

*The Budget and Finance Guide for Municipalities in Bosnia and Herzegovina* is a collaborative effort between the professional experts at the USAID/Sida Government Accountability Project and The OSCE Mission to Bosnia and Herzegovina Democratization and Public Administration Reform Department working with municipal administration counterparts across the country. This project would not have been possible without funding from USAID, Sida and The OSCE Mission to Bosnia and Herzegovina. We would like to thank Rudy F. Runko, Chief of Party GAP USAID/SIDA and Trefor Williams, Director Democratization and Public Administration Reform Department whose support has been invaluable in completing this endeavor.

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BFD	Budget Framework Document
BFP	Budget Framework Paper
CIP	Capital Investment/Improvement Plan
CSC	Citizen Service Center
CPC	Capital Planning Committee
CT	Coordination Team
EU	European Union
FBiH	Federation of Bosnia and Herzegovina
GDP	Gross Domestic Product
HR	Human Resources
HRM	Human Resource Management'
IPSAS	International Public Sector Accounting Standards
IT	Information Technology
IMF	International Monetary Fund
MC/MA	Municipal Council/Municipal Assembly
MDPC	Municipal Development Planning Committee
MoF	Ministry of Finance or Minister of Finance
NGO	Non-governmental Organization
OG	Official Gazette
PPA	Public Procurement Agency
PRB	Public Review Body
RS	Republika Srpska
SPC	Strategic Planning Committee
SWOT	Strengths Weaknesses Opportunities and Threats
VAT	Value Added Tax

Municipal staff, mayors, councilors and citizens have consistently highlighted the need for a comprehensive guide to the preparation and management of municipal budgets. The collaborative efforts of the USAID/Sida funded Governance Accountability Project (GAP), the OSCE Mission to Bosnia and Herzegovina's Democratization and Public Administration Reform Department (DPARD) and many municipalities in BIH, have pooled their resources to make this a reality.

*The Budget and Finance Guide for Municipalities in Bosnia and Herzegovina* addresses the main issues that have a significant impact on municipal budgeting. It is hoped that this *Guide* provides information that will be of practical use to municipalities. The aim is to provide enough detail for the professional and clarity for the non-professional, so that citizens can understand how the complex system of budgeting operates and how public funds are used for the activities that should make their community a better and more vibrant place to live.

*The Guide* has been designed to assist municipalities in meeting current and future challenges. The *Guide* looks at developments in the budgeting process and provides detailed guidance on the key aspects of budget preparation and realization. In doing so, it addresses the current legal framework and recent developments in areas of budget accounting, budget planning and preparation, reporting, and public procurement.

The *Guide* highlights the importance of citizen participation and suggests how municipalities can strengthen this aspect of the budget process. It offers practical information on conducting public hearings, consulting with citizens, and on how to meet, both the needs of communities, and municipalities' legal obligations. The *Guide* also introduces modern management practices, including human resource management, which will be increasingly necessary for municipalities in meeting the challenges of decentralization and the inevitable increase in the complexity of their tasks and responsibilities.

The *Guide* has been designed to allow information to be added as legislation changes, or new developments introduced. A CD, containing useful supplementary information, relevant forms and examples of good practice, has been included to support the text of this *Guide*.

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## Budgeting for Local Self-Governance

The *Budget and Finance Guide for Municipalities in Bosnia and Herzegovina* is intended as a practical guide to assist municipal officials in developing and managing their budgets in line with legally prescribed requirements. In addition, the *Guide* offers approaches to budget management that supplement the requirements explicitly prescribed by law. In this way, it is hoped that the *Guide* will provide the practical guidance necessary to bring BiH municipalities closer to international standards of local self-governance.

After reading this chapter you should understand:

- New practices in approaching municipal budgets
- Roles and responsibilities of key actors in the budget process

Developing a sound and transparent budget based on realistic revenue estimates, which takes into account the relevant views of citizens and input from municipal representatives, requires strong commitment and consistent effort. However, the reward for the community as a whole is invaluable. It is hoped that this guide will support municipal efforts in this direction.

### Factors that Influence Financial and Political Reality

The system of government in BiH is complex and includes several levels (the State, two Entities, and Brcko District). In the Federation of Bosnia and Herzegovina (FBiH) there are three levels of government below the State, with the Entity, 10 cantons and 79 municipalities. There are two levels of government in Republika Srpska (RS), with the Entity and 62 municipalities.

Level of Government	TITLE and/or Number of Units	
State level	Bosnia and Herzegovina	
Entity level	Republika Srpska	The Federation of BiH
Cantonal level	N/A	10
Municipal/city level	62	79

Despite the existence of laws regulating local self-government there is still a great deal of work to be done to harmonize the division of functions and accountability at all levels of government. Almost all functions (education, health, social welfare, the housing-utility sector, agriculture and forestry, sports and culture) receive funds from all levels of government, including the municipal level, even when there is no legal obligation to do so. Therefore, it is necessary to distinguish precisely between functions and financial responsibilities at each level of government.

It is imperative that **non-tax revenues** (such as fees from flooded land, utilities, construction land, business premises, compensations and other fees and charges) increase as part of overall municipal revenues. Increasing non-tax revenues should provide municipalities with the financial capacity to meet local needs independently. This, in turn, should lead to increased public accountability in both revenue collection and expenditure.

