until 2008²⁰.

However, some changes within the last budget proposal constituted a slight setback compared with the previous year. For example, the budget proposal by the functional classification was excluded from the Memorandum. In contrast with the Annual Budget Law for 2007, the 2008 budget law did not present the state borrowings and guarantee issuance. Instead, these are now regulated²¹.

In summary, performance under PI-6 is assessed as follows: the budget documentation contains information on macroeconomic projections²². Furthermore, the budget documentation contains projections for the fiscal deficit or surplus, defined according to GFS classification, anticipated composition of surplus. The debt stock is presented in detail with the budget final statement and various MoF reports. Explanations of budget implications of new policy initiatives, with estimates of the budgetary impact of all major revenue and or expenditures changes is available within the annual budget documentation. However, the budget proposal does not include Government's financial assets, prior year's and current year's budget outturn, presented in the same format as the budget proposal and the summarized budget data for both revenue and expenditure according to the main classification heads and including data for the current and previous years. In total 5 of nine sub-indicators of PI-6 are met justifying a score of B.

1. Macro-economic assumptions, including at least estimates of aggregate growth, inflation and exchange rate.

Macro-economic projections of aggregate growth and inflation are covered in Memorandum to the Budget Proposal, but no projections of exchange rates because the vast majority of Montenegro's trade is within the EURO zone.²³ The macro-economic projections without exchange rate projections contain three case scenarios. As noted above, even under the high case scenario, macro-economic projections underestimated budget outturn over the 3 years. A medium-term expenditure framework (MTEF) for the next 3 years is attached to the budget proposal. The MTEF is based on the first 9-months developments of the current year and the macro-economic assumptions, and includes projections of consolidated public spending for the next three years. Given the relatively minor role of exchange rate in the budget projections, the criteria can be considered met.

2. Fiscal deficit, defined according to GFS or other internationally recognized standard.

As noted in the discussion on PI-5, the budget classification is consistent with GFS and COFOG standards. However, as noted in section 2.2, the government's computation of their deficit differs from international standards. The criterion is not met.

3. Deficit financing, describing anticipated composition

The general structure of deficit financing is defined by the Law on Budget (Article 17), whereas the more detailed structure of deficit financing or spending structure of projected surplus is

²⁰ Within the reform of program budgeting, it is planned to introduce a logical program classification for the whole budget, as well as the preparation of IT system for monitoring and budget execution according to the program budget structure.

²¹ Decree on Borrowing and Guarantee Issuing of Montenegro for 2008, Official Gazette of Montenegro, No. 15/08 and 59/08,

²² Exchange rate are not projected as only 13% of foreign trade is made with non-Euro countries

²³ 87% in 2007

defined in the Annual Budget Law (the information on the anticipated spending of budget surplus is presented in the Memorandum to the Budget Proposal)²⁴. The criterion is met.

4. Debt stock, including details at least for the beginning of the current year

In the budget proposal the stock of state debt²⁵ is included, but at an aggregate level (presented in terms of domestic and foreign, nominal and in % of GDP) and only for the current and previous years, but not for the year of the budget proposal. However, more detailed information on debt stock is included in the final budget statement for the previous year as adopted by the legislator shortly before the budget proposal for the next year is discussed in the parliament. Final budget statements contain annual projections for the state debt stock over the next three years, including the year of the budget proposal, and present a debt sustainability assessment²⁶. Since the important issue to consider is whether that information is available to the members of the legislature at the time of reviewing the budget proposals, this criteria is considered met.

5. Financial Assets, including details at least for the beginning of the current year

Financial assets are not presented with the annual budget. Financial assets for the previous year are presented within the Final Budget Statement that has usually been adopted by the legislator shortly before the annual budget law. However, the absence of information on financial assets for the current and new budget year means that this criterion cannot be considered met.

6. Prior year's budget out-turn, presented in the same format as the budget proposal.

Prior year's budget out-turn is not presented in the Budget Law proposal or in the Memorandum accompanying the Budget Proposal. However, as mentioned above, the previous year's budget outturn is presented to the parliament in the Final budget statement prior to the adoption of the new budget. As a result, parliament is able to compare previous year's spending with the proposed budget albeit not at the same level of detail as presented in the original budget (see PI-24i). Accordingly the criterion is met.

7. Current year's budget (revised budget or estimated out-turn), presented in the same format as the budget proposal.

The budget proposal is based on administrative and economic classification, and partly on programs –so far on 16 out of 102 administrative units. The budget Memorandum contains the estimate of the current year's out-turn but only based on economic classification. Since budgets have been revised every year, the revised budget is in fact the current year's estimated out-turn. As a result, the criterion is not met.

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.

²⁴ For example, the Annual Budget Law for 2008 presents the uses of the planned surplus: debt repayment, financing of capital projects and increase of deposits.

²⁵ Montenegrin Law on Budget defines the state debt in accordance with the terminology of the European system of integrated economic accounts, ESA-95. According to ESA-95, the state debt refers only to the general government sector debt (central government, regional governments (if any), local governments and social funds. Debt of SOE is not supposed to be included within the state debt, but MoF does present the overall figure.

²⁶ Within the presentation of the final statement of the state budget by the economic classification, the repayment of debt and guarantees is presented showing planned and executed expenditures. The final budget statement contains the description of the main changes in the structure of both domestic and foreign debt stock, as well as the description of changes in loans stocks, capitalization of interest and conversion of debt to bonds. Final budget statement for the previous year does contain the public debt stock for the previous five years, structured as the loans, T-bills, arrears, local government's debts and restitution bonds. In addition, the Ministry of Finance reports debt stock on a quarterly and on annual basis within the publications on fiscal developments available in print as well as on MoF website. In the annual reports, MoF presents the expectations of medium-term projections of the state debt stock. In the MoF publications debt stock is structured in a way that presents domestic and foreign debt stock in total as well as by creditors for foreign debt, i.e. by the type of commitments for domestic debt stock.

The budget proposal does not contain the summarized budget data for most classifications for previous, current and budget year. The Memorandum contains only the main budget incomes presented by economic classification (without incomes from the asset sale, credits, loans and grants) with comparisons over three years. As some of the required documentation under this criterion is not available, the criterion is not met.

9. *Explanation of budget implications of new policy initiatives, with estimates of the budgetary impact of all major revenue policy changes and/or some major changes to expenditure programs.*

Based on legislation introduced in 2007, the implications of the major new policy initiatives are reported to MOF and their budgetary impact is calculated in the budget proposal and described within the Memorandum, but only at the aggregate level, not detailed for every administrative unit. Later comparison between predicted and actual impact of policy changes to the budget, revenues and expenditures, is not being calculated or described. According to the Law on Budget, the adoption of every new regulation, whether is it proposed by the Government, Parliament or other bodies (such as unions of employees), that affects budget income or expenditures structure, causes revision of the budget and is described within the Memorandum to the Revised Budget Law Proposal²⁷. The criterion is met.

PI 7: Extent of unreported government operations

PI 7	<p>Scoring method M1:</p> <p>(i) All funds are included within the annual budget estimates and, save for the development and restitution funds, included within in-year budget execution and annual financial statements. (B)</p> <p>(ii) There is no system in place for reporting on income and expenditure of donor-funded projects. (D)</p>	D+
------	---	----

(i) The level of extra-budgetary expenditure (other than donor-funded projects and public business enterprises) which is unreported, i.e. not included in fiscal reports.

All government funds are included within annual budget estimates, and, save for the Development Fund and the Restitution Fund, included within in-year budget execution reports and the year-end annual financial statements.

Annual budget estimates: As of 2008, all state funds were brought into the Budget as spending units. Until then all the extra-budgetary funds were included in Annual Budget as an annex document, and presented to the Parliament for adoption. The Annual Budget Law is published on the government web-portal, Ministry of Finance web-page, as well as the web-site of the Parliament of Montenegro.

²⁷ Explanation of budget implications of new policy initiatives and of the proposed legislation has been sent to the Parliament Committee for Financial System, Social Activities and Social Policy Measures for discussion and comments.

In-year budget execution reporting: All funds are obliged to report to the Ministry of Finance on budget execution during the year. These reports are presented in the Quarterly Bulletin of the Ministry of Finance which is publicly available in both print and electronic forms on the website.

Year-end annual financial statements: All funds are also reported within the annual year-end Budget Execution Report, both individually and consolidated. The Report is also presented to the legislator for the approval, and is published on the website of the government and the Parliament.

In FY 2007 the three major extra-budgetary funds (The Pension Fund, The Health Fund and The Employment Fund) accounted for some 35% of total public expenditures. As of 2008, these funds were included within the budget and the process of the incorporation of these funds within the Single Treasury Account started with the integration of the Health Fund. In respect of the two other state funds, the Development Fund and the Restitution Fund, they are both presented in the annual budget estimates but are not consistently included within in-year budget execution reports and were not included in any year-end annual financial statements. In 2007, the Development Fund and the Restitution Fund represented 1.8% of total public expenditure.

(ii) Income/expenditure information on donor-funded projects which is included in fiscal reports.

There is no system in place for reporting on income and expenditure of donor-funded projects, thus such information is not systematically presented in the three required reports, i.e. annual budget estimates, in-year reports and year-end financial statements.

The data on all donor-financing (excluding in-kind grants) is managed and administered by the Department for Debt and Cash Management of the Ministry of Finance, as part of its overall public debt. All the data are centralized into the Debt Management Tracking System, which is a point of reference for managing repayment, disbursements and for producing various types of reports using different criteria such as creditors and users. However, although the annual budget, in-year budget execution reports as well as the year-end budget execution report contain information about the status of grants and concessional loans, they do not contain information about donor-financed projects' income and expenditures.

PI 8: Transparency of inter-governmental fiscal relations

PI 8	<p>Scoring method M2:</p> <p>(i) There is a transparent, clear and rule-based system in place for allocation of conditional and unconditional transfers from central government to municipalities. (A)</p> <p>(ii) Municipalities are getting reliable information on allocation from central government in a timely manner before their detailed budget process starts. (A)</p> <p>(iii) Data on total annual expenditure of local governments are not consolidated either by sector or functional categories (D)</p>	B
------	--	---

The Constitution of Montenegro provides for a decentralized sub-national level of government, being so-called local self-government or municipalities. There are 21 municipalities in Montenegro. The Law on Local Self-government prescribes the organization, authority and competent bodies of a municipality, as well as financing in broad terms.

(i) Are there transparent and rule-based systems for the horizontal allocation among lower tier governments of conditional and unconditional transfers from central government?

There are clear, transparent and rules-based systems of allocation of conditional and unconditional transfers from central government to the municipalities. The Organic Budget Law and the Law on Financing of Local Self-government prescribes municipalities' sources of revenues and methods of financing as well as the procedures applicable to municipalities for budget planning, budget execution and financial reporting. There are four sources of municipal financing²⁸:

1. Own sources²⁹. These include: municipal taxes and surtaxes, communal and administrative fees, interests on deposits, and fees for the provision of services.
2. Common revenues³⁰. These include a proportion of revenues from state taxes: 10% of personal income tax; 50% of tax on immovable property; and 30% of concessions and other fees for use of natural resources awarded by the State.
3. Conditional subsidies³¹ (earmarked revenue) from State Budget. These are based on clear criteria/rules and are used to finance up to 50% of the cost of investment projects of special significance to an individual municipality or group of municipalities³². By March of every year, municipalities must present requests for such investment projects together with a five-year investment plan to the Ministry of Finance who in turn consolidates, presents and makes recommendations on these requests for approval by Government.
4. Equalization Fund³³. The Law on Financing of Local Self-government provides for financing of municipalities through an Equalization Fund. The criteria for allocation of the Fund, its management rules and the Commission's operations are prescribed by the Law and secondary legislation³⁴.

(ii) Timeliness of reliable information to lower tier governments on their allocations from central government for the coming year.

²⁸ Excluding municipal borrowings.

²⁹ Articles 5 of the Law on Financing of Local Self-government

³⁰ Articles 22 to 28 of the Law on Financing of Local Self-government

³¹ Articles 36 to 38 of the Law on Financing of Local Self-government

³² The level of conditional subvention is determined by the level of collected municipal revenues per capita from the fees on use of construction land comparing to the average of these revenues of all municipalities in the previous year. (E.g. If the revenue per capita of a municipality is 50%, 50-70%, 90-70% or above 90% of the overall municipal average then the municipality has the right for conditional subvention at the level of 50%, 35%, 20% and 10% respectively.

³³ Articles 29 to 35 of the Law on Financing of Local Self-government

³⁴ The secondary legislation includes: (i) the Rulebook on criteria on fund allocation from Equalization Fund to municipalities and way of the utilization of these funds ("Official Gazette of Montenegro", No. 07/07, February 5, 2007); (ii) Instruction on the distribution of the Equalization Fund to municipalities ("Official Gazette of Montenegro", No. 27/08, April 24, 2008); (iii) Decision on planned funds for Equalization Fund for 2007 and the distribution to municipalities with the Table on allocation as per municipalities ("Official Gazette of Montenegro", No. 81/06, December 29, 2006); (iv) Decision on final Equalisation Funds allocation for 2007.

Municipalities get reliable information on their allocation from central government well before the beginning of their budget preparation process. More specifically, in June of every year, the Ministry of Finance issues a circular (technical instruction) for the preparation of the following fiscal year's budgets by spending units and local self-government. The technical instructions include: important economic parameters; instructions, guidelines and deadlines for preparation of the budget; and approximate amounts of expenditures for each spending unit and recommendations for the approximate amounts of expenditures of local self-governments. Municipalities thus have sufficient time to prepare and submit a draft budget to the Ministry of Finance by the end-October deadline specified by the Law on Financing of Local Self-Government. Municipalities' budgets are approved by the relevant Municipal Assemblies by end-November³⁵.

