MONTENEGRO

PUBLIC EXPENDITURE AND FINANCIAL ACCOUNTABILITY ASSESSMENT

PUBLIC FINANCIAL MANAGEMENT

PERFORMANCE REPORT

THE WORLD BANK

July 30 2013

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ABBREVIATIONS

AGA	Autonomous Government Agency
CCPP	Commission for Control of Public Procurement
CHU	Central Harmonization Unit
CIPFA	Chartered Institute of Public Finance and Accountability, UK
COFOG	Classification of the functions of government
COSO	Committee of Sponsoring Organisations (of the Treadway Commission, US, 1992)
DPL	Development Policy Loan (WB)
EBF	Extra-budgetary Fund
EC	European Commission
EU	European Union
EUROSAI	European Organization of Supreme Audit Institutions
FMC	Financial Management and Control
GDDS	General Data Dissemination System
GDP	Gross Domestic Product
GFS	Government Finance Statistics
GOM	Government of Montenegro
HIF	Health Insurance Fund
HRM	Human Resources Management
HRMA	Human Resources Management Authority
IA	Internal Audit
IAU	Internal Audit Unit
IIA	Institute of Internal Auditors
IMF	International Monetary Fund
INTOSAI	International Organization of Supreme Audit Institutions
IPA	Instrument for Pre-Accession Assistance
IPSAS	International Public Sector Accounting Standards
IPSASB	International Public Sector Accounting Standards Board
ISSAI	International Standards for Supreme Audit Institutions (issued by INTOSAI)_
MDAs	Ministries, Departments and Agencies (budget units)
MOE	Ministry of Education
MOF	Ministry of Finance
NGO	Non-governmental Organisation
PE	Public Enterprise
PEFA	Public Expenditure and Financial Accountability
PEP	Pre-Accession Economic Programme
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
PPA	Public Procurement Administration (formerly Directorate)
PPL	Public Procurement Law
SAA	Stabilization and Association Agreement
SAFE	Strengthening Accountability and the Fiduciary Environment
SAI	State Audit Institution
SECO	Swiss Secretariat for Economic Affairs
SIGMA	Support for Improvement in Governance and Management

SN	Sub-National
SOE	State-owned enterprise
UNDP	United Nations Development Programme
USD	US Dollars
VAT	Value Added Tax
WB	World Bank

Financial year is the calendar year 1 January – 31 December
National currency is the euro. At 1 February 2013, 1 Euro = USD 1.36

OVERVIEW OF THE INDICATOR SET

	PFM Performance Indicator	Scoring Method	Dimension Ratings				Overall Rating 2013
			i.	ii.	iii.	iv.	
PI-1	Aggregate expenditure out-turn compared to original approved budget	M1	B				B
PI-2	Composition of expenditure out-turn compared to original approved budget	M1	B	A			B+
PI-3	Aggregate revenue out-turn compared to original approved budget	M1	C				C
PI-4	Stock and monitoring of expenditure payment arrears	M1	C	B			C+
PI-5	Classification of the budget	M1	A				A
PI-6	Comprehensiveness of information included in budget documentation	M1	A				A
PI-7	Extent of unreported government operations	M1	B	D			D+
PI-8	Transparency of inter-governmental fiscal relations	M2	D	D	D		D
PI-9	Oversight of aggregate fiscal risk from other public sector entities	M1	C	A			C+
PI-10	Public access to key fiscal information	M1	A				A
PI-11	Orderliness and participation in the annual budget process	M2	A	C	A		B+
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	M2	C	A	C	C	C+
PI-13	Transparency of taxpayer obligations and liabilities	M2	A	A	B		A
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	M2	B	C	A		B
PI-15	Effectiveness in collection of tax payments	M1	D	A	D		D+
PI-16	Predictability in the availability of funds for commitment of expenditures	M1	A	A	A		A
PI-17	Recording and management of cash balances, debt and guarantees	M2	B	B	A		B+
PI-18	Effectiveness of payroll controls	M1	A	A	A	B	B+
PI-19	Transparency, competition and complaints mechanisms in procurement	M2	A	B	A	D	B
PI-20	Effectiveness of internal controls for non-salary expenditure	M1	D	B	B		D+
PI-21	Effectiveness of internal audit	M1	C	B	C		C+
PI-22	Timeliness and regularity of accounts reconciliation	M2	A	A			A
PI-23	Availability of information on resources received by service delivery units	M1	A				A
PI-24	Quality and timeliness of in-year budget reports	M1	D	A	B		D+
PI-25	Quality and timeliness of annual financial statements	M1	C	A	D		D+
PI-26	Scope, nature and follow-up of external audit	M1	C	A	A		C+
PI-27	Legislative scrutiny of the annual budget law	M1	B	B	B	B	B
PI-28	Legislative scrutiny of external audit reports	M1	A	C	B		C+
D-1	Predictability of direct budget support	M1	NA	NA			NA
D-2	Financial information for budgeting and reporting project aid	M1	NA	NA			NA
D-3	Proportion of aid that is managed by use of national procedures	M1	C				C

TABLE OF COMPARISON WITH 2008

	A. PFM OUT-TURNS: I. Credibility of the budget	2008	2013	Comparable Scores	Change since 2008 (for more details see text of each PI)
PI-1	Aggregate expenditure out-turn compared to original approved budget	B	B	Yes	No change
PI-2	Composition of expenditure out-turn compared to original approved budget	C	B+	Yes, after re-rating on new method	No: 2008 would similarly have rated B on dimension (i)
PI-3	Aggregate revenue out-turn compared to original approved budget	A	C	Yes, after re-rating on new method	Yes: 2008 would have rated D on current conventions
PI-4	Stock and monitoring of expenditure payment arrears	D	C+	Yes	Improvement reflecting better data availability
	B. KEY CROSS-CUTTING ISSUES: II. Comprehensiveness and Transparency				
PI-5	Classification of the budget	B	A	Yes	Improvement reflecting introduction of programme classification
PI-6	Comprehensiveness of information included in budget documentation	B	A	No	No underlying change (2013 report considered information on fiscal deficit to be adequate, when 2008 report did not.)
PI-7	Extent of unreported government operations	D+	D+	Yes	No change
PI-8	Transparency of Inter-Governmental Fiscal Relations	B	D	No	Wider range of factors taken into consideration in 2013. Difficult economic conjuncture has exposed problems with current arrangements.
PI-9	Oversight of aggregate fiscal risk from other public sector entities	C+	C+	Yes	No change
PI-10	Public Access to key fiscal information	A	A	Yes	No change
	C. BUDGET CYCLE				
III. Policy-Based Budgeting					
PI-11	Orderliness and participation in the annual budget process	B	B+	No	More favourable view taken in 2013 of time available for preparation of budget submissions
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	C+	C+	Yes	Better debt sustainability analysis and better macro-economic projections, and more systematic planning of future costs and benefits of investment projects
IV. Predictability & Control in Budget Execution					
PI-13	Transparency of taxpayer obligations and liabilities	A	A	Yes	No change
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	B	B	No	Penalties considered less effective, but audits more fully based on risk analysis
PI-15	Effectiveness in collection of tax	C+	D+	No	No real change: better

	payments				information in 2013 on tax arrears
PI-16	Predictability in the availability of funds for commitment of expenditures	A	A	Yes	No change
PI-17	Recording and management of cash balances, debt and guarantees	B	B+	Yes	Fuller consolidation of balances in Single Treasury Account
PI-18	Effectiveness of payroll controls	C+	B+	Yes	New control machinery in place and comprehensive audit undertaken
PI-19	Competition, value for money and controls in procurement	B	B	No	Indicator respecified: substantial progress in legislation and administration
PI-20	Effectiveness of internal controls for non-salary expenditures	D+	D+	Yes	Higher rating of general understanding of financial management and control
PI-21	Effectiveness of internal audit	C+	C+	Yes	Structure of internal audit changed
V. Accounting, Recording and Reporting					
PI-22	Timeliness and regularity of accounts reconciliation	A	A	Yes	No change
PI-23	Availability of information on resources received by service delivery units	A	A	Yes	No change
PI-24	Quality and timeliness of in-year budget reports	C+	D+	No	The absence of reports on functional or administrative classification was not noted in 2008
PI-25	Quality and timeliness of annual financial statements	C+	D+	No	Clearer evidence in 2013 of inadequacy of definition and disclosure of accounting standards
VI. External Scrutiny and Audit					
PI-26	Scope, nature and follow-up of external audit	C+	C+	Yes	Improvements in timing of reporting and evidence of follow-up
PI-27	Legislative scrutiny of the annual budget law	B	B	Yes	Involvement of Committees other than Economy, Finance and Budget
PI-28	Legislative scrutiny of external audit reports	D+	C+	Yes	Some hearings with representatives of spending units with negative audit reports
	D. DONOR PRACTICES				
D-1	Predictability of Direct Budget Support	NA	NA	No	Only one very recent receipt of DBS, so no evidence over a period
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	C	NA	No	Government controls timing and amounts of drawings on external finance
D-3	Proportion of aid that is managed by use of national procedures	D	C	Yes	Recent provision of budget support results in higher rating

EXECUTIVE OVERVIEW

This overview is provided in addition to the PEFA report to summarise key findings and issues for attention. It is not intended to replace the more detailed summary assessment required under the PEFA guidelines which is provided on pages 12-19.

This is the second PEFA assessment for Montenegro and reflects data for the years 2010 to 2012. The first assessment was published July 2009 based on 2005 to 2007 data. There has been progress in many areas between the two assessments, particularly in regard to aggregate revenue outturn (PI-3), expenditure payment arrears (PI-4), classification of the budget (PI-5), management of cash, debt and guarantees (PI-17), effectiveness of payroll controls (PI-18), procurement controls, competition and value for money (PI-19), legislative scrutiny of external audit reports (PI-28) and use of national procedures for international aid (D-3).

The 2010-12 assessment results are summarised in Table 1. The assessment scores are colour coded to highlight the areas of strength and opportunities for further reform. The table shows that the key strengths of Montenegro public financial management (PFM) are in budget classification (PI-5), budget documentation (PI-6), public access to information (PI-10), transparency of taxpayer obligations (PI-13), predictability in the availability of funds (PI-16), accounts reconciliation (PI-22) and information on resources received by service delivery units (PI-23).

Summary of PEFA 2013 results is as follows:

A. PFM out-turns	B. Key cross-cutting issues	C. Budget Cycle				D. Donor practices
I. Budget credibility	II. Comprehensiveness and transparency	III. Policy-based budgeting	IV. Budget execution	V. Accounting and reporting	VI. External scrutiny and audit	
PI-1 Expenditure outturn (aggregate)	PI-5 Budget classification	PI-11 Budget process	PI-13 Taxpayer obligations	PI-22 Accounts reconciliation	PI-26 External audit	D-1 Direct budget support
PI-2 Expenditure outturn (composition)	PI-6 Budget documentation	PI-12 Multi-year perspective	PI-14 Tax registration and assessment	PI-23 Information on resources	PI-27 Legislative scrutiny (annual budget)	D-2 Information provided by donors
PI-3 Revenue outturn (aggregate)	PI-7 Unreported operations		PI-15 Tax collection	PI-24 In-year budget reports	PI-28 Legislative scrutiny (audit reports)	D-3 Use of national procedures
PI-4 Arrears in expenditure payments	PI-8 Inter-governmental fiscal transparency		PI-16 Predictability of funds	PI-25 Annual financial statements		
	PI-9 Fiscal risks		PI-17 Cash, debt and guarantees			
	PI-10 Public access to fiscal information		PI-18 Payroll controls			
			PI-19 Procurement			
			PI-20 Internal controls (non-salary)			
			PI-21 Internal audit			

KEY

A	
B+	
B	
C+	
C	
D+	
D	
N/A	

The table shows that six indicators, while nine dimensions, were rated D or D+ and are obvious candidates for attention. In particular, the limitations relating to the omission of significant donor project expenditure in fiscal reports (PI-7 (ii)), the lack of transparency and predictability of central government grants to local self-governments (PI-8 (i), (ii), and (iii)), lack of data on collection of tax arrears and of regular reconciliation of assessments, collections and arrears (PI-15 (i) and (iii)), lack of commitment control on expenditure (PI-20 (i)), no functional or administrative breakdown of expenditure for comparison with budgets (PI-24 (i)), and non-disclosure of accounting standards in the annual financial statements (PI-25 (iii)). Some of these matters are already being addressed, or there are plans to address them, which are referred to in the text.

Credibility of the Budget (P-1 to PI-4)

The Government's actual revenues and expenditures have varied significantly from what was originally budgeted in 2010, 2011 and 2012. Revenue forecasting has improved as a result of greater experience and better staffing of the MoF sector responsible.

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

Budget classification has improved with the implementation of programme budgeting in all central government units. Almost all central government activities are covered by the budget, except for the (relatively small) Development Fund. Donor-funded project expenditure, whether from grants or loans, is not yet systematically included in both budget and out-turns. The most significant information gap concerns state-owned enterprises.

Policy-Based Budgeting (PI-11 and PI-12)

The budget calendar laid down in the organic Budget Law is clear and generally respected, with each year's budget approved before the start of the year. A three-year horizon is maintained for planning and monitoring.

Predictability and Control in Budget Execution (PI-13 to PI-21)

The legal framework and procedures for tax and duty administration are clear and the tax and customs administrations have well-developed channels for educating taxpayers and keeping them informed. The tax appeals machinery appears to function satisfactorily. Cash flows are forecast and monitored monthly. External and domestic debt records are generally good. There is no comprehensive central control of expenditure at the commitment stage.

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

A Treasury Single Account is operated at the central bank into which most State receipts flow and from which most State payments are made. Budget execution reports are produced monthly from the SAP system and posted onto the MOF website, but they show only aggregate revenue and expenditure on the economic classification. Outstanding commitments are not yet recorded and reported. Annual financial statements are produced with detailed breakdowns on all three classifications. They include information on arrears, but do not include any balance sheet information or explanatory notes.

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

Parliamentary committees examine the macroeconomic background, general fiscal policy and estimates of revenue and expenditure, but not the medium-term fiscal framework and sectoral prioritization. The State Audit Institution audits all public sector entities on a rotation basis, covering about 66% of all expenditure in 2012. The Parliamentary Committee on Economy, Budget and Finance considers audit reports within two months of receiving them and routinely endorses the SAI's recommendations.

Donor Assistance (D1 to D3)

Only GOM counterpart contributions are included in the budget, not donor contributions. There is no formal reporting of actual donor project support.

SUMMARY ASSESSMENT

This assessment of public financial management (PFM) in Montenegro is based on the PEFA Performance Measurement Framework.[1] The Framework was developed by the Public Expenditure and Financial Accountability (PEFA) partners as a tool that can provide reliable information on the performance of PFM systems, processes and institutions at a point of time and, by comparing ratings at two points of time, assess the progress over the intervening period. This assessment is made in January/March 2013, and reflects data for the three years 2010-12. The last assessment was made in May 2008 based on 2005-07 data (published July 2009). Progress has been assessed over the five years since then. The standard 31 indicators have been used for both assessments. Two of the three indicators that were revised in February 2011 (PI-2 and 3) have been assessed on both the old and new basis to facilitate comparisons: the third (PI-19) could not be assessed at 2008 on the new basis. A summary table of scores is provided at Annexe 1 with justifications for scores and related sources of information. Ongoing or planned reforms are mentioned in the text on each indicator.

It should be noted that the assessment focuses on PFM systems and how they compare with good international practice as set out in the PEFA criteria for each Performance Indicator. In accordance with the philosophy of the Strengthened Approach to PFM Reform, this Performance Report does not evaluate past reforms or the individuals responsible for implementing them, nor does it assess or make recommendations on ongoing and planned reforms. It is intended only to provide a pool of objective information to assist all stakeholders in decisions on future reforms. Following approval by the Government PEFA Working Group, the final report will be published by the Ministry of Finance on its website, with a link to the PEFA Secretariat website. Agreed findings may be incorporated into a PFM reform strategy and action plan.

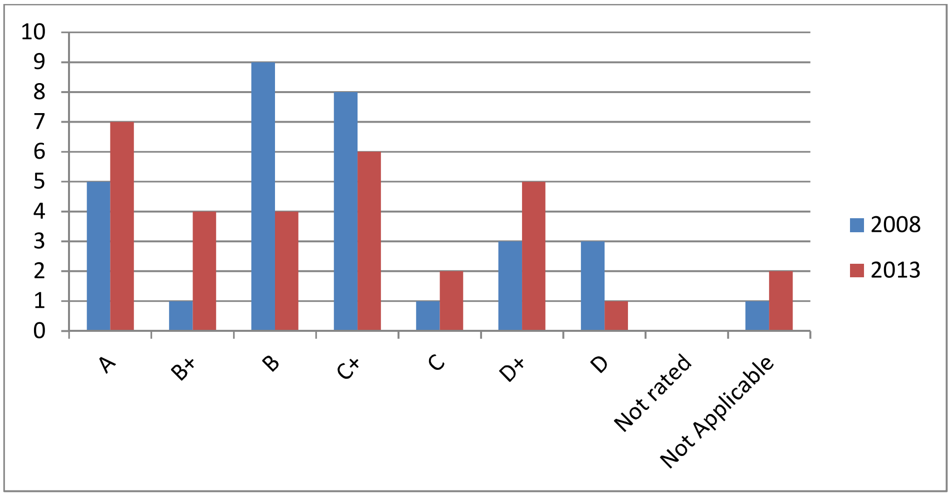
(i) Integrated Assessment of PFM Performance

Out of the 31 performance indicators, scores in 2008 and 2013 can be directly compared in only 21 cases. Two indicators (D-1 and D-2) are not applicable. In seven other indicators PI-6, 8, 11, 14, 15, 24 and 25, uncertainty over the validity of scores given in 2008 upset the comparison (see text on each such indicator). For three indicators (PI-2, 3 and 19), the method of calculation has changed, but for PI-2 and PI-3, it has been possible to re-calculate the 2008 ratings using the new method and compare with 2013 ratings. For PI-19 on procurement, it was not possible to re-calculate the 2008 rating, but it is evident that substantial progress has been made**. In summary, nine indicators have clearly improved (PI-3, 4, 5, 17, 18, 19, 20, 28 and D-3). On 21 indicators there is no change of rating**, though in some cases there has been progress, but insufficient to change the rating.

[1] Public Expenditure and Financial Accountability: Public Financial Management Performance Measurement Framework Performance Report. The methodology is available at the PEFA website: www.pefa.org. It is available also in Montenegrin.

The distribution of scores after re-rating PI-2 and 3 is as follows:

Chart 1. Distribution of scores



Since the assessment in 2008, there has been progress in several areas, though not all of these were sufficient to improve the relevant ratings. Better data on expenditure arrears has raised the rating on PI-4; greater use of programme classification has improved PI-5 to an A rating; debt sustainability analysis is now annual, there are better macro-fiscal projections and improved project planning (but no overall change to PI-12 rating); there has been an improvement in risk-based tax audits (but no overall change to PI-14); the establishment of the Treasury single account and the consolidation of funds improved the rating on PI-17; major improvements were made in payroll systems (PI-18) and procurement systems (PI-19, though the rating on the latter was let down by the dual role of the CCPP); the Financial Management and Control Handbook has improved understanding of the rules (PI-20 ii, though there was no change to the overall rating of this indicator); there is better follow up of audit recommendations (PI-26 iii, but no change in the overall rating); and there has been improvement in the parliamentary hearings on audit findings (PI-28). It appears that there is a strong GOM commitment to PFM reform, which is a necessary part of the requirements for accession to the EU.

Credibility of the Budget (P-1 to PI-4)

The Government's actual revenues and expenditures have varied significantly from what was originally budgeted in 2010, 2011 and 2012. In 2011 and 2012, supplementary budgets had to be sought and approved by Parliament, due mainly to a shortfall in revenues. **The largest expenditure variance in every year has been on general public services**, which groups together a range of different activities, which has over-spent its budget by an average 50% each year, at the expense of economic affairs, environmental protection, and recreation, culture and religion. This appears to have been the main cause of variance in aggregate expenditure and its composition. Part of the over-spending on general public service is attributable to the unbudgeted payments in 2011 and 2012 arising from guarantees of borrowing by enterprises. The capital budget has generally been underspent, with the shortfalls in part a response to fiscal stringency. Outcomes on other economic categories are close to budget.

Overall, aggregate expenditure variance (PI-1) is rated B as in 2008; there would have been an improvement had it not been necessary to repay guarantees in 2011 and 2012. On the composition of expenditure (PI-2 (i)) there is no significant change, as 2008 data would be rated B using the new method of calculation. Spending from the contingency reserve is low, in accordance with good practice.

Central government expenditure arrears (defined as amounts outstanding at year end in respect of goods and services already delivered, rather than amounts which are actually overdue for payment) **have amounted to about 5% of total expenditure for the last three years** (a rating of C), and are monitored quarterly by MOF. Expenditure arrears are a more acute issue in the municipalities, where the latest data (at 30 September 2012) showed that they amount to about 75% of annual total municipal expenditure. These arrears reflect the fact that municipal revenues are heavily dependent on investment and construction activity, and thus liable to fall sharply in a recession. This statistic is not counted in this assessment, which is confined to central government.

Revenue forecasting has improved as a result of greater experience and better staffing of the MoF sector responsible. The rating in 2008, based on the years 2005-2007, would now be D rather than A, as the new method of calculation penalizes under-estimates as well as over-estimates. The rating for 2010-2012 is C, and would have been higher except for the failure to budget privatization proceeds more accurately.

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

Budget classification has improved with the implementation of programme budgeting in all central government units. This allows classification down to COFOG sub-functional level as well as administrative and GFS-compatible economic classification. The budget documentation meets international benchmarks as set out in the PEFA criteria except for comparability of the budget with the previous year's budget, and lack of summarized classifications by main administrative head and by programme.

Almost all central government activities are covered by the budget, except for the (relatively small) Development Fund. The substantial expenditures on pensions and health largely financed through social contributions were brought within the budget in 2008. The expenditure of six regulatory agencies financed from charges, and expenditure out of income earned by health and education institutions, together amounting to about 3% of total expenditure is reported only at the out-turn stage. **Donor-funded project expenditure, whether from grants or loans, is not yet systematically included in both budget and out-turns.**

In addition to bringing the former extra-budgetary funds within the budget, fiscal transparency has been improved since 2008 by wider use of websites and timely postings. **The most significant information gap concerns state-owned enterprises**: there is a lack of up-to-date and consolidated data on the 30 SOEs which account for about 4 percent of total employment, including data on their contingent liabilities and other fiscal risks.

Transparency of inter-governmental fiscal relations is reduced by complex rules for sharing joint revenues and the Equalisation Fund. It is difficult for municipal authorities to make reliable projections of either their own revenues or of the following year's transfers from central government *before* they finalise and present their budgets to their councils for approval. Municipalities report their revenues, expenditures (which currently amount to about 8 per cent of total general government expenditure) and debt quarterly to MOF, but a functional classification is missing.

Policy-Based Budgeting (PI-11 and PI-12)

The budget calendar laid down in the organic Budget Law is clear and generally respected, with each year's budget approved before the start of the year. Budget units have sufficient time for preparing their estimates, but preliminary 'ceilings' to recurrent and capital expenditure are not observed. Though units prepare their budgets by programme, these do not include any data about planned and achieved outputs and outcomes. The Budget Department plans to develop this aspect further, with technical assistance from the Netherlands government.

A three-year horizon is maintained for planning and monitoring, but the projections for year n+1 made when the budget was fixed for year n have no impact when the budget is subsequently fixed for year n+1. Fiscal projections are made only in aggregate on an economic classification, so **the fiscal framework does not serve sectoral planning**. Some sectoral strategies have been prepared but they are not made with reference to the projected availability of funds and do not systematically include associated operating and maintenance costs of existing and new projects. However, **there has been some improvement in the planning of the future costs and benefits of individual investment projects**.

Predictability and Control in Budget Execution (PI-13 to PI-21)

The legal framework and procedures for tax and duty administration are clear and the tax and customs administrations have well-developed channels for educating taxpayers and keeping them informed. **The tax appeals machinery appears to function satisfactorily as a safeguard for taxpayers**, with a high proportion of contested assessments being annulled by the Ministry of Finance. (There is no appeals machinery independent of the administration below the Administrative Court). Taxpayers are registered in databases but linkages between them and with the national identification database and other sources of information on potential taxpayers are not yet electronic. Tax and customs arrears have risen over the last two years from about 20% to 34% of annual revenue collections. Tax collections are promptly transferred to the Treasury, but there is no overall reconciliation of assessments with collections and arrears.