Municipalities must establish operational controls to minimize the risk of increasing **deficits**. Without properly accounting for previous years' debts and a proper plan to pay them off, municipalities face the possibility of blocked bank accounts and new, additional, debts. This vicious cycle diminishes the ability of a municipality to invest locally and to remain financially independent.

There are certain constraints on **borrowing funds** at all levels of government and the revision of debt laws for both FBiH and the RS is still pending. This is an obstacle to infrastructure development throughout BiH, as is the weak municipal credit market. Having both debt laws and a healthier credit market would pave the way for a modernized infrastructure.

The new single-rate **Value Added Tax (VAT)** that replaces the current sales tax will play a significant role in revenue collection at all levels of government in the future. However, at the time of the publication of this *Guide*, the law has not been fully implemented and issues related to revenue allocation have yet to be fully resolved. This is significant since the largest portion of overall municipal revenues comes from sales tax.

## Local Finance

The basic characteristics of local finance are complex. In the RS the sales tax allocation rate, (which forms the largest portion of overall municipal revenues) differs from one municipality to another, depending on the estimated level of development, which is determined by criteria set by the RS government on an annual basis. Depending on the level of development, a municipality will receive between 40 to 70 % of the taxes collected within its borders.

In FBiH the situation is more complex because of an additional level of government. Canton governments act as regulatory authorities in allocating municipal revenues. Each canton has a different system and tax allocation rates differ in each. Cantons collect 100% of sales tax and they share these revenues with municipalities in an uneven manner.

Municipal expenditures account for only 8.4 % of total public expenditures in FBiH, which is, in international terms, an extremely low percentage. In addition, there is a significant discrepancy between municipal revenues within and between cantons. Standardization of cantonal laws and practices would be one way of ensuring a clear division of competencies between different levels of government and an appropriate distribution of taxes.

All of these factors influence municipal budget activities. In transitional countries a wide range of functions have been transferred from central to local governments, which has increased the importance of transparency and accountability in the collection and allocation of revenues. The importance of the municipal budget has increased, as has the complexity of municipal responsibilities and the need to improve efficiency and competence of local government.

The process of budget planning and preparation should be an opportunity to ask questions and seek answers. Effective budgeting involves taking a wide range of difficult decisions and using limited funds to meet a variety of needs (social, economic, and administrative). Public administrations have to identify priorities in a systematic and realistic manner, while at the

same time remaining focused on the achievement of strategic goals and meeting citizens' demands. Budget preparation is the means by which municipalities seek to reconcile political influences and identify strategic priorities and legal requirements, in order to meet the needs of the community.

### **The Purpose of the Budget**

The budget represents an important tool in communicating the goals, policies, programs, and services that a municipality intends to implement in the coming year. The budget demonstrates how funds are collected through taxes, contributions, fees and other forms of public revenues, and provides the framework for spending these revenues. The budget also serves as a basis for reporting.

Application of the *budgetary specification principle* ensures budgetary discipline. This principle means that the budget is divided into sections, chapters, categories etc. Revenue and expenditure are presented in accordance with these divisions. This principle ensures that the executive only spends funds in accordance with the budget and that this is shown clearly in terms of:

- **Quantitative specification** of a determined amount
- **Qualitative specification** of a determined purpose or goal
- **Timeline specification** for a determined period of time

**Quantitative specification** means that revenues can only be spent in accordance with budget estimates, i.e. that an amount of funds spent cannot exceed the amount which is indicated in the budget.

**Qualitative specification** means that funds can only be used for settlement of liabilities that have been specified in the budget. The main purpose of this is to prevent the executive from deviating from the budget plan.

**Timeline specification** means that funds can only be provided and used within the period of time for which the budget has been adopted.

A democracy requires budget transparency from planning and preparation through to adoption and realization. Realization, control of budget realization and the final budget reports must be presented publicly. Both the executive and the municipal council/assembly (MC/MA) represent and serve citizens. They are responsible for safeguarding public funds and utilizing those funds for the good of the whole community. Existing laws require local budgets to be comprehensive, precise, timely and transparent.

It is very difficult to provide one single definition of the budget and the budget creation process that includes all its characteristics. The key issue in the effective creation of a budget is to look "beyond figures" and to recognize that the budget process has many functions and purposes:

- ***Guiding Local Economy***

Local government can significantly influence the local economy and this should be reflected in the budget. Steps taken by local government to increase the amount of municipal funds allocated to capital investment can have a positive impact in this regard.

- ***Balanced Distribution of Resources***

Based on an assessment of the community's needs conducted through public dialogue, funds are allocated to the identified areas of need, which should positively influence the local

economy. When making decisions on the allocation of funds, it is important that citizens participate in the decision-making process. The consequences of funding decision should be clearly understood. For instance, a decision to fund a local art festival could be the starting point for tourism activities in a town or a municipality; a decision to allocate funds to support a local business centre could stimulate the growth of new and existing companies in a community.

- ***Control of Local Public Companies and other Budget Users***

Local government should have insight into the balance sheet and other financial reports of local public companies and other budget users. Only then can local government influence the efficiency and effectiveness of local agencies. In order to do this the MC/MA must insist on proper reporting, including execution reports, in order to provide evidence for further financial requests.