(iii) Extent to which consolidated fiscal data (at least on revenue and expenditure) is collected and reported for general government according to sector categories.

Fiscal data on general government revenues and expenditures are consolidated and reported on only by economic classification despite the fact that municipalities' financial reports as submitted to the Ministry of Finance contain analyses by sector.

Municipalities are obliged to report quarterly to central Government on their planned and executed budget revenues and expenditures as well as on their debts and outstanding liabilities. In addition, the Law on Financing of Local Self-government obliges municipalities to report annually³⁶ on budget execution in accordance with the provisions of the Rulebook on Accounting and the Chart of Accounts for Budget and Extra-budgetary Funds. These annual accounts are required to be submitted to the Municipal Parliament by the end of May for approval. They are also submitted to the Ministry of Finance for information within 30 days upon their adoption.

PI 9: Oversight of aggregate fiscal risk from other public sector entities

PI 9	<p>Scoring method M1:</p> <p>(i) Most major AGAs and PEs submit fiscal reports to central government at least annually. However, a consolidated overview is missing (C)</p> <p>(ii) There is continuous central government monitoring of lower tier governments and lower tier governments are not allowed to generate fiscal liabilities for central government (A)</p>	C+
------	--	----

There are two dimensions to this indicator (Scoring Method M1) measuring, respectively, the extent of central government monitoring of fiscal risks³⁷ with national implications arising from activities of:

- (i) autonomous government agencies (AGAs) and state-owned enterprises (SOEs); and
- (ii) sub-national (SN) levels of government.

³⁵ Articles 23 and 24 of the Organic Budget Law

³⁶ Articles 55 through 58 of the Law on Financing of Local Self-government

³⁷ Fiscal risks, inter alia, take the form of debt service defaulting (with or without guarantees issued by central government), operational losses caused by unfunded quasi-fiscal operations, expenditure payment arrears and unfunded pension obligations

Taking each dimension in turn:

(i) the extent of central government monitoring of fiscal risks with national implications arising from activities of autonomous government agencies (AGAs) and state-owned enterprises (SOEs).

Independent Regulatory Agencies

The five independent regulatory agencies (equivalent to AGAs) established under separate industry-specific laws and regulated by their own specific laws comprise: the Regulatory Agency for Energy; the Regulatory Agency for Telecommunications; the Broadcasting Regulatory Agency; the Insurance Agency and the Securities and Exchange Commission of Montenegro. These agencies' expenditures are financed not by the Central Government but rather from their own sources of revenues as prescribed by their respective laws³⁸. Surpluses are either transferred to the Central Government Budget or retained for future years' operations as specified in each agency's specific regulations. Each agency is required to and indeed does prepare annual financial statements and submits these to government and/or Parliament, again as specified in each agency's specific regulations.

As of 2008, a new MOF Ordinance requires these agencies to submit annual financial statements to the Ministry of Finance by March 31 for the previous calendar year, or upon request. These annual financial statements are to comprise: an income statement, a balance sheet, a statement of changes in equity, a cash flow statement, and a table of operational indicators. These reporting formats are consistent with International Financial Reporting Standards (IFRS) although it is too early to comment on agencies' compliance with these reporting requirements.

State-owned Enterprises

There are 15 main SOEs and these are monitored by the Department of Budget within the Ministry of Finance (MOF). SOEs are required to and indeed do submit financial statements on an annual basis, including: an income statement, a balance sheet, a statement of changes in equity, a cash flow statement, and a table of operational indicators. The SOEs are audited annually and the audit report is also made available to the MOF. In February 2008, the MOF adopted an Ordinance which, amongst other things, requires SOEs quarterly to produce and submit financial and operational information based on IFRS. Finally, guarantees made on behalf of SOEs are under the tight control of the MOF Treasury, and are monitored very closely in accordance with the Organic Budget Law. While the MOF is clearly making an effort to obtain and monitor the financial situation of the main SOEs, enforcement of the legislation remains uncertain at this point. Similarly, the analysis and the use of this information in budgetary management remain to be clarified and implemented.

Other public sector fiscal risks

In addition to the fiscal risks with national implications arising from activities of AGAs, SOEs and sub-national (SN) levels of government, the Government of Montenegro has identified and monitors three fiscal risks which due to their significant size merit description in this PEFA

³⁸ The Regulatory Agency for Telecommunication is the only exception to this general rule of agencies not being financed by the Budget. If this agency's revenues (from license fees, registration fees etc.) are insufficient to cover its expenses they will be covered from the Central Government Budget.

assessment³⁹: land restitution claims; frozen foreign exchange savings; and pension indexation liabilities. Taking each in turn:

1. *Land restitution claims (€1 billion)*. The Restitution Law adopted in March 2004, prescribes the process of determining the claims, establishment and financing of Compensation Funds, issuing restitution bonds, etc. A detailed assessment of the restitution liability has not been performed but some estimates show that it exceeds €1 billion. The laws presently include an annual cap of 0.5 percent of GDP and a total cap of 10 percent of GDP). While these caps seek to limit the fiscal risks attaching to restitutions, the restitution claims remain a considerable fiscal risk - there are over 300 pending claims at the International Court for Human Rights in Strasbourg.
2. *Frozen foreign exchange savings (€135 million)*. In 2003, the Government of Montenegro decided to repay the domestic debt generated by the former freezing of foreign exchange savings including: savings with resident banks; savings with non-resident banks; and savings with pyramidal banks. The debt resulting from frozen foreign exchange savings with resident and nonresident banks is €124.1 million and has been converted into state bonds which mature annually through 2017. The debt resulting from frozen foreign exchange savings with pyramidal banks is regulated by a separate law and amounts to some €9.5 million.
3. *Pension indexation liabilities (€100 million)*. In 2007, the Government agreed with the Union of Pensioners to recognize liabilities estimated at €100 million in respect of pension indexation. The government paid an extra-ordinary pension in December 2007 and a new law was adopted by Parliament in June 2008 which prescribes for the liabilities to be paid from the Budget in six semi-annual installments from October 20, 2008 through April 20, 2011 at an annual interest rate of 2%.

From the above, it is clear that the Government is making every effort to strengthen its monitoring of AGAs, SOEs and other sources of perceived fiscal risks. However, the PEFA indicator places emphasis not only on the need for reports in respect of each source of fiscal risk (i.e. a report for and from each AGA, SOE and other source of fiscal risk) but also on the production and analysis of a consolidated overview of fiscal risk. Whilst there is considerable reporting in respect of each source of fiscal risk, the government does not consolidate overall fiscal issues into a report. Accordingly, dimension (i) is rated C i.e. AGAs and SOEs submit fiscal reports to central governments at least annually but a consolidated overview is missing.

(ii) the extent of central government monitoring of fiscal risks with national implications arising from activities of sub-national (SN) levels of government.

In accordance with articles 38 and 40 of the Organic Budget Law municipal governments may not borrow without approval from Central Government approval thus providing for strict fiscal discipline at the sub-national level of government. Similarly, reporting requirements by municipal governments are discussed under PI-8: municipal governments are obliged to and indeed do report to the MOF on a quarterly basis including information on debts and liabilities. Accordingly, dimension (ii) is rated A.

The overall rating for PI-9 (Method M1) is C+.

³⁹ In addition the government recognizes the vulnerability of the Montenegrin economy and economic policies, particularly: (i) large dependence of VAT on import (75% of total VAT receipts); (ii) large dependence on one seasonal (tourism) industry; (iii) dependence on aluminum production and related economic activities (50% of Montenegro GDP) where price of aluminum is exogenously determined; and (iv) fiscal pressure due to (a) large highways infrastructure spending plans; (b) spending related to EU-accession obligations; and (c) spending pressure created from historic over-performance on the revenue side.

PI 10: Public access to key fiscal information

PI 10	<p>Scoring method M1:</p> <p>Annual budget documentation is available on the web-site of the MOF in-time, in electronic and in paper form. The in-year budget execution reports are available on the MOF website. Year-end financial statements are published in November as soon as the Parliament adopts the audited annual final statements. Regardless of the contracted amounts all contracts are published on the web site of Administration for Public Procurement, as soon as the decision on awards has been allocated. All external audit reports on central government consolidated operations are made available to the public within six months of the date of audit completion. However, information on resources allocated to primary service units with national coverage (schools and hospitals) is not available to the public</p>	A
-------	--	---

This Indicator assesses whether information on fiscal plans, positions and performance of the government is easily accessible to the general public, or at least to the relevant interest group. Six elements of information to which public access is essential are considered.

(i) Set of annual budget documentation (as in PI-6) obtainable by the public

Law on Budget defines the annual budget documentation and the structure of the Annual Law on Budget that is available on the web-site of the Ministry of Finances when it is submitted to the legislature. Annual budget documentation is available in a paper form as well, upon the request to the Ministry of Finances. Annual budget documentation comprises: estimation of incomes and expenditures; Memorandum the Budget describing the assumptions for budget preparation and ways of execution, by the organizational, functional and programmatic classification. It also comprises an MTEF. This criterion is fully met.

(ii) Availability of in-year budget execution reports

In-year budget execution reports have been presented to the public on the Ministry of Finances' website since 2004 on a quarterly and annual basis. Quarterly reports are published within one month and annual reports within the three months after the end of the report period. Quarterly and annual reports have been published in a paper form since 2005 and sent to all relevant domestic and international institutions, whereas the rest of public can obtain it upon the request to the Ministry of Finances, for the price that cover the actual expenses of printing and copying. This criterion is fully met.

(iii) Publication of year-end financial statements within six months of completed audit

According to the [Organic] Law on Budget, the Government sends a Proposal of the Law on Year-end Financial Statements to the Parliament until end July (Article 49). According to the Law on State Audit Institution (SAI), this institution is obliged to send the Annual Report on Year-end Financial Statements to the Government and to the legislator until the end of October (Article 19). Legislator discusses the Proposal of the

Law on Year-end Financial Statements together with the report of SAI. Year-end financial statements are being published in November - one month after the Parliament adopts the audited Year-end financial statement. This criterion is fully met.

- (iv) *Availability by the public of consolidated external audit reports on central government operations within six months of completed audit*

External audit reports on central government consolidated operations for 2005 and 2006 have been made available to the public within six months of completed audit, as the individual report or within some other SAI report. This criterion is fully met.

- (v) *Publication at least quarterly of awards of all contracts with value in excess of about US\$ 100,000*

The award of all contracts smaller as well as bigger than US\$ 100,000 is published on the web site of Administration for Public Procurement (Article 17) as soon as the decision on awarding a contract has been made by the contracting authority (usually within the range of 10 days). The Law on Public Procurement requires all the contracting authorities (central and decentralized entities, SOEs, etc) to publish the award of all contracts, no matter the value and the type of the contract (Articles 33 and 36). However, the Law does not prescribe when the award of contracts should be published. This criterion is fully met.

- (vi) *Resources available to primary service units: is information published at least annually, or made available on request, about resources allocated to primary service units with national coverage in at least two sectors (e.g. elementary schools, primary health clinics)*

Information on resources available to primary service units with national coverage is available only on hospitals but not schools. Information on funding provided by the Central government to local schools or health clinics is not available to the public. This criterion is only partially met.

As five out of six criteria are met, the score for this indicator is A.

3.3. Policy-based budgeting

PI 11: Orderliness and participation in the annual budget process

PI 11	<p>Scoring method M2:</p> <p>(i) A clear annual budget calendar exists, is generally adhered to, and allows spending units about two months to complete their detailed budget requests. (A)</p> <p>(ii) A budget circular is issued to the spending units, but it has so far not contained ceilings that constrain the spending units' budget requests. (D)</p> <p>(iii) The Parliament has, during the last three years, approved the budget before the start of the fiscal year. (A)</p>	B
-------	--	---

The (organic) Budget Law provides a detailed framework for the budget process. The budget calendar is defined in articles 20 - 28 of the Law. The law was updated in 2007, and the new version provides some more time for the capital budget process, but the main elements of the budget calendar have been in place since 2001. There were no indications of significant

deviations from the timetable over the last three years. The table below describes some key milestones in the budget process.

Montenegro budget calendar

Month	Milestone
February	MOF provides instructions for capital budget proposals
April	Ministries submit capital budget proposals Cabinet determines medium-term strategic priorities
May	Fiscal policy statement with medium-term estimates
June	MOF issues budget circular
August	Ministries submit spending requests
October	Draft budget law to Cabinet
November	Draft budget law to Parliament
December	Budget approval by Parliament

The MOF issues a comprehensive budget circular in June each year. The budget circular did not provided spending ceiling for the ministries during the period. However, the 2007 revision of the budget law included provisions for such ceilings, and the MOF plans to include this in the circular for preparation of the 2009 budget.

The budget has been approved by Parliament prior to the fiscal year in each of the last three years. The Budget System Law does provide procedures for budget execution if the Parliament fails to approve the law in time, but these have not been needed for the 2006, 2007 or 2008 budgets.

The Budget System Law includes a general requirement that the budget be amended in the case of decreased receipts or increased payments. In 2007, the supplementary budget was passed in October, and entailed significant changes compared to the initial budget both on the revenue and expenditure side, largely as a result of higher-than-expected economic growth and subsequent policy adjustments.

The MOF is planning to include spending ceilings in the circular for the preparation of the 2009 budget. These ceilings will be approved by the Cabinet in connection with its discussion of the fiscal policy statement. For 2009, the plan is to try to establish binding sub-ceilings for salaries and other current spending, but to accept that the overall budget requests will continue to be uncapped. For 2010, the plan is to establish binding overall ceilings for each spending unit.