Cash flows are forecast and monitored monthly and spending units are able to plan their programmes and make commitments up to at least six months ahead. Budget allocations have been adjusted by a supplementary budget during the year in two of the last three years. While some reallocations of provision are possible within given totals by agreement with MOF, any overall increase, or any imposition of reductions, requires a "rebalanced" budget approved by Parliament. **External and domestic debt records are generally good**: debt operations and stocks are reported monthly. There is central management and control of all borrowing and issue of guarantees. The overall amount of outstanding guarantees (of the order of 10 per cent of GDP) is nonetheless substantial, and the fiscal risks associated with them have become only too clear.

Payroll and procurement have been improved since 2008. Payroll is tightly linked to the personnel records and payroll changes have to be approved by the spending agency, the Human Resources Management Authority and MOF. The central government payroll was rigorously examined by a specially appointed group (including people from outside government service and employee representatives)in 2010/11. The legal framework for procurement has been brought more closely into line with EU requirements by a new law that came into effect in 2012. Open competitive procurement is the default method which is followed in the large majority of cases, and the use of other methods should be justified. It appears that they are justified in the majority of cases where negotiated procedures (which currently account for about 5 per cent of procurement expenditure) are used. Procurement has been made more transparent through a web-based portal that shows the procurement plans of spending units, bidding opportunities, and contracts awarded. There is an expert body that reviews and adjudicates on procurement appeals in a timely manner, but its involvement in approving deviations from open competition in the cases of large projects means that it is not altogether independent.

While there is effective control of expenditure at the payment stage through the SAP computerized system, there is as yet no comprehensive central control of expenditure at the commitment stage (although the requirement that annual procurement plans must be approved by MOF provides a partial control). Spending units can make commitments against their budgets, but if revenues fall short it may not be possible to make some of the payments as they become due, so resulting in the accumulation of arrears. It is understood that a new computer system is being developed in the Treasury which will require the registration of commitments at the time they are made, so providing MoF with an instrument to prevent commitments from being made in excess of budgetary provision, and also provide reliable information about future payment obligations.

Since 2008 Internal audit has been largely decentralized to Internal Audit Units in spending units covering 90% of total central government expenditure, whose work is coordinated by the Central Harmonisation Unit in MOF. A major effort has gone into the legal framework and its operationalisation, including the training and certification of internal auditors using international internal audit standards. At present, the number of trained internal auditors is inadequate and their reports have not yet achieved the impact of those previously produced under the centralized regime.

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

The Treasury operates a Treasury Single Account at the central bank into which most State receipts flow and from which most State payments are made. Payments are made by bank instruction, and reconciliation is made daily and electronically. Outside the TSA, some spending units still hold balances in commercial banks, eg. educational and health institutions and some donor-assisted projects. Advances are promptly cleared to expenditure.

Information is available from routine accounting systems on all resources received by service delivery units such as schools and health clinics.

Budget execution reports are produced monthly from the SAP system and posted onto the MOF website, but they show only aggregate revenue and expenditure on the economic classification without breakdown by administrative unit or by programme, although the SAP system would enable the production of reports by administrative unit or programme. (MOF Budget Department uses the system to review the position of individual ministries.) **Expenditure reports show only payments** (including amounts outstanding in respect of goods and services already received): **outstanding commitments are not yet**

recorded and reported. **Annual financial statements (final executed budget) are produced with detailed breakdowns on all three classifications. They include information on arrears, but do not include any balance sheet information or explanatory notes.** Thus there is scope for improving both the in-year monitoring of budget execution and the scope and coverage of the annual financial statements.

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

Parliamentary committees examine the macroeconomic background, general fiscal policy and the detailed estimates of revenue and expenditure, but not the medium-term fiscal framework and sectoral prioritization. The time allowed for this scrutiny is limited (one month), and it has only marginal impact on the budget. A proposed new Law on Budget and Fiscal Responsibility is expected to extend the time available for Parliamentary scrutiny. During the year, the executive has relatively wide discretion to reallocate the budget without consulting Parliament, or it can push a budget 're-balance' through Parliament using an accelerated procedure.

The State Audit Institution audits all public sector entities on a rotation basis, covering about 66% of all expenditure in 2012. It has adopted INTOSAI's international standards for supreme audit institutions (ISSAIs) and meets the standards in many respects. Audits are primarily focused on the reliability of financial statements and the compliance of transactions with applicable regulations: there is as yet only limited experience in performance audit. Audit reports are issued in good time and recommendations made in the reports are systematically followed up in subsequent audits.

The Parliamentary Committee on Economy, Budget and Finance considers audit reports within two months of receiving them and routinely endorses the SAI's recommendations. Responsible officers from the audited entities have only very occasionally been required to appear before the Committee.

Donor Assistance (D1 to D3)

Montenegro has been in receipt of direct budget support only in 2012 (a Development Policy Loan from World Bank disbursed in a single tranche). There is no formal notification by the donor to GOM of amounts to be released or their timing in relation to the Government's budget cycle, as this depends wholly on the timing of the GOM's request once it has met the prescribed conditions. With regard to project support, **only GOM counterpart contributions are included in the budget, not donor contributions, though the out-turn statements include all support passing through the Treasury**, including movements on project accounts held in commercial banks. **There is no formal reporting of actual donor project support**. This has created difficulties for the GOM in ensuring that they have accurate, complete and timely information on donor contributions for use in budget planning, execution and monitoring.

(ii) Assessment of the Impact of PFM Weaknesses

Macro-fiscal Discipline

Recurrent expenditure budgets have largely been executed as originally proposed. Expenditure increases have primarily reflected the calling of guarantees given to support the continued operation of industrial enterprises. These expenditure increases concentrated in one sector result in changes in the mix of expenditure as now measured for PI-2. Because of unbudgeted expenditures and revenue shortfalls, budgets have had to be rebalanced in 2011 and 2012, largely through increases in tax rates and holding back on capital expenditure. Despite this debt has increased rapidly since 2008 as a proportion of GDP. Spending units have been able to commit expenditure without regard to available resources, provided they kept within their budgets and their approved public procurement plans. The need for a control over commitments is recognised, so that expenditure can be restrained in response to revenue shortfalls, and a new system is being implemented to assist the MOF in its monitoring of commitments. Expenditure arrears (defined as amounts outstanding at the end of each year in respect of goods and services already delivered, rather than as payments overdue) have remained roughly constant at about 5 per cent of total expenditure, and thus do not indicate a failure of fiscal discipline. However, some further action may be needed in relation to local self-governments, where municipalities' aggregate arrears are running at almost €100 million. MOF has improved revenue forecasting but still needs better projections on such items as privatization proceeds.

A further problem of fiscal discipline may arise in relation to contingent liabilities of public enterprises and former public enterprises where GOM has recently had to meet guarantees that were not budgeted. Land restitution claims and quasi-fiscal losses of the electric power utility are other contingent liabilities that do not appear to have been regularly appraised. There is still no comprehensive and regular review of fiscal risks and sustainability across the public sector. Public debt reporting, however, is relatively comprehensive and reliable. Low collection of tax arrears undermines fiscal management and may contribute to unplanned reallocations of resources.

Strategic Allocation of Resources

Resources are allocated in an annual budget procedure. Attempts to set budgets within a three-year fiscal framework have had limited success as the framework projects only fiscal aggregates without a sectoral breakdown that is politically determined and enforced, and reflects deliberate choices related to the development of different public services. The system of dual budgeting maintains a separation between capital expenditure (investment) and recurrent expenditure (consumption) that creates a bias against operating and maintenance expenditures, and thereby reduces the usefulness of capital assets and undermines the delivery of public services.

Operational Efficiency

There have been major reforms in the management of payroll and in procurement, which should result in greater value for money and improved efficiency in service delivery. The budget system, however, does not promote performance management as there is no regular comparison of planned and actual outputs and resource inputs.

Spending units can plan their programmes and enter into commitments as soon as the budget is approved, which promotes good planning, consolidation of procurements and operational efficiency. However, revenue shortfalls in recent years have reduced confidence in the availability of budgeted resources and foreshortened planning horizons. Limited capacity of internal audit and limited external audit coverage are also likely to reduce operational efficiency.

(iii) Prospects for Reform Planning and Implementation

Eventual membership of the EU is Montenegro's central priority. A Stabilization and Association Agreement (SAA) was signed with the European Union in October 2007 and came into force in May 2010. An Instrument for Pre-Accession Assistance (IPA) was signed with the EU in November 2007. This provided €235 mn over the period 2007-13. Membership negotiations were started in June 2012.

The Government of Montenegro has a successful track record of implementing PFM reforms including: 1) establishing the State Audit Institution, a Directorate for Public Procurement (now the Public Procurement Administration) and the Commission for Supervising the Process of Public Procurement; 2) introduction and upgrading of the SAP management information system; 3) introduction of a medium-term macro-fiscal framework and capital budgeting (although this has yet to make an impact through greater stability in fiscal planning); 4) consolidation of the budgetary structure by inclusion of four former extra-budgetary funds into the state budget and Treasury Single Account, and the inclusion of regulating agencies and public enterprises in the Memorandum to the Annual Budget Law; 5) introduction of programme budgeting; 6) re-organization of the internal audit and control system.

GOM now prepares each year a Pre-Accession Economic Programme (PEP), which it submits to the European Commission. The current (2012) plan looked for the continuation of fiscal consolidation while achieving greater efficiency in government operations. It noted that work was in progress on the production of a National Economic Development Plan 2013-16, as is normally required by the EU as part of the pre-accession process. (It is understood that such a plan has now been adopted as "Development Trends for Montenegro for 2013-2016".) **This should provide a framework within which sector strategies can be prepared consistent with the aggregate medium-term fiscal framework GOM already produces. The proposed new Budget Law should provide stronger underpinning for efforts both to make a reality of medium-term planning of the main public services, and to ensure that public debt is controlled within manageable limits. Current on-going work to improve financial management and control in spending ministries and to spread effective internal audit across the government system should reinforce these initiatives, as should the general establishment of commitment controls and the continuing work to improve public procurement practice**.

1. INTRODUCTION

Objective of the PFM Performance Report

1. The purpose of the assessment is to provide the Montenegrin authorities with an internationally-recognized evaluation of the current performance of the Montenegrin public financial management (PFM) systems and progress since 2008. This will be used (i) to assist the authorities to identify reform priorities and review the Public Finance Reform Strategy and Programme, (ii) to raise the capacity of the national authorities to undertake future PEFA self-assessments, and (iii) to provide key information to development partners, such as the reliability of different areas of the PFM system for greater use of country systems in donor-assisted projects.

Process of Preparing the PFM Performance Report

2. The Minister of Finance requested technical support from the World Bank in conducting a repeat Public Expenditure and Financial Accountability (PEFA) assessment to measure progress since the previous assessment in 2008, published in 2009. To this end, the Government set up a PEFA Working Group comprising ten senior government officers, coordinated by the Assistant Minister for Budget, Nemanja Pavlicic, later Nikola Vukicevic. The assignment was led by the World Bank, and Task Team Leader for the World Bank was Aleksandar Crnomarkovic, Senior Financial Management Specialist. The rest of the World Bank team included Henri Fortin (Head of the Centre for Financial Reporting Reform) and Iwona Warzecha (Senior Financial Management Specialist). A Terms of Reference/Concept Note was drawn up for an international consulting firm to undertake the assignment under the direction of the Working Group. The contract was won by ACE International Consultants, Madrid, whose team consisted of two international consultants, John Wiggins and Tony Bennett, and a local consultant, Radislav Jovovic. The assessment is funded from the Strengthening Accountability and the Fiduciary Environment (SAFE) Trust Fund, which is financed by the European Commission and Swiss Secretariat for Economic Affairs (SECO).The SAFE Trust Fund Manager was Lewis Hawke.

3. After an initial delay due to Montenegrin elections in October 2012, the timetable was agreed as follows:

ASSESSMENT TIMETABLE

Action	Date/duration
PEFA introductory workshop	22-23 January 2013
Data collection	21 January – 29 March 2013
Data analysis and preliminary ratings (first draft report)	1 – 11 March 2013
Workshop on first draft	22 March 2013
Second draft report issued (in Montenegrin)	5 April 2013
Final comments from GOM and stakeholders	30 April
Third draft report issued	7 May 2013
Comments by PEFA Secretariat and donor partners	3 June 2013
Revision of draft by consultants	14 June 2013
Verification of the revisions by WB and further revisions if needed	26 June 2013
Minutes of the virtual review and management endorsement of the report	25 July 2013
Translation of the report to Montenegrin	29 July 2013
Delivery of the report	30 July 2013

4. The first workshop was successfully held 22-23 January and attended by 21 senior officers from the MOF, SAI, PPA, Tax Administration, Chamber of Commerce, Directorate for Anti-corruption Initiative and development partners. An interim presentation of findings was made to the Assistant Minister for Budget on 1 February 2013, and a further mission was undertaken from 18-26 February. A one day workshop was held on 22 March, where the Chairman of the Parliamentary Committee and senior officers from the MOF, SAI, PPA, Tax Administration, two municipalities and donor partners provided comments on the first draft report to the assessment team. Meetings with the Ministry of Education and the Health Fund were eventually held during the latter half of April.

Methodology

5. The PEFA methodology is set out in the Public Finance Management Performance Measurement Framework (available also in Montenegrin, at http://www.pefa.org). It is based on 28 indicators covering aspects of 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 point-of-time assessments (snapshots) of the state of PFM[2], so successive assessments provide a measure of the improvements over the intervening period. They do not provide, however, for an analysis of the causes of existing weaknesses, nor do they make recommendations or prescribe reforms, as these are matters for the host government in consultation with its stakeholders.

6. Each indicator is rated (scored) on a scale from A to D. Scores are based on the minimum requirements set out in the methodology. Many indicators include two or more dimensions, which are combined using either method M1 or M2 in accordance with the Framework. For method M1, the overall rating is based on the dimension with the lowest score (the 'weakest link'). For M2, an average of the dimension scores is used to arrive at the score for the overall indicator. Scores given in this assessment have been compared with the scores given in the 2009 PEFA report, which were based on the status of PFM when data was collected in May 2008. Changes in scores reflect improvement or (in some cases) deterioration in performance. These are attributed, as far as possible, to specific reforms and other identifiable factors. Three indicators (PI-2, PI-3 and PI-19) were changed in February 2011; PIs 2 and 3 were retrospectively re-assessed according to the new requirements so as to provide valid comparisons, but it was not possible to do this for PI-19.

7. The main sources of information that have been used for this PEFA assessment are: (a) government reports and data; (b) external evaluations and reports (by WB, IMF, EU, SIGMA); and (c) interviews with users and providers of PFM information and other stakeholders (government officials, parliamentary committee members, 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 corroborate information from alternative sources. Sources of information are cited in Annexe 1 and listed at Annexes 3 and 4.

8. *Quality assurance* of the assessment has been and will be secured: (1) by a review of the Concept Note/Terms of Reference by GoM, the PEFA Secretariat and invited peer reviewers (see Annexe 3); (2) review of the preliminary draft report by the Government

[2] Exceptionally, indicators PI-1, 2 and 3 refer to the last three years for which data are available at the time of the assessment, in this case, 2010, 2011 and 2012. The 2012 data have not yet been approved by Parliament but are sufficiently reliable for use in this assessment.

Working Group and discussion at a workshop on 22 March 2013; (3) review of the second draft report by GoM and the World Bank and (4) review of the third draft by the PEFA Secretariat and invited peer reviewers (see Annexe 3).

Scope of the Assessment

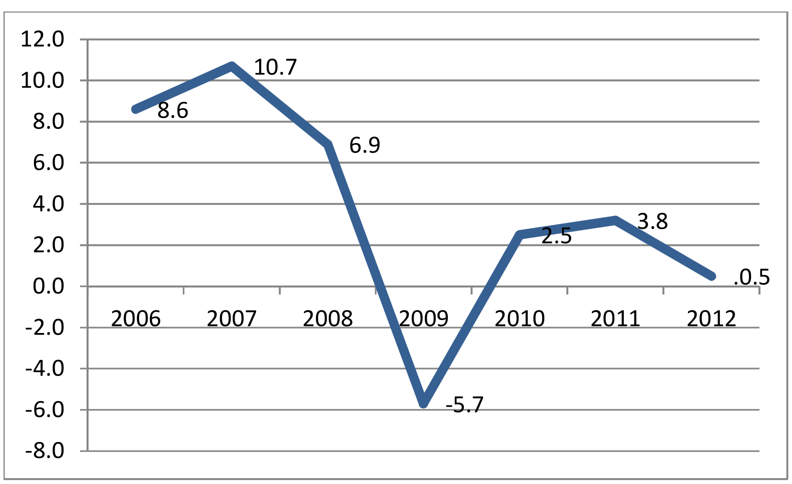
9. The focus of the PFM performance indicator set is PFM at central government level, including the related regulatory and oversight institutions, and state funds.[3] Public enterprises, financial and nonfinancial, are outside the boundary of government, and outside the scope of this assessment except in so far as they affect overall fiscal risk (PI-9). Sub-national governments (local self-governments) comprise 21 municipalities. Indicator PI-8 examines the interaction between central government and these municipalities which are responsible for less than 10 per cent of general government expenditure. PFM at the municipality level is not normally covered by a central government assessment, but in this case there is an exception: as expenditure arrears are an important issue, the TOR for this assessment require that arrears at local government level are assessed as far as possible and reported on. To maintain comparability they are not aggregated with central government arrears and do not enter into the scoring of PI-4.

2. COUNTRY BACKGROUND INFORMATION

2.1. Description of Country Economic Situation

10. Montenegro is a small country (13,812 km² and 620,029 inhabitants) with one of the lowest population densities in Europe (44.9 inhabitants/km²). GDP growth rate in 2011 was 3.8%, but growth has stalled in 2012, with hardly any growth expected over the year as a whole[4]. Total GDP in 2012 was approximately \$4.25 billion (€3.3 billion). GDP per capita of about \$6,875 is comparable to or higher than other Western Balkan countries.

o ***Graph1: Annual growth of GDP for the period 2006 – 2012***



Source: Ministry of finance Montenegro

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[3] Pension and Disability Insurance Fund, Health Insurance Fund, Employment Office and Compensation Fund. These Funds were incorporated into the Budget in 2010. The Development Fund, which functions as a financial public enterprise, remains outside the Budget.

[4] World Economic Outlook – October 2012

Macroeconomic Indicators and Trends

11. Montenegro is a small open economy with a relatively narrow productive base. Most consumption goods have to be imported, while industrial output has been dominated by aluminium and steel production. There is inevitably a large deficit on the balance of trade, with imports of goods in excess of 50 per cent of GDP and exports around 15 per cent. The balance on services has been improving in recent years as tourism has developed, and is now running at a surplus of about 16 per cent of GDP. Broad overall balance has been secured through a continuing inflow of foreign direct investment, although this has fallen back from the high rates before 2009, and positive unidentified flows running at about 10 per cent of GDP. The economic situation has changed significantly since 2007. The global financial crisis began in the middle of 2007, but its consequences were not felt in Montenegro until the last quarter of 2008. By the end of 2009, the crisis had led to a drop in the level of economic activity in Montenegro, with real GDP contracting by 5.7 per cent. Growth resumed in 2010 as aluminium prices recovered, and these were reflected in higher production and exports, which continued in 2011. But the continued stagnation in the Eurozone and in neighbouring countries caused the recovery to stall in 2012, and the outlook is for the economy to remain flat.

12. The following table summarises the country's balance of payments position.

Table 1: Montenegro Balance of Payments 2009-12 (percentages of GDP)

	2009	2010	2011	2012
GDP growth	-5.7	2.5	3.8	0.5
Imports	-54.3	-52.3	-54.7	-54.4
Exports	9.9	11.5	14.6	14.8
Trade balance	-44.3	-40.8	-40.1	-39.6
Services, net	11.7	13.2	16.3	16.2
Current Balance	-29.6	-24.6	-19.4	-19.7
Foreign Direct Investment	35.8	17.8	11.9	11.4
Errors and omissions	11.9	12.7	10.8	10.8

Sources: IMF Article IV report 2012, Montenegro Statistics Office and Central Bank of Montenegro

13. The persistence of external and internal imbalances and the fiscal risks from contingent liabilities present a challenge for the economy. The following table shows the development of the main elements of revenue and expenditure over the period 2009-12. Overall revenue shows a declining trend in current cash terms, which of course implies a sharper fall once the amounts are adjusted for inflation. On the expenditure side the apparent increase in the share of total expenditure absorbed by employment costs primarily reflects the integration within the budget of the social security and health funds which were previously the recipients of transfers from the budget. Capital expenditure fell from €112.4 mn in 2009 to €58.7mn in 2012 in response to the fiscal stringency. Despite the cut-backs in capital and other discretionary expenditure, some increases in excise tax rates, and the introduction in mid-2012 of temporary fees on SIM cards, electronic counters, smoking areas and cable TV, the fiscal deficit each year substantially exceeded the planned amounts. The result has been a continuing increase in net government debt both absolutely and as a percentage of GDP, and at the same time an increase in the proportion of the debt which is owed to external lenders from 61.4 per cent in 2009 to 76.0 per cent at the end of 2012.

Table 2: Main elements of revenue and expenditure, 2009-12 (Euro millions)

	2009	**2010**	**2011**	**2012**
Total revenue	1189.27	1138.17	1127.48	1114.33
o/w Income taxes	149.73	110.02	117.74	146.28
VAT	370.78	364.18	392.24	354.71
Contributions	307.54	379.76	353.58	362.75
Current expenditure	1162.49	1169.98	1234.69	1223.88
o/w Wages and salaries	259.16	283.66	371.26	374.66
Goods and services	115.07	148.69	127.55	172.94
Social security transfers	412.97	423.15	454.76	481.64
Transfers to Institutions, NGOs, etc	204.67	174.64	87.91	31.51
Capital expenditure	112.36	63.25	67.12	58.74
Reserves, loans and repayment of guarantees	30.32	16.66	47.80	44.58
Net fiscal balance	-132.10	-112.24	-189.67	-163.80
Net fiscal balance as % of GDP	-4.4	-3.6	-5.9	-5.0
Public debt as % of GDP	38.25%	40.94%	45.99%	51.23%
External debt as % of total public debt	61.4%	71.8%	71.5%	76.0%

Source: MOF GDDS tables, discussions with Economic Policy Department, MOF

14. A new framework of transparent fiscal responsibility is being established. A draft Law on Budget and Fiscal Responsibility is intended to set legal limits on annual deficits and State debt. The intention is that the maximum deficit in 2014 will be 2% of GDP, falling to 1% in subsequent years. State debt should not be allowed to exceed 60% of GDP during the period up to the end of 2015; thereafter the plan is to reduce it to less than 45% by 2020 and eventually to less than 30%. The sustainability of public finances has been improved with the adoption of structural reforms, including in particular changes to the public pension system, and tighter control of public employment, although the full effect of these reforms will take several years to work through. Meanwhile the Montenegrin economy remains constrained by limited diversification and competitiveness.

Memberships of International Organization, and Relations with European Union

15. Montenegro is a member of the United Nations, the Organization for Security and Cooperation in Europe, the Council of Europe, the World Trade Organisation, and a founder-member of the Union for the Mediterranean. The European Commission has acknowledged that Montenegro has made significant progress toward meeting the requirements for EU membership. On 17 December 2010 the European Union granted Montenegro the official status of candidate country, and accession negotiations began in mid-2012. Diplomatic relations between Montenegro and the European Communities are conducted through the Montenegrin Mission to the EU in Brussels, which has been fully functional since 2006, and the EU Delegation to Montenegro in Podgorica, which has been open since November 2007.

System of Government

16. Public administration of Montenegro has a total of 54 bodies: 16 ministries, 2 secretariats, 18 administrations, 10 institutes, 6 directorates and 2 agencies, employing a total of 10,512 people - roughly a quarter of all employees in the public sector. Most of the remaining 30,000 are employed in municipalities and in the health and education services. In total there are some 382 budget beneficiaries; most are second-tier 'indirect budget beneficiaries', including primary schools and health care institutions. In addition, there are 21 municipalities and five former extra-budgetary funds, four of which have been integrated into the central government budget. Total municipal expenditure in 2012 is expected to amount to some €124 mn, or about 9 per cent of general government expenditure. Expenditure in 2012 was made up as follows:

Table 3: Size and Structure of the General Government Sector (2012)

	Expenditure in € mn	**% of total**
Central government including 4 main state Funds	1278	88
Regulatory authorities (6) and other extra-budgetary units (see PI-7 (i))	42	3
Local self-government (21 municipalities)	124	9
TOTAL	**1444**	**100**

Source: Budget Department (PE and Self Government Section) and Assessment Team calculations.