- ***Control over Revenues and Expenditure***

Since the budget is both a plan and a statement of revenues and expenditures for a fiscal year, it offers an opportunity to compare the plan with actual achievements and to identify the causes of variations. Such analysis enables local government to exert better control over its revenues and expenditures.

- ***Identification of Priorities***

Identification of priorities is an important issue for any government, as there is never enough money to meet all requirements. It is critical to develop municipal criteria for identifying priorities. Whenever needs and requests exceed the amount of funds available, there is a struggle to identify “the right” needs and requests and to allocate the appropriate funds. This is why the art of compromise is critical in the budget process.

The budget process is the most significant activity of the annual municipal calendar and it is a central element in the decision-making process. The budget determines how funds will be spent, how they will be disbursed and it serves as a work plan for local government. Through its budget, a municipality defines the number of projects to be implemented and the extent to which they will be realized. While the Mayor and the MC/MA take a broad range of decisions, most decisions are influenced by, and have, budgetary implications

### **Special Considerations for Bosnia and Herzegovina**

In Bosnia and Herzegovina Entity level governments allocate revenues. However, State level involvement in the allocation of revenues is increasing, to create greater fiscal stability in the country.

Municipalities are being required to solve increasingly complex problems using limited funds. Municipal officials are now being challenged to find innovative effective management practices to maximize the use of funds in the short and long-term.

Comprehensive ongoing reforms in BiH will help municipalities institutionalize significant changes and introduce innovative solutions to the challenges facing local government, especially in areas of finance and budget. Municipal governments have the most direct involvement in citizen’s lives, providing services and meeting the needs of local communities. Public administrations should always be looking for ways to develop and improve services, and to change as the needs of the community change. Budgets are very important because, if prepared and realized properly, they can show citizens how their money is going to be spent,



who will benefit and how much citizens have to pay. A transparent budgetary system, taking into consideration the functions and purposes described above, is an essential element of democratic reform.

Municipal budgets provide a mechanism for controlling financial transactions and for the allocation and management of funds. Budget documents, which include working standards, indicators and service delivery goals, transform a budget from a very simple accountancy document into a statement of local public policy.

### **Basic Budget Formats**

There are several ways of presenting the budget and the policies funded by it. The budget narrative is essential in explaining the vision and policy. Using the three basic budget formats ensures greater transparency and assists the MC/MA and citizens see more clearly what is being done with their money. The three basic budget formats are:

- A linear budget which focuses on what has been bought.
- A budget divided according to tasks, which enables better allocation of financial and property assets and links expenditures with activities in a way that is clear to citizens.
- A performance budget, which is divided according to tasks and highlights performance, such as the number of citizens served.

Each of the three basic budget formats has strengths and weaknesses, since each has been created to highlight specific aspects of public policy and to provide the relevant information to decision-makers. We recommend the use of all three formats, a practice followed in many countries.

### **Changes in Roles and Responsibilities**

Creating a more transparent budget process and including citizens in the budget development process, requires a change in the roles and responsibilities of all parties involved in budget preparation. The Mayor, councilors, Finance and Budget Department staff, Heads of Departments and directors of local public companies and funds, must provide more information on their financial activities and improve spending controls. At the same time, citizens must participate in providing input and requesting budget execution information. Because there are so many participants in the process, with views and attitudes that can be contradictory, compromise and constructive solutions that take into account the views of all interested parties, must be found.

### **Role of Municipal Council/Assembly**

The MC/MA must consider all programmatic policies and the budgetary consequences of the proposals and recommendations of the executive (the Mayor). By adopting the budget, the MC/MA establishes municipal policy and the actions to be taken by the municipality to meet citizens' needs using available funds in the most efficient manner possible. The MC/MA is responsible for the following activities in the budget creation process:

- Setting priorities
- Informing the public and communicating with individual citizens
- Adopting the budget
- Monitoring the implementation of programs, projects and policies

- Supporting the implementation of the adopted budget

### **Citizens**

The public should have role in the budget creation process, providing input to the budget plan and proactively seeking information on how their funds are used. Although many chapters refer to citizen participation, Chapters 5, 10 and 11 go into greater detail.

### **Role of Executive (the Mayor)**

The Mayor is responsible for developing the vision and overall policies outlined in the budget. This essential function is an obligation and responsibility of the Mayor in accordance with the *Laws on Local Self-Governance* of both Entities. The role of the Mayor in the budget process is extremely important in terms of providing guidelines on the overall municipal policy. The Mayor should discuss general financial policy with members of the MC/MA, representatives of departments, direct and indirect budget users and the other parties responsible for controlling and spending budget funds. In addition, the Mayor needs to know the policy to be applied to salaries and compensations, to what extent capital projects are going to be funded and other financial issues affecting the municipality, such as debt servicing. This will ensure that presentation of the planned budget is in line with fiscal policy guidelines and meets the community's needs.