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

PI 12	Scoring method M2: (i) Forecasts of fiscal aggregates based on the economic classification are prepared for three years on a rolling basis. There is no functional or organizational breakdown. (C)	C+
-------	--	----

	<p>(ii) DSA for external and domestic debt was undertaken in 2007. (B)</p> <p>(iii) Sector strategies exist for some important sectors, but are only substantially costed for a few sectors. These cost estimates are not fully reconciled with aggregate fiscal forecasts. (C)</p> <p>(iv) Many investment decisions have weak links to sector strategies and their recurrent cost implications may be unidentified or unreliable (C)</p>	
--	--	--

The annual fiscal policy statement includes three-year fiscal projections based on an economic classification. However, the projections do not include any functional or organizational breakdown. Because of this, there are no direct and transparent links between the fiscal estimates and subsequent budget allocations.

The Ministry of Finance prepared a comprehensive debt sustainability analysis in 2007, as part of the development of its debt management strategy. The analysis benefited from substantive inputs from the peripatetic IMF debt and cash management advisor, but the MOF took strong ownership of the process and analysis, which provided an important base for the strategy. Previous debt sustainability analyses were prepared by external institutions and were not fully endorsed by the MOF.

Sector strategies are prepared for some sectors and ministries, such as education, transport and tourism. However, these strategies often give a partial picture of the sector, and the costing is often incomplete. This is the case for education and tourism. For some sectors, such as transport, cost estimates are quite comprehensive, but not reconciled with the overall fiscal framework.

Capital budget regulations require that projects are related to sector strategies and that current cost implications are identified for all capital budget proposals. The estimates should cover the period up to three years after project completion. For projects that are approved, these current cost estimates should be included in the forward estimates that budget organizations provide together with their annual budget proposal. Compliance with this regulation is somewhat uneven. Many project proposals are forwarded without any reference to sector strategies. Recurrent cost estimates are sometimes missing. When they are provided, the reliability may be limited due to inadequate project analysis and planning.

The development of a National Program for EU Integration, which will include common methodologies for sector development strategies, will provide the basis for strengthened sector plans. The MOF will also prepare detailed methodological guidance for development of a national investment program.

3.4. Predictability and control in budget execution

PI 13: Transparency of taxpayer obligations and liabilities

PI 13	<p>Scoring method M2:</p> <p>(i) Legislation and procedures for all major taxes are comprehensive and clear, with strictly limited discretionary powers of the government entities involved. (A)</p> <p>(ii) Taxpayers have easy access to comprehensive,</p>	A
-------	---	---

	<p>user-friendly and up-to-date information on tax liabilities and administrative procedures for all major taxes, and the tax authorities supplement this with active education campaigns. (A)</p> <p>(iii) There is a transparent system of procedures relating to tax appeals but there are some concerns about the operation of the system. (B)</p>	
--	--	--

The main tax revenues accruing to the Budget, as administered and collected by the two main tax authorities, Tax Administration and Customs Administration, are:

Tax	Summary description	Administered by		2008 % of total	2008 Budget € '000	2007 Draft actual € '000
		Tax Admin	Customs Admin			
Personal	15% flat rate plus social insurance.	13%	-	13%	83,785	85,402
Corporate	9% flat rate	7%	-	7%	47,402	39,077
Property	3% of value (VAT payable on new property)	2%	-	2%	11,980	20,591
Value-added	17% unless lower (7%) or zero-rated	9%	40%	49%	310,655	393,174
Excise	Various on alcohol, tobacco, mineral oils etc.	14%	2%	16%	99,516	94,538
Customs	Various on imports	-	12%	12%	72,893	68,496
Total		<u>45%</u>	<u>54%</u>	<u>100%</u>	<u>633,699</u>	<u>708,017</u>

The three dimensions to be assessed for this performance indicator according to scoring method M2 are:

- (i) Clarity and comprehensiveness of tax liabilities
- (ii) Taxpayer access to information on tax liabilities and administrative procedures
- (iii) Existence and functioning of a tax appeals mechanism

(i) Clarity and comprehensiveness of tax liabilities

Each tax is legislated by a corresponding tax law which clearly defines the tax liability arising in respect of that tax. The laws are being harmonized with relevant EU directives in accordance with the National Program for European Integration as prescribed by the Stabilization and Association Agreement. In addition, there are clear laws on: Tax Administration; Customs Administration; Administrative Procedures; and Inspection. Discretionary powers are strictly limited. See Annex 3 for a list of these tax laws.

(ii) Taxpayer access to information on tax liabilities and administrative procedures

The Tax Administration and Customs Administrations have established a variety of arrangements to educate taxpayers thereby enabling compliance with registration, declaration and payment procedures. These include: a dedicated cadre of staff for providing education to the public; a network of branch offices; on-line access to all guidance and forms; papers including leaflets, a Guidebook and series of Frequently Asked Questions; dedicated telephone lines; and public information campaigns through seminars, television, radio and other activities. Detailed statistics are maintained of the various outreach activities. In addition, tax payers have ready access to their tax records and can request a copy of such records from their local tax office at their convenience.

(iii) Existence and functioning of a tax appeals mechanism

In accordance with the Law on Administrative Procedure, there is a generalized escalating four-step procedure to appeal any decision made by the administration. With respect to taxation, the so-called “first instance” authority is the relevant tax authority (either the Tax Administration or Customs Administration); the “second instance” authority regarding the assessment and collection of tax liabilities is the Ministry of Finance and regarding the performance of tax audits is the Tax Administration; the “third instance” authority is the Administrative Court; and thereafter the appeal may be taken to the Supreme Court. Appeals appear to have a high rate of success despite the relatively small number of appeals made which may warrant further investigation both in terms of the reasons for few appeals and the high success rate of those which are lodged. Decisions of the “second instance” authority are not publicly available. Decisions of the “third instance” authority are available on the Administrative Court’s website.

PI 14: Effectiveness of measures for taxpayer registration and tax assessment

PI 14	<p>Scoring method M2:</p> <p>(i) Taxpayers are registered in a complete database system with links with to other relevant government registration systems. (B)</p> <p>(ii) There are penalties for non-compliance with registration and declaration obligations, but they may not always be an effective deterrent. (B)</p> <p>(iii) There are annual tax audit plans as well as a continuous program of tax audits and fraud investigations. (B)</p>	B
-------	---	---

Three dimensions are to be assessed (Scoring Method M2):

- (i) Controls in the taxpayer registration system
- (ii) Effectiveness of penalties for non-compliance with registration and declaration obligations
- (iii) Planning and monitoring of tax audit and fraud investigation programs

(i) Controls in the taxpayer registration system

All citizens in the Tax Administration’s databases are derived from and are regularly reconciled with databases maintained by the Ministry of Internal Affairs and Public Administration, the Statistics Bureau and the Central Bank by reference to the citizens’ unique identification number (JMB). However, as the linkages are not automated, comprehensiveness is undermined. Since the period under review, the Tax Administration has implemented the first phase of a unified taxpayer registration project to automate linkages with the Health Fund, Social Disability Fund and Employment Fund. Once the Ministry of Interior’s Central Registry of Citizens is complete, the project will be continued to automate linkages with that database also. Companies are also registered with a tax identification number (PIB) as well as, if appropriate, a VAT registration number.

With respect to the Customs Administration, all imports are registered in the Customs Administration’s databases at the point of entry and all importers are assigned a unique identification number.

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

With respect to taxes administered by the Tax Administration, tax penalties as established by the Ministry of Finance for non-compliance with registration, declaration and payment obligations are levied on the basis of a multiple of the legal minimum net salary, currently EUR 55 per person per calendar month. Penalty multiples are: in respect of personal income tax: 2-10 for physical persons and 10-200 for legal entities; in respect of corporate tax: 50-300 for the legal entity and 5-20 for the manager of the legal entity; and in respect of value-added tax: 10-300 for legal entities and 5-20 for the manager of the legal entity. Given that Montenegrin gross wages were on average around EUR 630 per person per calendar month (or EUR 429 net) in September 2008, and the fact that the majority of companies are small- and medium-sized and owner-managed, the deterrent effect of the penalties established by the Ministry of Finance may be considered high. However, given the flat-rate structure of the penalties, these penalties may not be such a significant deterrent for large tax payers.

With respect to taxes administered by the Customs Administration, the Customs Administration requires importers to present bank guarantees for payment of taxes. Although, the Customs Administration permits importers to import their goods without full documentation, they may only do so upon presentation of a bank guarantee which will then enable them to receive a so-called "Transit Visa" that permits them to present the full set of documentation at any so-called "Terminal" for final processing. In addition, the Customs Authorities imposes interest charges on late payment. Although no statistics were made available for the purposes of this PEFA Performance Report, it is understood that for 2006, the Customs Authority achieved a near 100% collection rate. Thus, the deterrent effect of the penalties may be considered high.

(iii) Planning and monitoring of tax audit programs

With respect to taxes administered by the Tax Administration, there are annual tax audit plans. In addition, all tax returns are first entered onto the Tax Administration's systems by data-entry clerks. So-called "classifiers" run computerized queries on the tax returns to identify those falling within certain parameters and then, on the basis of professional experience, identify those tax returns warranting further and more detailed investigation. These returns are investigated by the tax inspection department.

In respect of taxes administered by the Customs Administration: all imports are registered in the Customs Administration's databases at the point of entry and all transactions are monitored by supervisors and processed in accordance with a risk analysis framework which aims to support customs officers by directing their inspections to high risk shipments.

PI 15: Effectiveness in collection of tax payments

PI 15	Scoring method M1: (i) Average debt collection in the two most recent years was 90% or above. (A) (ii) All tax revenues are collected into accounts controlled by the revenue collection agencies and transferred daily to Treasury. (A) (iii) Complete accounts reconciliation of tax assessments, collections, arrears and transfers to the Treasury are performed annually. (C)	C+
-------	---	----

This Indicator focuses on the questions whether, once liability has been assessed, payment is actually secured, the money paid into the Treasury without delay, and assessments, collections, arrears records and Treasury receipts reconciled without delay.

(i) Success in collecting tax arrears (proportion of the amount outstanding at the beginning of the year actually collected during the year)

Tax collection for the two most recent fiscal years is presented in the table below. Average debt collection was 90% or above. Accordingly, this dimension is rated A.

(Amounts in Euro'000)

		FY 2006	FY 2007	FY06 and FY07
1	Tax collected	318,043	411,726	729,769
2	Tax arrears at the beginning of the year	57,863	87,751	145,614
3	Debts written off	2,716	7,526	10,242
4	Amount of assessed Taxes	264,037	269,278	533,315
	Average debt collection (1+3)/(2+4)	100%	117%	109%

In addition, in accordance with article 14 of the Organic Budget Law, the Ministry of Finance may waive the collection of tax and non-tax claims that belong to the State Budget, postpone the due date for payment or may allow payment by installment up to the amount and under conditions determined by the Government. Any claims written off are to be promptly reported to the Government by the Ministry of Finance, along with the explanation of the circumstances under which the write off was done. The Government makes so-called conclusion for each write off and the Ministry of Finance issues the decision for every case. The list of write offs and associated companies is disclosed with the year-end account (Budget Execution Report). In 2007, the government wrote-off some Euros 7.5 million as follows: personal income tax € 3.7m; excise tax € 0.5m; sales tax € 0.1m; corporate profit tax € 2.7m; value-added tax € 0.5m. The majority of write offs related to personal income tax for six companies from under-developed regions as well as Podgorica airport and the steel plant in Niksic. Excise write-offs related to a privatized oil company and a state-owned oil storage company. Other write-offs related to companies with government ownership.

(ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administrations

Each tax revenue stream is collected in a specific so-called “virtual” account, being a bank account held by the relevant revenue collection agency (Tax Administration or Customs Administration) at the Central Bank of Montenegro with the specific sole purpose of separately identifying the taxes for which funds were received. There are over 100 such virtual accounts. These virtual accounts are monitored regularly during the day. Unidentified receipts are investigated and all identified / cleared transactions are transferred daily to the Treasury Single Account of the Ministry of Finance.

(iii) Frequency of complete reconciliations of tax assessments, collections, arrears records and Treasury receipts

Both revenue collection agencies perform daily reconciliations of their “virtual” accounts in terms of taxes collected, unidentified receipts and taxes remitted to the Treasury Single Account managed by Treasury. Although not presented in a single reconciliation statement, complete reconciliation of tax assessments, collections, arrears and transfers to Treasury takes place at least annually within three months of the year-end.

PI 16: Predictability in the availability of funds for commitment of expenditures

PI 16	Scoring method M1:	A
-------	--------------------	---

	<ul style="list-style-type: none"> (i) A cash flow forecast is prepared for the fiscal year, and the main figures are updated at least monthly on the basis of actual cash inflows and outflows. (A) (ii) Spending units are able to plan and commit expenditure for the whole budget year, as long as the resulting payments are kept within the monthly spending ceilings approved at the beginning of the year. (A) (iii) The last two years, significant in-year budget adjustments have taken place only once or twice during the year, and been conducted in a transparent and predictable way. (A) 	
--	--	--

The Treasury prepares annual cash flow forecasts, building on inputs from the Budget Department. Revenue estimates are prepared by the macroeconomic section of the Budget Department. Spending estimates reflect the proposed spending plans from the spending units, as approved by the MOF. The forecasts are continuously monitored and updated at least every month.⁴⁰

Spending plans are approved for the whole budget year, broken down by months. There are no explicit commitment limits or commitment controls, but the budget law requires that spending units ensure that commitments are consistent with approved spending plans. In the last two years, budget amendments have been concentrated to the mid-year budget review in a transparent and predictable way. Monthly spending plans can be restructured during the year by the Budget Department, and the Treasury has the authority to delay payments up to 30 days. However, the last two years the Treasury has had ample liquidity, and the MOF indicates that there have been no significant spending plan adjustments or payment delays during this period.

