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USAID ASSISTANCE IN FISCAL REFORM

STRENGTHENING MUNICIPAL FINANCIAL MANAGEMENT IN MONTENEGRO

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MONTENEGRO

USAID ASSISTANCE IN STRENGTHENING MUNICIPAL FINANCIAL MANAGEMENT IN MONTENEGRO: THE GOOD LOCAL GOVERNANCE PROJECT

I. PROJECT DATA

Level of Funding: \$ 9.2 million (overall project funding)

Period of Assistance: September 2003-March 2006

Types of Assistance:

1. Technical assistance: (a) resident project team; and (b) short-term specialists;
2. Equipment and materials (computer hardware and software)
3. Training: (Including extensive on-the-job training, workshops and seminars for municipal administrative personnel and elected municipal assembly members)

Areas of Assistance:

1. Creation of Republic- and municipal-level fiscal decentralization policy frameworks and organizational structures to guide and coordinate implementation and demonstrate results.
2. Strengthening municipal financial management competence
3. Procurement and installation of IT hardware and software for Municipal Treasury Management Systems
4. On-site IT and technical support to all 21 municipalities and further enhancement and upgrades of the systems to include additional functionalities

Main Counterparts:

1. Ministry of Finance
2. Municipal administrations
3. Central Bank of the Republic of Montenegro
4. Commercial banks
5. Union of Montenegrin Municipalities

II. THE PROJECT: BACKGROUND, PRINCIPAL RESULTS AND IMPACT

Introduction

Since the late 1990s, Montenegro has undertaken a series of reforms designed to transition from a socialist to a modern, market-based economy. USAID assistance has played an important role in this reform process. With the implementation of currency and fiscal policy reforms, Montenegro has succeeded in reining in inflation and bringing about macroeconomic stability. In parallel to the stabilization policies, it also implemented a number of structural reforms, including price and trade liberalization, privatization, public administration reform, financial sector reform, and labor market and business environment reforms. The government has recently updated its Economic Reform Agenda for 2005-2007 to guide the implementation of the remaining economic reforms.

Fiscal and administrative decentralization have been key parts of the structural reform process in Montenegro. An ambitious set of laws that establishes the framework for decentralization and local government autonomy was adopted including the Organic Budget Law (2001), the Law on Local Self Government (2003), the Law on Local Government Finance (2003), the Law on the Direct Election of Mayors (2003), and the Law on Real Estate Tax (2003). In the field of fiscal decentralization, USAID's Good Local Governance (GLG) project worked with the Ministry of Finance (MoF) to elaborate these laws into well-conceived regulations and other implementing measures, and assisted Montenegro's 21 municipalities with building the capacity to translate the fiscal decentralization framework into effective and transparent practice at the local level.

A. Background and Economic Context of the Project

The primary purpose of a municipal treasury system is to optimize the financial management of municipal resources. This is achieved through the careful programming and monitoring of inflows and outflows, ensuring that revenue shortfalls or over-spending are identified early; through the appropriate and timely allocation of resources for the provision of municipal services; and, through systems that give senior municipal officials, elected representatives, and the public access to timely, accurate, and complete financial information on which to base management decisions and hold municipal officials accountable. Municipal treasury systems also give the MoF the ability to obtain timely and accurate reports of municipal revenues and expenditures, provide information to international financial institutions, and ensure the execution of laws governing the intergovernmental fiscal framework.

At the inception of the GLG project, municipalities did not follow a uniform system of accounting. Financial management functions were scattered over numerous departments and were uncoordinated. In the less developed municipalities, three staff members had to spend 10 to 15 working days each to record all the previous month's transactions, and financial reports were not usually completed until the end of the following month. In more advanced municipalities, monthly budget reporting was performed by three separate departments (revenue, accounting and budget), and outstanding obligations were not recorded until the end of each year. A particular problem was the practice of keeping two sets of books—one for budgeted items and another for “off-budget” activities. Several different municipal departments were responsible for collecting various revenues and managing their expenditure, with little or no oversight from, or accountability to, the municipal Secretariat of Finance. Municipal revenues and expenditures were all channeled through the State Payment Bureau, and bank statements served municipalities as their primary accounting record. Municipalities also maintained multiple bank accounts, reflecting the multiple municipal departments responsible for revenues and expenditures, but did not regularly consolidate or reconcile their bank account information. The recording and reporting delays and inaccuracies inherent in these procedures created opportunities for error and mismanagement, and severely limited the transparency of municipal financial operations, prohibiting effective decentralization of financial management responsibilities to municipalities.