When requests for funds are collected, it is very likely that the total will exceed the resources available. The Mayor must identify priorities, based on the administration's preferences, what is legally mandated and what is affordable. The Mayor with the support of the Heads of Department is responsible for:

- Preparation of a draft budget for MC/MA discussion
- Preparation of a precise, comprehensive and harmonized budget
- Explanation of the local financial environment
- Implementation of the adopted budget
- Regular reporting and monitoring of the budget

In some cases, the Mayor can delegate budget-related authority to competent staff members. Based on the municipal organizational structure, the Mayor may delegate authority to the Deputy Mayor (where this position exists), the Head of the Finance Department, the Head of Budget or the Head of Accounting. Apart from delegation of authority, the Mayor must ensure that budget preparation is completed by competent staff. The Mayor should normally delegate authority to the Head of Finance. Delegation of authority to the Head of Finance or other relevant staff can include the following:

- Development and issuing of budget preparation instructions and guidelines for all budget users, including all details related to the budget planning and preparation process, threshold expenditure amounts, limits of expenditure, constraints related to the increase or reduction of services. (In this phase, the budget calendar with strict dates and all necessary budgetary applications and forms, should be sent to all budget users)
- Preparation of a revenue forecast and expenditure assessment
- Preparation of a financial strategy based on the forecast and assessment

- Provision of direct assistance to all budget users in line with budgetary instructions
- Assessment of budget users' requests in accordance with budgetary instructions
- Provision of recommendations for the Mayor based on an analysis of budget users' requests
- Assistance to the Mayor in the process of harmonization of budget requests with actual revenues
- Preparation of a budget draft to be presented to the MC/MA
- Assisting the Mayor in presenting the draft budget to the MC/MA and citizens during public hearings
- Preparation, publication and distribution of the adopted annual budget to all budget users and stakeholders

### **Role of Budget Users**

Budget users play a key role in the budget creation process. Because they are more directly involved in, and directly accountable for, public service delivery, they are in a position to understand service delivery needs and requests. Therefore, preparation of precise expenditure requests; preparation of necessary documentation related to requests for funds and submission of all requested budgetary forms in a timely and accurate manner, is essential if the Head of Finance is to prepare an accurate budget for the Mayor's review.

### **Final Note**

It is hoped that through this *Guide*, the reader, whether a Mayor, Head of Finance, MA/ MC members, or citizen, will understand how they are involved in developing better municipal governance, using the budget as a tool to set policy and, ultimately to provide quality services in a more effective and efficient manner.

## Law on Budget and Budget System Law

The Bosnia and Herzegovina (BiH) budget system is regulated by law. This chapter provides an overview of the Entities' Budget Laws and the legal implications for municipal budgeting.

After reading this chapter you should understand:

- Key points of the Law on Budget of the Federation of Bosnia and Herzegovina (FBiH)
- The FBiH Budget Calendar
- Key points of the Law on Budget System of Republika Srpska (RS)
- The RS Budget Calendar

### Law on Budgets of the Federation of Bosnia and Herzegovina

The Law on Budget of FBiH, (hereinafter 'the Law'), came into force on 21 May 1998, and has been applied since 1 June 1998.

The essence of this Law is to promote precise budget planning from a revenue point of view. The level of planned revenues is used as a limiting factor in planning expenditure. The core of this Law is the principle of *earmarking spending of funds* within a precisely established framework, for cost-effective budget planning. Below is an overview of the most important articles for budget activities in municipalities.

*Basic Provisions* are presented in Articles 1 – 14 of the Law. These provisions are related to: content and scope of the Law, definitions, budget funds, harmonization of budget funds and expenditures, budget revenues, budget surplus and budget deficit.

The budget system is composed of:

- The Budget of FBiH
- Canton budgets
- Budgets of municipalities and cities
- Fund financial plan

This Law regulates the following:

- Preparation, planning, adoption and the budget creation practice of FBiH, cantons, municipalities and cities
- Implementation of the budgets of FBiH, indebtedness and debt management
- Budget accountancy, the control and audit of the budgets of FBiH, municipalities and cities

*Articles 2 – 14:* Define the integrity of the budget system, which is created by a common legal basis, single budget classification, use of uniform budget creation documentation, consistent criteria for the control and audit of the budget and consistent principles of the budget procedure.

*Article 2:* Defines basic terms: the budget, the budget of FBiH, budgets of municipalities and cities.

*Article 8:* Defines budget funds used for financing budget users' operations and performance of their respective tasks. This Article also sets forth an obligation for harmonization of budget funds and budget expenditure.

*Article 9:* Defines the revenues and incomes of FBiH, cantons, municipalities, cities i.e. their respective budgets consist of tax revenues, non-tax revenues and revenues collected from basic activities within the competencies of a municipality. Tax revenues are allocated in compliance with a special Law (the Law on Allocation of Public Revenues). More details on this law and what types of revenues belong either to the FBiH or to cities/ municipalities are provided at the end of this chapter.

*Article 10:* Defines outlays of current expenditures, capital expenditures, loans and shares of registered capital which have been reduced for an amount of loan repayment as defined by Articles 10:b, 13, 17:4 and 5, and 29:5. Anticipation of investment revenues and expenditure is presented in the capital part of the budget.

*Article 11:* Defines excess of revenues over expenditures (*surplus*), excess of expenditures over revenues (*deficit*) and revenue surplus allocation practice, as well as the manner of covering a deficit.