The MOF is planning further strengthening of cash flow forecasting and cash management.

PI 17: Recording and management of cash balances, debt and guarantees

PI 17	<p>Scoring method M2:</p> <ul style="list-style-type: none"> (i) The foreign debt records are updated regularly and checked with creditor payment advice at least twice a year. Data quality is considered relatively fair. Domestic debt data is considered to be high quality. (C) (ii) Most government cash balances are kept in the Central Bank, and the total balances are calculated monthly. The system does not yet provide for consolidation of resources belonging to four major government funds and some foreign-financed projects into the consolidated account structure. (C) (iii) Government borrowing is restricted to purposes stated in the organic Budget Law. 	B
-------	--	---

⁴⁰ The mission was not able to assess how comprehensive the monthly updates are, or the reliability of the cash flow estimates. However, sub-indicator 16 i) does not include any requirements regarding comprehensiveness or reliability.

	The yearly budget law imposes a ceiling on the borrowing and the guarantee issuing. The Minister of Finance signs all loan and guarantee contracts. (A)	
--	---	--

Government foreign debt is recorded in the Debt Tracker system. The records are regularly updated from creditor information on disbursements and payment advices. Information in the system is compared with the payment advices. Since the loans mainly have semiannual debt service payments this control is conducted twice a year for every loan. The data records are not subject to any other type of reconciliation. Data quality is considered relatively fair. Domestic debt consists of frozen savings certificates and debt relating to restitution and compensation of pensioners. The primary debt recording is within administrative systems in the Central Bank and the Compensation Fund respectively. The records are considered to be high quality. A comprehensive report on the operations and the outstanding debt, but not including debt service payments, is produced monthly, but made public on quarterly basis.

Most central government cash balances are kept in the treasury single account and in a number of deposit accounts introduced for specific purposes in the Central Bank. The Treasury receives a monthly statement from the Central bank regarding the daily balances on these accounts. However, cash resources of five major government funds (pension, health, employment, development, compensation), which were included in the budget from 2008, are not yet consolidated in the government account structure in the Central Bank. Some resources related to foreign-financed projects are also kept in special accounts in commercial banks, and not consolidated with the Central Bank accounts during the year.

Government borrowing is restricted to purposes stated in the organic Budget Law. The yearly budget law imposes a ceiling on the borrowing and the guarantee issuing. The Minister of Finance signs all loan and guarantee contracts.

The MOF is planning to strengthen the procedures and routines concerning the Debt Tracker system. All state funds (previously extra-budgetary) are planned to be integrated in the Treasury system.

PI 18: Effectiveness of payroll controls

PI 18	Scoring method M1: (i) Personnel and payroll data are not directly linked but payroll data is supported by full documentation for all changes to personnel records. (B) (ii) Personnel records and the payroll are updated monthly. (A) (iii) Controls exist, but are not adequate to ensure full integrity of data. (C) (iv) Partial payroll audits have been undertaken within the last three years. (C)	C+
-------	--	----

There are, broadly-speaking, three main channels through which central government public employees are paid: directly from the budget; indirectly from the budget to education sector employees; and indirect payments to health sector employees via the Health Fund.

	Approx. no. of employees	%
• Paid directly from the Budget managed by MOF-centralized payroll system	6,000	15%
• Paid directly from the Budget managed by spending units' payroll systems	12,000	31%
Total public employees paid directly from the Budget	18,000	46%
• Education sector employees paid indirectly from the Budget	12,000	31%
• Health sector employees paid indirectly via the Health Fund	9,000	23%
Total public employees	<u>39,000</u>	<u>100%</u>

For public employees paid directly from the Budget, monthly payroll computations are submitted to Treasury for payment by the relevant spending unit. Each spending unit (or, in the case of spending units using the MOF-centralized payroll system, the MOF payroll department) prepares one payment request for each bank at which its employees hold their bank accounts together with a matching electronic file containing details of its employees' bank accounts into which the funds should be transferred. Treasury makes payments to each bank on the basis of the payment requests. The spending unit (or, in the case of spending units using the MOF-centralized payroll system, the MOF payroll department) sends the relevant electronic file to the bank. Each bank then transfers the funds received from Treasury to the employees' bank accounts as specified in the electronic file.

For education sector employees paid indirectly from the Budget, each education institution prepares a monthly payroll computation and submits the same to the Ministry of Education (MOE). The MOE submits to Treasury a payment request for each school in the amount of the total net-of-tax salary due to its employees. Treasury makes payments to each school on the basis of the payment requests. Each school, upon receipt of the funds in its own bank account, transfers the appropriate net-of-tax salaries to its employees in accordance with the monthly payroll computation.

For health sector employees paid indirectly via the Health Fund, each health facility prepares a monthly payroll computation and pays its employees in accordance with the monthly payroll computation. (Note: health facilities derive their income from the Health Fund substantially on the basis of services delivered. The Health Fund in turn derives its income from mandatory health insurance contribution collected and remitted to it by the Tax Administration via Treasury).

There are four dimensions scored for this indicator:

- (i) Degree of integration and reconciliation between personnel records and payroll data
- (ii) Timeliness of changes to personnel records and the payroll
- (iii) Internal controls of changes to personnel records and the payroll
- (iv) Existence of payroll audits to identify control weaknesses and/or ghost workers

In respect of each dimension:

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

Substantially all of the personnel records and payroll data are maintained on computerized systems. As such, spending units assume data is consistent and automatically reconciled. However, see dimension (iii) below.

- (ii) *Timeliness of changes to personnel records and the payroll*

Personnel records and the payroll are updated as required and normally monthly. It is understood that retroactive adjustments are rare.

(iii) Internal controls of changes to personnel records and the payroll.

Changes to the payroll are authorized by the head of the relevant spending unit. However, exception reports are not produced nor manual reviews performed of any reconciliation between personnel records and payroll data such as those that would confirm that expected changes in employees' status have been reflected in the payroll or such as those that would identify unexpected changes. In addition, and consistent with the findings in respect of PI-20, payroll systems are not documented thus leading potentially to inconsistent application of procedures and controls but also preventing a proper analysis of the internal control framework for payroll. Therefore, whilst the audit trail is clear, the overall system of internal controls over payroll could be much improved.

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

Payroll audits are in principle within the scope of the MOF Internal Audit Unit as well as the external audit performed by the SAI. However, specific payroll audits as such are not performed although payrolls have been partially audited as part of other audit work. Finally, and as discussed with respect to dimension (iii) above, payroll systems are not documented thus preventing a proper analysis of the internal control framework for payroll.

PI 19: Competition, value for money and controls for non-salary expenditure

PI 19	<p>Scoring method M2:</p> <p>(i) Data on the method used to award public contracts exists and shows that more than 89% of contracts above the low-value threshold are awarded on the basis of open competition. However, the full accuracy of the data has been questioned. (B)</p> <p>(ii) Other less competitive methods when used are justified in accordance with regulatory requirements. However, issues related to division of activities to be procured under less competitive process, among others, have been reported. (B)</p> <p>(iii) There is a functioning procurement complaints mechanism. However, concerns about private sector's full confidence in the remedy process before the contracting authorities have been reported. (B)</p>	B
-------	---	---

A new Public Procurement Law (PPL)⁴¹ was adopted in 2006 in the context of EU *acquis* approximation. This law provides for an institutional framework which includes a state

⁴¹ Official Gazette no. 46/06 of July 21, 2006

authority in charge of public procurement operations (the Public Procurement Directorate⁴²) and an independent entity responsible for the second-step-review process of the complaints (the Commission for Control of Public Procurement). The procurement system is decentralized and the PPL applies to all procurement processes for goods, civil works and services conducted by state and local-self-government authorities; state owned enterprises; and legal persons that use funds provided, as a subsidiary or as a guarantee, by the GoM or a unit of local self-government. There are some 800 contracting authorities which in 2007 contracted Euros 406,663,039 which is equivalent to approximately 18% of GDP.

There are three dimensions scored for this indicator:

- (i) Evidence of the use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases (percentage of the number of contract awards that are above the threshold)
- (ii) Extent of justification for use of less competitive procurement methods
- (iii) Existence and operation of a procurement complaints mechanism

In respect of each dimension:

(i) Evidence of the use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases (percentage of the number of contract awards that are above the threshold)

The nationally established monetary thresholds for small (known in Montenegro as “low-value”) purchases are: Euros 10,000 for goods and services and Euros 30,000 for works. Of the total value contracted in 2007, Euros 389,143,574 (95.6%) were awarded in 1,535 contracts using public procurement (i.e. non low-value) procedures as follows: open public procurement procedures 1,368 contracts (89.1%); negotiated procedures without publication 90 contracts (5.9%); negotiated procedures with publication 4 contracts (0.3%); framework agreements 51 contracts (3.3%); design contest 22 contracts (1.4%).

By law the Directorate is responsible for collecting the data on public procurement activities issued by the contracting authorities. To that end, the Directorate has developed simplified forms for the contracting authorities when certifying the accuracy of their data. Despite the high proportion of contracts awarded using open competition (for contracts that exceed the nationally established monetary threshold for small purchases), there is a concern by the PEFA Team about the robustness of the data on which the statistics are based. This problem was also raised by the Montenegro State Auditing Institution, SAI, in its 2008 Annual Report, stating that: “Lack of representing the data on public procurement undertaken by the immediate agreements seriously questions the scope of the data on the expenditure on public procurement, as presented in the Public Procurement Directorate’s Report.”⁴³ To address the issue may require actions enhancing the capacity of the contracting authorities to produce fully accurate data. Furthermore, state-of-the-art instruments for monitoring and evaluating public procurement operations are also needed. This would involve development of a set of indicators

⁴² The Directorate was made functional in June 2007 when appointing its staff. Before it, the Directorate’s responsibilities were carried out by the Office for Joint works of the State Administration.

⁴³ Page 46 of the 2008 Annual Report regarding the audit performed and activities of the State Auditing Institution of Montenegro for the period October 2007 to October 2008. Republic of Montenegro, State Auditing Institution, SAI

related to procurement planning, efficiency, competitiveness, delays in contract completion and deviation in contract prices.

(ii) Extent of justification for use of less competitive procurement methods

The PPL allows contracting authorities to use less competitive procedures (such as negotiated procedures with and without publication as well as framework agreements) with the prior approval of the Public Procurement Directorate. The Directorate reported this provision of the PPL is fully respected. For example, the 90 contracts concluded in 2007 after negotiated procedures without publication were approved by the Public Procurement Directorate after consideration of 301 requests. However, questions on the institutional capacity of the contracting authorities to fully implement the PPL and the quality of their processes have been raised by the SAI and by SIGMA in its 2008 Report on Public Procurement in Montenegro.⁴⁴ For example, issues regarding lack of planning, fractioning-division of procurement activities to be awarded through less competitive procedures; absence of professional procurement staff in a number of contracting authorities, among others, were reported in the SAI 2008 Audit Report.

(iii) Existence and operation of a procurement complaints mechanism

The PPL envisages both an administrative and a judicial process for dealing with complaints. The administrative review process is performed first by the contracting authority itself which issued the decision subject to be reviewed and then by the Commission for Control of Public Procurement, the second tier of the administrative review process.

A complaint may be logged before the Commission only after the remedy before the contracting authority has been exhausted. The Commission is an independent and autonomous entity. In 2007, the Commission received 170 complaints, of which 55 were accepted, 92 refused and 23 rejected⁴⁵. These decisions are publicly accessible in the Commission's website.

Moreover, the PPL requires the Commission to reach a decision within 15 days; in 2007, the Commission's decisions were issued on average within 12 days. After the completion of the administrative process, aggrieved parties may resort to judicial remedies at the Administrative Court. In 2007, the Court issued 20 decisions: 12 complaints were refused thus confirming the decision of the Commission; and 8 were accepted thereby overruling the decision of the Commission.

Overall, the complaint system operates satisfactorily at the Commission tier. However, there is a concern that the number of complaints submitted could underestimate the extent of the dissatisfaction with the procurement processes carried out by the contracting authorities. Discussions with the private sector suggest that the submission of a complaint by a company before a contracting authority (the first tier) could result in its "de facto" exclusion from future procurement processes. This finding was also reported by SIGMA in its 2008 report on the public procurement system in Montenegro. Given the small size of the Montenegrin economy and the consequent small number of domestic market participants, the threat of exclusion from procurement processes by the contracting authorities and lack of confidence in the complaints system is thought significantly to deter companies from submitting complaints.

⁴⁴ SIGMA 2008 Report on the Montenegro Public Procurement System.

⁴⁵ In accordance with the PPL, complaints may be rejected if they are unlawful, untimely submitted and or submitted by unauthorized persons.

Addressing this problem the Commission has launched programs aimed at developing private sector's awareness and confidence of it right as bidders. It includes training and workshops. Furthermore, the Commission is preparing a publication, to be financed by the World Bank, on protection of suppliers' rights and the public interest aimed at building contracting authority capacity on remedies and building private sector awareness of the right to submit lawful complaints.

The Commission has enhanced the transparency, accountability and predictability of its own decisions by making them fully accessible to the public, and publishing a compilation of these decisions in a yearly report. This compilation is considered as a good practice.

With regard to the first tier of the administrative review process, which is not within the Commission's legal scope, there is a need to develop actions targeting private sector's perception of a possible retaliation by the contracting authorities when they submit complaints.