The Law on Local Government Finance, enacted in 2003, required all municipalities to set up new municipal treasury management systems, institutions, and procedures to ensure comprehensive tracking of municipal revenues and expenditures. With support from a separate USAID Economic Policy Reform Program, the State Payment Bureau was officially dissolved in December 2004, requiring municipalities to engage commercial banks to fulfill all of their banking functions. Accounting for municipal transactions became the responsibility of the municipal Secretariat of Finance. Municipalities were now required to record revenues and expenditures according to a uniform chart of accounts published by the MoF and in line with international government accounting standards. Furthermore, municipalities were instructed to close multiple bank accounts, consolidate funds into a single treasury account controlled by the municipal treasury, and create treasury general ledger accounts to replace separate bank accounts for

municipal spending units. Finally, municipalities were required to develop an integrated financial management function and the capacity to ensure timely and consolidated financial reporting.

Key challenges in implementing the Municipal Treasury Management System were numerous. Municipal staff had little or no experience in using computers or IT software. There was political resistance to consolidating bank accounts and to centralizing control over revenues and expenditures. Due to local politics and the election cycle, municipalities frequently lost competent staff, only to be replaced by inexperienced political appointees who lacked knowledge of best practices in financial management. Automated financial management systems were rudimentary at best, and those in existence simply automated existing manual procedures with little value added. In the absence of a comprehensive automated budget, accounting and financial reporting system, most municipalities relied on a manual bookkeeping system that was slow and inefficient. The need for a good, sound and flexible accounting system was paramount.

USAID's GLG project focused on assisting its counterparts at the Republic and Municipality levels to develop sustainable systems to implement fiscal decentralization, as embodied in the key 2003 decentralization laws, and to improve municipal financial management and reporting, transparency, effectiveness, and accountability. The establishment of municipal treasury departments using an IT-enabled treasury system was essential to implementing municipalities' new, decentralized financial management responsibilities and to improving the effectiveness and transparency of municipal financial management.

New municipal treasury software programs and procedures have strengthened budget control by requiring regular reporting and comparison of departmental expenditures against budget limits. With the new system, moreover, each payment must be fully recorded and "authorized" before it is issued. These authorizations limit the potential for incurring unpaid expenses and adding to arrears. Centralized payments through the consolidated account reduce bank fees and administrative expenses by an estimated 15 to 20 percent, thus saving taxpayers money. Local officials can lead with better policy decisions by relying on more frequent and detailed reporting on budget performance; and they can recognize financial problems while they are small. By using uniform procedures, municipalities are now able to compare performance and learn from each other's success.

B. Outcomes and Impacts in the Project's Principal Areas of Assistance

1. Creating a Policy Framework and Organizational Structures and Coordinating Implementation

At the outset, each municipality had to prepare and adopt an ordinance to create a treasury department within the existing municipal Secretariat for Finance, including specification of staff roles and responsibilities. The treasury has exclusive control over recording all receipts and expenses and performing all payments. As part of the establishment of the treasury, municipalities have consolidated the multiple accounts, administered by several different department heads, into a single municipal treasury account, operating under the management of the Secretary of Finance. The system records all municipal inflows and outflows. In addition, establishment of the treasury management system entailed the preparation and adoption by the Mayor of a second municipal ordinance that establishes treasury management procedures, instructions, and administrative forms to ensure proper recording and payment system integrity and full financial accountability and reporting.

To support these activities, the GLG project facilitated the formation and operation of a Municipal Treasury Working Group, including representatives of pilot municipalities and the MoF. The Working Group developed a detailed operational plan for treasury implementation and held regular forums to plan

and guide implementation of municipal treasuries in all 21 Montenegrin municipalities. With the cooperation of municipalities and the Republic government, the GLG project drafted municipal regulations and procedures and designed the guidelines for consolidated municipal treasury reporting to the municipal Secretary of Finance.

2. Building Financial Management Competence

The GLG Project conducted a series of training workshops and seminars for municipal finance officers from all 21 municipalities. The initial training focused on basic steps the municipality would have to take to establish a municipal treasury and provided a “road map” illustrating each step in the process.

The project then conducted quarterly workshops for staff in all 21 municipalities to discuss the results of treasury management system implementation and to foster networking and sharing of experiences, challenges, and “lessons learned.” In cooperation with USAID/Montenegro’s Economic Policy Reform Program, the GLG project delivered workshops for municipal finance officers addressing the establishment of private sector banking services, the adoption of cash management and investment policies, management of the municipal treasury consolidated account, and final decommissioning of the State Payment Bureau.

In addition, the GLG project also worked closely with the MoF in conducting joint workshops for municipal officials in expenditure control, budget execution, accounting, and financial reporting. In this context, the project helped the MoF prepare regulations specifying the requirements for periodic municipal financial reporting to the Republic Government and providing public access to those reports on the MoF website.