Rationale for Public Administration Reform and PFM Reforms

17. The EC's Montenegro 2011 Progress Report noted that "important steps are taken to address reform of the public administration". The Public Administration Reform Strategy for 2011-2016, with the accompanying action plan (AURUM), was adopted by the government in March 2011. The strategy includes introducing European standards covering recruitment and promotion and measures to increase the efficiency of the State administration. It also envisages an overall reduction of employment in the public sector, but does not specify how this would be achieved without affecting the performance and efficiency of services. Some measures have already been taken to introduce economies of scale and integrate bodies whose activities have been disparate and uncoordinated (e.g. the various State inspection services). Some steps have been taken to reform the legal framework governing the civil service, in particular by adopting two essential pieces of legislation: the Law on Civil Servants and State Employees and amendments to the Law on General Administrative Procedure.

18. In December 2012, the Government of Montenegro adopted the Pre-accession Economic Programme (PEP) for Montenegro 2012-2015, drafted by the Ministry of Finance. The PEP outlines the policies and structural reforms that need to be implemented over a three-year period. It will serve as a basis for creating a consistent economic policy aimed at boosting Montenegro's economic competitiveness, mitigating the negative effects of the continuing economic stagnation in the Eurozone, and establishing a stable basis for a sustainable growth in the long term. The programme provides two macroeconomic and fiscal scenarios: baseline and lower growth scenario. It was submitted to the European Commission in January 2013, and will be presented and discussed at the ministerial meeting between candidate states and the European Commission in May 2013. The PEP is part of the pre-accession fiscal surveillance procedure, which aims at preparing the candidate countries for participation in the multilateral surveillance and economic policy co-ordination procedures currently in place in the EU as part of the Economic and Monetary Union (MOF website).

2.2. Description of budgetary outcomes

Fiscal Performance

19. The economic situation described in section 2.1 affected the aggregate levels of public income and expenditures. The annual budget for 2010 was maintained, but the budgets for 2011 and 2012 were 're-balanced' so as to provide for inescapable increases in expenditure such as those relating to the calling of guarantees and at the same time cut back on discretionary expenditure where feasible without significant disruption. In 2012 there was a 5.0% reduction in revenue and a 0.6% increase in expenditure. The table below presents original General Government budgets as a percentage of GDP.[5]

20. It can be seen that revenue has fallen, as a share of GDP, by 5.3 percentage points, while expenditure has fallen by 5.2 percentage points, despite a heavier burden of interest. The aggregate deficit has widened slightly to 3.9% of GDP. Deficits have been met mainly from external sources.

Table 4: General Government Budget as Executed (In Percentage of GDP)

	2010	2011	2012
Total revenue	43.3	40.3	38.0
- Own revenue	42.2	39.6	37.4
- Privatisation receipts	0.8	0.5	0.4
- Grants	0.3	0.3	0.2
Total expenditure and net lending	47.1	45.0	41.9
- Non-interest expenditure	46.0	43.6	40.1
- Interest expenditure	1.0	1.5	1.8
Aggregate deficit (incl. grants)	-3.8	-4.7	-3.9
Primary deficit	-2.8	-3.3	-2.1
Net financing	3.8	4.7	3.9
- external	5.2	4.0	6.0
- domestic	-1.4	0.7	-2.1

Source: GDDS. Own revenue excludes receipts from repayment of loans

Allocation of Resources

21. Table 5 below shows a significant increase in the allocation of resources to social security from 36.3% of total expenditure to 39.9%. This was made at the expense of all other sectors, except public order and safety, which absorbed savings on defence.

5Presentation of the central government budget in the table differs from the standard presentation that the government uses for calculating the deficit/surplus. Specifically, (1) grants and privatization receipts are counted here as revenue, rather than financing, and (2) receipts from repayment of loans are not counted as a part of total revenue but as a part of net lending.

Table 5: Actual Budgetary Allocations by Sector (as a percentage of total central government expenditure)

	2010	2011	2012
1. General public services	8.1	8.3	8.5
2. Defence	3.4	3.0	3.0
3. Public order and safety	9.8	9.7	10.2
4. Economic affairs	12.2	11.9	9.8
5. Environmental protection	0.7	0.5	0.3
6. Housing and community amenities	0.7	0.8	0.6
7. Health	14.7	14.0	14.6
8. Recreation, culture and religion	2.5	2.5	2.2
9. Education	11.7	11.3	11.0
10. Social protection	36.3	38.0	39.9
Total expenditure (final execution)	100.0	100.0	100.0

Source: Budget Dept, MoF

2.3. Description of the Legal and Institutional Framework for PFM

Legal Framework

23. The Constitution of 2007 establishes the three branches of the State – legislative, executive and judicial. Article 144 establishes the State Audit Institution to audit "the legality of and success in the management of state assets and liabilities, budgets and all the financial affairs of the entities whose sources of finance are public or created through the use of state property". The legislative branch (Parliament) adopts the annual budget proposed by the Government and the final statement of the budget (the final accounts). Most of the legal framework is set out in laws passed by Parliament. Draft legislation (for example on the proposed new Budget Law) may be the subject of public consultation before being presented to the Parliament. Each year's budget requires the approval of the Parliament, which should have at least a month to consider the proposals, although in practice this period may be shortened, while "rebalanced" budgets introduced in the course of a year are typically adopted by an accelerated procedure which leaves very little time for Parliamentary discussion. The Budget Law,[6] which dates from 2001 and was most recently amended in 2010, together with the Treasury Regulations and other subsidiary legislation, govern public financial management in Montenegro. Together they cover central and local government. A former Law on Public Debt became an integral part of the Budget Law, while other changes have transformed the extra-budgetary funds into state funds included within the Budget. Another change was the adoption of the Law on Internal Financial Control in December 2008, further updated in 2011. This replaced section 9 of the Budget Law dealing with internal audit. There is a large body of subsidiary legislation. For instance, accounts are kept in accordance with the Rulebook on Consistent Accounts Classification for the State Budget, Extra-Budgetary Funds and Municipal Budgets. Intergovernmental fiscal relations are mainly regulated by the Law on Local Self-Government Finance. This was most recently amended in 2010. The State Audit Institution performs external audits in accordance with the Law on State Audit Institution.

[6] Often called the Organic Budget Law, so as to distinguish it from the annual Budget Law by which Parliament authorises appropriations.

24. In addition to the legislative changes, the Government of Montenegro has adopted PFM reform strategies covering the development of Public Internal Financial Control (PIFC) [2007 and 2011], the Management of Public Debt [2008, about to be updated] and Public Procurement [2011]. The need to match EU standards is an important motivation for many of the changes in law and regulations on taxation, public procurement and PIFC; although substantial progress has been made, there is still considerable further work to do before Montenegro's arrangements are fully aligned with the EU acquis.

Institutional Framework

25. The President of Montenegro is the head of state and is elected directly by the people for a period of five years. At the last elections in October 2012, the Coalition for a European Montenegro maintained its position as the largest party in Parliament (39 seats out of a total of 81), although with fewer seats so that it is now dependent on coalition partners. Members of Parliament are elected for a four-year mandate. The Government consists of a Prime Minister, two Deputy Prime Ministers and 15 Ministers. The Minister of Finance oversees the implementation of the main Budget Law, which regulates budget preparation, budget execution, debt management, budget accounting and reporting through the establishment of the Treasury. The Ministry of Finance (MoF) comprises eight sectors (departments) and supervises several 'administrations' including the Tax and Customs Administrations, the Administration for Properties, the Administration for the Prevention of Money Laundering, and the State Bureau of Statistics. Within MoF the Budget Department prepares and controls the execution of the budget (including approving public procurement plans), while the Treasury Department is responsible for the payment and accounting systems and the management of public debt. Other key institutions in the Montenegrin PFM framework include the State Audit Institution, the Administration for Anti-Corruption, the Public Procurement Administration and the Commission for Control of Public Procurement.

Key Features of the PFM System

26. PFM in Montenegro is largely decentralized, with central policymaking and standard setting centralized and execution decentralized. As the country's IT infrastructure is advanced, all revenue collection is immediately made available to the Treasury and the Treasury runs a single account from which all payments are made on behalf of budgetary entities. Responsibility for authorising payments is assigned by heads of spending units to designated Financial Management and Control Officers. Wages are also paid centrally on payroll requests from budgetary entities. Virtually all payments are made by bank transfer, not using cash or checks. Procurement is mainly decentralized to spending units, designated as contracting authorities. Internal audit is gradually evolving as a service to the management of budgetary entities, though with strong support and direction from the centre (Central Harmonization Unit). All in-year and annual financial reporting is made through the Treasury computerized system (SAP).

3. ASSESSMENT OF THE PFM SYSTEMS, PROCESSES AND INSTITUTIONS

3.1 Budget Credibility

27. 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 an important measure of the overall performance of the PFM system at a high level.

PI 1: Aggregate Expenditure Out-Turn Compared to Original Approved Budget

28. From 2010 to 2012, central government expenditure (excluding interest and debt repayments, and donor-funded project expenditure) deviated from original budgets by 3.1, 6.3 and 6.6% respectively, resulting in a score of B. Detailed calculations are at Annexe 2 and summarized in Table 6 below. The expenditure figures include repayment of guarantees and expenditure from the contingency reserve, but exclude interest payments and amounts of expenditure from external grants. The expenditure increases in 2011 and 2012 are mainly the result of the requirement to repay guarantees.

Table 6: Actual Expenditure Out-Turn Compared with Original Budget (Euro millions)

	Original budget	Actual out-turn	Percentage difference between budget and out-turn
2010	1285.57	1245.46	-3.1
2011	1250.26	1328.52	+6.3
2012	1204.63	1284.27	+6.6

Performance Change and Other Factors since 2008 PEFA Assessment

29. In the years 2005-2007, the deviations were 5.5%, 0.3% and 8.3% of budget, resulting in a B rating. There has been only slight change since then in the measured deviation. The relatively large increase in expenditure between budget and out-turn in 2007 will have been facilitated by the collection of revenues substantially in excess of the amount budgeted. **Indicator rating: B**

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-1	B	B	Scoring method M1 (weakest link)	
(i)	B	B	Out-turn expenditure did not deviate from original budget by as much as 10% in any of the three years.	Apart from the need to repay guarantees in 2011 and 2012, some improvement in performance, as in a situation of very tight fiscal constraints the government has tried to stick closely to its budget plans.

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

30. The specification of this indicator has changed since 2009. The method of calculating the variance of expenditure has been re-specified, and a further dimension introduced to take account of different practices in the management of contingency reserves.

Dimension (i) Extent of the variance in expenditure composition during the last three years, excluding contingency items

31. This indicator assesses budget discipline and demonstrates government's ability to sustain or stick to the budget allocations given to spending units. In other words, it evaluates the credibility of the budget as a statement of policy intent. The calculation of the expenditure variance takes as its starting point the functional allocation of the same expenditure as in PI-1. The original allocation to each sector is adjusted by the overall percentage difference between the original budget and the actual out-turn as calculated for PI-1, and the sum of the differences between these adjusted allocations and the actual expenditure for each sector is shown as a percentage of total actual expenditure. Under this method of calculation, a significant increase in expenditure in one sector not only affects the aggregate (PI-1) but also the mix of expenditure (PI-2(i)), since other sectors' proportionate shares in the total are automatically reduced.

32. Variation in expenditure composition exceeded 10% in only one of the last three years (see Annexe 2) which meets the PEFA criterion for a B rating. The calculated figures for the three years were 11.3%, 9.8%, and 9.1% respectively**. Dimension rating: B**

Table 7 : Variances as a percentage of expenditure out-turn (excluding contingency)

Year	Expenditure out-turn(Euro mn.)	Sum of variances (Euro mn.)	Sum of variances as percentage of out-turn
2010	1232.87	139.36	11.3%
2011	1316.73	129.44	9.8%
2012	1266.19	115.76	9.1%

Source: MoF Budget Dept: for details see Annex 2

Dimension (ii) The Average Amount of Expenditure Actually Charged to the Contingency Vote Over the Last Three Years

33. The change in the method of calculation of dimension (i) above was accompanied by the introduction of a new dimension. This is intended to promote good practice in the use of contingency reserves, by rewarding the avoidance of charging significant expenditure to the reserve. Since actual expenditure charged to the Contingency Reserve amounted to 1.0%, 0.9%, and 1.5% of total expenditure for the three years 2010-12, well below the good practice threshold of 3%, the rating for this dimension is A. See calculation at **Annexe**

2. Dimension rating: A

	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-2	**C**	**B+**	Scoring method M1 (weakest link)	
(i)	C	B	Variance in expenditure composition exceeded 10% in only one of the last three years.	When the 2008 data is re-calculated on the new method, it results in variances of 8.7%, 5.6% and 15.6% in the years 2005-2007. This would be rated B under the new convention because of the high variance in 2007.
(ii)	NA	A	Since the amounts charged to the Contingency Reserve were less than 3% of total expenditure in each of the three years 2010-12, rating is A.	New dimension introduced in 2011, so no direct comparison with previous situation. But the Reserve was always small and would have justified A in 2008.

PI 3: Aggregate Revenue Out-Turn Compared to Original Approved Budget

34. Actual domestic revenue compared to domestic revenue in the originally approved budget. This indicator assesses government's performance on domestic revenue collection (tax and non-tax), compared with forecast. The main taxes are personal income tax, social security contributions, corporate income tax, value-added tax, excise duty, customs duty and property tax. The proceeds of privatisation are included in domestic revenue in accordance with the GFS Manual, 1986. Receipts from repayment of loans and funds carried over from the previous year have been excluded, as these are offsets against expenditure, rather than revenue.

35. Revenue estimates are prepared annually by the MOF Department for Economic Policy and Development. A simple Excel model has been developed over the last few years for forecasting GDP and other macroeconomic parameters and from these each item of revenue (30 items) for the next three years. An estimate is made in April in consultation with the Tax and Customs Administrations (with respect to changes in taxes), the Central Bank and Statistics Office, and passed to the Budget Department. It is updated in August and in the event of any Supplementary Budget. As a working rule, revenue growth should not exceed the expected nominal growth of GDP. Forecasts can easily be upset by unexpected weather conditions (eg. the harsh weather of first quarter of 2012), delays in the implementation of tax changes or other unexpected change.

36. As with PI-2, there has been a change in the method of scoring PI-3. Now over-collections/under-estimates are penalised as well as under-collections/over-estimates. **Under the new method, the score in 2008 would have been D rather than A (see calculation at Annexe 2).** In fact, there has been an improvement in revenue forecasting, to which the more stable, although depressed macro-economic environment will have contributed, as well as greater experience and improved staffing of the MoF sector responsible. The following table shows the main elements of revenue, budget and out-turn, for the three years 2010-12.

Table 8: Domestic Revenue Out-turn compared to original Budget (Euro millions)

	2010		2011		2012	
	Budget	Out-turn	Budget	Out-turn	Budget	Out-turn
Personal income tax	83.63	89.75	88.59	81.64	91.64	82.26
Company income tax	49.58	20.27	32.90	36.10	34.22	64.02
VAT	398.86	364.18	401.26	392.24	417.81	354.71
Excise duties	149.89	134.26	147.48	143.38	161.81	151.77
Import duties	48.87	50.81	53.53	45.33	52.89	28.97
Other tax revenue	15.44	16.53	4.95	5.39	5.14	5.72
Fund contributions	323.93	379.76	359.61	353.58	371.99	362.25
Fees and charges	54.49	47.97	47.67	41.71	39.12	30,55
Privatisation proceeds	59.00	2.78	15.00	3.35	10.00	0.01
Other revenue	33.36	31.86	30.41	24.78	31.01	34.08
Total	1217.05	1138.17	1181.40	1127.48	1215.64	1114.14
Percentage difference between Out-turn and Budget		6.5%		4.6%		8.3%

Source: Budget Department, MOF

37. As is clear from the table, most elements of revenue were consistently over-estimated throughout the period. The most important revenue sources are VAT and contributions to Pension and Health Funds. Personal income tax receipts have not fallen very far below estimate, although company tax receipts fell sharply in 2010 as a result of the abolition of advance payments. There was a significant shortfall in VAT receipts in 2012as economic activity slowed. Import duty receipts fell as a result of duty reductions associated with accession to the World Trade Organisation. Company tax receipts in 2012 exceeded the estimate, presumably as a result of higher profits the previous year. There were shortfalls in expected privatisation proceeds. **Indicator rating: C**

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-3	**A**	**C**	Scoring method M1 (weakest link)	
(i)	A	C	Revenue performance the last 3 years has been 93.5%, 95.4% and 91.7% of budget. This meets the standard for C rating (between 92% and 116% in at least 2 of the last 3 years). Except for the shortfall in privatisation proceeds, the score would have been B.	Under the new method, which penalises under-estimates of revenue, the score in 2008 would have been D due to major under-estimates of revenue in 2006 and 2007. There has therefore been a real improvement in revenue forecasting.

PI 4: Stock and monitoring of expenditure payment arrears

Dimension (i) Stock of expenditure payment arrears (as a percentage of actual total expenditure for the corresponding fiscal year) and any recent change in the stock

38. On a cash basis of accounting, expenditure arrears are omitted from expenditure reports: they are 'hidden expenditure'. Expenditure arrears in the Government of Montenegro are defined as liabilities on goods and services delivered but not paid for, irrespective of the due date for payment, in accordance with accrual accounting conventions, and are fully disclosed. Arrears do not include commitments (orders made) for which the goods or services have not been received. They are supposed to include liabilities on goods and services received even if the relevant invoices are delayed.

39. In Montenegro it appears that arrears have arisen, particularly at municipal level, essentially because revenue has fallen short of expectations, and it has not been possible to cut back approved budget allocations quickly enough to bring total expenditure into line with available resources. It does not appear that the arrears reflect, to any significant extent, the deliberate making of commitments by central government spending units which go beyond their budget allocations.

40. At 31 December 2010, central government arrears were €61.3 mn, being 4.9% of total recorded executed expenditure. At 31 December 2011, arrears had increased slightly to €61.9 mn, which was 4.7% of total expenditure that year. At 31 December 2012, arrears had again increased slightly to €65 mn, being 5.1% of total expenditure (data from the Final Budget Execution Statements and the SAI reports on 2010 and 2011, and Budget Department for 2012).[7] There is no age profile, but at end 2012, €44 mn of the liabilities were not due until 2013. The greater part is arrears of social security payments: an annexe in the annual financial statements provides an economic classification.[8] Since arrears fall into the range 2-10 per cent of annual expenditure, and have not been falling, year on year, the **dimension rating is C**.

Dimension (ii) Availability of data for monitoring the stock of expenditure arrears

41. Spending units are required to submit statements of arrears along with their quarterly revenue and expenditure statements to MOF within one month of the end of quarter. They are generally on time. Such data were not available at the time of the 2008 assessment.

42. As spending units have an incentive to report these liabilities in order to maintain their expected Treasury warrants and because arrears data are audited, they are accepted as sufficiently reliable for scoring this indicator, based on the two years to December 2012. **This dimension is rated B**, for lack of an age profile.

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[7] These figures are from the Draft Annual Financial Statements, as reported by the SAI. The 2009-2012 Budget Summary compiled by Budget Department from the Treasury General Ledger shows a net increase of arrears (liabilities) of €29.1 mn in 2009, €29.8 mn in 2010 and €29.2 mn in 2011. It has not proved possible to reconcile these figures.

[8] At 31 December 2011, arrears were analysed as follows: current expenditure 13.3 mn, social security transfers 41.4 mn, transfers to institutions and individuals 5.7 mn, capital expenditure 0.4 mn, loans and credits 0.6 mn and repayment of debt 0.5mn. (The last is a financing item, not expenditure, but is not material).

Local Government Arrears

43. Municipalities submit fiscal statements quarterly to MOF Budget Department. These are usually received three months after the end of each quarter. The statements show revenue, expenditure, formal debt and guarantees, and expenditure arrears. At 30 September 2012, arrears of the 21 municipalities, including their public enterprises, totalled €94.9 mn, a small improvement on the total of Euro 98.5m at the end of 2011. This compares with total municipal expenditure for 2012 (forecast out-turn) of Euro 123.6m, and is considerably higher than central government arrears, both absolutely and relatively. The arrears essentially result from the downturn in the economy in 2009, which led to a collapse in previously buoyant revenues associated with construction activity and property transfers, on which municipalities were heavily dependent. The following table shows the main elements of expenditure arrears at the end of 2010 and 2011, and the position at the end of September 2012. Net additions to arrears are being avoided, but as arrears of one type have been repaid, they have been replaced by new arrears of a different kind, as some payments have been delayed so as to enable older arrears to be paid off. Overall the Budget Department emphasises that the picture is of municipalities' budgets currently being in surplus, with arrears being gradually reduced.

Table 9: Local Government Arrears (Euro millions)

	End 2010	**End 2011**	**30 September 2012**
Current expenditure	27.7	42.2	48.4
Social protection transfers	0.1	0.1	0.1
Transfers to individuals, NGOs	4.9	9.9	4.3
Capital expenditure	19.2	34.7	27.9
Loans	42.7	10.7	13.5
Other	0.3	0.9	0.7
Total	95.0	98.6	94.9

Source: Budget Department, MOF

Planned Reforms

44. A web-based software application has been designed to enable spending units to record liabilities on invoices as they are received. 15 spending units including the Ministry of Education are using this system, and all other spending units will receive training in making inputs by June 2013. In the next phase of development, orders and other commitments will also be captured (see PI-20 (i)).

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-4	**D***	**C+**	Scoring method M1 (weakest link)	*The combined score in 2008 should have been NR rather than D. No comparison can be made with 2013 for lack of reliable data.
(i)	NR	C	The stock of arrears appears to be in the range 2-10% of total expenditure, and there is no evidence that it has been reduced significantly in the last two years.	No comparison can be made with 2008.
(ii)	D	B	Data on the stock of arrears is generated quarterly, but may not be complete and does not include an age profile	Improvement in the availability of data.

3.2. Comprehensiveness and transparency

Indicators 5 to 10 are concerned with the comprehensiveness of the budget and whether fiscal and budget information is accessible to the public. They also cover arrangements for financing local government (PI-8) and fiscal risks to central government from the activities of public enterprises and municipalities (PI-9).

PI 5: Classification of the budget

45. This PI assesses the classification system used for formulation, execution and reporting of the central government's budget. Budget formulation and execution is based on administrative, programmatic, economic and main functional classification using GFS and COFOG standards. The Chart of Accounts provides for all transactions to be recorded in the Treasury SAP system, with all details according to the different classifications. Assessment of the annual budget law for 2013 indicates that the budget classification is reasonably consistent with GFS and COFOG standards (see next paragraph). The classification is sufficient to produce fiscal statistics in accordance with the cash-based GFS Manual 1986. In a recent (October 2012) return to a Survey of Treasury and fiscal reporting arrangements in Eastern Europe and Central Asia it was stated that Montenegro plans to move to accrual accounting, but that no firm timetable had been set for the achievement of this objective. The 2013 budget provides a full breakdown of the budget according to organizational, economic and the ten main functional classifications. In the 2013 Budget the line item "contractual services" has been broken down into a number of different elements. All spending units have had a programmatic breakdown since 2011, which corresponds to COFOG sub-functions. Thus information is now available according to administrative, economic, functional and sub-functional classifications.

46. The economic classification differs from GFS in three respects: (i) grants and privatisation receipts are presented as financing items, rather than revenue, (ii) receipts from repayments of loans and funds carried over from the previous year are taken as a revenue item, rather than an offset to expenditure and net lending, and (iii) capital expenditures below €30,000 are treated as current expenditures. All three items are shown separately so the GOM statements can easily be re-formatted to GFS. **Indicator rating: A**

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-5	B	A	Scoring method M1 (weakest link)	
(i)	B	A	The Chart of Accounts supports the provision of consistent information according to economic, administrative, functional, sub-functional and programme classifications.	Improvement in functional classification through completion of the programme structure

PI 6: Comprehensiveness of information included in budget documentation

47. Annual budget documentation (the annual budget and budget supporting documents), as submitted to the legislature for scrutiny and approval, should allow a complete picture of central government fiscal forecasts, budget proposals and out-turn of previous years. In addition to the detailed information on revenues and expenditures, and in order to be considered complete, the annual budget documentation should include information on certain elements. The assessment examines which of nine pieces of information are included in the Budget documentation submitted to the Parliament.