*Article 12:* Defines covering of deficits in line with Articles 37 – 44.

*Article 16:* Stipulates that the Minister of Finance (MoF) is obliged to create a preliminary report on economic and fiscal policy before 30 June. It also requires the MoF, in cooperation with other governmental bodies, to propose an assessment based on the main revenue and expenditure categories for the following fiscal year. This report, called the Budget Framework Paper (BFP), sets out key projections of revenues, expenditure policies and strategies needed to guide the preparation of the budget for the Entity, cantons and municipalities.

*Articles 16 – 19:* Outlines budget adoption procedure, the **Budget Calendar**, which defines final deadlines for completion of different phases in the budget process.

**The Budget Calendar** begins on **1 July**. In this month, municipalities are obliged to start the process of analyzing BFP from the MoF.

By **22 July**, municipalities are to provide their respective budget users with the *Manual on Draft Budget Preparation*.

By **mid September**, budget users must submit a request to their Finance Department for the following year.

By **15 October**, the Finance Department creates draft budget in compliance with the Manual guidelines, paying special attention to budget users' needs.

By **15 November**, a competent municipal executive body adopts the budget proposal and submits it to the Ministry of Finance.

The calendar provides an opportunity for harmonization of timeframes related to adoption of all budget documents.

## Law on Budget System of the Republika Srpska

The Law on Budget System of the (RS) came into force in December 2003, and has been applied since January 2004.

The essence of this Law is detailed budget planning in terms of revenues, which is a limiting factor on potential expenditure. Earmarked funds and spending a precisely determined amount of funds, represents the fundamentals of this Law in terms of creation of a realistic and cost-effective plan.

*The Basic Provisions* are presented in Articles 1-12. These provisions are related to: content and scope of the Law, definitions, budget funds, harmonization of budget funds and expenditure, budget revenues, budget surplus and deficit.

The budget system is composed of:

- The budget of the RS
- The budget of municipalities and cities
- The fund financial plan

This law regulates the following:

- Preparation, planning, creation and adoption practice of the budget of the RS, budgets of municipalities and cities and fund financial plan
- Implementation of the budget of the RS, budgets of municipalities and cities and fund financial plan, indebtedness and debt management
- Budget accountancy, the control and audit of the budget of the RS, budgets of municipalities and cities and fund financial plan

*Article 2:* Gives definitions of basic terms: the budget, the budget of the RS, the budget of municipalities and cities, budget reserve, the Memorandum on Budget, fiscal year, Decision on Adoption of Budget, public revenues, assistance, long-term and short-term credits and loans, budget expenditure, a long term obligation, budget surplus, the Public Revenue Account, the General Treasury Ledger, the Treasury Single Account and the Special Purpose Account.

*Article 3:* Outlines that the integrity of the budget system is ensured by a common legal basis, single budget classification, use of uniform budget creation documentation, consistent criteria for the control and audit of the budget and consistent principles of the budget procedure.

*Articles 4 – 6:* Define that budget funds are used for financing budget users and the performance of their tasks, as well as for balancing of budget funds and expenditures. Budget funds which are a part of the RS budget, and which are shared among the budget of the RS and budgets of municipalities, are automatically paid from the Public Revenue Account on the Single Treasury Account of the RS, municipalities and cities.

*Articles 7 – 9:* Outlines which revenues belong to the RS, how budget revenues are shared between the RS and the municipalities and which revenues belong only to the budgets of municipalities and cities. Further information on revenue allocation can be found at the end of this chapter.

*Article 12:* Defines the method of use of surplus and the method of financing deficits.

*Articles 13 – 17:* Outline budget preparation starting with creation of a Budget Framework Document (BFD) by 30 June (defined in Article 2 item 5) which should provide

macroeconomic projections of a forecast of revenues and expenditures for the next fiscal year and the following two (this is different from the existing budget law in FBiH that only predicts one year).

*Article 15:* More explicitly outlines the *Budget Calendar*, which is the timeline for the budget preparation period as follows:

**The Budget Calendar** starts from the month of July (**5 July**). On this date, municipalities are obliged to begin analyzing the preliminary BFD.

By **20 July**, municipalities are to submit the *Manual for Preparation of the Budget Draft* to their budget users.

By **mid September**, budget users submit requests for the following year to their Finance Department.

By **15 October**, the Finance Department will create a draft budget, taking into consideration needs of budget users and guidelines, as stated in the BFD

By **1 November**, the competent executive municipal body adopts the budget draft and submits it to the Ministry of Finance.

The Ministry of Finance can give recommendations for and approval of the proposed draft by **20 November**.

By **5 December**, the competent executive municipal body adopts the budget draft, which is to be passed-adopted by the Municipal Assembly by **15 December**.

Finance Department is obliged to submit the adopted budget for the following year to the Ministry of Finance by no later than 15 December. The same procedure is valid for the budget of the Entity Government, and offers an opportunity for complete harmonization of timeframes for passing all budget documents in the RS.