Finally, the GLG project conducted training seminars for Deputy Mayors and Municipal Assembly members to deepen their understanding of the municipal budget and treasury functions, expenditure control, budget execution accounting, and financial reporting, as well as to clarify the respective roles of the municipal administration and the municipal assembly in those processes.

3. Support Procurement and Installation of Municipal Treasury Software

The GLG project and the Municipal Treasury Working Group determined user needs and evaluation criteria for the IT component of implementing the municipal treasury management system. Together, they developed detailed specifications for system functionality to meet the accounting requirements set in the Law on Local Government Finance. These functionalities included use of a national chart of accounts; budget appropriations; allocations; a commitments-based structure; and, recording of vendors. With GLG project support, the Working Group evaluated multiple software products, invited vendors to demonstrate their software, and selected the best available software solution. The GLG project conducted a detailed analysis of the selected software, determined the modifications required to suit the user needs (as defined by the Working Group), and engaged local software programmers to modify the software accordingly. The project also prepared and distributed software user manuals that fully documented the software and allowed them to troubleshoot problems on their own, without external support.

In addition, the GLG project provided a standard package of IT hardware to the treasury offices in all 21 municipalities, consisting of five desktop computers, five printers, six uninterruptible power supply (UPS) devices, a server, and installation of wiring for networking.

In late 2004, the Municipality of Podgorica, Montenegro’s capital, was the first to fully implement the municipal treasury management system. By late 2005, a consolidated treasury structure and a fully

operational treasury management system was in place in 18 more municipalities. And, by early 2006, all 21 municipalities in Montenegro were using the new treasury management system.

4. Further Enhancement of the Treasury Management System

Following implementation of the treasury management system by most Montenegrin municipalities, the GLG project provided ongoing IT support by engaging local software developers to modify the software in response to users' experiences and identified needs. The project also provided assistance to selected municipalities that expressed interest in introducing E-Banking services linked to the treasury management software.

In order to ensure the long-term sustainability of the IT applications supporting the new system, the GLG project facilitated the creation of an IT User Group to serve as a forum for the exchange among municipal officials and IT staff of ideas and experiences related to a wide range of IT applications. The User Group now publishes a quarterly IT Bulletin—the first of its kind in Montenegro—featuring articles written by municipal IT staff and outside IT experts. Until the GLG project ended in March 2006, project staff continued to support the IT Bulletin by contributing articles and publishing the Bulletin both in magazine form and on the project web site. Moreover, through USAID-facilitated coordination with other donors, the User Group is now receiving some continued support from GTZ and UNDP municipal IT projects in Montenegro.

C. Results in Strengthening Municipal Financial Management

Following are several key results of treasury system implementation in strengthening municipal financial management. These results are told both in narrative form and through testimonials from municipal government officials who have benefited from the new systems:

“Before the new procedures and software, every day I received a pile of bills and bank statements and had to decide which [bills] could be paid. Now I have a series of reports listing all bills due, all vendors, and all spending units, and I can authorize payment without fear of exceeding budget limits.” – Anka Vojvodic, Mayor, Municipality of Bar

Using the new treasury management system, one staff member is able to generate budget execution reports within three days following the end of each month, a task that previously took 30 to 45 person-days. The municipal treasury is also able to report on inflows and outflows on a daily basis, including information on arrears. These improvements allow senior municipal officials and elected representatives, citizens, the media, MoF, and international donors and financial institutions to have accurate and up-to-date information on the financial performance of the municipality as well as individual municipal departments.

“With this new treasury software system and the treasury procedures, I am able to produce timely and accurate reports for municipal officials and staff by simply pressing a key.” – Dragan Nisavic, Secretary of Finance, Municipality of Bar

The municipal treasury management system allows municipalities to meet their statutory obligations under the Law on Local Government Finance and other relevant fiscal decentralization laws. It also allows the municipal administration to adhere to municipal budgets and other financial policies and requirements adopted by the municipal assembly, and to report on that compliance to the municipal assembly in a timely and accurate manner.

“Before this system was put in use, it would take more than three hours to record transactions and obtain relevant reports. Now, I am able to complete these activities within 15 minutes.” – Slavka Karadzic, Chief Accountant for Treasury General Ledger, Municipality of Podgorica

“It is an extremely useful financial management tool. In the past, we used a so-called ‘system of cards,’ which in fact was manual recording of invoices and data on vendors. Now, I have it all in my computer, and it is updated regularly. Having an efficient computer system makes it possible for me to submit regular reports to the Municipal Assembly while the Mayor is now used to reviewing the reports on a daily basis. Last year, he was only provided with three reports at most for the whole fiscal year. In addition to this, all payments and receipts are channeled and recorded through the Treasury Consolidated Account, whereas in the past we operated multiple accounts with no accountability and in a non-transparent way. And last -- the most important -- the independent audit report performed this year indicated great improvements in the financial management of my Municipality and for the first time in my career we were able to provide the required data in a timely and efficient manner!” – Vlatko Pekovic, Secretary of Finance, Municipality of Berane

The IT training for and the successful use of the municipal treasury management system has improved the morale of the municipal staff who operate the system and has enhanced the understanding of senior municipal officials of the opportunities to utilize IT solutions in other aspects of municipal management. The GLG-supported municipal IT User Group and IT Bulletin have been very effective forums for the exchange among municipal officials and IT staff of ideas and experiences related to a wide range of IT applications.