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

Macro-economic projections of aggregate growth and inflation are stated in the Memorandum to the Budget. Since Montenegro uses the Euro, there is no question of its exchange rate varying independently, and in practice the bulk of its trade (including its tourism industry) is with the Eurozone or with countries whose currencies are tied to the Euro. The macro-economic projections take into account the prospects for the development of economic activity, and incorporate a three year aggregate fiscal projection of government revenue, expenditure and debt consistent with the overall economic outlook. This benchmark is considered to be 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, external grants have hitherto been treated as financing rather than revenue, as would be normal in GFS presentations (the other divergences from the normal GFS economic classification do not affect the overall fiscal balance). Expenditure resulting from the calling of guarantees, which in previous years would have been treated as financing, is now recognized as contributing to the fiscal deficit. Since grants have hitherto represented only a very small fraction of total revenue, and full information is provided enabling the calculation of the deficit on alternative definitions, this benchmark may now be considered to be met. The 2008 assessment considered this benchmark not to be met.

3. Deficit financing, describing anticipated composition

Article 17 of the Organic Budget Law requires the budget proposals to include details of how any fiscal deficit is to be financed (or how any surplus is to be used). In practice this information has been incorporated in recent Budgets. This benchmark is met.

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

This benchmark requires only that full information should be available about the debt stock at the beginning of 2012 when the budget proposals for 2013 are put forward. In practice information about government debt (including guarantees and municipal borrowing) is published quarterly, including a full breakdown of amounts outstanding due to external lenders, so that details of government debt at the end of June 2012 will have been available when the 2013 budget proposals were being considered. Accordingly this benchmark is considered to be met.

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

Again the benchmark requires only that details of the government's holdings of financial assets at the beginning of 2012 should be available when the 2013 Budget is considered. Since these are disclosed in the final budget execution statement for 2011 which will have been adopted by the Parliament shortly before the Budget proposals are presented, this benchmark can 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. 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, programme and economic classification. The Budget Memorandum contains the estimate of the current year's out-turn but only based on economic classification. 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.

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 elements, revenue and expenditure, presented by economic classification (without incomes from the asset sale, credits, loans and grants) with comparisons over the three years. Expenditure summaries by functional sector and main administrative unit are not provided. 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.

Recent annual Budgets have essentially shown the impact of the continuation of established policies governing revenue and expenditure, and have not been used as a vehicle for the implementation of policy changes. Article 7 of the Organic Budget law requires the budgetary consequences of any legislative proposal to be explained, together with any necessary steps to restore budget balance, and the rebalancing has to be approved by Parliament through the normal procedure. Projected revenue shortfalls or expenditure over-runs should give rise to corrective action through a budget rebalancing; during the preparation of this report (subsequent to the enactment of the 2013 Budget) revisions to the economic outlook, and so to estimates of revenue, resulted in budget rebalance incorporating increases in taxation and reductions in expenditure. This benchmark is met. **Since 7 of 9 benchmarks are met, Indicator rating: A**

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-6	B	A	Scoring method M1 (weakest link)	
(i)	B	A	Since 7 of the 9 benchmarks are considered to be met, the rating is A.	No underlying change: the current assessment accepts that the presentation of the deficit is not significantly misleading, and that the disclosure of financial assets as at the beginning of the current year in the previous year's budget execution statement meets the benchmark.

PI 7: Extent of unreported government operations

Annual budget estimates, in-year execution reports, year-end financial statements and other fiscal reports for the public, should cover all budgetary and extra-budgetary activities of central government to allow a complete picture of central government revenue, expenditures across all categories, and financing. This will be the case if (i) extra-budgetary operations (central government activities which are not included in the annual budget law, such as those funded through extra-budgetary funds), are insignificant or if any significant expenditures on extra- budgetary activities are included in fiscal reports, and if (ii) activities included in the budget but managed outside the government's budget management and accounting system (mainly donor funded projects) are insignificant or included in government fiscal reporting.

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

48. All government Funds (Pension, Health, Employment, etc) except the Investment and Development Fund (called simply Development Fund) are included within annual budget estimates, in-year budget execution reports and the year-end annual financial statements since 2008. The Annual Budget Law should be published on the Ministry of Finance web portal as well as the website of the Parliament of Montenegro, although it was not possible in February 2013 to confirm that this had been done. The Development Fund is a revolving fund for loans to small and medium enterprises. Its original capital in 2009 of €97.2 mn was derived from privatisation receipts. Outstanding loans at the end of 2011 were €10.1mn. Its annual new lending is currently about €32mn, and it aims to cover all its financing and administrative costs through the interest paid on its loans. This is a government function and the Fund comes within the IMF/GFS definition of central government despite its omission from the Single Treasury Account. It submits annual budget reports, planned and executed, to MOF. Total expenditures of the Fund in 2011 were €3.4 mn.

49. There are six regulatory agencies - the Regulatory Agency for Energy, Agency for Drugs and Medical Supplies, Regulatory Agency for Telecommunications, Broadcasting Regulatory Agency, Insurance Agency and the Securities 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 laws. 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 prepares and submits annual financial statements to government and/or Parliament, as required by its regulations. However, since this expenditure is reported only at the out-turn stage, with no comparable reporting at the budgeting stage, it counts as unreported. In 2011, their expenditure is estimated at € 9mn.

50. In addition, fees and other revenues received by hospitals and educational institutions are retained and used by them without passing through the Single Treasury Account (see Budget Law, Article 32a). They report these 'own revenues' to MOF monthly, but they are not included in the state budget, in-year execution reports or annual financial statements. They are estimated at €30 mn in 2012 (about 3 per cent of total budget expenditure), of which about half is attributable to the University. This treatment is justified by GOM by the incentive it provides to the respective institutions to ensure that fees, etc are collected, and the flexibility it provides for unanticipated and emergency expenditures to maintain and improve service delivery. However, the amounts collected and spent should be more transparent. Since the total of unreported expenditure as estimated by MoF is in the range 1-5 per cent of total budget expenditure, **the rating for this dimension is B**.

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

51. Where activities are financed by external loans or grants, only any required local co-financing is included in Budget Estimates, although the out-turn figures include all the relevant expenditure except where (mainly external) payments are made by donor agencies without passing through the Treasury. Hitherto grants have been regarded as part of financing rather than as revenue, with the result that the fiscal deficit as presented by the government is somewhat overstated. However, the amounts of grants received during 2010-12 have been only about €5mn a year, so that the impact on the deficit figure has so far been very small. Since EU-funded IPA expenditure is expected to increase substantially from 2013 onwards to some €20-30mn a year, it will be important to ensure that such expenditure is fully included in reports at both budgeting and out-turn stages, and to treat grants as revenue rather than financing. Given that externally funded expenditure remains outside presentations of the Budget, **the rating for this dimension is D.**

Planned reforms

52. MOF expects to change the presentation of grants and to include total expenditure on externally financed activities. This will in any event be necessary if Montenegro is to meet all the criteria required for accession to the EU.

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-7	**D+**	**D+**	Scoring method M1 (weakest link)	
(i)	B	B	Unreported expenditure is roughly estimated at €42 mn a year, which is within the range of 1-5% of total expenditure.	No net change
(ii)	D	D	Information on donor-financed projects is seriously deficient	No change

PI 8: Transparency of inter-governmental fiscal relations

53. While the performance indicator set is focused on PFM by central government, sub-national (SN) governments in many countries have wide-ranging expenditure responsibilities. Specific laws determine the layers of SN government, their expenditure responsibilities and revenue sharing arrangements. Transfers falling in these categories are usually unconditional grants, the use of which will be determined by SN governments through their budgets. In addition, central government may provide conditional (earmarked) grants to SN governments to implement selected service delivery and expenditure responsibilities e.g. by function or program, on a case by case basis. The overall level of grants (i.e. the vertical allocation) will usually be budget policy decisions at the central government's discretion or as part of constitutional negotiation processes and is not assessed by this indicator. However, clear criteria, such as formulas, for the distribution of grants among SN government entities (i.e. horizontal allocation of funds) are needed to ensure allocative transparency and medium-term predictability of funds available for planning and budgeting of expenditure programmes by SN governments. It is also crucial for SN governments that they receive firm and reliable information on annual allocations from central government well in advance of the completion (preferably before commencement) of their own budget preparation processes.

The Constitution of Montenegro provides for a sub-national level of government called local self-government consisting of 21 municipalities. The Law on Local Self-Government prescribes the organization, authority and competent bodies of a municipality, and the Law on Local Self-Government Financing covers their financial management.[9] Municipalities are responsible for the provision and maintenance of local infrastructures, and for local social and cultural activities. They are not involved in the provision of health or education services. Much of their expenditure has been on capital projects, assisted in some cases by external grants and loans, although such expenditure has been cut back during the current period of fiscal stringency. As explained below, there are no central government transfers to municipalities, while the revenues accruing to municipalities are heavily dependent on investment –and particularly inward investment – activity which tends to fluctuate markedly depending on the overall economic conjuncture. The extent of the problems arising from this was not as clearly visible in 2008 as it is in 2013.

[9] Law on Local Self-Government, Official Gazettes 42/2003, 28/2004, 75/2005, 13/2006, 88/2009 and 3/2010.
Law on Local Self-Government Financing, Official Gazette December 2010 (Law 74/2010). Regulations prescribe the eligibility criteria for receiving assistance from the Equalisation Fund each year, how the allocations are to be determined and how the final distribution is to be made.

54. In June of every year, the Ministry of Finance issues a circular (technical instruction) for the preparation of the following year's budgets by spending units and local self-governments. The technical instructions include important economic parameters, instructions, guidelines and deadlines for preparation of the budget, and approximate amounts of expenditure recommended[10] for each local self-government.

Dimension (i) Transparency and objectivity of systems for the horizontal allocation among sub-national governments of conditional and unconditional transfers from central government.

55. The Law on Financing of Local Self-Government (Law 74/2010) prescribes municipalities' sources of funds and methods of financing and the procedures for budget planning, execution and financial reporting. There are four sources of municipal financing:

1. Own resources. These comprise surtax on income and other taxes; real estate tax; local communal and administrative charges; fees for the installation of utilities on development land; fees for road use and environmental protection; amounts realized from the sale or letting of municipal property; revenues from concessions under municipal control; and charges for other services provided by municipalities. A municipality may impose a surtax of up to 13% (15% in Podgorica and Cetinje) of the national tax amounts paid by each taxpayer on personal or corporate income (including self-employment income), capital gains and property and property rights. A smaller but relatively prosperous municipality said such revenues accounted for about 30% of its income.

2. Municipal share of national revenues (in accordance with Law 74/2010).These comprise 12% (16% for Cetinje and 15% for Podgorica) of the personal and corporate income tax yield in the territory of each municipality; 80% of revenues from real estate transfers; 70% of revenues from concessions for the use of natural and forest resources; 20% of revenues from port fees and fees for the use of coastal resources; and 30% of charges for the registration and use of motor vehicles. The municipality mentioned above obtains about 20% of its revenue from this source.

3. Equalisation Fund. Law 74/2010 provides for poorer municipalities (defined as those with below average fiscal capacity) to be financed through an Equalisation Fund. The resources of this Fund consist of 11% of the national yield of personal and corporate income taxes; 10% of the yield of taxes on real estate transfers; 100% of the yield of the tax on the use of motor vehicles, ships and aircraft; and 40% of concession fees on games of chance. The Fund may also receive short term loans from the State Budget. The criteria for allocation of the Fund, its management rules and operations are prescribed by the Law and secondary legislation. A Commission for Monitoring of Development of Municipalities Fiscal Equalisation System applies the criteria and manages the Fund. The Fund does not appear anywhere in the central government budget, since its revenues accrue directly from tax collections before these reach the Treasury, and its expenditures represent part of the revenue of the municipalities concerned. MOF informs the municipalities concerned in July each year how much they can expect to receive out of 90% of the Fund's expected revenues during the following year; the remaining 10% is only allocated in a final accounting exercise after the end of

[10] As municipalities have legal autonomy, the MOF ceilings are expressed as recommendations rather than directions.

the year in question. The municipality mentioned above expects to receive about 40% of its annual revenue from this source, but poorer municipalities depend on it to a much greater extent because they have so little scope for raising their own revenue.

4. Conditional grants from the State Budget for investment projects. These are used to finance 10-50% of the cost of investment projects as requested by a municipality. The percentage of grant depends on the municipality's collection of tax on undeveloped land the previous year: the lower the per capita tax collection compared with other municipalities the higher the percentage of grant. By March of every year, municipalities must present requests for desired investment projects (to be implemented in that same year) together with a five-year investment plan to the MOF, who review and make recommendations on these requests for approval by Government. These grants are frequently used to supply required co-financing for externally funded projects. The municipality mentioned above typically receives about 10% of its income in the form of external and conditional grants.

56. This system is relatively opaque, and subjects municipalities to significant risks. Tax revenues are subject to significant fluctuation depending on the state of the economy, thereby introducing an element of uncertainty into the yields of both municipalities' own and shared revenues, while any revenue shortfall will similarly reduce the scope for any revenue loss to be compensated through the Equalisation Fund whose resources will also have been reduced. Finally there remains an uncertainty about which municipalities will qualify each year for a share in the Fund, since their relative fiscal capacities may fluctuate from year to year. The PEFA criteria look for a transparent and rules-based system for determining the horizontal allocation of transfers from central government. Since there are no transfers from central government other than conditional grants for investment projects, and municipalities' incomes are largely dependent on complex arrangements for sharing a revenue stream that may fluctuate considerably with the economic cycle**, this dimension is rated D.**

Dimension (ii) Timeliness of reliable information to sub-national governments on their allocations from central government for the coming year.

57. Municipalities get information from central government on the amounts of revenue they can expect (items 2-4 above) before, during and after they start their budget preparation process. Part of their "own revenues" (item 1 above) depends on the amounts of national collections of income taxes, while their other own revenues may fluctuate even more sharply because of unpredictable changes in the level of investment activity. The experience of 2008-9 indicates that municipal revenues may on occasion fall short of budget by 20 per cent or more. Local government revenues fell from 257m Euro in 2008 to 184m Euro in 2009, a reduction of nearly 30 per cent. 15m Euro of this reduction was attributable to the municipal share of tax revenue (a fall of 15 per cent), while income from fees fell from 127m Euro to 77m Euro (a fall of nearly 40 per cent). MoF provides information about the previous year's actual transferred (shared) revenues and estimates of the following year's receipts. But there are significant uncertainties both about the overall amount accruing to the Equalisation Fund and about the shares to be allocated to each municipality. Conditional grants for projects, as noted, are not known until well after the beginning of the budget year (usually April). These are kept in the State budget, not municipality budgets, but still count as central government allocations. The exact amount of the Equalisation Fund and its final allocation are not known until after the end of each year when actual revenues are known. By law, municipalities are required to submit their draft budget to MOF by the end of October and to secure its approval by the relevant Municipal Assemblies by end-November. In practice, final municipality budgets are usually set before the end of December each year.

58. Since reliable estimates of revenues are not available before municipal budgets should be finalized, **the rating for this dimension is D.**

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

59. Fiscal data on municipal revenues and expenditures are reported and consolidated in economic classification. Municipal financial reports do not include any functional classification, as programme budgeting has not yet been implemented at that level. In the general government reports, MOF includes all municipal expenditure under the heading 'General Public Services'. Local government expenditure is currently (2013) about 8% of total general government expenditure.

60. Since no reports are made by local governments of the sectoral/functional distribution of their expenditure, no consolidation of fiscal data for general government by sectoral categories is possible. Rating for this dimension: D

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-8	**B**	**D**	Scoring method M2	
(i)	A	D	The allocation of transfers to municipalities is covered by detailed rules, but these are not transparent to the beneficiaries and they cannot predict their receipts.	It appears that the 2008 assessment interpreted the requirement in terms of the allocation rules alone, without considering their transparency to the beneficiaries. No real change since then.
(ii)	A	D	Complete information on central government allocations is not available before municipalities are required to submit their budgets for approval	It appears that some information was not available to the 2008 assessment and that there has not been any significant change since then.
(iii)	D	D	There is no functional classification of SN government expenditure	No change

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

61. This indicator is concerned with the extent of central government monitoring of fiscal risk. 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. The indicator has two dimensions, which relate (i) to autonomous government agencies and state-owned enterprises and (ii) sub-national levels of government.

Dimension (i) the extent of central government monitoring of autonomous government agencies and state-owned enterprises.

62. As mentioned under PI-7 (i) there is a Development Fund and six regulatory agencies: the Regulatory Agency for Energy, Agency for Drugs and Medical Equipment, Regulatory Agency for Telecommunications, Broadcasting Regulatory Agency, Insurance Agency and the Securities Commission of Montenegro. Each agency submits annual financial statements to government and/or Parliament. Their total expenditure amounts to less than one per cent of total central government expenditure. From 2008, an MOF Ordinance requires these agencies to submit annual financial statements to the Ministry of Finance by 31 March 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.

63. There are 30 SOEs, which are monitored by the MOF Budget Department. Together they account for about 4% of total employment in Montenegro. They are required to submit their annual audited financial statements by 31 March of the following year. For the FY 2011, 20 had been received by the due date. Statements include an income statement, a balance sheet, a statement of changes in equity, a cash flow statement, and a table of operational indicators. In 2008, the MOF adopted an Ordinance which, amongst other things, requires SOEs to submit quarterly financial and operational information based on international financial reporting standards. The Budget Department consolidates data from the 10 largest SOEs, which are responsible for the great majority of expenditure. Contingent liabilities and other fiscal risks are not collated by MOF. The ten largest SOEs suffered an overall loss of €69.1 mn in 2011, of which the Electric Power Industry was responsible for €66.6 mn. Since electricity prices are controlled by an independent body appointed by the Parliament, these losses (equivalent to about 5% of annual budget expenditure) could eventually fall to be met by the government.

64. In addition to the fiscal risks arising from SOE operations, the government may have to take responsibility for risks arising from the operations of private sector companies. The most important of these concern the operations of the formerly publicly-owned aluminium plant (KAP) whose borrowings were guaranteed by the government as a means of ensuring its continuing operation. This guarantee has now been called in two tranches in 2011 and 2012, resulting in total payments of nearly €60mn. The annual subsidy in respect of the plant’s electricity consumption, which had been costing about €5mn a year has been discontinued as from the beginning of 2013. In addition to payments arising from its support for aluminium operations the government also bore the redundancy costs arising in 2012 from the restructuring of a bankrupt steel plant, in order to facilitate its sale to a new investor and the resumption of production.

65. In addition to the fiscal risks with national implications arising from activities of AGAs, SOEs and sub-national levels of government, the GOM has identified and monitors two significant fiscal risks essentially arising from the break-up of former Yugoslavia: land restitution claims and frozen foreign exchange savings. 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 mn) 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 mn 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 mn.

66. As noted above, the Government has taken steps to strengthen its monitoring of AGAs, SOEs and other sources of perceived fiscal risk through reports received after the event. On the other hand it does not appear that any steps have yet been taken to review the projected financial performance of SOEs, with a view to maximizing their contribution to the economy and avoiding any significant financial losses. Since the PEFA indicator places emphasis not only on the need for reports in respect of each source of fiscal risk (ie. reports from each AGA, SOE and other source of fiscal risk) but also on the production and analysis of a consolidated overview of fiscal risk, the absence of any consolidated overview of SOEs' financial performance results in **this dimension being rated C.**

Dimension (ii) The extent of central government monitoring of SN government's fiscal position

67. Municipality budgets should be balanced, but the 'balancing' may be through borrowing (Law on Local Self-Government Financing article 41), so the Law does not absolutely prevent municipalities from spending more than their revenue. However, borrowing for more than a year may be undertaken only to finance capital investment and requires the consent of the Ministry of Finance under the main Budget Law, while debt service costs are required under the law on local self-government finance to be kept within 10 per cent of the previous year's revenue. 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 Local Self-Government Financing obliges municipalities to report 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 should be submitted to the Municipal Assembly by the end of May for approval. They are also submitted to the Ministry of Finance for information within 30 days of their adoption.

68. There is thus close supervision of municipal borrowing. But when municipalities have found themselves under severe financial pressure they have incurred payment arrears through unpaid invoices, delayed salary payments, negotiations for postponement of payments to suppliers and in other ways. As noted in relation to PI-4 above the total reported amount of these arrears remains nearly €100mn, although it appears that they are now being gradually reduced. Since there is close and effective monitoring of municipalities' borrowing and payment arrears, **the rating for this dimension is A.**

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-9	**C+**	**C+**	Scoring method M1 (weakest link)	
(i)	C	C	Most AGAs and PEs submit fiscal reports to the Government at least annually, but there is no consolidation of fiscal issues into a report	No change
(ii)	A	A	Municipalities submit quarterly and annual fiscal statements to MOF, including tracking their payment arrears, and these are consolidated into a quarterly report. The existence of significant arrears is regrettable, but the overall position is clearly recognised.	The 2008 assessment omitted the issue of arrears, but at that time there may not have been arrears.

PI 10: Public access to key fiscal information

69. 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.

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

The main Budget Law defines the annual budget documentation and the structure of the Annual Law on Budget that is available on the website of the Ministry of Finance 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 Finance. Annual budget documentation comprises: estimates of revenues and expenditures; Budget Memorandum describing the assumptions for budget preparation and how the budget is to be executed according to economic, organizational, functional and programmatic classifications. It also includes expenditure projections for the two subsequent years. This benchmark is met.

2. Availability of in-year budget execution reports

Quarterly summary reports of expenditure on the economic classification are available on MOF website within one month of their completion. This benchmark is met. It should be noted, however, that information is not provided on an organizational or functional classification.

3. Publication of year-end financial statements within six months of completed audit

According to the main Budget Law, the Government should send a Proposal for the Law on Year-end Financial Statements to the Parliament by the end of July (Article 49). According to the Law on State Audit Institution (SAI), this institution should send its Annual Report on Year-end Financial Statements to the Government and Parliament before the end of October (Article 19), thereby providing the basis for Parliament to adopt the annual budget execution law, and opening the way to publication of the financial statements. This benchmark is met.

4. Availability to 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 2010 and 2011 were each published the following October, shortly after the completion of the audit. This benchmark is met.

5. Publication at least quarterly of awards of all contracts with value in excess of about US$ 100,000

The award of all contracts whatever their value is published on the web site of the Public Procurement Administration (Article 107 of the 2011 Public Procurement Law) within three days of the decision on the contract award. This benchmark is met.

6. 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 benchmark is only partially met.

70. As five out of six benchmarks are fully met**, rating for this indicator is A.**

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-10	**A**	**A**	Scoring method M1 (weakest link)	
(i)	A	A	5 of 6 benchmarks are met.	No change

3.3. Policy-based budgeting

PI 11: Orderliness and Participation in the Annual Budget Process

While the Ministry of Finance (MOF) is usually the driver of the annual budget formulation process, effective participation in the budget formulation process by other ministries, departments and agencies (MDAs) as well as by the political leadership, impacts the extent to which the budget will reflect macro-economic, fiscal and sector policies. Full participation requires an integrated top-down and bottom-up budgeting process, involving all parties in an orderly and timely manner, in accordance with a pre-determined budget formulation calendar.

Dimension (i) Existence of and Adherence to a Fixed Budget Calendar

71. The 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 2010, 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. Table 9 below shows actual dates of some key milestones in the budget process. **Rating of this dimension is A.**

Table 10: Montenegro Budget Calendar			
1	**Budget Year 2011**	**Budget year 2012**	**Budget year 2013**
MOF issues guidelines for macroeconomic and fiscal policy	April 2010	April 2011	April 2012
MOF issues Budget Circular	20 May 2010	30 May 2011	May 2012
Spending units submit budget requests	End July	End July	End July
State funds submit budget requests	End August	End August	End July
MOF submits draft budget to Government (Cabinet)	October	October	October
Budget presented to Parliament	6 November 2010	21 November 2011	December (delayed following October 2012 elections
Parliament approves budget	16 December 2010	23 December 2011	17 December 2012

Dimension (ii) Guidance on the Preparation of Budget Submissions

72. MOF issues a comprehensive budget circular in May each year, which incorporates expenditure ceilings within which spending units are asked to work. However, these ceilings do not reflect any prior collective consideration by Ministers, and have been regarded as the starting points for negotiations with MOF. Current and capital budgets are treated separately. Budget submissions do not separate the cost of continuing existing programmes and policies from the cost of changes, except that the budget for ongoing projects can be separated from the budget for new projects (MOF 2012 Annual Report). Details of staff numbers and employment costs are required. Though the budget is structured by organisational unit and by programme (within each spending unit), there are no requirements for output or outcome indicators, nor targets for achievement each year that would enable the assessment of efficiency or effectiveness. Budget submissions should include forward estimates for the two following years, but these forward estimates are not published with the budget, or reconciled with the aggregate medium-term projections (see PI-12 below). Because the expenditure ceilings issued to spending units do not reflect collective decisions by Ministers, but instead have been regarded as the starting point for negotiations**, the rating for this dimension is C.**

Dimension (iii) Timely Approval of the Budget by the Legislature

73. The annual budget law has been approved by Parliament by 31 December in each of the last three years. The Budget Law provides for continued budget execution if the Parliament fails to approve the law in time, but this has not been needed for the last three budgets. The Budget Law includes a general requirement that the budget be amended in the case of decreased receipts or increased payments. In 2011 and 2012 the original budgets were amended (once) during the year**. Rating for this dimension: A**

Planned Reforms

74. The government is currently (March 2013) consulting on a new draft Law on Budget and Fiscal Responsibility. Article 24 would require spending ceilings to be set for each spending unit, separately for current and capital expenditure, and for salaries. These would be mandatory only for the budget year, and indicative for the following two years.