The Commission may wish to consider designing and conducting surveys of private sector perceptions of the remedy system as a means to monitor the effectiveness of efforts to target private sector concerns about possible retaliation by the contracting authorities when they submit complaints. Furthermore, consolidated information of the number of complaints submitted to, reviewed and decided by the contracting authorities needs to be collected and evaluated.

Notwithstanding the positive overall score for this performance indicator, there is a concern that the score may not fully reflect the current status of the public procurement reform system in Montenegro. A more detailed assessment such as a Base Line Indicator Study in accordance with the OECD-DAC-World Bank procurement diagnostic tool may help to clarify the situation.

PI 20: Effectiveness of internal controls for non-salary expenditure

PI 20	Scoring method M1: (i) Commitment control systems are weak. (D) (ii) Other internal control rules/procedures consist of a basic set of rules for processing and recording transactions, which are understood by those directly involved in their application. (C) (iii) Compliance with rules is fairly high, but simplified / emergency procedures are used occasionally without adequate justification. (B)	D+
-------	--	----

Three dimensions are to be assessed (Scoring Method M2):

- (i) Effectiveness of expenditure commitment controls
- (ii) Comprehensiveness, relevance and understanding of other internal control rules/ procedure
- (iii) Degree of compliance with rules for processing and recording transactions

In respect of each dimension:

- (i) *Effectiveness of expenditure commitment controls*

The Treasury system prevents spending units from submitting payment requests that would result in them exceeding their funds warrants. (Funds warrants are issued to spending units effectively in respect of each calendar-month based on an annual plan consistent with the annual appropriations in the Budget Law. At the start of every month, spending units submit so-called “reservations” to Treasury by which they effectively specify the use they intend to make of the funds warrants issued to them. Payment requests submitted by spending units to Treasury are matched to “reservations” prior to payment). However, commitments per se, being the government’s payment obligations, are not captured in the Treasury system. Rather, it is left to the spending unit to record and manage commitments but this does not in practice appear to happen. It is therefore possible that spending units may incur commitments in excess of available funds warrants issued to them but will “manage” this issue by delaying payment until they have sufficient funds warrants available. Thus, the government is not able properly to determine whether its payment obligations remain within the limits of projected cash availability, thereby avoiding arrears. The Ministry of Finance receives information on commitments from spending units on a quarterly basis and from funds and municipalities on a monthly basis.

(ii) Comprehensiveness, relevance and understanding of other internal control rules/procedures

The [Organic] Budget Law together with Treasury Regulations, the Instruction on Accounting and Chart of Accounts for Budget and Extra-Budgetary Funds and the Chart of Accounts are the main documents which specify the internal control rules and procedures. These instructions are comprehensive as far as processing transactions through the Treasury systems are concerned. However, these documents are general to all budget institutions and do not contain sector-specific instructions.

It is understood that some spending units have issued additional sector-specific instructions which operate in addition to the three main documents but the development and issuance of such sector-specific instructions is left to the discretion of the relevant ministry. For example, both the Tax and Customs Administrations appears to have a considerable set and degree of documentation of their internal procedures and processes. However, the sector-specific controls and procedures which operate in the Ministry of Education and Science (MES) in relation to the expenditures of schools and other educational facilities, a considerable proportion of which are ultimately paid through systems other than Treasury (e.g. through the schools’ systems), are not documented. The operation of the MES systems and enforcement of controls over those systems are therefore reliant upon the institutional memories of the staff of the MES and its subordinate institutions. Similarly, the Health Fund’s specific procedures and control are also not documented. Consistent with the above, the State Audit Institution’s 2007 report notes that, contrary to the requirements of the Law on Property of Montenegro, there are no by-laws for the maintenance of records relating to state property. A new Law on State Property is expected shortly which may address the above issues.

Thus, in general, systems’ procedures and controls are not documented thus leading potentially to inconsistent application of procedures and controls but also preventing a proper analysis of the internal control framework pertaining to those systems.

(iii) Degree of compliance with rules for processing and recording transactions

The State Audit Institution’s 2007 report on the 2006 Annual Budget Report suggests that rules for processing and recording transactions are not always respected. For example, the report suggests: (i) the Ministry of Finance does not keep an accurate register of advance deposits; (ii) claims for budgetary spending and payment are being signed by only one person rather than

two; (iii) some spending units do not authorize expenditures within the prescribed time limit; and (iv) payments in respect of the Health Fund were authorized by the competent ministry rather than the Fund. In addition, the State Audit Institution made other observations of non-compliance in its other audit reports.

Consistent with the above, the 2007 Annual Report by the MOF's Internal Audit Unit noted that "accounting documentation supporting executed transactions concerning confirmations of the receipt of goods, the provision of services and completion of works is incomplete, which indicates that there are failures in observing the rules and procedures for the supervision of budgetary expenditures prescribed by the Guidelines for the Operation of the State Treasury".

Notwithstanding these observations, the State Audit Institution's 2007 report on the 2006 Annual Budget Report contained what could be interpreted as a clean audit opinion suggesting that in their opinion the compliance with rules is fairly high. Discussions with the MOF's Internal Audit Unit of the Ministry of Finance also suggest that compliance with rules is generally good.

PI 21 Effectiveness of internal audit

PI 21	Scoring method: M1 (i) Internal audit is operational for some entities but does not generally meet recognized professional standards. (C) (ii) Reports adhere to a fixed schedule and are distributed to the audited entity, Ministry of Finance and the SAI. (A) (iii) A fair degree of action is taken by managers but follow-up by the internal audit unit is not timely. (C)	C+
-------	---	----

Three dimensions are to be assessed (Scoring Method M1):

- (i) Coverage and quality of the internal audit function
- (ii) Frequency and distribution of reports
- (iii) Extent of management response to internal audit findings

The Budget Law includes an entire section on internal audit. It empowers the Ministry of Finance (MOF) to perform internal audits of spending units and municipalities using internal auditors in accordance with appropriate MOF-prescribed procedures. In December 2003, and compliance with the internal audit provisions of the Budget Law, the MOF established a single Internal Audit Unit within the structure of the MOF comprising, as at the time of this PEFA assessment, eight staff. In February 2004, after technical assistance from USAID, the MOF adopted an Internal Audit Charter and an Internal Audit Manual.

In addition, the Tax and Customs Administrations as well as the Health Insurance Fund have internal control departments that, notwithstanding the specific names of these departments, seem to function as internal audit units. More specifically, they have rules and procedures by which they assess the effectiveness of the operations of their respective administrations and subordinate health sector institutions.

In December 2006, consistent with the European Commission's recommendations, the Government of Montenegro (GOM) adopted the Action plan for implementation of

recommendations from the draft European Partnership, which in turn required the Ministry of Finance (MOF) to prepare a Public Internal Financial Control Strategy (PIFC Strategy). Subsequently, in the GOM's 2007 Program of Work, it was proposed that the MOF would prepare a PIFC Policy Paper. In December 2007, after technical assistance from OECD SIGMA, the Government adopted a PIFC Strategy Paper based on the EU model of PIFC, the implementation of which started in January 2008 and is foreseen to extend through 2013. Following on from the PIFC Strategy Paper the government adopted a Public Internal Financial Control Law (PIFC Law) in late 2008 and created a so-called Central Harmonization Unit (CHU) in the Ministry of Finance responsible for the coordination of all PIFC issues including internal audit. The CHU is developing secondary legislation including a decree on internal audit, a rulebook on internal audit and a rulebook on financial control. .

In respect of each dimension:

(i) Coverage and quality of the internal audit function

The Internal Audit Manual as used by the MOF's now former Internal Audit Unit (which predates the CHU) appears very comprehensive. It is based on and includes references to the professional standards of the Institute of Internal Auditors (IIA). Additionally, the MOF's Internal Audit Unit has a copy of the full set of IIA standards albeit in the Serbian language rather than in the Montenegrin language. However, due to the small number of internal auditors, it is understood that the manual and IIA standards are not applied in their entirety in every audit including the application of systems-based audits. Whilst the MOF's Internal Audit Unit performs audits of expenditures in the ordinary course of its work, it has not audited revenues since 2004.

As discussed above, the Tax and Customs Administrations as well as the Health Insurance Fund have internal control departments that, notwithstanding the specific names of these departments, seem to function as internal audit units. However, they do not follow recognized standards on internal auditing. Rather, they comply with their own internal rules and procedures by which they assess the effectiveness of the operations of their respective administrations and subordinate health sector institutions.

(ii) Frequency and distribution of reports

All internal audit units, including the MOF Internal Audit Unit as well as those of the Tax and Customs Administrations as well as the Health Insurance Fund, as a matter of course always issue a report after every internal audit assignment, finalize such reports only after discussion and agreement with the audited entity and distribute the finalized report to the management of the audited entity. The MOF Internal Audit Unit additionally distributes its reports to the Minister of Finance. If requested by the State Audit Institution (SAI), the MOF's Internal Audit Unit shares any requested report with the SAI. In any event, the SAI annually requests and thus the MOF's Internal Audit Unit annually shares all its internal audit reports with the SAI.

(iii) Extent of management response to internal audit findings

All the internal audit units were of the view that most recommendations and findings are acted upon by the management of the audited entity. During subsequent internal audits of an entity, the internal audit units check whether compliance has been achieved although this is not always documented. However, in view of the small number of internal auditors, particularly of the MOF's Internal Audit Unit, the number and frequency of repeat internal audits is rather low – of the 21 internal audits performed by the MOF Internal Audit Unit in 2007, only one institution had also been audited in 2006. Thus, and as acknowledged by the MOF Internal Audit Unit, it has not to-date been possible and indeed was not standard practice for the unit to follow-up on

the implementation of its recommendations in a timely manner. The implementation of the PIFC Strategy is expected to result in an improvement of this situation.

3.5. Accounting, recording and reporting

PI 22: Timeliness and regularity of accounts reconciliation

PI 22	Scoring method M2: (i) Bank reconciliations for all central government bank accounts take place at least monthly at aggregate and detailed levels. (A) (ii) Suspense accounts are cleared very quickly and the process for the clearance of advance accounts appears very well controlled. (A)	A
-------	--	---

(i) Regularity of bank reconciliations

There are four main types of bank accounts operated by central government. The regularity with which each of them is reconciled is discussed below.

1. Treasury operates a Treasury Single Account comprising one bank account at the Montenegrin Central Bank into which all Budget revenues flow and from which all Budget expenses are paid. The Treasury Single Account is reconciled daily and electronically with statements received from the Central Bank.
2. As discussed in respect of performance indicator 15(ii), the revenue collection agencies hold and manage “virtual” accounts held at the Central Bank for the purposes of revenue collection. These are reconciled daily.
3. In the education sector, education institutions financed by the Budget (including schools), being separate legal entities, own and manage their own bank accounts held at commercial banks into which Budget funds are received for expenditures already scrutinized and approved by the Ministry of Education and Science and from which those same expenditures are paid. These bank accounts are reconciled monthly within four weeks of the month-end.
4. In the health sector, the Health Insurance Fund (HIF) operates five bank accounts held at commercial banks into which mandatory health insurance contributions as collected by the Tax Administration are received and from which HIF expenditures are paid. The HIF in turn transfers funds from its five bank accounts to the bank accounts of its subordinate health institutions (also held at commercial banks) so that these health institutions may pay for their expenditures. All these bank accounts are reconciled monthly within four weeks of the month-end.

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

The strict operation of the Treasury Single Account ensures that there are no suspense accounts. Budget expenditures financed from the Treasury Single Account require full documentation before they can be paid from the Treasury Single Account. A review of the reconciliations of the “virtual” accounts held and operated by the revenue collection agencies indicated that they contain only a few and short-term unreconciled items.

Spending units may obtain advances for items such as business trips and small expenditures. Spending units operate an imprest cash account whereby the MOF advances an amount of cash to each spending unit sufficient to enable it to pay for expenses in cash. Imprest ceilings are

determined by the MOF after an assessment of the spending units' needs. In order to obtain a replenishment of any cash spent, spending units must submit valid expenditure claims to justify the utilization of the cash spent. At the end of every financial (calendar) year, each spending unit must return unutilized cash to Treasury together with valid expenditure claims to justify any cash spent. Although the MOF Internal Audit Unit's 2007 report noted that "cash required for the cash in-hand purposes is also released to cover financial needs that may be efficiently satisfied through the usual treasury payment system", it is understood that this process of reconciliation and clearance of the imprest suspense accounts works very well.

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

PI 23	Scoring method M1: (i) Accounting systems provide reliable information on all types of resources received by both primary schools and primary health clinics across the country and compiled into reports at least annually. (A)	A
-------	---	---

(i) Collection and processing of information to demonstrate the resources that were actually received by the most common front-line service delivery units

In the education sector, the Ministry of Education produced the budget for each school based on the most recent annual and 6-monthly budget execution data. Thus, the 2008 budget for primary schools was developed by the Ministry of Education in September 2007 based upon the 2006 Budget execution reports as well as the Budget execution reports for the six-month period ending June 30, 2007. However, these budgets are neither developed together with nor shared with the primary schools. This may be because the education sector budget process serves more to formulate an aggregate education budget rather than at the level of disaggregated individual schools. In terms of budget execution, as discussed above with respect to performance indicator PI-22(i), education institutions financed by the Budget (including schools), being separate legal entities, own and manage their own bank accounts held at commercial banks into which Budget funds are received for expenditures already scrutinized and approved by the Ministry of Health and from which those same expenditures are paid. As discussed above with respect to performance indicator 18, each education institution prepares a monthly payroll computation and submits the same to the Ministry of Education (MOE). The MOE submits to Treasury a payment request for each school in the amount of the total net-of-tax salary due to its employees. Treasury makes payments to each school on the basis of the payment requests. Each school, upon receipt of the funds in its own bank account, transfers the appropriate net-of-tax salaries to its employees in accordance with the monthly payroll computation. Thus, both the Ministry of Education and the individual education institutions are fully aware of the expenditures actually financed by Budget. Full reports are prepared quarterly by each education institution and reconciled by the Ministry of Education with the Budget execution data.