### How Revenues are Owned or Shared in FBiH

In FBiH, revenues are owned or shared according to the provisions of the “Law on Allocation of Public Revenues in the Federation of BiH” and similar Canton laws, except Canton 9 (Sarajevo):

The following revenues shall be allocated to the Federation:

- All customs duties
- Special taxes - excises
- Corporate income tax of the banks and other financial organizations, persons & property insurance and reinsurance companies, legal Entities in the domain of power industry, postal industry and telecommunications and legal Entities in the domain of games of chance and entertainment industry, where such activities are the sole activities they perform
- FBiH administrative fees
- FBiH court fees
- Revenues from natural resources
- Donations
- Other revenues (from property, etc...)

The following public revenues shall be allocated to the Cantons established under the Law on Federation Units (Cantons)

- Sales tax on goods and services
- Enterprises' profit tax, *except for the corporate income tax referred to in Article 1, sub-paragraph 4 of this Law*
- Payroll tax
- Fines under Cantonal regulations
- Donations
- Other revenues

The legislative bodies of the Cantons shall pass laws on Canton fees (court fees, administrative fees, etc...)

Public revenues shall be allocated to municipalities according to Canton regulations.

Municipal Councils shall pass regulations on municipal fees (utility fees, fines, etc...), as well as regulations on taxation (agriculture tax, property tax, etc...), and in other ways provide the necessary funding.

### **How revenues are owned or shared in RS based on Law on Budget System in the RS**

Revenues that belong to the RS are:

- Customs
- Excises, except for oil derivatives excises
- Tax on profit
- Income tax
- Tax on movable property
- Tax on income gained from lottery and fun games
- Tax on fees
- Compensations
- Fines
- Revenue from illegally obtained property and material gain
- Other revenues

Revenues that are shared between the budget of the RS and budgets of municipalities and cities:

- Sales tax on goods and services
- Oil derivatives excises
- Compensations for roads
- Tax on citizens income
- Compensation for change of purpose of agricultural land
- Compensation for use of mineral raw material
- Confiscation of material gain



Revenues that belong to the municipal budget are presented in Article 9 of the Law, as primary-source revenues of municipality that are not limited by the budget. These are as follows:

- Tax on property
- Tax on citizens income
- Fines prescribed by a criminal offence procedure
- Municipal administrative fees
- Utility fees
- Municipal compensations for use of natural and other resources of general interest
- Tax on lottery
- Other municipal revenues

## Budget Accounting

Budget accounting is a system of collecting, recording, analyzing and reporting the financial activity of organizations, companies, and institutions on the basis of financial transactions made in the course of their work. There are different definitions of an accounting system but all have the same basic elements:

- A system is established for accounting
- Data is collected about business events for analyzing, systemizing, classifying, and measuring
- Data is processed and presented to users

After reading this chapter you should understand:

- The significance of the accounting system in the budget system
- The specific items that mark budget accounting

In order to understand budget accounting there are two major aspects to be considered in the budget system of a municipality:

- Accounting is an informative system which assesses, processes, and presents financial data of a legal entity
- Book-keeping consists of registering, classifying and summing business transactions of a legal entity and keeping the original business documentation as proof of those transactions

Budget accounting is a legal obligation for all municipalities in BiH. At the end of this chapter, you will find a list of current legislation and standards for reference.

### The Budget Accounting System

In contrast to international standard accounting, budget accounting in BIH recognizes and confirms revenues on a cash basis, at the moment when revenue is available and can be measured. The municipality records all revenues in its accounting books. At the same time, expenditures are confirmed at the moment of the beginning of a business event and on an accrual basis. Generally, the accounting system of budget users is based on the modified *evolution of event principle*, (this is also called modified accrual). Financial reports are prepared based on the modified method of accounting, which is in accordance with provisions on budget accounting in both Entities. (For more information, please see Chapter 9 Financial Reporting to Ministries of Finance).

The quality of financial reports (filling in forms and drafting attachments) for all budget users depends on the quality of the established accounting system. Before preparing any reports for the Ministry of Finance or MC/MA, it is necessary to complete pre-balance operations including reconciliations and reviews. One example is the inventory review or the reconciliation of the status of accounts and registering inventory differences. The level of verification depends on the quality of established accounting policies and procedures and the quality of internal control mechanisms.

The Finance Department should regularly review the accounting ledgers for accuracy and completeness during the accounting period. Special attention should be paid to the reconciliation of capital and financial transactions before the drafting of reports begins. The Finance Department should bear in mind that review procedures require less time if they are done on a regular basis throughout the year. This reduces the number of mistakes, discrepancies or omitted records and will make the final review at the end of year much faster. By using the appropriate accounting software, mistakes can also be reduced and accuracy between ledgers and the accounting books will be significantly improved.

### **Double Accounting / Bookkeeping Entry**

In bookkeeping, budget users follow the principle of double entry accounting. Double entry bookkeeping is a method of recording transactions, which allows a check on the accuracy of data recording. Bookkeeping entries are divided into debits and credits. Debits record transactions relating to received payments, expenses and an increase in the claims or assets of the municipality. Credits record transactions relating to revenues, payment for goods and increases in the liabilities of the municipality. Recording a transaction always requires a debit and a credit entry. Provided these entries have been correctly recorded, both sides of the ledger should agree when totaled.

### **Standard Budget Classifications**

Budget classification provides a framework that defines and registers financial activities. The standard budget classifications are listed in the table below.