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-11	**B**	**B+**	Scoring method M2	
(i)	A	A	Budget calendar is observed and provides sufficient time for discussions.	No change
(ii)	D	C	Expenditure ceilings not subject to prior government approval.	No underlying change. View taken in 2013 that there is sufficient opportunity for collective government discussion before proposals are submitted to Parliament.
(iii)	A	A	Budgets are approved before the beginning of each year.	No change

PI 12: Multi-year Perspective in Fiscal Planning, Expenditure Policy and Budgeting

Expenditure policy decisions have multi-year implications, and must be aligned with the availability of resources in the medium-term perspective. Therefore, multi-year fiscal forecasts of revenue, expenditure aggregates and potential deficit financing (including reviews of debt sustainability involving both external and domestic debt) are an essential element in policy formulation. The aggregate framework needs to be complemented by detailed plans for the development of each sector (including any necessary investments) which in total are consistent with the aggregate.

(i) Multi-year Fiscal Forecasts and Functional Allocations

75. The annual fiscal policy statement includes three-year fiscal projections in an economic classification. The analytical basis for these projections has been considerably improved since 2008, and they are set out in detail in the government's Pre-accession Economic Programme which is submitted each year to the EU. But the projections do not include any sectoral or organizational breakdown of expenditure beyond the budget year immediately ahead, and are made afresh each year rather than being rolled forward from the previous year. Because of this, there are no direct and transparent links between the macro-fiscal framework and subsequent budget allocations**. Rating for this dimension: C**

(ii) Scope and Frequency of Debt Sustainability Analysis

76. The government undertakes a comprehensive debt sustainability analysis each year in consultation with the IMF. The rhythm of annual debt sustainability reviews in the context of Article IV consultations with the IMF had not yet been fully established when the 2008 assessment was undertaken. The impact of the continuing economic recession on the fiscal balance and thus on overall public debt is fully recognized, and the implications for the level of public debt are fully disclosed in the government's medium-term fiscal projections. The IMF have drawn attention to the need to consider problems arising from a bunching of the maturity of some debt in the years immediately ahead, which will need to be rolled over. The government has made clear its determination to reverse the recent rapid increase in debt as a proportion of GDP. It is envisaged that the new law on fiscal responsibility will include provisions defining the government's approach to the control of public debt**. Rating for this dimension: A**

(iii) Existence of Costed Sector Strategies

77. As noted in PI-11 above forward estimates for the two years subsequent to the budget year now have to be provided as part of budget submissions. But these are not yet derived from sector development strategies directed towards clear policy objectives and endorsed by the government as a whole. Sector strategies incorporating clear objectives have been prepared for some sectors and ministries, such as education, transport and tourism, but these do not have the authority of the government collectively. Moreover these strategies may give only a partial picture of the sector, and the costing may be incomplete. As noted in (i) above the forward estimates produced by each budget user are not yet reconciled with the overall fiscal framework**. Rating for this dimension: C**

(iv) Linkages Between Investment Budgets and Forward Expenditure Estimates

78. 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. MoF Budget Department considers that budget users' performance in this area has improved following the Government's decision in October 2010 to require much more systematic information about the expenditures and revenues resulting from the execution of investment projects and the subsequent operation of the facilities so created. But investments are still planned separately from recurrent expenditure, and are not yet fully integrated into sectoral strategies. **Rating for this dimension: C**

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-12	**C+**	**C+**	Scoring method M2	
(i)	C	C	Projections do not include any sectoral allocations	Some improvement in content, but this does not qualify for a higher rating
(ii)	B	A	Comprehensive analysis undertaken annually	Annual reviews in consultation with IMF had not been fully established in 2008.
(iii)	C	C	Sectoral strategies not consistent with overall fiscal framework	Some development but not yet justifying higher rating
(iv)	C	C	Systematic consideration of future costs and benefits of investments, but no consistent links to sector strategies	Some improvement in quality of investment planning of individual projects, but without consistent links to overall strategies

3.4. Predictability and Control in Budget Execution

PI 13: Transparency of Taxpayer Obligations and Liabilities

79. The main tax revenues are administered and collected by the two main tax authorities, Tax Administration and Customs Administration. The data presented for PI-3 above summarizes the main elements of revenue over the period 2010-12. This Indicator assesses whether tax liabilities are clearly defined in law and regulations, whether necessary information is readily available to the taxpayer, and whether there is a functioning tax appeals mechanism.

(i) Clarity and Comprehensiveness of Tax Liabilities

80. Each tax is based on a specific law, which defines the liability arising in respect of that tax. The laws are gradually being harmonized with relevant EU directives, although this process still has some way to go. In addition, there are specific laws on tax administration, customs administration, administrative procedures, and inspection. The process of changes in laws and procedures includes consultation with taxpayers or their representatives where the timetable allows. Discretionary powers of the revenue authorities are strictly limited. Some penalties are expressed in the law as a range (see PI-14 (ii) below): the authorities have to decide on actual penalties within the range. There are also the usual difficulties of assessment in an economy where records are often inadequately kept. Tax advisers did not identify any problems with current arrangements. **Dimension rating: A**

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

81. The Tax Administration and Customs Administrations have established a variety of arrangements to educate taxpayers thereby enabling compliance with registration, declaration and payment procedures. The Tax Administration has: a network of eight branches and offices in each of the 21 municipalities; on-line access to all guidance and forms; brochures and leaflets; a Guidebook and series of Frequently Asked Questions; a dedicated telephone line; and media campaigns through seminars, television, radio and other activities. Detailed statistics are maintained of the various outreach activities. In addition, taxpayers have ready access to their tax records and can request a copy of such records from their local tax office at their convenience**. Dimension rating: A**

(iii) Existence and functioning of a tax appeals mechanism

82. In accordance with the Law on Administrative Procedure, there are four levels of appeal against any decision made by the administration. With respect to taxation, the 'first instance' authority is the relevant tax authority (either the Tax Administration or Customs Administration). The 'second instance' authority is the MOF Taxes and Customs Department. The 'third instance' authority is the Administrative Court, and thereafter the appeal may be taken to the Supreme Court. Most appeals relate to customs duty, where the valuation provided by the importer (where there is a risk of fake invoices) is challenged by Customs Administration. In 2012 Customs rejected the importer's valuation on 6,609 occasions; these led to 812 appeals, of which MOF allowed 310 (38%). Customs were accordingly concerned that compliance is being eroded. Protocols for cooperation with other country customs authorities do not always work and may take 2-3 months to resolve. There are also many appeals with regard to VAT and difficulties with refunds, though this tax has been implemented since 2006. In 2012, 394 appeals were made to MOF Taxes and Customs Department against assessments by the Tax Administration: of these, 245 (62%) assessments were annulled. Overall, the arrangements appear to work reasonably well in protecting the interests of taxpayers, although it would in principle be desirable to have some system independent of the administration to review appeals before they are referred to the Administrative Court. **Rating for this dimension: B.**

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-13	**A**	**A**	Scoring method M2	
(i)	A	A	Legislation and procedures are clear for all major taxes and the tax and customs administrations have strictly limited discretionary powers.	No change
(ii)	A	A	Taxpayers have easy access to comprehensive, user-friendly and up-to-date information on tax liabilities and procedures for all major taxpayers, which is supplemented by media campaigns	No change
(iii)	B	B	The tax appeals system is functional and transparent but some issues on its fairness need to be addressed	No change

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

Effectiveness in tax assessment is ascertained by an interaction between registration of liable taxpayers and correct assessment of tax liability for those taxpayers.
Taxpayer registration is facilitated by control mechanisms introduced by the revenue administration (RA). Maintenance of a taxpayer database based on a unique taxpayer identification number is an important element of such a control system, but is most effective if combined with other government registration systems that involve elements of taxable turnover and assets (such as e.g. issue of business licenses, opening of bank accounts and pension fund accounts). In addition, RAs should ensure compliance with registration requirements through occasional surveys of potential taxpayers e.g. by selective, physical inspection of business premises and residences. Compliance with declaration obligations will depend on the perceived effectiveness of arrangements for tax inspection and audit, and on the level of penalties imposed for under-declaration and late payment.

(i) Controls in the Taxpayer Registration System

83. All citizens of Montenegro have identification cards and are registered in a Central Registry. This now comes under the Tax Administration. Records in the Tax Administration's database (analytical cards) are regularly reconciled with the Central Registry database. There is cooperation and communication with the Customs Administration, which has a separate database, and with the Health Fund, Pension and Disability Fund and Employment Office records, but not electronic linkage. Companies are also registered with a tax identification number (PIB) and, if appropriate, a VAT registration number. All companies are required to submit their annual financial statements to the Tax Administration. There is also a Real Estate Register. As the linkages are not automated, comprehensiveness is undermined. A major IT project is ongoing to enable e-returns, create linkages through data warehousing, and speed up the system and improve reporting facilities. On-line reporting is already in place for monthly income tax and fund contribution payments, and on-line filing is scheduled to become operational for VAT in June 2013.

84. With respect to the Customs Administration, all imports are registered in the Customs Administration's database at the point of entry and all importers are assigned a unique identification number. There are currently 5,210 importers registered with Customs. Given that linkages between databases are incomplete, **rating for this dimension: B**

(ii) Effectiveness of Penalties for Non-Compliance with Registration and Declaration Obligations

85. With respect to taxes administered by the Tax Administration, penalties for non-compliance with registration, declaration and payment obligations are all levied on the basis of a multiple of the legal minimum net salary, currently €193 per person per month. Penalty multiples are 2-10 months with respect to personal income tax; for companies, 50-300 months for the company and 5-20 months for the manager of the company; and for VAT, 10-300 months for companies and 5-20 months for the manager of the company. Montenegrin average wage was €728 per person per month (or €480 net) in June 2013. Most companies are small- and medium-sized and owner-managed, so the flat-rate structure of penalties affects them more than for large taxpayers. Penalties are considered to be effective for small taxpayers, but may not be so effective for large taxpayers.

86. With respect to taxes they administer (import duties, some excise duties and VAT on imports), the Customs Administration requires importers to present bank guarantees for payment of duty. They permit importers to import goods without full documentation, but only on presentation of a bank guarantee. This enables importers to receive 'transit visas' that permit them to present the full documentation at any terminal for final processing. In addition the Customs Administration imposes interest charges on late payment. The risk of non-payment is relatively small. It is not clear, therefore, why customs arrears are increasing, in fact from €0.5 mn at December 2010 to €23.3 mn at December 2012 (see PI-15 (i) below). Given that outside the area of customs, the penalties may not be effective for large taxpayers, and given the high incidence of errors detected in tax audits (see (iii) below), which would indicate that penalties have an insufficient impact, **rating for this dimension is C.**

(iii) Planning and Monitoring of Tax Audit Programmes

87. The Tax Administration has created a Large Taxpayers Office responsible from January 2012 for about 500 taxpayers who have tax liabilities of over €0.5 mn a year. From these, 107 were selected in 2012 for tax audit to be done at least every other year based on their size, length of time since last audit, sectoral risks, etc. Returns from medium (12,524) and small (18,786) taxpayers are audited by branch offices within their staff capacity on an annual plan agreed with head office, based on an assessment of risks. Risk criteria include: mistakes in tax declarations, size, low declared profit margins, and sector-specific risks (such as tourism). The SAI report for the year to October 2011 revealed that claims for refunds of VAT were incorrect in 858 cases out of 980, and claims for refunds of income tax were incorrect in 329 cases out of 415, resulting in total additional assessments of €37.8 mn.

88. In respect of taxes administered by the Customs Administration, all imports are registered in the Customs Administration's database at the point of entry and all transactions are monitored by supervisors and processed in accordance with a risk analysis framework. This ensures that a much higher proportion of higher risk shipments are subject to on-site inspection than the generality of imports. In 2012 Customs collected €3.7m in additional revenue as a result of 62 on-site inspections. Given that audits are substantially based on an analysis of risks**, rating for this dimension: A**

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-14	**B**	**B**	Scoring method M2	
(i)	B	B	Taxpayers are registered in a database with some linkage to other government registers	No change
(ii)	B	C	Penalties for non-compliance exist but may not always be effective for large taxpayers. Evidence from tax audits of high incidence of non-compliance by taxpayers.	More evidence of non-compliance by taxpayers. 2008 assessment did not receive any data about the results of tax audits.
(iii)	B	A	Income tax audits and fraud investigations are managed and reported on according to a documented audit plan based on clear risk assessment criteria	Tax audits clearly based on risk assessments.

PI 15: Effectiveness in Collection of Tax Payments

89. 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) Collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of a fiscal year which was actually collected during that year (average of the last two fiscal years)

90. Tax arrears include a high proportion of old claims, dating from 2003. The SAI reported that many were not collectable (Report for 2010/11). Tax Administration stated that as much as 80% of arrears was uncollectable. The MOF may postpone due dates for payment, or allow payment by installments (Budget Law Article 14). Any irrecoverable claims should be promptly reported to the Cabinet by MOF with explanation. The Cabinet should decide each write off, which should then be disclosed in the year-end financial statements (Budget Execution Report). However, in practice, write-offs are regarded as unjustified concessions to tax debtors, and are therefore avoided. The Tax Administration stated that the proposed new Budget Law did not provide for any write-off, and that irrecoverable debt would be identified and separately controlled. The SAI report on FY 2010, while advocating the write-off of uncollectable amounts, and the stronger pursuit of other debts, does not identify any amount actually written off.

91. Tax and duty arrears at the end of the last three fiscal years, including interest on unpaid taxes, are presented in the table below.

Table 11: Tax arrears 2010-2012 (Euro millions)

	December 2010	December 2011	December 2012
Corporate income tax	11.8	16.1	20.7
Real estate tax	25.5	29.1	34.1
Excise duty	14.5	19.1	28.4
VAT	54.1	70.9	85.6
Penalties	1.9	2.1	2.5
Concessions and fees	11.9	12.2	17.0
Local duties	2.4	2.4	2.4
Turnover tax (now discontinued)	2.3	2.5	2.8
Taxes and contributions of self-employed taxpayers	85.7	93.6	97.3
Customs duty	0.5	4.9	23.3
Sub-total	210.8	252.7	314.1
Of which accumulated interest on debts to Tax Administration	43.9	58.9	75.9
Taxes and contributions withheld from salaried employees (estimated)	na	na	64.0
TOTAL	na	na	378.1

Source: Tax and Customs Administrations

Arrears at the end of 2012 represent 33.9% of total collections that year. Excluding the taxes and contributions withheld from salaries, which could be estimated only at the end of 2012, tax arrears have risen from €211 mn to €314mn in the last two years (22 % per annum increase). 40 per cent of the €80.5 mn increase in arrears owing to the Tax Administration (excluding amounts owed in respect of unpaid income tax and social contributions) is attributable to additional interest owed on outstanding debts. As a result the proportion represented by the interest component in these arrears increased from 20.8% to 24.2% during this period. The Tax Administration stated that, out of the tax arrears at December 2012, €24.7 mn had been collected up to 21 March 2013.

The PEFA rating is based on collection of gross arrears. In view of the high proportion of uncollectable arrears, it is evident that the percentage of arrears that could have been collected each year must be correspondingly low. A more detailed view of the extent of the problem may be obtained by focusing on recent movements in amounts outstanding on the different taxes, net of interest penalties. Thus company tax owed increased from €9.9m to €15.8m, excise duties from €10.9m to €22.2m, and VAT from €45.9m to €66.5m between December 2010 and December 2012. Meanwhile the principal amount owing in respect of taxes and contributions owed by the self-employed fell slightly from €62.2m to €60.7m, which would suggest that the Tax Administration is relatively more successful in securing the prompt payment of recent obligations of this type. **Dimension rating: D** *(ii) Effectiveness of Transfer of Tax Collections to the Treasury by the Revenue Administrations*

92. Each tax revenue stream is collected in a separate account for each type of tax held by the relevant revenue collection agency (Tax Administration or Customs Administration) at the Central Bank of Montenegro. All identified transactions are transferred daily by collecting banks to the Treasury Single Account of the Ministry of Finance. Unidentified receipts in suspense are negligible. **Dimension rating: A**

(iii) Frequency of Complete Reconciliations of Tax Assessments, Collections, arrears records and Treasury receipts

93. Both revenue collection agencies perform daily reconciliations of their accounts in terms of taxes collected, unidentified receipts and taxes remitted to the Treasury Single Account managed by Treasury. However, there is no regular reconciliation of aggregate tax assessments, collections and arrears. **Dimension rating: D**

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-15	**C+**	**D+**	Scoring method M1 (weakest link)	
(i)	A	D	Debt collection ratio in 2012 was below 60%, and the total amount of tax arrears is significant	The assessment in 2008 gave collection ratios of over 100%, which are not possible. It appears that there has been no real change.
(ii)	A	A	All tax revenue is paid into the Treasury Single Account daily	No change
(iii)	C	D	There is no regular reconciliation of arrears with assessments and collections.	The 2008 assessment was not based on any reconciliation statement. It appears there has been no real change.

PI 16: Predictability in the Availability of Funds for Commitment of Expenditures

Effective execution of the budget, in accordance with the work plans, requires that the spending ministries, departments and agencies (MDAs) receive reliable information on availability of funds within which they can commit expenditure for recurrent and capital inputs. This indicator assesses the extent to which the central ministry of finance provides reliable information on the availability of funds to MDAs, that manage administrative (or programme) budget heads (or votes) in the central government budget and therefore are the primary recipients of such information from the ministry of finance. The MDAs concerned in this indicator are the same as those concerned in indicator PI- 11.To be reliable, the amount of funds made available to an entity for a specific period should not be reduced during that period.

(i) Extent to which Cash Flows are Forecast and Monitored

94. The Treasury prepares annual cash flow forecasts on inputs from the Budget Department and Economic Policy Department. Spending estimates reflect the approved spending plans from the spending units, broken down by month. The forecasts are continuously monitored and re-forecast each month**. Dimension rating: A**

(ii) Reliability and Horizon of Periodic in-year Information to Spending Units on Ceilings for Expenditure Commitment

95. Cash is released to spending units through monthly warrants, and payment requests have to be kept within the cumulative total of the warrants released to each spending unit. Provided that they keep within the expenditure profiles notified to MOF, and within their total annual budget allocations on each budget line, spending units have generally been able to be confident in making commitments at least six months ahead. **Dimension rating: A**

(iii) Frequency and Transparency of Adjustments to Budget Allocations, which are Decided above the level of Management of Spending Units

96. In the event of a cash squeeze, resulting for example from a revenue shortfall or the calling of outstanding government guarantees, the Budget Department may require a new plan and cash forecast from each spending unit. These are discussed with the units and expenditure reductions may be made selectively. This constitutes a supplementary budget and has to be approved by the Government (Cabinet) and Parliament. The 2012 Budget Rebalance incorporated some in-year expenditure reductions to offset some of the impact of lower revenues and guarantee payments. These were undertaken with full transparency. **Dimension rating: A**

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-16	**A**	**A**	Scoring method M1 (weakest link)	
(i)	A	A	Cash flow forecasts are updated monthly.	No change
(ii)	A	A	Spending units can normally make commitments at least 6 months ahead.	No change
(iii)	A	A	Supplementary budgets are required only once a year at most and are undertaken transparently	No change in the system, although the economic environment is more difficult.

PI 17: Recording and Management of Cash Balances, Debt and Guarantees

Debt management, in terms of contracting, servicing and repayment, and the provision of government guarantees are major elements of overall fiscal management. Poor management of debt and guarantees can lead to unnecessarily high debt service costs and create significant fiscal risks. The maintenance of a debt data system and regular reporting on main features of the debt portfolio and its development are critical for ensuring data integrity and related benefits such as accurate debt service budgeting, timely service payments, and well planned debt roll-over. An important requirement for avoiding unnecessary borrowing and interest costs is that cash balances in all government bank accounts are identified and consolidated (including those for extra-budgetary funds and government controlled project accounts). Calculation and consolidation of bank accounts are facilitated where a single Treasury account exists or where all accounts are centralized. In order to achieve regular consolidation of multiple bank accounts not held centrally, timely electronic clearing and payment arrangements with the government's bankers will generally be required. Effective debt management depends on the contracting of all loans and the issue of all guarantees being controlled by a single authority, with the amounts outstanding determined by reference to transparent criteria.

(i) Quality of debt data recording and reporting

97. Public debt amounted to about 50 per cent of GDP at the end of 2012, of which about three quarters was external. 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 debt management system was improved in 2011 through technical assistance provided by the UNDP Bratislava Regional Centre and the Slovak Ministry of Finance. There are no doubts about the quality of the data on external debt. Domestic debt includes frozen savings certificates and debt relating to restitution claims as well as bank and other borrowing and the Treasury Bill issue. Municipal debt is included as well as that of the central government, although the debts of municipally-owned utilities are not covered. Reports are also produced regularly on the status of government guarantees. The records are considered generally to be good, although information about municipal debt (including arrears) may be slightly incomplete. A comprehensive report on the operations and the outstanding debt is produced monthly, with quarterly publication of the breakdown of outstanding debt**.** There is no publication of the future schedule of payments of interest and repayments of capital. **Dimension rating: B**

(ii) Extent of Consolidation of the Government's Cash Balances

98. Since the establishment of the Treasury Single Account (TSA) in January 2010, the government deposits in the Central Bank and a number of commercial banks through which the TSA operates have been the subject of daily consolidated reports. During the period of fiscal stringency since the establishment of the TSA, the government deposits have been largely drawn down. At the end of 2010 they still amounted to over €100mn, but at the end of 2011 they amounted to only about €20mn, and there are now only limited operating balances. There are also some resources related to foreign-financed projects kept in special accounts in commercial banks, and not consolidated with the TSA during the year. Health institutions' payrolls are operated through commercial banks, but purchases of goods and services are paid directly from the TSA. Some deposits of health and education institutions resulting from payments for their services remain outside the TSA, although these are small in relation to overall expenditure. **Dimension rating: B**

(iii) Systems for Contracting Loans and Issuance of Guarantees

99. The yearly budget law imposes a ceiling on new borrowing and guarantees. The Minister of Finance signs all loan and guarantee contracts, and his consent is required for municipal and SOE borrowing for more than 12 months. It is envisaged that the new law on fiscal responsibility will include provisions intended to ensure the effective implementation of the government's strategy for controlling public debt. **Dimension rating: A.**

Planned Reforms

100. UNDP are sponsoring a project, with technical assistance from Slovakia, to install new debt management software.

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-17	**B**	**B+**	Scoring method M2	
(i)	C	B	Debt records are adequate, and there is full and regular publication of outstanding amounts.	Improvement in monitoring and reporting
(ii)	C	B	Most bank balances are known daily and can be consolidated, but accounts of individual health and education institutions remain outside the Treasury Single Account	Improvement due to consolidation of three State funds with the Treasury single Account
(iii)	A	A	All public borrowing, including the issue of guarantees is effectively controlled by MOF	No change

PI 18: Effectiveness of payroll controls

This indicator is concerned with the payroll for public servants only. Wages for casual labour and discretionary allowances that do not form part of the payroll system are included in the assessment of general internal controls (PI-20). However, different segments of the public service may be recorded in different payrolls. All of the more important of such payrolls should be assessed as the basis for scoring this indicator, and mentioned in the narrative. The payroll is underpinned by a personnel database (in some cases called the "nominal roll" and not necessarily computerized), which provides a list of all staff, who should be paid every month and which can be verified against the approved establishment list and the individual personnel records (or staff files). The link between the personnel database and the payroll is a key control. Any amendments required to the personnel database should be processed in a timely manner through a change report, and should result in an audit trail. Payroll audits should be undertaken regularly to identify ghost workers, fill data gaps and identify control weaknesses.

101. According to MOF (Budget Department and Central Harmonisation Unit) control of the government payroll has been considerably improved since 2008. In 2010-11 a special Commission including representatives from different spending units as well as staff representatives identified numerous irregularities in the operation of the payroll, resulting in the introduction of new arrangements for payments to staff. The MOF payroll unit now has full details (36 parameters in relation to each individual employee) of all employees, and runs regular checks to test the riskier elements – overtime, shift pay, maternity allowance, etc – in each person's remuneration.