In the health sector, the Health Insurance Fund (HIF) together with its subordinate health institutions jointly prepare annual budgets for each institution based on estimated workload and minimum staffing and operational activities required to sustain that workload. As discussed above with respect to performance indicator PI-22(i), the HIF transfers funds to the bank accounts of its subordinate health institutions so that these health institutions may pay for their expenditures. Full reports are prepared quarterly by each health institution and reconciled to the transfers made to them by the HIF.

PI 24: Quality and timeliness of in-year budget reports

PI 24	Scoring method M1: (i) Classification of data allows direct comparison to the budget. Expenditure is covered at the payment stage only (i.e. there is no information about commitments). (C) (ii) Reports are prepared quarterly or more frequently and issued within four weeks of the period-end. (A) (iii) There are no material concerns regarding data accuracy. (A)	C+
-------	--	----

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

Budget revenue and execution reports enable a comparison with the original budget although the reports themselves only present the latest revised budget (even though the Ministry of Finance maintains information on the original budget within its Treasury systems which would allow it to present the original budget in its reports). The Ministry of Finance makes public the budget outturn reports at a consolidated level rather than at the full level of detail as presented in the original budget. As discussed above with respect to indicator 20(i), commitments are not systematically captured in the Treasury system at the time obligations are incurred. Rather, it is left to spending units to record and manage commitments. The Ministry of Finance receives information on commitments from spending units on a quarterly and annual basis but these are not published. Consistent with this, budget outturn reports do not disclose expenditures at the commitment stage but rather only disclose expenditures at the payment stage.

(ii) Timeliness of the issue of reports

Budget reports were produced monthly but it is understood that since January 2008 they are now produced quarterly. The consolidated reports appear to have been made public within one month of the period-end.

(iii) Quality of information

There are no noted material concerns regarding data accuracy. The State Audit Institution's 2007 report on the 2006 Annual Budget Report contained what could be interpreted as a clean audit opinion suggesting that in their opinion the quality of information is fairly good.

PI 25: Quality and timeliness of annual fiscal statements

PI 25	Scoring method M1: (i) The budget execution statement is prepared annually but is not complete in respect of financial assets and liabilities. (C) (ii) The statement is submitted for external audit within six months of the end of the fiscal year. (A) (iii) Statements are presented in a consistent format in accordance with consistent accounting	C+
-------	--	----

	standards. (C)	
--	----------------	--

(i) Completeness of the financial statements

The annual budget execution report is produced by Treasury in compliance with Articles 26 and 51 of the Organic Budget Law on the basis of budget execution as performed through the Treasury Single Account. It follows the format of the annual budget and includes revenues and expenditures, on a cash basis, as well as supplementary information on programs, debts and guarantees. There is also additional statistical information. However, as discussed below with respect to dimension (iii), the information is not complete in respect of financial assets and liabilities.

(ii) Timeliness of submission of the financial statements

In accordance with the [Organic] Budget Law, the Ministry of Finance is required to prepare a draft budget execution statement (aka “draft final account”) and submit the same to Government by June 1 in respect of the year ended December 31. The Government, in turn, after a period of internal discussion, is obliged to submit the final budget execution statement (aka “final account”) to Parliament by the end of July together with the audit report from the State Audit Institution (SAI). The latest available budget execution statement was in respect of the year ending December 31, 2006. The MOF produced the draft budget execution statement at end-May 2007 and the Government forwarded the final budget execution statement to Parliament on July 27, 2007 together with the audit report from the SAI. Although there was no formal submission by the Government to the SAI of the draft or final budget execution statements, the SAI received a copy of the end-May draft budget execution statement in order that it could complete its audit in time for Government to satisfy its end-July reporting obligation to Parliament.

(iii) Accounting standards used

There is no clear reference in the annual financial statements to the accounting standards used for preparation of the financial statements. The format of the annual budget execution statement is thought to have originated from a combination of the Rulebook on the Preparation of Annual Accounts, the Rulebook on the Unified Classification of Accounts and a project to improve the quality of Government’s financial reporting and bring it closer to International Public Sector Accounting Standards (IPSAS), particularly Cash Based IPSAS. The format then developed over time to incorporate additional information requirements and remove redundancies without a clear reference to any specific set of accounting standards or financial reporting framework.

The financial statements do not show compliance with accrual based IPSAS even at the most general level. The financial statements comprise cash receipts and payments (supplemented with analytical presentations of those categories e.g. by user), and do not include a complete set of statements prescribed by IPSAS 1 “Presentation of Financial Statements”, which ought to comprise (i) a statement of financial position (ii) a statement of financial performance (iii) a statement of changes in net assets/equity and (iv) a cash flow statement. This effectively means that the annual budget execution report contains no information on financial assets or liabilities.

Although the financial statements to a certain extent correspond to cash based IPSAS, there is not full compliance due to a number of departures from the provisions of the standard. Whereas financial statements do appropriately present cash receipts and payments, with line items classified to high degree consistent with cash based IPSAS, and they include information on both budgeted and actual figures (albeit with no direct comparison i.e. difference is not presented on the face of the financial statements), they still depart from cash based IPSAS in

various areas, including: (i) comparative figures are not presented; (ii) no separate column for payments by third parties; and (iii) although analytical presentation does provide further details of a number of specific line items of cash receipts and payments, notes to financial statements are not presented in accordance with IPSAS. There is no reference to accounting policies and basis of preparation. It is considered that the data required for production of financial statements in accordance with IPSAS is readily available in various government financial data collection systems; however, the financial statement as currently presented do not conform with IPSAS.

3.6. External scrutiny and audit

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

PI 26	<p>Scoring method M1:</p> <p>(i) Central government entities representing at least 50% of total expenditures are audited annually. Audits predominantly comprise transaction level testing, but reports identify significant issues. (C)</p> <p>(ii) The audit report on the annual budget execution statement is submitted to legislature within eight months of receipt by the audit office but other audit reports may be submitted to legislature significantly after the end of the period audited (B)</p> <p>(iii) There is clear evidence of effective follow-up on audit recommendations (B)</p>	C+
-------	--	----

The country's Supreme Audit Institution, the State Audit Institution (SAI) of Montenegro, is a relatively new institution having been established in April 2004. Its status is guaranteed in the Constitution of Montenegro. Parliament appoints the five-member Senate which in turn is responsible for the management of the SAI. It is governed primarily by a Law on the SAI; however, references to the SAI are also included in the [Organic] Budget Law. The SAI comprises around 25 staff including 14 auditors who have passed an internally-administered professional examination. Since July 2002, it has been receiving technical assistance from GTZ, the continued status of which is unclear. It has yet to develop a medium- or long-term strategy for its further development. It recently became a member of both INTOSAI and EUROSAI.

Dimensions to be assessed:

- (i) Scope/nature of audit performed (including adherence to auditing standards)
- (ii) Timeliness of submission of audit reports to legislature
- (iii) Evidence of follow-up on audit recommendations

(i) Scope and nature of audit performed

The SAI represented that it performs audits in accordance with its Instruction on the Methodology of Work of the SAI and its Rules of Procedures both of which require audits to be

conducted in accordance with INTOSAI auditing standards. However, and as already recognized by the SAI⁴⁶, whilst the Instruction and Rules of Procedures contain the basic elements of a sound audit approach, there is no detailed audit manual to describe the detailed implementation procedures including, for example, the method in which audited entities' systems should be documented and evaluated, how audit risks should be identified and how samples should be selected. Thus, and although a review of an SAI audit file suggested that the SAI performs audits in a well thought-out manner, in the absence of a detailed audit manual and demonstrated compliance with that manual, it is not possible to be confident that audits are indeed performed in a manner consistent with recognized professional auditing standards. According to the SAI, due to time and resource constraints, it audits entities on a rotation basis and in any one year it audits entities that account for around 70% of consolidated public expenditures.

(ii) Timeliness of submission of audit reports to the legislature

In accordance with the [Organic] Budget Law, the Government is required to attach an audit report from the SAI on the annual budget execution statement ("final account") and submit both to Parliament as one package by the end of July. At the time of the data collection visit in May 2008, the latest available audit report from the SAI on an annual budget execution statement was in respect of the year ending December 31, 2006. The MOF produced its first draft of the annual budget execution statement at end-May 2007; the SAI submitted its audit report on the annual budget execution statement to the MOF on July 24, 2007; and the Government duly attached this audit report to the annual budget execution statement and forwarded the entire package to Parliament on July 27, 2007.

Additionally, in accordance with the Law on the SAI, the SAI is required to submit an annual report on its activities to Parliament by the end of October. In practice, the SAI's annual report is a compilation of its report on the annual budget execution statement together with other audit reports it issued since the SAI's last annual report. The SAI is not obliged to and chooses not to submit these other audit reports formally to Parliament except within its annual report. However, these other audit reports are publicly available from the SAI once approved and therefore Parliament, should it wish to do so, can review them independently of when they are formally submitted by the SAI within the compiled annual report. The latest available annual report from the SAI covered its activities from October 2006 through October 2007, included audits relating to the period ending December 31, 2005, and was submitted to Parliament in October 2007. Given that the SAI performs audits throughout the year, it is possible that audits reports are formally shared with Parliament only after a considerable period of time has elapsed.

On balance, given the two sets of deadlines for reporting to Parliament but recognizing the greater importance of the SAI's audit report in respect of the annual budget execution statement as well as the fact that the other audit reports are publicly available despite not being formally shared with Parliament prior to the annual report, this dimension is rated B.

(iii) Evidence of follow-up on audit recommendations

All audits reports issued by the SAI contained audit recommendations. The management of the audited entities appears to respond to all recommendations - including the Ministry of Finance in respect of the SAI's recommendations flowing from its audit of the annual budget execution statement. In subsequent audits, the SAI appears diligently to follow-up on its recommendations. Indeed, in its annual report to Parliament, the SAI comments specifically on the follow-up or implementation of the recommendations it made in its previous annual report. However, given the demonstrated significant elapsed time between the end of the period

⁴⁶ Refer to section 3.32.1.2 of the April 2008 draft National Program for Integration of Montenegro into the EU (NPI) for the Period 2008-2012

audited and the date the audit report is issued (the SAI's October 2007 annual report covering its activities from October 2006 through October 2007 included audits relating to the period ending December 31, 2005), it is not clear that all audit recommendations are made and followed-up on a timely basis.

In line with the approach to (ii) above, and recognizing the greater importance of the SAI's audit report in respect of the annual budget execution statement than its other reports, this dimension is rated B.

PI 27: Legislative scrutiny of the annual budget law

PI 27	<p>Scoring method M1:</p> <p>(i) The legislature's review covers fiscal policies and aggregates for the coming year as well as detailed estimates of expenditures and revenues. (B)</p> <p>(ii) The legislature's procedures are well-established and respected. (B)</p> <p>(iii) The legislature has one month to respond to budget proposals. (B)</p> <p>(iv) Clear rules exist for in-year budget amendments by the executive but they allow extensive administrative reallocations. (B)</p>	B
-------	---	---

This indicator addresses the work of Parliament in considering the Government's budget proposals. (Note that the materials provided by the Government in support of its proposals are covered in PI-6). This indicator is scored using Method M1. The dimensions to be assessed are:

- (i) Scope of the legislature's scrutiny
- (ii) Extent to which the legislature's procedures are well-established and respected
- (iii) Adequacy of time for the legislature to respond to budget proposals
- (iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature

(i) Scope of the legislature's scrutiny

The PEFA criteria require consideration of whether the scope of the legislature's examination extends to fiscal policies, the medium-term fiscal framework and medium-term priorities as well as details of revenue and expenditure.

In accordance with the [Organic] Budget Law, the government is obliged only to submit the proposed Annual Budget to Parliament⁴⁷ and the Annual Budget comprises only: an estimate of inflows and outflows by economic classification for current and capital expenditures; a normative part regulating the execution of the budget; the usage of surplus and the cover of deficit; the current and permanent budgetary reserve; as well as a specific part detailing the

⁴⁷ In accordance with Article 24 of the [Organic] Budget Law

expenses of spending units according to organizational, functional, program and project classification with sources of funding⁴⁸. In addition, the legislature only receives the proposed Annual Budget by end-November⁴⁹ in respect of the fiscal year beginning the following January and the budget needs to be adopted by end-December. Thus, the legislature is not explicitly afforded the opportunity to scrutinize fiscal policies, the medium-term framework and medium-term priorities. The legislature's review of the proposed Annual Budget occurs only at a stage where detailed proposals have been finalized and with only one month to complete the review. Finally, given both the amount of work expected of the relevant legislative committee⁵⁰ and that its secretariat comprises only two full-time staff, it is clear that there is not enough capacity within the legislature to perform either a detailed analysis of the proposed budget.