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<b>Fund:</b>	Identifies sources of financing and resources
<b>Economic:</b>	Constitutes identification of all types of revenues, expenditures, obligations and resources
<b>Organizational:</b>	Identifies transactions per place of origin
<b>Functional:</b>	Identifies the aim of a transaction
<b>Sub-economic:</b>	Gives details on the type of transaction
<b>Programmatic:</b>	Enables monitoring of projects and programs related to a specific transaction

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Further explanation is required for some of these classifications, as detailed below.

### **Fund Classification**

This classification, while not so significant for municipal financial activities, can be of use. Fund classification can be used when a municipality has a limited amount of funds, which should be spent for a specific purpose.

### **Economic Budget Classification**

To record revenues, expenditures, assets and resources uniformly, budget users are obliged to apply the Chart of Accounts. Budget users must apply the Rulebook on Accounting using the classes, categories, sub-categories, main groups, sub-groups and analytical accounts of the Chart of Accounts. Financial changes, i.e. budget transactions, are coded by, and recorded directly in, the analytical accounts, while summary codes and booking are used in the booking orders and journal, depending on the technique of booking. Budget institutions are obliged to book the budgetary transactions directly to the regulated six digit accounts.

### **Organizational Budget Classification**

The organizational classification enables the identification of financial responsibility at the level of primary, secondary and tertiary budget users and is organized hierarchically on the basis of Entity, canton and municipal regulations.

### **Functional Budget Classification**

The functional classification enables recording of financial transactions by the functions prescribed by law.

### **Accounting Principles and Rules**

The Head of Finance, in the first instance, and the accounting office of the budget user are responsible for accounting and bookkeeping. The responsible person is obliged to ensure that:

- Drafting of financial reports is conducted on basis of the data obtained from the accounting books
- Keeping registries in the official accounting books is conducted exclusively with adequate identification of each transaction
- Only existing values are registered
- Booking of debts and claims is conducted exclusively with correctly identified business events
- Forged documents are not created or used
- Bookkeeping registries and documents are properly stored and disposed of
- Reports are not signed if they have not been prepared in accordance with accounting standards, keeping professional ethics in mind
- Financial reports are signed by the person/s who have kept the accounting books and prepared the reports

### **Developing Accounting Policies and Rulebooks**

International Public Sector Accounting Standards (IPSAS) should be used as the basis for accounting policies. Accounting policies are special principles, foundations, conventions,

rules and practices adopted by an organization in preparing and presenting financial reports. Accounting policies have to offer information of importance for users. The information must be reliable, truly and fairly reflecting the financial situation, showing the economic core of the events and transactions. Finally, the information must be neutral, impartial, clear and reasonable.

Each municipality should establish its own accounting policies in line with the *Guidelines of Internal Control of Budget Users (FBiH OG 19/05)*; however according to *FBiH Budget law Article 46 and 47* the Federation Government and the Ministry of Finance issues the regulations to be used by all levels of government. The same is true for the RS according to the *RS Law on Budget System article 58*. The policies should be harmonized with the Rulebook on Accounting of Budget issued by the Entity governments. The Municipal Accounting Rulebook must be a guide for all accounting activities of the bookkeeping unit or department during the recording of all municipal transactions.

When developing policies and rulebooks budget users must have relevant and reliable information in order to make realistic and sound economic decisions; therefore, financial books must:

- Truly reflect the budget user's financial position
- Reflect the economic essence of transactions, other events and conditions, not just their legal form
- Be neutral and free of any kind of unprofessional activity
- Be clear
- Be complete and contain all relevant data

### **Accounting Registries**

Accounting registries are kept according to the accounting framework prescribed by the Rulebook on Content of Certain Accounts within the accounting framework for users of the budget of the Entities, cantons, municipalities, cities, budgetary funds and the funds.

The Chart of Accounts contains 10 main classes, described in the following table. The Charts of Accounts are not quite the same in RS and FBiH. Both Charts of Accounts contain 10 classes, with the same titles but the numbering is different.

Title	Description <sup>1</sup>	Class Number RS and FBiH
<b>Fixed Assets</b>	Fixed assets are used in providing public services and/or for administrative purposes that are expected to be utilized during the year.	<b>Class 0: RS</b> <b>Class 0: FBiH</b>
<b>Stocks</b>	Expenditures related to basic materials and petty inventory, which is always in the amount of the supply cost of that material/inventory i.e. at the price at which it is supplied. Expenditures are recorded by supply, which means that the partial correction of material and petty inventory stocks is not done at the level of net selling value because the accounting value of the stocks does not exist.	<b>Class 1: RS</b> <b>Class 2: FBiH</b>
<b>Cash / Short-Term Claims and Demarcations</b>	<p>Deposited money is registered in the transaction account at the bank. Financial resources related to revolving funds and credits are registered in separate accounts. Money in foreign currency parallel to KM is registered in foreign currency accounts. The resources are balanced according to the BiH Central Bank currency rate.</p> <p>Short-term claims are claims with a payment deadline shorter than one year from the date of the business event.</p> <p>Short-term demarcations consist of the active portion, rents, and other anticipated positions of the active account as well as the passive portion, rents and other transitory activities all for the term of one year (that include advance calculated revenues which are not collected immediately and advance paid expenditures which will be paid later).</p>	<b>Class 2: RS</b> <b>Class 1: FBiH</b>
<b>Sources of Equity</b>	<p>Sources of equity are available to budget users at any time. Regular fixed sources of assets increased for the part of revalorization effects must be equal to the value of the fixed assets.</p> <p>Undistributed surplus of revenues is primarily used for covering deficits from the previous period.</p>	<b>Class 3: RS</b> <b>Class 5: FBiH</b>
<b>Long-Term Liabilities and Demarcations</b>	Long-term liabilities are liabilities, which are to be paid in the term longer than one year from the date of obligation occurrence. Revenues and sources of revenues prepared in accordance with special legal regulations can be long-term accruable.	<b>Class 4: RS</b> <b>Class 4: FBiH</b>