(i) Degree of Integration and Reconciliation between Personnel Records and Payroll Data

102. The MOF payroll in effect incorporates the personnel records of all employees (including all those in the health and education services) in its electronic database. No one can be added to the payroll without MOF approval, and any promotion must be authorized by the Human Resources Management Authority (HRMA) before it can be registered on the database. Any promotion must also be notified to the Tax Administration before it takes effect. Spending units are required to notify MOF every month of any factors that would result in a change to the payments to each individual**. Dimension rating: A**

(ii) Timeliness of Changes to Personnel Records and the Payroll

103. Personnel records and the payroll are updated as required and normally monthly. It is understood that retroactive adjustments are rare. **Dimension rating: A**

(iii) Internal Controls of Changes to Personnel Records and the Payroll

104. Changes to the payroll must be initiated by the spending units, and then require the approval of MOF and HRMA; thus they are fully documented, and subject to effective central supervision. **Dimension rating: A**

(iv) Existence of Payroll Audits to Identify Control Weaknesses and/or Ghost Workers

105. As noted above, the whole payroll system was the subject of a thorough audit in 2010-11, which led to substantial changes in its operation. Its continued satisfactory functioning was confirmed by an Internal Audit study in the Ministry of Finance in 2012. **Dimension rating, reflecting the fact that the 2010-11 audit is not repeated every year: B.**

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-18	**C+**	**B+**	Scoring method M1 (weakest link)	
(i)	B	A	The payroll operated by MOF fully reflects changes in personnel records	Substantial improvement since 2008
(ii)	A	A	Changes are made in a timely way, minimising retrospective adjustments	No change
(iii)	C	A	Changes in the records are fully documented.	Improvement in control
(iv)	C	B	A complete payroll audit was conducted in 2010-11.	Improvement in control

PI 19: Transparency, Competition and Complaints Mechanism in Procurement

106. This indicator was changed in 2011. It now consists of four dimensions as follows:
(i) Transparency, comprehensiveness and competition in the legal and regulatory framework,
(ii) Use of competitive procurement methods,
(iii) Public access to complete, reliable and timely procurement information,
(iv) Existence of an independent administrative procurement complaints system.

107. The new Public Procurement Law (PPL) of August 2011 replaced the Procurement Law of 2006, and represents a major step towards conformity with EU standards. The institutional framework includes a state authority in charge of public procurement operations (the Public Procurement Administration - PPA) and an independent entity responsible for review of complaints (the Commission for Control of Public Procurement - CCPP). Procurement operations are decentralized to about 600 contracting authorities of which about 400 are active. Of these about 200 are central government bodies. The PPL applies to all procurement processes for goods, civil works and services purchased by state and local government authorities, state-owned enterprises, and legal persons that use funds provided by the GOM or local government. In 2012, the number of public contracts was about 5,000 with a total value about €400 mn, including 2,700 'low value' contracts. All contracting authorities prepare annual procurement plans, which are reviewed and approved by MOF Budget Department and PPA, and posted on the PPA web portal by 31 January in the plan year. Anyone can access the portal. Contracts should only be awarded if they are in the plan: changes in the plan have to go through a similar review process. Contracting authorities must submit signed contracts within three days to PPA for posting on the portal.

Dimension (I) Transparency, Comprehensiveness and Competition in the Legal and Regulatory Framework

108. The requirements in the legal and regulatory framework for procurement and the current situation in Montenegro are set out in the following table.

(i)	*Organized hierarchically and precedence clearly established?*	YES. The new Public Procurement Law (PPL) of August 2011 came into effect in January 2012. This and regulations made under the law establish hierarchical authority of contracting authorities in a mainly decentralized procurement system
(ii)	*Freely and easily accessible to the public through appropriate means?*	YES. Published by Official Gazette , printed (including English edition 2011) and downloadable from the website of the Public Procurement Administration (www.ujn.gov.me)
(iii)	*Applies to all procurement undertaken using government funds?*	YES. With strictly limited exceptions (PPL, Article 3)
(iv)	*Makes open competitive procurement the default method of procurement and defines clearly the situations in which other methods can be used and how this is to be justified?*	YES. PPL Article 6 makes open competitive bidding the default procedure. Articles 23-30 and subsidiary regulations define other procedures and when they can be used
(v)	*Provides for public access to all of the following procurement information: government procurement plans, bidding opportunities, contract awards, and data on resolution of procurement complaints?*	YES. PPL provides for public access and all the required items are posted on the PPA and CCPP websites.
(vi)	*Provides for an independent administrative procurement review process for handling procurement complaints by participants prior to contract signature?*	YES. Complaints are investigated and decided by the Commission for Control of Public Procurement, an independent body. Further appeal can be made to the Administrative Court.

109. Because all six benchmarks are satisfied, **rating is A**.

Dimension (ii) Use of Competitive Procurement Methods

110. Direct (sole source) contracting is used for contracts of up to €5,000, subject to the total value of such contracts not exceeding 10% of the unit's total executed procurement in the previous year (with the percentage then declining in subsequent years). The shopping method of contracting may be used for 'low value' contracts, that is, up to €25,000 for goods and services or €50,000 for works contracts. Above these thresholds a contracting authority wishing to use less competitive methods of contracting (negotiated, framework, consulting services) is required by the PPL to seek the prior approval of PPA. PPA must respond to requests within eight days. In 2011, PPA received 176 requests of which 23% were not approved (PPA Annual Report for 2011). In 2012 34% of requests for approval of negotiated contracting were rejected, as a result of which either the case for negotiated contracting was reformulated or the contracting authority reverted to the open procedure.

111. According to PPA, the law is generally respected. During 2011, the PPA received and investigated 149 allegations of irregularity. 26 cases of irregularity were proven and the PPA reported them to the SAI and MOF. The SAI Audit Report for 2011 comments that records are often missing (or false) for direct procurements and that the 10% limit is exceeded, eg. by the Radio and TV Agency (SAI 2011 Report). There is also splitting of contracts to bring them within non-competitive thresholds, but this is declining. Despite extensive support and advisory services provided by PPA, the problem appears to be partly due to lack of technical capacity, particularly in the spending units, some of which have no procurement officers, and partly in the organisation of procurement. There are 350-400 procurement officers. They hold degrees and 136 have received training and passed an examination set by the PPA, but some spending units lack a procurement officer, so professional advice is not always available to Procurement Committees, or their advice may be disregarded in procurement decisions. It should be also noted that in line with the law the ordering unit may empower another unit to conduct public procurement process in its name and account.

112. The Commission for Control of Public Procurement (CCPP) should review ("perform control" PPL Article 139) the procurement procedure in contracts over €500,000, and PPA should police ("perform inspection control" PPL Article 148) the procedure on contracts above €5,000 and below €500,000. This responsibility for CCPP is incompatible with its status as independent arbiter of procurement issues. The Law makes PPA responsible for monitoring compliance, but the Inspection Control Service at the end of 2011 had only two Inspecting Officers, and is now outside the authority of the PPA because in early 2012 the Inspecting Officers were transferred to an Inspection Administration under the Ministry of the Economy. The PPA does not have any input to their annual plan nor does it receive copies of reports by Inspection Officers. Although the PPL Article 147 says that inspection control shall be performed by the "competent state authority", elsewhere identified (Article 19) as the PPA, it is no longer possible for PPA to discharge this function.

113. According to PPA, only 5.3% of procurement expenditure in 2011 was contracted through negotiated procedures. Although the number of successful appeals (see paragraph 115 below) may indicate that the use of less competitive procurement methods is not always fully justified, PPA's well-established role in restraining unjustified reliance on negotiated procedures ensures that **adequate justification for deviation from open procedures is presented in the large majority of cases, thus resulting in the rating: B**

(iii) Public Access to Complete, Reliable and Timely Procurement Information

114. The new PEFA criterion looks for key procurement information (government procurement plans, bidding opportunities, contract awards, and data on resolution of procurement complaints) to be made available to the public through appropriate means. In practice Government procurement plans, bidding opportunities and contract awards are posted promptly on the PPA website portal (www.ujn.gov.me). The resolution of complaints is posted on the Commission's website (www.kontrola-nabavki.me). **Rating for this dimension is accordingly A.**

(iv) Existence of an Independent Administrative Procurement Complaints System.

115. The new PPL requires that any complaint or allegation of corruption in procurement may be made directly to the Commission for Control of Public Procurement, with a copy to the relevant contracting authority. The Commission is an independent and autonomous entity, consisting of a President and four members, responsible to Parliament. In 2011, the Commission made 516 decisions on complaints, of which 165 were accepted, 299 rejected, 47 dismissed as inadmissible and the rest withdrawn. These decisions are publicly accessible in the Commission's website. In appeal cases which the Commission had for the first time in 2012, the Commission decided in cases of 516 complaints, in the manner that 471 decisions were made, out of which 258 decisions of rejecting/dismissing the complaint, 19 dropped cases due to retiring of the entity which filed a complaint, 168 decisions of full or partial accepting the complaint and 26 cases in which complaints could not be examined.

116. The PPL requires the Commission to reach a decision within 15 days (which may be extended by 10 days if expert assistance is required): in 2011, the Commission's decisions took up to 25 days, with an average of 10-12 days. After the completion of the administrative process, aggrieved parties may resort to judicial remedies at the Administrative Court. The PPA estimates that about 10% of the refusals (about 30 decisions) were taken to the next appellate level (the "third instance"), the Administrative Court.

117. Overall, apart from CCPP's responsibility for supervising the operation of competition in the largest contracts, which is incompatible with its function as independent arbiter of complaints, the complaint system may be considered to operate satisfactorily, although the apparent 30 per cent success rate for complaints may be an indication of shortcomings in the public procurement process. There is some concern by suppliers that the fee (1% of the contract value subject to a maximum of €8,000) is high and may deter some serious complaints, as well as frivolous complaints. However, the fee appears to be less than the administrative cost of the system, and is refunded if a complainant is successful.

118. The requirements for scoring this dimension and actual present performance are shown in the table below. The PEFA requirements make it clear that the first two dimensions must be fully satisfied if any rating higher than D is to be proposed.

(i)	*The body should be comprised of experienced professionals, familiar with the legal framework for procurement, and includes members drawn from the private sector and civil society as well as government;*	MET The Commission consists of a President and four other members, who are lawyers with substantial contracting experience, mainly from private practice. They have 9 staff, mainly professional lawyers.
(ii)	*It should not be involved in any capacity in procurement transactions or in the process leading to contract award decisions;*	NOT MET: Although the appeals process works satisfactorily in respect of most contracts, CCPP's responsibility for supervising competition in the largest contracts is incompatible with its status as independent arbiter in the case of complaints.
(iii)	*It should not charge fees that prohibit access by concerned parties;*	MET The fee is believed to be reasonable

(iv)	*It should follow processes for submission and resolution of complaints that are clearly defined and publicly available;*	MET The process for submission and resolution of complaints is clearly set out in the PPL
(v)	*It should exercise the authority to suspend the procurement process;*	MET PPL Article 139
(vi)	*It should issue decisions within the timeframe specified in the rules/regulations; and*	MET PPL Articles 130 and 131 set time limits for the contracting authority and the Commission which are mainly achieved
(vii)	*Its decisions should be binding on all parties (without precluding subsequent access to an external higher authority).*	MET The Commission's decisions are binding, but complainant may still seek judicial review from the Administrative Court

119. Since the first two benchmarks must be fully met to justify any rating higher than D, **the rating for this dimension is D.**

Planned Reforms

120. A Strategy for Public Procurement and Action Plan was issued in December 2011 (www.ujn.gov.me). Planned reforms include the further development of e-procurement, capacity building and professionalization of procurement officers, a focus on the environmental and social impacts of procurement, strengthening cooperation with the Directorate for Anti-Corruption Initiative and the SAI, and regional cooperation.

121. The GOM has established a Coordination Body, with quarterly reporting to the Cabinet to monitor strategy implementation, including representatives of MOF, PPA, CCPP and other authorities that participate in implementation. Q&A meetings, round tables and public discussions will be organised to provide for exchange of views with parliamentarians, employers, the Chamber of Commerce, the Employers' Federation, academic community, State Audit Institution, Directorate for Anti-Corruption Initiative, Commission for the Prevention of Conflict of Interest, Administrative Court, Misdemeanours Council, Police Directorate, Judicial Council, etc.

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-19	**B**	**B**	Scoring method M2	
(i)	B	A	All six listed requirements are met	The method of scoring has changed since 2008, so a direct comparison of scores is not valid. However it appears that considerable progress has been made in the legal framework, greater transparency through the web portal, and streamlining the complaints procedure. But the involvement of CCPP in control of large contracts means that it is not fully independent in considering appeals against procurement decisions.
(ii)	B	B	Although the data are not absolutely clear, it appears that appropriate justification for the use of less competitive methods is available in the great majority of cases.	
(iii)	B	A	Procurement plans, bidding opportunities, contract awards and resolution of complaints are posted on public websites	
(iv)	NA	D	The CCPP's responsibility for control over divergences from open competition for the largest contracts means that the first two benchmarks are not met, so requiring the rating D.	

PI 20: Effectiveness of Internal Controls for Non-Salary Expenditure

An effective internal control system is one that (a) is relevant (i.e. based on an assessment of risks and the controls required to manage the risks), (b) incorporates a comprehensive and cost effective set of controls (which address compliance with rules in procurement and other expenditure processes, prevention and detection of mistakes and fraud, safeguard of information and assets, and quality and timeliness of accounting and reporting), (c) is widely understood and complied with, and (d) is circumvented only for genuine emergency reasons. Evidence of the effectiveness of the internal control system should come from government financial controllers, regular internal and external audits or other surveys carried out by management. One type of information could be error or rejection rates in routine financial procedures.
Other indicators in this set cover controls in debt management, payroll management and management of advances. This indicator, therefore, covers only the control of expenditure commitments and payment for goods and services, casual labor wages and discretionary staff allowances. The effectiveness of expenditure commitment controls is singled out as a separate dimension of this indicator due the importance of such controls for ensuring that the government's payment obligations remain within the limits of projected cash availability, thereby avoiding creation of expenditure arrears (ref. indicator PI-4).

(i) Effectiveness of Expenditure Commitment Controls

122. At the start of every month, spending units submit 'reservations' to the Treasury by which they effectively specify the use they intend to make of funds warrants to be issued to them. The Treasury issues monthly funds warrants to spending units based on their annual appropriations in the Budget Law. All payment requests from spending units must be within the cumulative warrants issued or the SAP system will not pay them.

123. The Treasury makes all payments after matching them to reservations. However, neither the previous *commitments* on orders, contracts, etc nor *liabilities* on deliveries of goods and services are yet systematically captured in the Treasury system. Spending units are not prevented from incurring commitments in excess of the funds warrants issued to them, and then delaying making payment requests until they have sufficient funds warrants available, thus creating arrears (see PI-4 above). The MOF receives information on commitments from spending units on a quarterly basis and from funds and municipalities on a monthly basis, but there is doubt about the reliability of their systems to record and report all outstanding commitments, and in any case the current reports do not constitute an operational control. The SAI report for the year 2011 says that the method of recording of repayment of obligations from a previous period and the data presented in the Report on Arrears do not provide a sufficiently reliable evidential basis. The SAI recommended establishment of a better system of recording commitments. A new computer application is currently being developed by the Treasury (see future reforms below).

124. Because there is no control over commitments, **rating for this dimension is D**.

(ii) Comprehensiveness, Relevance and Understanding of other Internal Control Rules/ Procedures

125. A considerable effort has been undertaken since 2010 to strengthen Financial Management and Control (FMC) throughout the government, supported by the EU through the IPA programme. A new Public Internal Financial Control law was enacted in 2008 and further improved in 2011, and a new FMC Rulebook issued in 2010. This material was then brought together in a new FMC Handbook issued in July 2011, which has been used as the basis for extensive training throughout the government in 2012. All aspects of organization, purposes and procedures are covered in this document. Officers responsible for co-ordination of FMC have been appointed in 82 spending units. According to MOF CHU, spending units accounting for 80 per cent of budget expenditure have now adopted written rules and procedures for financial management and control. However the training is still ongoing and its full benefits are not yet realized**. Dimension rating, reflecting the need to complete the coverage of the new procedures: B**

(iii) Degree of Compliance with Rules for Processing and Recording Transactions

126. The State Audit Institution's 2011 report on the 2010 Budget suggests that rules for processing and recording transactions have not always been respected. There have been misclassifications of some items of expenditure, such as 'contracted services' and bank charges. The budget reserve has been misused for payment of medical treatment, vehicles, education and other expenditures that were not "urgent and unforeseen". However, the amounts involved in these irregularities were relatively small, and the SAI gave qualified opinions (conditional positive) to the 2010 and 2011 Budget Execution Statements. **Dimension rating: B**

Planned Reforms

127. According to the Treasury Department, a web-based software application has been designed to enable spending units to record liabilities on invoices as they are received. 15 spending units including the Ministry of Education are currently using this system, and all other spending units will receive training in making inputs by June 2013. In the next phase of development, orders and other commitments will also be captured. This will enable the Treasury to monitor and report commitments.

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-20	**D+**	**D+**	Scoring method M1 (weakest link)	
(i)	D	D	There is no commitment control against available budgetary authority	No change
(ii)	C	B	A considerable effort has been made to improve understanding of and compliance with financial control rules and procedures throughout the government.	Substantial improvement since 2008.
(iii)	B	B	Compliance with rules is fairly high, but there is still scope for improvement.	No change

PI 21: Effectiveness of Internal Audit

128. Internal audit is an independent service reporting to the head of the spending unit within which it is established. Internal audit should apply modern risk management methods based on the COSO framework in order to provide reasonable assurance that public funds are used efficiently and effectively to the planned purposes. This Indicator assesses (i) the coverage and quality of internal audit function, (ii) the frequency and distribution of reports, and (iii) the extent of management response to findings. Internal audit as currently established in Montenegro is based on the Law on Public Internal Financial Control (2008) as further improved in 2011 and 2012. Central Harmonization Unit (CHU), operating within the MoF, coordinates the establishment and development of internal audit in the public sector, and is also responsible for promoting efficient financial management and control throughout government. The present decentralised IA structure has replaced the former centralised IA operation run by MoF.

129. The following secondary legislation has been adopted:

- Ordinance on the establishment of internal audit in the public sector (”Official Gazette of Montenegro”, No. 50/12), stipulating the method and criteria for the establishment of internal audit in the public sector;
- Ordinance on titles of internal auditors (”Official Gazette of Montenegro”, No. 23/09), prescribing the titles of internal auditor posts, requirements for posts and allocation to the salary grades;
- Rulebook on the method and procedure of internal audit work (”Official Gazette of Montenegro”, No. 32/09;
- Rulebook on the method and procedure for establishment and implementation of financial management and control (”Official Gazette of Montenegro”, No. 37/10);
- Instruction on the contents of reports and method of reporting on the operation of internal audit (”Official Gazette of Montenegro”, No. 55/12);
- Instruction on the contents of reports and method of reporting on the financial management and control system (”Official Gazette of Montenegro”, No. 55/12) which covers the quarterly and annual reports on the financial management and control system (see PI-20 above);
- Rulebook on methodology for quality review of internal audit in the public sector (”Official Gazette of Montenegro”, No. 11/13) prescribing the methodology for quality review of internal audit unit organization and individual audit files. The Rulebook includes questionnaires setting out the information required for quality review in each case;
- Rulebook on curriculum and method of taking the examination for qualification as authorised internal auditor in the public sector (”Official Gazette of Montenegro”, No. 63/11);
- Internal Audit Manual (third edition);
- Financial Management and Control Manual (PI-20);

- Guidelines for the Development of Internal Rules and Procedures, and
- Instruction for the preparation of the Book of Procedures for each spending unit.

130. CHU makes a consolidated report each year on the internal control system and internal audit function, which is considered and adopted by the Government. The most recent such report, for 2012, was adopted by the Government in May 2013 after the work on this PEFA assessment had been completed.

(i) Coverage and Quality of the Internal Audit Function

131. According to CHU, 39 internal audit units (IAUs) had been established by February 2013, covering 94 per cent of budget expenditure. 30 spending units made agreements to use IA services provided by larger bodies. 48 internal auditors are now in post, of whom 17 in municipalities. Seven auditors are already fully certified, and a further 40 are expected to complete a training programme prescribed by the UK Chartered Institute of Public Finance and Accountancy (CIPFA) by mid-2013.

The Internal Audit Manual is comprehensive and based on the **International Standards** for the **Professional Practice of Internal Auditing issued by the International Institute of Internal Auditors** (IIIA). The Manual prescribes the methodology of internal auditing in the public sector entities, based on the systems audit approach.

Additionally, IAUs have a copy of the full set of these standards (in Montenegrin). The MoF Internal Audit Unit has two internal auditors and a trainee. In 2012, it made six final reports.

According to the CHU's Consolidated Report for 2011, which was and adopted by the Government in June 2012, the processes which were subject of audit conducted by the established internal audit units included the payroll system (see PI-18 above), public procurement, the exercise of individual rights to pension, disability and health insurance, expenditure arrears, personnel management issues, revenue collection, the promotion of tourism and business vehicle fleet management. **Rating for this dimension, given that coverage remained limited, and did not yet fully meet professional standards: C**

(ii) Frequency and Distribution of Reports

132. All internal audit units are required to submit draft audit reports to the heads of the units which were the subject of each audit. After reaching agreement on the findings, the final audit report is delivered to the head of entity which was subject to audit, in line with Article 24 of the Law on Public Internal Financial Control. Internal Audit Units submit quarterly and annual summary reports on their work, including their main recommendations, to the CHU; the full reports may be requested by CHU. Internal audit units do not have obligation to deliver final audit reports after each performed audit to the MoF-CHU or the SAI, but only at their request. In preparing and conducting its planned audits, SAI uses internal audit reports. Heads of internal audit units are obliged to enable access to the final audit report and documentation based on which such final audit reports were made. **Rating for this dimension, given that IA coverage is not yet complete: B**

(iii) Extent of Management Response to Internal Audit Findings

133. In the course of subsequent audits, each IAU checks whether recommendations given in the previous audit reports are implemented and to what extent. According to the Consolidated Report on the Internal Control System in the Public Sector of Montenegro for 2012, entities in the public sector implemented fully 158 out of 269 recommendations (59%) given in the audit reports, while 30 recommendations (11%) were implemented partially.

Rating for this dimension, given that many of the recommendations were still under consideration: C

Planned Reforms

134. The Strategy of Further Development of the Public Internal Financial Control in Montenegro 2013-17, issued June 2012, sets out the main development directions over the next five years. The Strategy includes further delegation of tasks and responsibilities, further development of internal organization rules to supplement the general rules, development of cost analysis, use of risk management techniques, capacity building and the certification of authorised internal auditors.

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-21	**C+**	**C+**	Scoring method M1 (weakest link)	
(i)	C	C	Internal audit operates for the most important government entities and undertakes some systems review, but is understaffed.	Coverage has been widened, but work remains to be fully developed.
(ii)	A	B	There is a substantial flow of reports, which are the subject of regular returns to MoF CHU, and used by the SAI in its audit work. But the new decentralized IAUs have not yet been operational to their full capacity.	The decentralization of IA appears to have resulted in a (temporary) loss of productivity (see (iii) above).
(iii)	C	C	Fair degree of actions taken on recommendations.	Work has wider coverage, but needs to achieve greater impact.

3.5. Accounting, Recording and Reporting

PI 22: Timeliness and Regularity of Accounts Reconciliation

135. This Indicator assesses whether appropriate procedures are followed to ensure that financial information is accurate and reliable. Two dimensions are considered: (i) whether there are frequent reconciliations between Treasury and bank account data, and (ii) whether suspense accounts and advances are regularly reconciled and cleared.

(i) Regularity of Bank Reconciliations

136. There are three main types of bank account operated by central government. The regularity with which each of them is reconciled is described below.

1. The Treasury operates a Treasury Single Account comprising one bank account at the Central Bank of Montenegro and a number of accounts at commercial banks into which almost all State receipts flow and from which almost all State payments are made. The Treasury Single Account is reconciled daily and electronically with statements received from the Central Bank. As payment instructions are transmitted electronically for immediate action, there is no time difference between the date of payment instruction and the date of debit to the account.
2. As discussed in respect of PI-15(ii), the revenue collection agencies hold and manage accounts at the Central Bank for the purposes of revenue collection. These are reconciled daily.
3. As mentioned at PI-17 (ii), there are also some deposits related to donor-financed projects that are kept in special accounts in commercial banks, and not consolidated with the TSA balances. On the other hand, balances in commercial banks related to World Bank and other donor-funded projects are captured by the Treasury and included in the annual financial statements.