In respect of the proposed 2008 budget, the Parliamentary Committee on Economy, Finance and Budget received the Annual Budget from the Government on November 22, 2007. The Committee met over four non-contiguous days in December (December 13, 17, 24 and 26) with representatives of government (primarily from the MOF) as well as the SAI, think-tanks, non-governmental organizations (NGOs) and foundations. Notwithstanding the narrow scope of the budget documentation that the Government is required to submit to the legislature, the minutes of the Committee discussions indicate that the Committee considered all parts of the budget documentation including fiscal policies. However, the minutes also noted the Committee's dissatisfaction with the period of time available to it to scrutinize the budget documentation, its desire to be involved in the budget formulation process at an earlier stage, its desire in future periods to be able to discuss the budget in more detail with competent ministry representatives including those from line ministries, and its proposal to include other Parliamentary committees in future discussions of annual budget documentation.

(ii) Extent to which the legislature's procedures are well-established and respected

As discussed above with respect to dimension (i), government is required by the [Organic] Budget Law to submit the Annual Budget to the legislature by end-November. In addition, there are rules governing the scope and operation of the relevant legislative committee⁵¹. Thus, the procedures are simple and appear to be both well-established and respected. However, and as discussed above with respect to dimension (i), the effective role of the legislature in the formulation of the Annual Budget is rather limited.

(iii) Adequacy of time for the legislature to respond to the Government's proposals

As discussed above with respect to dimension (i), the legislature only receives the proposed Annual Budget by end-November⁵² in respect of the fiscal year beginning the following January and the budget need to be adopted by end-December. Thus, the legislature has around one month to review the proposed Annual Budget. In accordance with the PEFA Secretariat's *Clarifications to the PFM Performance Measurement Framework* dated September 2008, this dimension is rated B because the other dimensions of this indicator score B.

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

⁴⁸ In accordance with Article 26 of the [Organic] Budget Law

⁴⁹ In accordance with Article 24 of the [Organic] Budget Law

⁵⁰ The Parliamentary Committee on Economy, Finance and Budget

⁵¹ Rulebook on Parliament. Article 43 relates to the Committee on Economy, Finance and Budget.

⁵² The proposed 2008 Annual Budget was received by Parliament from Government on November 22, 2007.

The PEFA scoring envisages that there should be clear limits on the extent to which the executive can change or reallocate the Budget in the course of its execution. The [Organic] Budget Law⁵³ permits Government to reallocate appropriations among spending units by up to 10% and further permits spending units, with the approval of the Ministry of Finance, to reallocate up to 10% between programs and expenditure. In addition, the [Organic] Budget Law permits Government to redirect unused funds only to debt repayment, capital expenditure projects and reserves.

PI 28: Legislative scrutiny of external audit reports

PI 28	<p>Scoring method M1:</p> <p>(i) Scrutiny of audit reports is usually completed by the legislature within six months from the receipt of the reports (B)</p> <p>(ii) In-depth discussions are not conducted by the legislature of the external audit reports (D)</p> <p>(iii) The recommendations endorsed by the legislature are followed-up and implemented. (A)</p>	D+
-------	--	----

This Indicator examines the handling of external audit reports by the legislature. Three dimensions are assessed:

- (i) Timeliness of examination of audit reports (for reports received within the last three years)
- (ii) Extent of hearings on key findings
- (iii) Issuance of recommended actions by the legislature and implementation by the executive

(i) Timeliness of examination of audit reports

As discussed within the context of PI-26(ii), in accordance with the [Organic] Budget Law, the Government is required to attach an audit report from the SAI on the annual budget execution statement (“final account”) and submit both to Parliament as one package by the end of July. Additionally, in accordance with the Law on the SAI, the SAI is required to submit an annual report on its activities to Parliament by the end of October, the SAI’s annual report being, in practice, a compilation of its report on the annual budget execution statement together with other audit reports it issued since the SAI’s last annual report. The SAI is not obliged to and chooses not to submit these other audit reports to Parliament except within its annual report.

In respect of the year ending 2006, the Government attached a copy of the SAI’s audit report on the annual budget execution statement to the annual budget execution statement and forwarded the entire package to Parliament on July 27, 2007. The Parliamentary Committee on Economy, Budget and Finance discussed both the SAI’s audit report on the 2006 annual budget execution statement as well as the SAI’s 2007 annual report on its activities on October 29, 2007. Thus, the SAI’s audit report on the 2006 annual budget execution statement was discussed after a period of three months and two days from its receipt by the legislature. In part, this delay was attributable to the discussion of the new Constitution that took place around the same period. However, the SAI’s annual report on its activities was discussed within one month of the day of its receipt.

⁵³ In accordance with Article 35 of the [Organic] Budget Law

(ii) Extent of hearings on key findings

It would appear from the minutes of the discussions by the Parliamentary Committee on Economy, Budget and Finance that the discussions are not in-depth. Discussions lasted only four hours and did not include discussions of key findings with the responsible officers of the audited entities. The Committee appeared instead to rely heavily on the opinion and presentations of both the MOF and the SAI. In addition, and as discussed within the context of PI-27 (i), given both the amount of work expected of the committee and that its secretariat comprises only two full-time staff, it is clear that there is not enough capacity within the legislature to perform a detailed analysis of the external audit reports.

(iii) Issuance of recommended actions and their implementation by the executive

The Parliamentary Committee on Economy, Budget and Finance routinely endorses the recommendations made in the SAI's audit reports. The minutes of the Committee's discussions of the SAI's audit report on the 2006 annual budget execution statement as well as the SAI's 2007 annual report noted the Committee's endorsed the recommendations made by the SAI. The routine nature of these endorsements coupled together with the absence of additional recommendations, in part reflects the lack of capacity of the committee and that its secretariat as discussed earlier. As discussed within the context of PI-26(iii), the management of the audited entities appears to respond to all recommendations made by the SAI and, in subsequent audits, the SAI appears diligently to follow-up on its recommendations and, in its annual reports, specifically comments on the follow-up or implementation of the recommendations it made in its previous annual report. Thus implicitly, legislature follows-up on the implementation of recommended actions.

3.7. Donor practices

D 1: Predictability of direct budget support

D 1	Scoring method M1: Montenegro does not receive any direct budget support. Accordingly, D-1 is neither applicable nor assessed	N/A
-----	--	-----

There are two dimensions that are scored for this donor indicator:

- (i) Annual deviation of actual budget support from the forecast provided by donor agencies at least six weeks prior to the government submitting its budget proposals to the legislature (or equivalent approving body).
- (ii) In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates)

Montenegro does not receive any direct budget support. Accordingly, D-1 is neither applicable nor assessed.

D 2: Financial information provided by donors for budgeting and reporting on project and program aid

D 2	<p>Scoring method M1:</p> <p>(i) Financial donors provide complete budget estimates for disbursement of project aid at stages consistent with the Government's budget calendar. However, non-financial donors do not provide such information. (C)</p> <p>(ii) Financial donors provide disbursement reports on request (normally via the Internet). However, non-financial donors do not provide such information. (C)</p>	C
-----	---	---

There are two dimensions that are scored for this donor indicator:

- (i) Completeness and timeliness of budget estimates by donors for project support.
- (ii) Frequency and coverage of reporting by donors on actual donor flows for project support.

In respect of each dimension:

(i) Completeness and timeliness of budget estimates by donors for project support.

With respect to donations and projects financed in cash, the Annual Budget is the only authority by which spending units may spend funds. Thus, not only budget funds but also preferential loans and credits from development agencies as well as financial grants and donations from other sources need to be included within the Annual Budget in order that spending units may utilize these funds. This is reinforced by the operation of a Treasury Single Account and the central role of the MOF in compiling and implementing the Annual Budget as well as negotiating all loans and credits. The MOF's starting point for the annual appropriation of credits and loans are the signed loan and credit agreements as well as discussions with the spending units and donors. However, it is the MOF rather than the donor working alone who leads the discussion and defines how much of the total loan or credit will be drawn down in any one year. Accordingly, spending units are generally very good at obtaining budget estimates for donor-financed projects (other than for in-kind donations and projects) for inclusion within the Annual Budget.

The picture is considerably different in respect of in-kind (i.e. non-cash) donations and projects. The Government receives very little information in respect of in-kind donations and projects even though their values are likely to be quite significant. Thus budget and reporting comprehensiveness is undermined.

(ii) Frequency and coverage of reporting by donors on actual donor flows for project support.

With respect to donations and projects financed in cash, as discussed in respect of performance indicator 17, government foreign debt is recorded in the Debt Tracker system in the MOF's Debt and Cash Flow Management department. The records are regularly updated from creditor information on disbursements and payment advices and information in the system is compared with the payment advices. Since the loans mainly have semi-annual debt service payments this control is conducted twice a year for every loan. Financial grants are recorded in the Budget as received and are also managed by the MOF's Debt and Cash Flow Management department. The information provided by donors is sufficient to enable the MOF to reconcile its internal records with those of the donors.

As discussed above with respect to dimension (i), the Government receives very little information in respect of in-kind donations and projects. Although a database for the collection of information in respect of in-kind donations at the Department of European Integration has been devised with the assistance of the UNDP, this database is not yet operational.

D 3: Proportion of aid that is managed by use of national procedures

D 3	Scoring method M1: Aid is mainly managed by use of each development partners' individual procedures.	D
-----	---	---

This indicator is scored on the basis of assessments made by individual development partners and the GOM without quantitative data. Information on the proportion of aid that is managed by the use of national procedures is neither regularly collected by the government nor easily obtained specifically for the purpose of this PEFA assessment. However, unanimous representations from the GOM as well as from development partners suggest that the majority of aid is not managed by use of national procedures. Rather, it is the procedures of the various development partners that are applied.

4. Government reform process

This section aims to draw together the different strands of PFM reform activity in Montenegro, referring as appropriate to the discussion of the detailed indicators in Chapter 3.

Eventual membership of the EU is Montenegro's central priority. The signing of the Stabilization and Association Agreement (SAA) with the European Community in October 2007 was major step in the process and the National Program for Integration (NPI) to the European Union represents a comprehensive picture of reforms and activities that will be carried out in the first three years following the SAA. In mid-December 2008 Montenegro submitted the formal application for EU membership that was confirmed by the EU Council in early April 2009. Given the EC-focused reform efforts coupled with both the size of the funds allocated by the EC to Montenegro (€ 31.4 million was allocated in 2007) and the fact that the EC's Montenegro 2007 Progress Report⁵⁴ noted "a number of structural problems affect the performance of the public administration", there would appear to be considerable opportunities for EC-sponsored and -financed PFM reform.

The EC's Instrument for Pre-Accession Assistance (IPA) programs for 2007 and for 2008 include financing for the enhancement of management capacities and attainment of European standards in public procurement. The IPA 2009 program will include financing to support the SAI.

The Government of Montenegro and other institutions responsible for the country's public financial management systems have a successful track record of implementing PFM reform programs including: 1) establishing the State Audit Institution, a Directorate for Public Procurement and the Commission for Supervising the Process of Public Procurement; 2) introduction of medium-term budgetary framework and capital budgeting for which a number of strategies and laws were adopted; 3) consolidation of the budgetary structure by inclusion of former extra budgetary funds into state budget, as well as by the inclusion of regulating agencies and public enterprises into the Memorandum to the Annual Budget Law, 4) introduction of program budgeting with the aim of introducing it in all administrative units for the 2009 Annual Budget Law, 5) improvement of public debt management that resulted in reduction of public debt at the end of 2007 to €737.2 million or 29% of GDP (although liabilities based on restitution and repayments of frozen and other foreign exchange savings, as well as on pension arrears resulted in a significant increase of public debt); 6) the adoption of a new Law on State Property which defines use, management and disposition of assets and other goods owned by the state of Montenegro or local self-government and which will provide for better current and capital budget planning at both central and local levels; 7) Amendments to the Law on Excise that provided further harmonization with the EU Directives in regard to excises on tobacco products, alcohol beverages and taxation of energy generating products and electric power; 8) the continued work of Tax Administration to integrate data collection for income tax and social contributions, strengthen control and enforcement functions, centralize tax registries, and restructure the organization of the Tax Authorities; 9) amendments to the Customs Law to harmonise existing provisions with the EU *acquis*; 10) establishing a Coordination Committee comprising five ministers, four mayors and a representative of the Union of Municipalities to coordinate and monitor decentralization and reform of local self-government; 11) the public awareness and PR activities undertaken by both the Directorate for Public Procurement and the Commission for Public Procurement which include the publication

⁵⁴ The European Commission Staff Working Document (Brussels, 6.11.2007 SEC(2007) 1434), Montenegro 2007 Progress Report may be found at http://ec.europa.eu/enlargement/pdf/key_documents/2007/nov/montenegro_progress_reports_en.pdf

of various materials, the organization of conferences and the provision of training on the public procurement oversight process; and 12) the continued development of the State Audit Institution.

The Government of Montenegro has adopted some important reform strategies with the aim of further strengthening the PFM framework, including: Strategy of Public Administration Reform [2003], Strategy of Public Internal Financial Control [2007], and Strategy of Management of Public Debt [2008]. Other planned PFM reforms relate to planning of the budget, improvement of functional analysis and structure of the budget, capital budgeting and the adoption of a new law on public procurement which should provide for greater harmonization with relevant EU directives.

The Government recognizes the importance of sound public financial management (PFM) systems both because of the need to improve budget outcomes and control the economy's slowdown as well as the importance attaching to it by the European Commission. Over the past few years the Government and other in-country authorities have received considerable analytical, technical and other assistance from various development partners to strengthen the country's PFM systems. Primarily in recognition of the growing financial and technical support that will be made available by the European Commission to further strengthen the Montenegrin PFM systems, some development partners including USAID and GTZ are currently reconsidering their engagement in Montenegro. A PEFA assessment now will provide a useful measure of the state of the Montenegrin PFM systems at this stage of transition, the developments since the previous public financial management assessments including the CFAA and PEIR, and serve as a baseline to measure the impact of future PFM reform interventions howsoever they may be supported.