“The municipal treasury implementation is a very successful and comprehensive project. If we compare the results with the condition three years past, we are able to see great improvements: we have municipalities regularly reporting to the Ministry of Finance using a uniform chart of accounts, which makes it easy for the Budget Department within the Ministry of Finance to compile consolidated reports for the whole public sector. What strikes me as extremely useful and done in a highly professional manner are GLG trainings and seminars conducted for municipal staff and always highly graded by all participants. In my new capacity, I expect to meet improved conditions and transparent finances in municipalities when performing audits.” – Milan Dabovic, former Assistant Minister of Finance; current post: Council of the National Audit Institution

III. FACTORS OF SUCCESS

The key factors that contributed to the success of these USAID assistance efforts in Montenegro include the following:

1. Selection of user-friendly software. The Treasury Management System software selected by the Working Group is user-friendly, easy to use, and inexpensive to update and maintain. This factor was essential for the IT system to be accepted and implemented by smaller municipalities with small budgets and limited IT experience.
2. Use of local finance experts and local IT expertise. To support the development and implementation of the treasury management system, the GLG project engaged a local finance advisor and IT experts who had previously been involved in the implementation of a similar system at the Republic level and who had some familiarity with municipal IT capacity and requirements. Through project implementation, moreover, GLG’s IT staff gained extensive knowledge about municipal IT systems in general and the municipal treasury management system in particular. This expertise is now available to municipalities

through other donor-funded IT projects for which some of these people now work, and through private consulting arrangements.

3. Ongoing support by highly capable GLG project IT staff. The management, staffing, and IT infrastructure of the GLG project was designed specifically to serve the IT support needs of municipalities on a daily basis. Full-time IT staff members were present in all three regions of Montenegro and were able to travel quickly for on-site consultations on short notice. In addition, project-supported IT “hot line” for municipal treasury and IT staff members provided a convenient channel for real-time technical support.

4. Local capacity building. When the municipal treasury management system program was launched, management and human resources capacities in most municipalities was quite limited, To begin to overcome these limitations, the GLG project focused on persuading decision-makers in each municipality to adopt ordinances, directives, and instructions that required municipal treasury staff to be properly trained. GLG project training for implementing the treasury management system was aimed at municipal decision-makers as well as treasury staff, and ranged from basic computer literacy training and treasury operations to high-level training on cash management and cash-flow budgets.

5. Improved relations between municipalities and MoF. Republic-level institutions, including the MoF, lacked the capacity to provide the hardware, software, training or guidance that municipalities needed to meet the statutory requirements for implementing municipal treasury management systems and timely and accurate financial reporting. The training and IT support provided by the GLG project, in full cooperation with the MoF, filled this gap and reduced municipalities’ complaints about MoF’s failure to provide such support. In addition, municipalities required further guidance from MoF, in the form of regulations and instructions, with regard to legally mandated financial reporting obligations. Given limited capacity within the Ministry, the GLG project was able to support the MoF’s preparation of those regulations and instructions, with input from municipalities. These activities helped satisfy the needs of both MoF and municipalities with respect to improved municipal financial management and reporting. MoF now collects municipal budget execution reports, analyzes them, and publishes them on its web site. In spring 2005, MoF was able to include municipal government revenues and expenditures (which account for 5 percent of GDP) as part of its public sector reporting to the IMF. This was commended by the IMF Representative Office for Serbia and Montenegro, and made it possible for the media to publish the results and for the public to compare and discuss them.

6. Early attention to mechanisms to ensure sustainability. The GLG project facilitated the formation of a Municipal Treasury Working Group, comprising representatives of municipalities and MoF, to develop IT specifications and administrative guidance for implementing the system. The GLG project also facilitated the formation and operation of a municipal IT User Group to serve as a forum for discussing problems and solutions regarding the implementation of the IT aspects of the municipal treasury management system and sharing experiences in other municipal IT applications. The extensive and ongoing involvement of MoF and municipalities in these organizations greatly enhanced the successful implementation and operation of the treasury management system. Towards the end of the GLG project, the original Treasury Management Working Group and IT User Group held a forum at which they developed a treasury sustainability plan submitted to mayors and the Ministry of Finance.