137. 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 from which those same expenditures are paid. These bank accounts are reconciled monthly within four weeks of the month-end.

138. In the health sector, the bank accounts of service delivery units are replenished monthly to cover their payroll expenditure. Other costs are met directly from the TSA. All Health institutions' bank accounts are reconciled monthly within four weeks of the month-end**. Rating for this dimension: A**

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

139. 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 (suspense) accounts held and operated by the revenue collection agencies indicated that they contain only a few 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 each spending unit's 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 the year, each spending unit must return unutilised cash to the Treasury together with valid expenditure accounts to justify any cash spent. The system of reconciliation and clearance of cash imprest advances, travel advances, contractor advances and staff advances is satisfactory. Given that imprest advances are cleared promptly and that cash advances are renewed yearly**, rating for this dimension: A**

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-22	**A**	**A**	Scoring method M2	
(i)	A	A	All government bank accounts are reconciled at least monthly within four weeks of the end of month.	No change
(ii)	A	A	All advances are cleared promptly.	No change

PI 23: Availability of Information on Resources Received by Service Delivery Units

140. This Indicator assesses whether reliable information is available about resources actually reaching front-line service delivery units such as schools and health clinics.

141. In the education sector, the Ministry of Education (MOE) can show the budget estimate and actual out-turn for each school. 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 approved expenditures as well as income accruing to each institution from its own sources (including grants and amounts paid for the use of its facilities). Own source income and expenditure financed from it are not included in the budget but included in out-turn reports. As discussed above with respect to performance indicator 18, each education institution prepares its monthly payroll which MOE forwards to the Treasury. MoF now holds details of every individual on the public service payroll and applies checks to risky items. The 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.

142. 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 in the case of education institutions, own-source income and expenditure financed from it are not included in the budget but included in out-turn reports. The HIF transfers funds received each month from MOF to the bank accounts of its subordinate health institutions to cover their payrolls. Expenditure on goods and services by each institution is paid directly from the STA. Thus full information is available from the accounting systems about the resources received by each institution**. Rating for this Indicator: A**

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-23	**A**	**A**	Scoring method M1 (weakest link)	
(i)	A	A	Routine accounting systems provide reliable information on all types of resources received by both primary schools and primary health clinics across the country and complied into reports at least annually.	No change

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

143. This Indicator assesses whether timely and reliable information is available during the course of the year about progress in the execution of the approved budget, so as to provide a basis for any corrective action which might be necessary. Three dimensions are considered: (i) whether reports are available with the same detailed coverage as the budget estimates; (ii) whether reports are available promptly at the end of each period; and (iii) whether the information is accurate and reliable.

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

144. An Ordinance on the Manner of Submitting Financial Statements of the Budget, State Funds and Local Government (Official Gazette 32/10 and 14/11) prescribes the forms on which to submit quarterly and annual financial statements. These show for comparison the latest revised budget, not the original budget. The MOF posts on its website the budget outturn reports at a consolidated level rather than at the full level of detail as presented in the original budget. The reports are at an aggregate level based only on the economic classification, and do not report separately on different spending units, functions or programmes, although it appears that all the information needed to produce such reports is already available from the SAP system.

145. As mentioned above at PI- 20(i), commitments are not 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. These are not published, but this is not a requirement of this indicator. Because of the absence of any functional or administrative breakdown or comparability with the budget classification, **rating for this dimension: D**

(ii) Timeliness of the Issue of Reports

146. Aggregate reports in economic classification are produced monthly from the SAP system shortly after the end of each month. **Rating for this dimension: A**

(iii) Quality of Information

147. Quarterly reports are based on the SAP information system, which covers all units and funds within the Treasury Single Account. There are few concerns regarding data accuracy. The SAI report on the 2010 Final Budget Statements expressed a conditional positive opinion (as formulated by the SAI) on the state of the accounts. However it noted that audit findings on individual spending units requiring changes in their financial statements had not been incorporated in the Final Budget Statements. There were also some minor issues on classification with regard to contracted services and bank charges. **Rating for this dimension: B**

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-24	**C+**	**D+**	Scoring method M1 (weakest link)	
(i)	C	D	Comparison to the budget is possible only an aggregate economic classification basis, and expenditure is covered only at the payment stage	No underlying change: absence of information other than on an economic classification not noted in 2008.
(ii)	A	A	Information available without delay from Treasury SAP system	No change
(iii)	A	B	There are some concerns about data accuracy in SAI reports, but they do not compromise the overall consistency and usefulness of the reports	Some apparent deterioration in quality, which may just reflect more stringent auditing standards.

PI 25: Quality and timeliness of annual financial statements

148. This Indicator assesses the quality and timeliness of annual financial statements, which are an essential element in any transparent and well-managed PFM system. Three dimensions are considered: (i) the completeness of the financial statements; (ii) the timeliness of their submission; and (iii) whether International Public Sector Accounting Standards (IPSAS) or consistent national standards are used and fully disclosed.

(i) Completeness of the Financial Statements

149. The annual budget execution report is produced by the 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 programmes, 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**. Rating for this dimension: C**

(ii) Timeliness of Submission of the Financial Statements

150. In accordance with the Budget Law, the MOF is required to prepare a draft budget execution statement and submit it to Government (the Cabinet) by 1 June in respect of the year ended 31 December. The Government is obliged to submit the final budget execution statement to Parliament by the end of September together with the audit report from the State Audit Institution (SAI).

151. The latest available budget execution statement was in respect of the year ending 31 December 2011. The MOF produced the draft budget execution statement at 28 June 2012 and the Government forwarded the final budget execution statement to Parliament on 28 September 2012 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 June draft in order that it could complete its audit in time for Government to satisfy its end-September reporting obligation to Parliament**. Rating for this dimension: A**

(iii) Accounting Standards Used

152. There is no reference in the annual financial statements to the accounting standards used for their preparation. The format has developed over time to incorporate various information requirements and remove redundancies without reference to any specific set of accounting standards or financial reporting framework. The statements are in a consistent format from one year to the next, and are prepared in accordance with instructions issued by MOF under the main Budget Law. Although the statements are considered by MoF to be broadly consistent with cash-based IPSAS as they apply to the revenue and expenditure statements, they do not include other information required to comply with the standard.

153. The 2011 statements (in Montenegrin only) show revenue by item and expenditure by programme and economic classification, with comparison to revised budget figures, and bank deposits at the beginning and end of the year. There is some analysis of material variances. There is an annexe (last page) showing expenditure arrears at the beginning and end of the year, analysed by economic category, though not functionally. Financial assets and liabilities are not shown, though state debt is reported elsewhere. As a UNDP-sponsored study pointed out in 2011, there are no legally established definitions of assets and liabilities or valuation rules applicable to GOM financial statements, and the statements do not include even a partial balance sheet, information about changes in net assets, a cash flow statement, or explanatory notes. Because of these deficiencies, the **rating for this dimension is D.**

Indicator / Dimension	Score 2009	Score 2012	Justification for 2012 Score	Performance Change Other factors
PI-25	**C+**	**D+**	Scoring method M1 (weakest link)	
(i)	C	C	The statements show information on revenue, expenditure and bank account balances.	No change
(ii)	A	A	The draft annual statements have been submitted for external audit within 6 months of the end of the year	No change.
(iii)	C	D	Standards are not disclosed	Some apparent deterioration, but this may be due to a less stringent assessment in 2008. No real change.

3.6. External scrutiny and audit

PI 26: Scope, Nature and Follow-up of External Audit

154. The supreme audit institution - the State Audit Institution (SAI) of Montenegro - was established in 2004 by the Law on State Audit Institution, with changes and amendments thereof made in 2006, 2007, 2010 and 2011. The Constitution of Montenegro (2007) positioned the State Audit Institution as "an autonomous and supreme audit body ". The Institution examines the regularity, effectiveness and efficiency of operation of the bodies and organizations which manage the state budget and assets, local governments, public enterprises, state funds, the Central Bank of Montenegro and other legal entities with the state ownership share. The Institution has not audited the funds from donor agencies, except upon request of the Danish development agency to audit donor funds of the Kingdom of Denmark for financing the Project "Organic Agriculture Development Program in Montenegro" in 2011, 2012 and 2013.[11]

155. In 2012, SAI Senate adopted Strategic Plan, as well as Action Plan for the Implementation of the Strategic Goals and Activities for the period 2012-17. The SAI made the Strategic Plan for development of the Institution based on comparative analysis of the findings and recommendations given in the self-assessment report prepared by the Institution and those given in the external assessment report prepared by the SIGMA expert team.

156. Even though the Constitution of Montenegro (2007) defines SAI as an autonomous and supreme body, legal framework does not allow for its full financial independence as it is financed by the MoF nor its operational independence as it is subject to centralized human resource procedures. In 2011, the SAI proposed changes and amendments to the Law on State Audit Institution so as to enable its full financial independence and autonomy in employing, evaluating and promoting its employees, which was also defined in its Strategic Plan.

157. The SAI is managed by five-member Senate appointed by the Parliament.[12] The Senate provides the Parliament with Annual Report on performed audits and activities, which includes the Audit Report on annual financial statements of the state budget (legal requirement) and summaries of the reports on individual audits performed during the fiscal year (from October to the next October). Pursuant to Article 28 of the Law on State Audit Institution, the Parliament may appoint, by special act, an expert organization to audit the SAI's financial statements. Following recommendation made by SIGMA expert team in the external assessment report of the Institution, in 2012 the SAI initiated public procurement procedure for selecting independent audit firm and after completing legally prescribed procedure, had its financial statements audited.

158. Currently, the SAI employs 55 people, of which 36 are auditors who passed exam for state auditor. GIZ provided the Institution with its technical assistance from 2002 to 2012. Separate unit for in performance audit was established in 2012, and development of performance audit is taking place in cooperation with the Swedish National Audit Office

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[11] In 2011, for instance, at request of the Danish development agency SAI audited Organic Agriculture Development Program under the Ministry of Agriculture funded mainly by the Danish grant. The Strategic Plan envisages that the use of all donor funds is audited by SAI.

Presently, there is one vacancy, which is expected to be filled shortly.

and audit institutions of Bosnia and Herzegovina. Cooperation with the international organization SIGMA led to short-term support in the implementation of three project activities: support for application of twinning light project for 2013; audit quality assurance and training of the auditors to audit financial statements of political parties and electoral campaigns.

In December 2011, SAI organized expert lecture for its employees in real sector accounting. In June 2012, in cooperation with the German Organization for Technical Assistance (GIZ) SAI also organized training for IDEA software aimed to collecting, analyzing and sampling of audit data. Training program was carried out in cooperation with the Court of Auditors of Slovenia. A number of seminars and meetings were held on the role of performance audit in the public sector and horizontal and vertical communication for performance auditors as the support to performance audit development.

Besides audits of the government bodies, the Institution also performed audits of public enterprises such as audits of the annual financial statements of Montenegro Airlines and Airports of Montenegro.

159. SAI has been a full member of the International Organization of Supreme Audit Institutions (INTOSAI) since 2007 and of its European counterpart (EUROSAI) since 2008. The SAI adopted the ISSAI framework of auditing standards.

(i) Scope and Nature of Audits Performed

160. The SAI performs its audits in accordance with its Rules of Procedure and Instruction on the Methodology of SAI Operation. During the audit of 2010 budget annual financial statements, which was conducted in 2011, the SAI expressed "conditional positive" opinion, which was not consistent with ISSAI framework standards. During the audit of 2011 budget annual financial statements, which was conducted in 2012, the SAI issued a qualified opinion, which was in line with ISSAI framework standards. In 2012, the SAI adopted Guidelines on planning and performing financial and regularity audit, covering standard processes and procedures including definition of risk, assessment of materiality and appropriate sampling arrangements.

Each audit is managed and monitored by a supervisory group which is also liable for the audit results. The supervisory group consists of two members of the Senate, one being head of the sector performing the audit. In case that the supervisory board does not pass the decision, the Senate does so.

The SAI Senate adopts the Annual Audit Plan based on the criteria for including entities to be audited into the Annual Plan. Limitations in terms of time and resources prevent complete audit coverage to be achieved each year, so the entities are selected for audits based on criteria which include information from other sources, opinion given in the previous audit (control audit), amount of approved funds and entities that were not audited in the prior period.

The Annual Report covering period from October 2011 to October 2012 shows that the SAI audited entities whose expenditures amounted to €850.2 million out of €1,281.6 million total expenditure (66.3%), and those with €1,267.0 million revenue out of €1,371.2 million total revenue (92.4%). According to the SAI, the staff is used up to the maximum level and it would be very difficult to achieve even 75% coverage each year. **Since the audit**

coverage was below 75 percent of total budget expenditure, rating for this dimension: C

(ii) Timeliness of Submission of Audit Reports to the Legislature

161. Pursuant to the Law on the State Budget Final Accounts, the Government is required to attach the SAI audit report of the final accounts of the state budget to the annual budget execution statements (annual financial statements) and submit both to the Parliament as one package by the end of September.[13] As the draft statements are due to be submitted by the MoF by June 1 each year, this implies a statutory period of four months for completing the audit. At the time of the data collection visit in February 2013, the latest available audit report from the SAI on the budget final accounts referred to the year ending December 2011. The Government approved draft statements on June 28 2012 and in October 2012 these were forwarded together with the audit report to the Parliament.

162. Additionally, in accordance with the Law on State Audit Institution, the SAI is required to submit annual report on its audits and activities to the Parliament by the end of October. The SAI annual report is actually a compilation of its report on final accounts of the state budget and summaries of individual audit reports issued in the reporting period from October last year to October of the current year. The SAI is not obliged to submit these individual audit reports formally to the Parliament except within its annual report. However, once approved these audit reports are available to public on the SAI official website, and therefore the Parliament, if it opts to do so, may review them independently of their formal delivery by the SAI within the consolidated annual report. The latest annual report from the SAI covered its activities from October 2011 to October 2012 (presently available in Montenegrin only) and was submitted to the Parliament in October 2012. The PEFA rating is based on the SAI audit report on the annual budget execution statement. Considering that the audit report is produced within 3 months of receiving the financial statements from MoF**, rating for this dimension: A**

(iii) Evidence of Follow-up on Audit Recommendations

163. Apart from the audit of the final accounts of Montenegrin budget for 2011, the SAI carried out 15 individual audits in the period from October 2011 to October 2012. The audit of the final accounts of Montenegrin budget for 2011 covered 22 entities which were given 47 recommendations in total. In the final reports of individual audits, audited entities were provided with 84 recommendations in total.

Apart from the audit of the final accounts of Montenegrin budget for 2010, the SAI carried out 14 individual audits in the period from October 2010 to October 2011. The audit of the final accounts of Montenegrin budget for 2010 included 20 recommendations and measures, while in the final reports of individual audits audited entities were provided with 121 recommendations in total. In subsequent audits, the SAI follows up the status of its recommendations and in its annual report to the Parliament the SAI comments on follow-up or implementation of the recommendations. During the same period, two

[13] This contrasts with the system implied in the PEFA Framework by which the SAI sends its report directly to Parliament. The reason for sending the annual statements first to the Government (Cabinet) is that the auditee has the right to respond to audit findings before the audit report is submitted to Parliament (SAI Law, section 15).

control audits were carried out, covering the Ministry of Tourism and the National Tourist Organization. It was concluded that out of 11 recommendations in total, four were fully implemented, five were partially implemented and two were not implemented. Other reports include numerous details of follow-up of the previous recommendations. **Rating for this dimension: A**

Planned Reforms

Changes and amendments to the Law on SAI are under consideration. Besides the above mentioned measures to enhance the financial and operational independence of the SAI based on draft Law on Changes and Amendments to the Law on SAI, it is proposed to require the audited entities to report back on the implementation of audit recommendations within a deadline prescribed by the SAI, which was not envisaged by the existing Law on SAI.

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-26	**C+**	**C+**	Scoring method M1 (weakest link).	
(i)	C	C	Central government entities which represent between 50% and 75% of total expenditure are audited annually.	No quantitative change.
(ii)	B	A	Audit reports on the annual financial statements are provided to the Parliament within 4 months from receiving draft statements.	The apparent change is due to a change in interpretation of the PEFA requirements. No real change in performance.
(iii)	B	A	There is clear evidence of some effective and timely follow-up.	Improvement in the quality of audit recommendations and management response.

PI 27: Legislative Scrutiny of the Annual Budget Law

164. 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). Four dimensions are considered: (i) the scope of the legislature's scrutiny; (ii) the extent to which the legislature's procedures are established and respected; (iii) the adequacy of time available to the legislature for its work: and (iv) the extent to which the budget can be amended by the executive without reference to the Parliament.

(i) Scope of the Legislature's Scrutiny

165. 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. According to the Chairman of the NA Committee on Economy, Finance and Budget, the NA's review of the budget proposals covers the macro-economic background and the overall stance of fiscal policy. But it does not extend to the medium-term fiscal framework, nor to medium-term priorities. The Committee holds hearings over a few days with officials, mainly from MOF and the SAI. The procedure has developed since 2008 that other Committees of the NA also consider the budget proposals from the standpoints of sectoral policy. However, the overall time available for scrutiny before the debate in Plenary Session is limited, and only minor changes at the margin to the government's proposals result from the NA's consideration. **Dimension rating: B**

(ii) Extent to which the Legislature's Procedures are Well-Established and Respected

166. As discussed above with respect to dimension (i), government is required by the 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 committees in the NA's Rules of Procedure, which have been further developed since 2008. 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**. Dimension rating: B**

(iii) Adequacy of time for the Legislature to Respond to the Government's Proposals

167. As discussed above with respect to dimension (i), the legislature receives the proposed Annual Budget only by end-November in respect of the fiscal year beginning the following January and the budget needs to be adopted by end-December. Thus, the legislature has around one month to review the proposals. The draft of the proposed new law on Budget and Fiscal Responsibility (see PI-11 above) would allow the NA up to two months to consider the budget proposals. The PEFA criteria for the ratings B and C are the same for this dimension: 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

168. 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 Budget Law 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 programmes. In addition, the Budget Law permits Government to redirect unused funds only to debt repayment, capital expenditure projects and reserves. The Executive thus has a relatively wide discretion to reallocate expenditure without consulting Parliament. If overall increases are to take place, or if action has to be taken to reduce the fiscal deficit by cutting expenditure and/or increasing revenue, this has to be done by a budget "rebalance" enacted by the NA. While the necessary procedure is transparent, and the NA's consent is required, such rebalances are normally enacted using the accelerated procedure provided for in Articles 151-153 of the NA's Rules of Procedure, which prescribe that after one day's notice has been given, all stages in the legislative process can be completed in as little as a single day. This has been the procedure followed in early 2013 when the 2013 budget was revised to provide for some revenue increases and expenditure reductions**. Dimension rating: B**

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-27	**B**	**B**	Scoring method M1 (weakest link)	
(i)	B	B	Scope of Parliamentary scrutiny does not extend to medium-term fiscal planning.	No change
(ii)	B	B	Procedures are well-established, and have been improved to allow other Parliamentary Committees to participate in the scrutiny process. But impact of Parliament on the budget remains limited.	Some improvement through the involvement of Parliamentary Committees other than the Committee on Economy, Finance and Budget.
(iii)	B	B	Parliament has only one month to examine the government's proposals before the budget is enacted by 31 December each year.	No change.
(iv)	B	B	There are clear rules concerning in-year amendments to the budget without the approval of Parliament, but these allow quite extensive reallocations.	No change.

PI 28: Legislative Scrutiny of External Audit Reports

169. 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

170. As discussed within the context of PI-26(ii), in accordance with Article 50 of the Budget Law, the Government is required to attach an audit report from the SAI on the annual budget execution statement ("final account") to its proposed law endorsing the budget execution and submit both to Parliament as one package by the end of September. 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 the main points from the other reports it has issued since its 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. Over the period 2010-2012 the Parliament every year completed its consideration of the SAI's report on budget execution, together with the annual law on budget execution within two months of receipt of the audit report. **This meets the criteria for the rating: A**

(ii) Extent of Hearings on Key Findings

171. According to the SAI, the Economy, Finance and Budget Committee holds hearings on its report on budget execution, and the other points in its annual report before the debate in Plenary Session on the draft law to approve budget execution. Representatives of the

SAI and MOF take part, and there have been one or two occasions when officials of spending units receiving negative opinions from the SAI have been required to appear. Since the procedure to call to account representatives of bodies subject to audit criticism remains relatively undeveloped, **rating for this dimension is C.**

(iii) Issuance of Recommended Actions and their Implementation by the Executive

172. The Parliamentary Committee on Economy, Budget and Finance routinely proposes the endorsement of the recommendations made in the SAI's audit reports, and this is accepted by the Parliament in Plenary Session. The routine nature of these endorsements coupled together with the absence of additional recommendations probably reflects the limited time and resources available to the Committee in its consideration of audit reports. As noted in relation to PI-26 (iii) above, the managements of the audited entities generally respond to all recommendations made by the SAI and, in subsequent audits, the SAI reports on the extent to which its recommendations have been implemented. The Parliament may propose a different ordering of the recommendations from that of the SAI in its Resolution addressed to the Government, but the substance is the same. Formally, therefore, the Parliament makes recommendations to the Executive, which are followed up and at least partially implemented. Since, however, the substance of this work is due to the SAI rather than to any independent initiative by the Parliament to impose its own stamp on the process, **the rating B is proposed.**

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
PI-28	**D+**	**C+**	Scoring method M1 (weakest link)	
(i)	B	A	Parliament completes its work on the SAI's annual report on budget execution within three months of receiving the report.	No underlying change. (Not clear why A not given in 2008.)
(ii)	D	C	There are hearings on both the report on budget execution and on the other points in the SAI's Annual Report, with representatives of criticised auditees occasionally required to attend.	Some modest improvement on the position reported in 2008.
(iii)	A	B	There are recommendations by the Parliament, and there is evidence they are acted on, but the involvement of the Parliament has relatively little real impact on the process.	No underlying change. More emphasis given in 2013 to the fact that the Parliament's involvement in the recommendations made to the Executive is essentially formal.

3.7. DONOR PRACTICES

D 1: Predictability of direct budget support

173. This group of "D" Indicators considers how development partners interact with the government concerned, and whether they provide timely and accurate information about assistance they may be providing, and about projects being implemented under their control.

(i) Annual Deviation of Actual Budget Support (i.e. Funds transferred into a country's budget which can be used at its discretion) from Forecast Provided by Donor Agencies

174. Direct budget support has been received from World Bank (WB) by way of one Development Policy Loan (DPL) in the period 2010-2012. It was disbursed on 30 January 2012 and amounted to €59.1 mn. In 2012, there was also a guarantee from WB amounting to €60 mn given in respect of a bond issue by Montenegro of €100 mn. Although there was no actual disbursement under this policy-based guarantee, it reduced overall fiscal risk to the GOM.

175. The World Bank does not officially notify the Government about DPLs in the coming year. DPLs are requested by the Government and preparation of DPLs by the World Bank and the Client Country lasts up to one year. Planned DPLs are usually foreshadowed in Country Partnership Strategies which the World Bank prepares for periods of four years, so that the Government concerned and the World Bank agree well in advance about the upcoming DPLs. However, the timing of actual disbursement of a DPL depends on the pace of its preparation and on the Government meeting the conditions for disbursement. The disbursement of a DPL in January 2012 was originally expected in 2011. The PEFA criteria envisage the regular receipt of budget support over a period of years. Since support was received in only one of the three years 2010-12, and its receipt was not the subject of any previous forecast provided by the donor, **this dimension is considered Not Applicable**.

(ii) In-year Timeliness of Donor Disbursements (compliance with aggregate quarterly estimates)

176. Since there was no pre-specified quarterly path for the disbursement of support, **this dimension is also Not Applicable.**

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
D-1	**NA**	**NA**	Scoring method M1 (weakest link)	
(i)	NA	NA	No forecast provided by donor	None
(ii)	NA	NA	No forecast provided by donor	None

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

(i) Completeness and Timeliness of Budget Estimates by Donors for Project Support

177. Montenegro's practice is to include only the national co-financing associated with externally-financed projects in its Budget Estimates, but to include total project expenditure in its execution statements. In most cases the rate of project execution is under the control of the Montenegro public authority concerned, so that the flow of information should be from the recipient to the donor rather than the reverse. In the case of EU projects where control rests with the Commission, most amounts do not enter the Budget at either the Estimate or out-turn stages. Many EU projects relate to municipalities or other authorities outside the national budget. The available information is shown in the following table.