Annex 1: Performance Indicators Summary

Indicator	Brief explanation and cardinal data used	Score
1. Aggregate expenditure out-turn compared to original approved budget	From 2005 to 2007, central government expenditure (less interest payment and debt repayment) deviated respectively by 5.5%, 0.3%, and 8.3% from original budgets	B
2. Composition of expenditure out-turn compared to original approved budget	From 2005 to 2007, overall variance in expenditure composition was 3.5%, 5.4%, and 11% respectively	C
3. Aggregate revenue out-turn compared to original approved budget	Higher than anticipated economic growth driven largely by unprecedented and increasing levels of FDI and domestic credit expansion resulted in better than expected revenues and surpluses. In 2005, 2006 and 2007, domestic revenues consistently exceeded budgeted by, respectively, 29.2%, 20.5%, and 34.7%.	A
4. Stock and monitoring of expenditure payment arrears	There is no reliable data on the stock of arrears.	D
5. Classification of the budget	Budget formulation and execution is based on administrative, economic and functional classification using GFS and COFOG standards.	B
6. Comprehensiveness of information included in budget documentation	Recent budget documentation fulfils five of the nine criteria required for this indicator	B
7. Extent of unreported government operations	All funds are included within the annual budget estimates and, save for the development and restitution funds, included within in-year budget execution and annual financial statements. However, there is no system in place for reporting on income and expenditure of donor funded projects	D+
8. Transparency of inter-governmental fiscal relations	There is a transparent, clear and rule-based system in place for allocation of conditional and un-conditional transfers from central government to municipalities. Furthermore, municipalities get reliable information on their allocations from central government in a timely manner in sufficient time for their annual budget formulation process. However, consolidated general government fiscal data is produced only by economic classification despite the provision by municipalities of sector information.	B
9. Oversight of aggregate fiscal risk from other public sector entities	All major AGAs and SOEs submit fiscal reports to central government at least annually. However, a consolidated overview is missing. There is continuous central government monitoring of lower tier governments and lower tier governments are not allowed to generate fiscal liabilities for central government without prior approval.	C+
10. Public access to key fiscal information	Five out of six criteria for this indicator are met	A
11. Orderliness and participation in the annual budget process	A clear annual budget calendar exists and is generally adhered to and Parliament has, during the last three years, approved the budget before the start of the fiscal year. However, the budget circular issued to the spending units has not contained ceilings.	B
12. Multi-year perspective in fiscal planning, expenditure policy and budgeting	Three-year forecasts of fiscal aggregates are prepared based on the economic classification but not functional or organizational classification. Some sector strategies exist but are not fully reconciled with aggregate fiscal forecasts. Many investment decisions have weak links to sector strategies.	C+

Indicator	Brief explanation and cardinal data used	Score
13. Transparency of tax payer obligations and liabilities	Legislation and procedures for all major taxes are comprehensive and clear. Taxpayer access to information is readily available. There is a transparent system of procedures relating to tax appeals with appropriate checks and balances.	A
14. Effectiveness of measures for tax payer registration and tax assessment	Taxpayer databases appear complete. There are annual tax audit plans as well as a continuous program of tax audits and fraud investigations.	B
15. Effectiveness in collection of tax payments	Average debt collection is 90% or above and all tax revenues are collected into accounts controlled by the revenue collection agencies and transferred daily to Treasury. Complete accounts reconciliation of tax assessments, collections, arrears and transfers to the Treasury are performed annually.	C+
16. Predictability in the availability of funds for commitment of expenditures	Over the last two years, the Treasury has had ample liquidity, and the MOF indicates that there have been no significant spending plan adjustments or payment delays during this period.	A
17. Recording and management of cash balances, debt and guarantees	Government foreign debt is recorded in the Debt Tracker system. The records are regularly updated from creditor information on disbursements and payment advices. However, the system does not yet provide for consolidation of resources belonging to four major government funds and some foreign-financed projects.	B
18. Effectiveness of payroll controls	Personnel and payroll data are directly linked and updated monthly on the basis of clear authority. However, only partial payroll audits have been undertaken within the last three years.	C+
19. Competition, value for money and controls in procurement	Procurement is generally good - more than 89% of contracts above the low-value threshold are awarded on the basis of open competition. However, there are concerns about the robustness of the data provided by the contracting authorities as well as private sector's full confidence in the remedy process before the contracting authorities.	B
20. Effectiveness of internal controls for non-salary expenditure	Commitment control systems are generally lacking. However, there is a lack of organization-specific operational procedures which should work in addition to the general PFM body of rules and regulations, as well as a proper internal audit function.	D+
21. Effectiveness of internal audit	Internal audit is operational for some entities but does not generally meet recognized professional standards.	C+
22. Timeliness and regularity of accounts reconciliation	Bank reconciliations for all central government bank accounts take place at least monthly at aggregate and detailed levels. Suspense accounts are cleared very quickly and the process for the clearance of advance accounts appears very well controlled.	A
23. Availability of information on resources received by service delivery units	Accounting systems provide reliable information on all types of resources received by both primary schools and primary health clinics across the country and compiled into reports at least annually.	A
24. Quality and timeliness of in-year budget reports	Financial reporting is reliable and regular. However, it could be considerably improved by producing budget revenue and execution reports in sufficient detail so as to enable a detailed comparison of budget outturn with the original budget.	C+
25. Quality and timeliness of annual financial statements	Annual financial statements are produced regularly and on a timely basis but not in accordance with consistently applied and recognized public sector accounting standards and are not complete in respect of financial assets and liabilities.	C+

Indicator	Brief explanation and cardinal data used	Score
26. Scope, nature and follow-up of external audit	The SAI audits entities that account for around 70% of consolidated public expenditures. In addition, while the audit report on the annual budget execution statement is submitted to legislature within two months of receipt by the audit office, it is possible that other audit reports – although publicly available - are only formally submitted to legislature significantly after the end of the period audited	C+
27. Legislative scrutiny of the annual budget law	Legislature’s review covers fiscal policies and aggregates for the coming year as well as detailed estimates of expenditures and revenues. The legislature’s procedures are well-established and respected. Legislature has one month to respond to budget proposals. Clear rules exist for in-year budget amendments by the executive but they allow extensive administrative reallocations.	B
28. Legislative scrutiny of external audit reports	Scrutiny of audit reports is usually completed by the legislature within six months from the receipt of the reports. However, discussions are not in-depth. The recommendations endorsed by the legislature are followed-up and implemented.	D+
D-1. Predictability of Direct Budget Support	Montenegro does not receive any direct budget support. Accordingly, D-1 is neither applicable nor assessed.	N/A
D-2. Financial information provided by donors for budgeting and reporting on project and program aid	Donor practice regarding donor-financed government-executed projects is good in terms of providing financial information for budgeting and reporting purposes. However, the government receives very little information regarding donor-financed donor-executed (in-kind) projects.	C
D-3. Proportion of aid that is managed by use of national procedures	Aid is mainly managed by use of each development partners’ individual procedures.	D

Annex 2: PEFA Team

Government and in-country authorities

Ministry of Finance

Mr. Nikola Vukićević, Deputy Minister (Coordinator of the PEFA assessment)

Ms. Iva Vuković, Senior Advisor III, Budget department

Mr. Stanko Jeknić, Independent Adviser I, Budget Department

Mr. Milorad Katnić, Deputy Minister

Mr. Dušan Perović, Deputy Minister

Ms. Mila Barjaktarović, Deputy Minister

Ms. Koviļjka Mihailović, Deputy Minister

Ms. Ana Miljanić, Assistant Minister

Others

Ms. Mirjana Pešalj, Director, Tax Administration

Mr. Mersad Mujević, Director, Directorate of Public Procurement

Ms. Katarina Radović, Secretary to Commission for Control of Procurement

Dr. Milan Dabović, Member of the Senate, State Audit Institution

Mr. Zarija Franović, Deputy Chairman, Parliamentary Commission for Economy, Finance and Public Spending

Ms. Biljana Šćekić, Local Consultant

Development partners

World Bank

Mr. Ranjan Ganguli, Financial Management Consultant

Ms. Pascale N. Kervyn De Lettenhove, Senior Financial Management Specialist

Mr. Lewis Hawke, Senior Financial Management Specialist

Ms. Danijela Vukajlović-Grba, Economist

Mr. Diomedes Berroa, Lead Procurement Specialist

Mr. Aleksandar Crnomarković, Financial Management Specialist

International Monetary Fund

Mr. Eivind Tandberg, Public Financial Management Adviser, South East Europe

European Commission

Ms. Thérèse Sobieski, Head of Unit for Serbia and Montenegro, DG Enlargement

Mr. Vassilis Maragos, Deputy Head of Unit responsible for Montenegro, DG Enlargement

Mr. Clive Rumbold, Acting Head of EC Delegation in Montenegro

Mr. Raymond Hill, Desk manager for Montenegro, DG Budget

Mr. Antonio Sanchez, Montenegro Desk, DG Economic and Financial Affairs

European Agency for Reconstruction

Mr. Dejan Mijović, Programme Manager

OECD SIGMA (A joint initiative of the OECD and the EU)

Ms. Ulrika Klingenstierna, Senior Adviser, Audit and Financial Control

Mr. Marian Lemke, Senior Adviser, Procurement

United States Agency for International Development (USAID)

Mr. Joseph Taggart, Officer in Charge

German Technical Cooperation (GTZ)

Mr. Thomas Waldraff, Country Coordinator

Ms. Nathalie Boljević, Assistant

United Nations Development Programme (UNDP)

Mr Mirsad Bibović, Senior Manager

Annex 3: Sources of Information

Ministry of Finance

1. Organic Budget Law («Official Gazette of the Republic of Montenegro,“ No. 40/01, 44/01, 71/05 and „Official Gazette of Montenegro,“ No. 12/07 from 14.12.2007)
2. Law on Financing of Local Self-government
3. Annual Budget Law for 2005
4. Annual Budget Law for 2006
5. Annual Budget Law for 2007
6. Annual Budget Proposal Law for 2008
7. Law on Changes and Amendments to the Budget Law for 2005
8. Law on Changes and Amendments to the Budget Law for 2006
9. Law on Changes and Amendments to the Budget Law for 2006
10. Year End Accounts for 2005
11. Year End Accounts for 2006
12. Draft Year End Accounts for 2007
13. Directions on Treasury Operations
14. The Rulebook on Accounting and Charter of Account
15. Strategy of public internal financial control in the public sector (PIFC-Public Internal Financial Control) in Montenegro
16. Ordinance on the Manner of Preparing, Generating and Submitting Financial Reports of Independent Regulatory Bodies, Legal Entities, Joint Stock Companies and Limited Liability Companies in which the State or Municipalities have majority share of ownership
17. Ordinance for The Rulebook on the manner of reporting on budget and actual revenues and expenditures of municipal Budgets and budget indebtedness of municipalities
18. Rulebook on the Organization and Systematization of the Ministry of Finance
19. Strategy for Public Debt 2008-2010
20. Decree on Borrowing and Guarantee Issuing of Montenegro for 2008, Official Gazette of Montenegro, No. 15/30
21. The Rulebook on criteria on fund allocation from Equalization Fund to municipalities and way of the utilization of these funds („Official Gazette of Montenegro”, No. 07/07, from February 5, 2007).
22. Instruction on the way and manner of distribution of the funds of Equalization Fund to municipalities („Official Gazette of Montenegro”, No. 27/08, from April 24, 2008).
23. Decision on planned funds for Equalization Fund for 2007 and the distribution to municipalities with the Table on allocation as per municipalities („Official Gazette of Montenegro”, No. 81/06, from December 29, 2006).
24. Decision on final Equalisation Funds allocation for 2007.
25. Law on Restitution of the Taken Away Property Rights and Compensation (“Official Gazette of the Republic of Montenegro,” numbers 21/04, 49/07 and 60/07)
26. Rulebook on Parliament operations
27. The Rulebook on consistent classification of accounts for the Republic Budget, Budgets of extra-budgetary funds and municipal budgets
28. Law on Compensation due to pension indexation debt
29. Law on Settlement of obligations and Claims due to Frozen Foreign Exchange Savings (“Official Gazette of the Republic of Montenegro,” No. 55/03 from October 1, 2003 and No 11/04 from February 2004).

Public Procurement

30. Law on Public Procurement (Official Gazette no. 46/06 of July 21, 2006)

SIGMA Reports

31. External Audit 2007
32. Public Internal Financial Control Report 2006
33. Public Internal Financial Control Assessment 2007
34. Public Expenditure Management System Assessment 2007
35. Public Procurement Report 2007

External Audit

36. Law on State Audit Institution
37. Instruction on Methodology of SAI Operations
38. Rules and Procedures of SAI
39. SAI Annual Report for 2007

Tax and Customs Regulation

40. Law on Tax Administration
41. Customs Administration Law
42. Law on Administrative Procedures
43. Law on Inspection
44. Law on Value Added Tax
45. Law on Corporate Profit Tax
46. Personal Income Tax

Other sources:

47. Economic and Fiscal Program for 2008-2010, Ministry of finance
48. Annual Report of the Ministry of Finance for 2006 and 2007
49. Quarterly Bulletin of the Ministry of finance form 2006-2008
50. The European Commission Staff Working Document (Brussels, 6.11.2007 SEC(2007) 1434), Montenegro 2007 Progress Report
http://ec.europa.eu/enlargement/pdf/key_documents/2007/nov/montenegro_progress_reports_en.pdf
51. Draft National Program for Integration of Montenegro into the EU (NPI) for the Period 2008-2012
52. IMF Business Outlook Review