Table 12: Externally funded project expenditure reported in Budget Out-turn Statements (Euro millions)

	2010	2011	2012
Project loans	17.74	11.13	14.44
Grants	4.47	3.93	4.21
IPA	0.39	0.09	0.64
Total	22.79	15.15	19.29

Source: Budget Department, MOF

178. The EU have provided approximate figures for the expected and actual IPA disbursements for 2010-12 which are shown in the following table.

Table 13: EU IPA - Forecast and actual disbursements (Euro millions)

Year	Amount forecast	Amount paid
2010	27.4	28.4
2011	31.1	27.8
2012	49.0	35.4

Source EU Delegation, Podgorica

179. As will be clear, the practice in Montenegro does not fit into the PEFA frame of analysis. The rate of expenditure on loan-financed projects is under the control of GOM, as is the decision how far it should be reported in the budget at Estimate and out-turn stages. According to MoF Budget Department, most IPA expenditure has so far been outside the ambit of the central government budget. **This dimension is therefore considered Not Applicable.**

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

180. As explained in (i) above, donor reports are not currently relevant in the context of reporting on the national budget**. This dimension is therefore considered Not Applicable**.

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
D-2	**C**	**NA**	Scoring method M1 (weakest link)	
(i)	C	NA	Donor forecasts not relevant to the national budget.	If the 2008 assessment was correct, the treatment of externally-financed project expenditure at the Budget estimate stage has changed.
(ii)	C	NA	Donor reporting not relevant	

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

181. This Indicator asks what proportion of aid funds is managed through national procedures for (i) procurement, (ii) payment/accounting, (iii) reporting and (iv) audit. Where assistance is provided through budget support, by definition national procedures are used in all four aspects. There was no provision of direct budget support during 2005-07. Where project aid is concerned the use of national procedures may vary depending on the case. In Montenegro projects generally use national procedures for payment and reporting, but so far none use national procedures for procurement and audit (although it is intended that there will be a pilot audit in 2013 of a World Bank project by the SAI). By definition, therefore, national procedures are used in only 50 per cent of the circumstances considered where projects are concerned. The rating thus depends on the balance between budget support and project aid. Given that the World Bank direct budget support provided in 2012 is a substantial amount compared with the continuing flow of project aid, it may be concluded that national procedures were used on average in more than 50 per cent of cases over the three year period 2010-12, **which qualifies for the rating C.**

Indicator / Dimension	Score 2008	Score 2013	Justification for 2013 Score	Performance Change Other factors
D-3	**D**	**C**	Scoring method M1 (weakest link)	
(i)	D	C	National procedures used in more than 50% of cases.	Provision of direct budget support increases the proportion of aid subject to national procedures.

4. GOVERNMENT REFORM PROCESS

Eventual membership of the EU is Montenegro's central priority. A Stabilization and Association Agreement (SAA) was signed with the European Union in October 2007 and came into force in May 2010. An Instrument for Pre-Accession Assistance (IPA) was signed with the EU in November 2007. This provided €235 mn over the period 2007-13. Membership negotiations were started in June 2012.

Public financial management reforms are a central component of the SAA. The GOM has a successful track record of implementing PFM reforms including: 1) establishing the State Audit Institution, a Directorate for Public Procurement (now the Public Procurement Administration) and the Commission for Supervising the Process of Public Procurement; 2) introduction and upgrading of the SAP management information system; 3) introduction of a medium-term macro-fiscal framework and capital budgeting (although this has not yet extended to sectoral allocations consistent with expenditure aggregates); 4) consolidation of the budgetary structure by inclusion of four former extra-budgetary funds into the state budget and Treasury Single Account, and the inclusion of regulating agencies and public enterprises in the Memorandum to the Annual Budget Law; 5) introduction of programme budgeting; 6) re-organization of the internal audit and control system. There is no central committee or other machinery guiding and coordinating these reforms, but the GoM contribution to the PEFA assessment was guided and coordinated by a Working Group, whose mandate could be extended and used for this purpose.

GOM now prepares each year a Pre-Accession Economic Programme (PEP), which it submits to the European Commission. The current (2012) plan looked for the continuation of fiscal consolidation while achieving greater efficiency in government operations. It noted that work was in progress on the production of a National Economic Development Plan 2013-16, as is normally required by the EU as part of the pre-accession process.(It is understood that the plan has now been adopted under the title “Development Trends for Montenegro 2013-2016”.) This should provide a framework within which sector strategies can be prepared consistent with the aggregate medium-term fiscal framework GOM already produces. The proposed new Budget Law should provide stronger underpinning for efforts both to make a reality of medium-term planning of the main public services, and to ensure that public debt is controlled within manageable limits. Current on-going work to improve financial management and control in spending ministries and to spread effective internal audit across the government system should reinforce these initiatives, as should the general establishment of commitment controls and the continuing work to improve public procurement practice.

Annexe 1 Performance Indicators Summary

No.	Indicator	Scoring	Brief Explanation and Cardinal Sources used
A.	**PFM-OUT-TURNS: Credibility of the budget**		
PI-1	Aggregate expenditure out-turn compared to original approved budget	**B**	*Out-turn deviated from budget by more than 10% in none of the three years 2010-12* *Information from Budget Department, MOF*
PI-2	Composition of expenditure out-turn compared to original approved budget	**B+**	(i) Composition variance exceeded 10% in only one of the last three years. (B) (ii) Expenditure charged to reserve never exceeded 3% in any year. (A) Information from Budget Department, MOF
PI-3	Aggregate revenue out-turn compared to original approved budget	**C**	Revenue out-turn fell below 92% of budget in only one of three years. Information from Budget Department, MOF
PI-4	Stock and monitoring of expenditure payment arrears	**C+**	(i) Stock of arrears appears to be in the range 2-10% of total expenditure, and no evidence of significant reduction (C) (ii) Data on arrears is generated quarterly but is not classified by age (B) Information from Budget Department, MOF
B.	**KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency**		
PI-5	Classification of the budget	**A**	Budget formulation and execution based on Chart of Accounts which supports consistent economic, administrative and sub-functional classifications. Information from Budget and Treasury Departments, MOF
PI-6	Comprehensiveness of information included in budget documentation	**A**	Seven out of the nine information benchmarks are met Information from Budget Department, MOF
PI-7	Extent of unreported government operations	**D+**	(i)Unreported expenditure is less than 5% of budget expenditure (B) (ii) Information on donor-funded projects in fiscal reports is seriously deficient (D) Information from Budget Department, MOF
PI-8	Transparency of inter-governmental fiscal relations	**D**	(i) Funding of municipalities is opaque and unpredictable (D) (ii) Municipal budgets have to be set before reliable information is available about revenue (D) (iii) No information is collected about the functional breakdown of municipal expenditure (D) Information from Budget Department, MOF and Podgorica and Danilovgrad municipalities
PI-9	Oversight of aggregate fiscal risk from other public sector entities.	**C+**	(i) Monitoring of SOEs is largely ex-post and does not include a consolidated assessment of the risks they represent (C) (ii) There is effective monitoring of Municipal financial performance, including control over municipal borrowing (A) Information from Budget Department, MOF
PI-10	Public access to key fiscal information	**A**	5 of 6 benchmarks satisfied Information from Budget Department, MOF and observed published sources

No.	Indicator	Scoring	Brief Explanation and Cardinal Sources used
C.	**BUDGET CYCLE**		
C(i)	**Policy-Based Budgeting**		
PI-11	Orderliness and participation in the annual budget process	**B+**	(i) Budget calendar clear and respected (A) (ii) Ceilings in Budget Circular not binding and not previously approved by Government collectively (C) (iii) Budget enacted before the beginning of each year (A) Information from Budget Department MOF and spending units
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	**C+**	(i) Aggregate fiscal projections for 3 forward years produced (C) (ii) Comprehensive debt sustainability assessment undertaken every year (A) (iii) Sector strategies not consistent with overall fiscal envelope (C) (iv) More systematic planning of costs and benefits associated with investments, but investment decisions not taken as part of sector strategies (C) Information from Budget and Macro-economic Policy Departments, MOF
C(ii)	**Predictability and Control in Budget Execution**		
PI-13	Transparency of taxpayer obligations and liabilities	**A**	(i) Tax liabilities clearly defined with little discretion for tax collectors (A) (ii) Information on liabilities readily available to taxpayers (A) (iii) The tax appeals system is functional and transparent, but there are some issues on its fairness (B)
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	**B**	(i) Incomplete linkages between relevant databases (B) (ii) Dissuasive effect of penalties insufficient to discourage widespread non-compliance (C) (iii) Tax audit programmes based on analysis of risks (A) Information from Tax Policy Department MOF and Tax and Customs Administrations
PI-15	Effectiveness in collection of tax payments	**D+**	(i) Arrears are high and mostly deemed uncollectable (D) (ii) All revenue immediately paid into Single Treasury Account (A) (iii) No regular reconciliation of assessments, collections and arrears (D) Information from Tax and Customs Administrations
PI-16	Predictability in the availability of funds for commitment of expenditures	**A**	(i) Monthly cash flow forecast made in consultation with spending units and updated monthly (A) (ii) Spending units can have confidence in making commitments 6 months ahead provided they remain within budget allocations (A) (iii) Imposition of in-year reductions can only be done with authority of Parliament and is fully transparent (A) Information from Budget and Treasury Departments, MOF
PI-17	Recording and management of cash balances, debt and guarantees	**B+**	(i) Information complete and reliable, except that information about municipal debt may be a bit delayed (B) (iii) All Govt balances except those of individual health and education institutions with some own revenue streams are held in the Single Treasury Account (B) (iv) All public borrowing including issue of guarantees effectively controlled by MOF (A) Information from Treasury Department, MOF
PI-	Effectiveness of payroll	**B+**	(i) Personnel and payroll databases effectively

No.	Indicator	Scoring	Brief Explanation and Cardinal Sources used
18	controls		integrated (A) (ii) Procedures ensure that changes are reflected in payroll database without delay (A) (iii) Controls are effective and ensure an audit trail (A) (iv) A comprehensive payroll audit was undertaken in 2010-11 (B) Information from CHU, MOF
PI-19	Transparency, competition and complaints mechanisms in procurement	**B**	(i) Clear and comprehensive hierarchy of law and regulations (A) (ii) Evidence that there is justification for a majority of cases where less competitive procurement methods are used (B) (iii) Full publication of procurement plans, tenders, contract awards and results of procurement complaints (A) (iv) Appeals machinery satisfies most criteria, but is not independent of the decision-making process for large contracts (D) Information from Public Procurement Administration and Commission for Control of Public Procurement
PI-20	Effectiveness of internal controls for non-salary expenditure	**D+**	(i) No currently operating control over commitments (D) (ii) Substantial recent improvement in understanding of financial management and control (B) (iii) SAI considers procedures for processing and recording transactions are generally complied with, although there are some errors (B) Information from Treasury and CHU, MOF and SAI
PI-21	Effectiveness of internal audit	**C+**	(i) Internal audit operational in most spending units but does not yet meet professional standards (C) (ii) Reports are issued regularly but have limited coverage (B) (iii) There is evidence of management responses, but they are sometimes incomplete (C) Information from CHU, MOF
C(iii)	**Accounting, Recording and Reporting**		
PI-22	Accounts Reconciliations	**A**	(i) Treasury records continuously reconciled with bank records of Single Treasury Account (A) (ii) Imprest accounts cleared and reconciled promptly (A) Information from Treasury Department, MOF
PI-23	Availability of information on resources received by service delivery units	**A**	Routine accounting systems provide reliable information on all resources received by primary schools and health clinics Information from Ministry of Education and Health Insurance Fund
PI-24	Quality and timeliness of in-year budget reports	**D+**	(i) Comparison to the budget is possible only on an aggregate economic classification(D) (ii) Reports issued monthly without delay (but no functional breakdown) (A) (iii) Data generally reliable, but some minor problems identified by SAI (B) Information from Budget and Treasury Departments, MOF and SAI
PI-25	Quality and timeliness of annual financial statements	**D+**	(i) Financial assets not included in Financial Statements (C) (ii) Statements submitted for audit within 6 months of

No.	Indicator	Scoring	Brief Explanation and Cardinal Sources used
			year-end (A) (iii) Reports do not comply with IPSAS and no disclosure of accounting standards (D)
C(iv)	**External Scrutiny and Audit**		
PI-26	Scope, nature and follow-up of external audit	**C+**	(i) Annual coverage of audit less than 75% of expenditure (C) (ii) Reports submitted to Parliament within 4 months of receipt of Financial Statements by SAI (A) (iii) Good evidence of effective and timely follow-up of recommendations (A) Information from SAI, CHU/MOF
PI-27	Legislative scrutiny of the annual budget law	**B**	(i) Parliamentary scrutiny does not extend to MT fiscal planning (B) (ii) Procedures are well-established, but impact of Parliament on the budget remains limited (B) (iii) Parliament has only a month to examine the budget (B) (iv) Clear rules allow in-year amendments to the budget without approval of Parliament, but these allow extensive reallocations (B) Information from Budget Department and Committee on Economy, Finance and Budget
PI-28	Legislative scrutiny of external audit reports	**C+**	(i) Parliament completes its scrutiny within 3 months of receiving the SAI report (A) (ii) Hearings are held on the report on budget execution with representatives of criticised agencies occasionally required to attend (C) (iii) Some evidence that recommendations are acted on, but little real impact (B) Information from SAI and Committee on Economy, Budget and Finance
D.	**DONOR PRACTICES**		
D-1	Predictability of Direct Budget Support	**NA**	(i) No experience of regular provision of budget support (NA) (ii) No forecasts provided of timing of payment of budget support (NA) Information from World Bank, (WB) only provider of budget support hitherto
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	**NA**	(i) No information provided by donors about future project support payments (NA) (ii) Donor reporting not relevant (NA) Information from WB and EU
D-3	Proportion of aid that is managed by use of national procedures	**C**	National procedures are applied on average to more than 50% of the cases considered (C)

Annexe 2 Calculation of PI-1, 2 and 3

Calculation Sheet for PFM Performance Indicators PI-1 and PI-2 (as revised January 2011)

Table 1 - Fiscal years for assessment

Year 1 =	2010
Year 2 =	2011
Year 3 =	2012

Table 2

Data for year =	**2010**					
Functional head (euro mn)	**budget**	**actual**	adjusted budget	deviation	absolute deviation	percent
General public service	105.72	139.91	102.46	37.45	37.45	36.5%
Defence	40.59	40.15	39.34	0.81	0.81	2.1%
Public order and safety	119.81	116.16	116.12	0.04	0.04	0.0%
Economic affairs	194.31	144.74	188.33	-43.59	43.59	23.1%
Environmental protection	30.05	8.31	29.12	-20.81	20.81	71.5%
Housing and community amenities	9.33	7.95	9.04	-1.09	1.09	12.1%
Health	177.25	175.13	171.79	3.34	3.34	1.9%
Recreation, culture and religion	33.53	30.11	32.50	-2.39	2.39	7.3%
Education	144.84	138.58	140.38	-1.80	1.80	1.3%
Social protection	416.61	431.83	403.78	28.05	28.05	6.9%
Allocated expenditure	1,272.04	1,232.87	1,232.87	0.00	139.36	
Contingency (reserve)	13.53	12.59				
total incl contingency	1,285.57	1,245.46				
overall (PI-1) variance						3.1%
composition (PI-2) variance						11.3%
contingency share of budget						1.0%

Table 3

Data for year =	2011					
Functional head (euro mn)	**budget**	**actual**	adjusted budget	deviation	absolute deviation	percent
General public service	135.29	208.56	143.84	64.72	64.72	45.0%
Defence	38.47	36.61	40.90	-4.29	4.29	10.5%
Public order and safety	119.48	116.68	127.03	-10.35	10.35	8.1%
Economic affairs	141.28	143.97	150.21	-6.24	6.24	4.2%
Environmental protection	8.44	6.61	8.97	-2.36	2.36	26.3%
Housing and community amenities	9.11	9.20	9.69	-0.49	0.49	5.0%
Health	170.92	169.39	181.72	-12.33	12.33	6.8%
Recreation, culture and religion	33.85	30.27	35.99	-5.72	5.72	15.9%
Education	140.62	136.56	149.51	-12.95	12.95	8.7%
Social protection	440.99	458.88	468.86	-9.98	9.98	2.1%
allocated expenditure	1,238.45	1,316.73	1,316.73	0.00	129.44	
contingency (reserve)	11.81	11.79				
total expenditure	1,250.26	1,328.52				
overall (PI-1) variance						6.3%
composition (PI-2) variance						9.8%
contingency share of budget						0.9%

Table 4

Data for year =	2012					
Functional head (euro mn)	**budget**	**actual**	adjusted budget	deviation	absolute deviation	percent
General public service	97.82	159.47	103.55	55.92	55.92	54.0%
Defence	37.79	36.54	40.00	-3.46	3.46	8.7%
Public order and safety	115.72	122.82	122.50	0.32	0.32	0.3%
Economic affairs	116.21	118.07	123.02	-4.95	4.95	4.0%
Environmental protection	4.89	3.90	5.18	-1.28	1.28	24.7%
Housing and community amenities	4.84	6.77	5.12	1.65	1.65	32.1%
Health	176.66	176.57	187.01	-10.44	10.44	5.6%
Recreation, culture and religion	29.98	26.95	31.74	-4.79	4.79	15.1%
Education	136.57	133.15	144.57	-11.42	11.42	7.9%
Social protection	475.61	481.95	503.48	-21.53	21.53	4.3%
allocated expenditure	1,196.09	1,266.19	1,266.19	0.00	115.76	
contingency	8.54	18.08				
total expenditure	1,204.63	1,284.27				
overall (PI-1) variance						6.6%
composition (PI-2) variance						9.1%
contingency share of budget						1.5%

Table 5 - Results Matrix

year	for PI-1 total exp. deviation	for PI-2 (i) composition variance	for PI-2 (ii) contingency share
2010	3.1%	11.3%	
2011	6.3%	9.8%	1.1%
2012	6.6%	9.1%	

Score for indicator PI-1: **B**
Score for indicator PI-2 (i) **B**
Score for indicator PI-2 (ii) **A** **B+**

PI-3

Year	Budg. Dom Rev	Actual Dom Rev	Actual as a % of budget
2010	1,217.05	1,138.17	93.5
2011	1,181.40	1,127.48	95.4
2012	1,215.64	1,114.14	91.7

Score for indicator PI-3: **C**

Sources: Budget Department/MOF, and Assessment Team calculations

Annexe 3

Disclosure of Quality Assurance Mechanism

The following quality assurance arrangements have been established in the planning and preparation of the PEFA assessment report for Montenegro, final report dated July 30, 2013.

1. Review of Concept Note

- Draft concept note dated June 19, 2012 was submitted for review on June 29, 2012 to the following reviewers:
  - 1) Nemanja Pavlicic, Ministry of Finance, Government of Montenegro
  - 2) PEFA Secretariat
  - 3) Zeljko Bogetic, World Bank
  - 4) Patrick Umah Tete, World Bank
  - 5) KlasKlaas, OECD, SIGMA

Final concept note dated July 17, 2012was forwarded to reviewers on July 20, 2012 including a table showing the response to all comments raised by the reviewers.

2. Review of draft report

- Draft report dated May 7, 2013 was submitted for review on May 21, 2013 to the following reviewers:
  - 1) Nikola Vukicevic, Ministry of Finance, Government of Montenegro
  - 2) PEFA Secretariat
  - 3) Sanja Madzarevic-Sujster, World Bank
  - 4) Klas Klaas, OECD, SIGMA
  - 5) Donka Prodanova, EU Delegation
  - 6) Sanja Medjedovic, UNDP

3. Review of final draft report

A revised final draft assessment was forwarded to reviewers on September 2, 2013 and included a table showing the response to all comments raised by all reviewers.

PEFA assessment report for Montenegro, July 2013

The quality assurance process followed in the production of this report satisfies all the requirements of the PEFA Secretariat and hence receives the '**PEFA CHECK'**.

PEFA Secretariat, September 4, 2013

Annexe 4 Persons consulted

Person Name	Person Surname	Company/institution	Position
Nikola	Vukicevic	Ministry of Finance/ Budget Department	Assistant Minister (Chairman of Co-ordinating Group
Nemanja	Pavlicic	Ministry of Finance/Budget Department	Assistant Minister (former)
Boris	Buskovic	Ministry of Finance/Treasury	Assistant Minister
Ana	Krsmanovic	Ministry of Finance/Central Harmonisation of Financial Management and Control and Internal Audit (CHU)	Assistant Minister
Tijana	Stankovic	Ministry of Finance/Sector for Economic Policy and Development	Assistant Minister (former)
Bojan	Paunovic	Ministry of Finance/Budget Dept.	Independent Advisor (Secretary of Working Group)
Milena	Milovic	Ministry of Finance/Budget Dept	Independent Advisor
Snezana	Mugosa	Ministry of Finance/Budget Dept	Advisor (Municipalities)
Dragan	Darmanovic	Ministry of Finance/Treasury	Manager
Iva	Vukovic	Ministry of Finance/Sector for Economic Policy and Development	Advisor
Tatjana	Boskovic	Ministry of Finance/Sector for Taxes and Duties	Advisor
Mihailo	Rajceta	Ministry of Finance/Sector for Taxes and Duties	Advisor (Customs)
Lela	Ivanovic	Ministry of Finance/Sector for Taxes and Duties	Administrator
Emilija	Saban	Ministry of Finance/Sector for Taxes and Duties	Administrator
Natasa	Simonovic	Ministry of Finance/CHU	Senior Internal Auditor
Stoja	Rocenovic	Ministry of Finance/CHU	Senior Internal Auditor
Nina	Blecic	Ministry of Finance/CHU	Senior Internal Auditor
Stela	Racepagic	Ministry of Finance/CHU	Manager
Valentina	Perovic	Ministry of Finance/CHU	Manager
Vaso	Vasovic	Ministry of Finance/CHU	Manager
Ivana	Radojicic	Ministry of Finance/Sector for Finance and Control of EU Funds	Advisor
Ivana	Maksimovic	Ministry of Finance	Independent Advisor
Milan	Lakicevic	Tax Administration	Director
Novo	Radovic	Tax Administration	Deputy Director
Biljana	Jelic	Tax Administration	Manager, Accounting
Radoje	Simonovic	Tax Administration	Manager

Nada	Jankovic	Customs Administration	Head of Revenue
Branislav	Jankovic	Customs Administration	Legal Advisor
Milan	Markovic	Customs Administration	Head of Enforcement
Radivoje	Pejovic	Customs Administration	Head of Podgorica Office
Mersad	Mujovic	Public Procurement Administration	Director
Suzana	Privilovic	Commission for Control of Public Procurement	Director
Milan	Dabovic	State Audit Institution	Member of Senate
Milena	Aleksic	State Audit Institution	State Auditor
Ljiljana	Boljevic	State Audit Institution	State Auditor
Stana	Besovic	State Audit Institution	Manager
Mladen	Tomovic	Anti-Corruption Directorate	Advisor
Sanja	Leskovic	Ministry of Sustainable Development and Tourism	Deputy Minister
Zoran	Tomic	Ministry of Sustainable Development and Tourism	Secretary to Ministry
Veljko	Vrbica	Ministry of Sustainable Development and Tourism	Manager, Accounting and Finance
Vesna	Vukurovic	Ministry of Education	DeputyMinister
Mirjana	Kuicic	Health Fund	Deputy Director, Planning and Control
Milena	Cvijanovic	Health Fund	Manager, Finance
Ranka	Andric	Health Fund	Manager
Aleksandar	Damjanovic	National Assembly	Chairman of Committee for Economy, Finance and Budget
Jovanka	Petrovic	Danilovgrad Municipality	Secretary for Finance
Zdravko	Bogetic	Danilovgrad Municipality	Head of Revenue
Memija	Boskovic	Danilovgrad Municipality	Deputy Head, Economy and Finance
Miomir	Jaksic	Podgorica Municipality	Secretary for Finance
Snezana	Popovic	Podgorica Municipality	Assistant Secretary, Finance
Dragan	Pajovic	Institute of Accountants and Auditors	Auditor
Rade	Scekic	Institute of Accountants and Auditors	Advisor
Nina	Drakic	Chamber of Commerce	Manager, Analysis
Dusica	Ivovic	KPMG	Senior Audit Manager
Ljiljana	Prelevic	Sterling Accountants	Partner
Donka	Prodanova	EUDelegation	Task Manager
Rastislav	Vrbensky	UNDP	Co-ordinator for Montenegro
Sonja	Medjedovic	UNDP	Programme Manager

Annexe 5. Documentary and Web Sources of Information

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