<sup>1</sup> Rulebook on Accounting for Budget of Federation of Bosnia and Herzegovina (FBiH OG 6/99); Rulebook on the Content of Certain Accounts in the Chart of Accounts for Budget (RS OG 18/99)

<b>Short-Term Liabilities and Demarcations</b>	<p>All liabilities from current business operation that occur in the same manner and under the same conditions. Short-term current liabilities posted to individual accounts respectively.</p> <p>Liabilities toward the employed and the supplier are always considered as short-term liabilities regardless of when they are due to be paid. All revenues paid in advance and all calculated and unpaid expenditures are recorded to the account. Short-term demarcations, if they relate to a period that is shorter than a year.</p>	<b>Class 5: RS</b> <b>Class 3: FBiH</b>
<b>Expenditures</b>	<p>Expenditures are booked on accrual basis, i.e. in the period when the obligation of payment occurred regardless of payment being done or not.</p> <p>Allocations to lower consumer units are used for registering transfers, allocations at the same level of government including allocations from the budget for budget users and allocations from budget users to lower consumer units.</p>	<b>Class 6: RS</b> <b>Class 6: FBiH</b>
<b>Revenues</b>	<p>Revenues and receipts are shown in the accounting period in which they are measurable and available. Revenues are measurable when it is possible to show them in value. Revenues and receipts are available when they are realized within the accounting period or just after and when available for payment of obligations.</p>	<b>Class 7: RS</b> <b>Class 7: FBiH</b>
<b>Memorandum Records on Capital Transactions</b>	<p>Memorandum records on capital transactions present a closed system of accounts for registering capital revenues and costs and do not present balance positions.</p>	<b>Class 8: RS</b> <b>Class 8: FBiH</b>
<b>Off-Balance Records</b>	<p>Off-balance records are presented finances and sources important for budget users and they are not presented in the balance.</p>	<b>Class 9: RS</b> <b>Class 9: FBiH</b>

### Accounting Books

The Legal basis for keeping accounting books is the *FBiH Law on Budget and Law on Budget System (RS)*.

The accounting books for budget users are:

- Transaction logbook
- Ledger: which includes an income and revenue book, book of properties, obligations and sources of properties
- Auxiliary books: which include an input and output invoice book, fixed assets book, cashiers book, giro account status book, material stock book, registry of debts book and registry of salaries

5 years. Accounting books have the value of a public document. At the end of fiscal year the accounting books are balanced, closed and bound in hard-copy. If the accounting is done electronically the general ledger and the diary are printed and bound. The Transaction Logbook and General Ledger must be kept at least 10 years and auxiliary books must be kept

### **Accounting Documents**

An accounting document is a record of an occurred business change. Business changes are:

- When you pay
- When you collect money
- When you buy
- When you receive something
- Any activity which has some result which must reflectd in the general ledger

The booking of business changes is done exclusively in accordance with accounting documents. An accounting document must be verified as legally correct, valid and truthful as well as mathematically correct, by the persons responsible. Accounting documents can be obtained electronically including electronic exchange of data in accordance with UN/EDIFACT<sup>2</sup> standards. Bookkeeping documents can also be received through telecommunications, including electronic exchange of information between PCs in accordance with UN/EDIFACT standards. In FBiH the *Rulebook on Budget Bookkeeping in FBiH (FBiH OG 56/02 Article 5)* allows for electronic data processing.

Budget users assign persons responsible for the legality and correctness of business changes and the preparation of the documents on business changes, arranging movement of accounting documents, and internal control procedures. An accounting document must be sent for booking, at the latest, within 8 days from the date of occurrence of the business change.

All budget users are obliged to run and keep accounting registries and documents that provide adequate and complete proof of their transactions for a period, which is not shorter than 6 years or for a longer period if it is a requirement of tax laws.

### **Preparation Steps for Drafting Annual Financial Statements**

At the end of the accounting period, budget users are obliged to:

- Record all financial transactions during a specific accounting period
- Reconcile analytical and sub categories of accounts
- Check all previous booked transactions
- Reconcile vendor accounts and data in the general ledger
- Reconcile short-term claims accounts and data in the general ledger
- Complete inventory of assets, debts and claims
- Finish all necessary pre-balanced booking

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<sup>2</sup> UN/EDIFACT is United Nations rules of Electronic Data Interchange for Administration, Commerce and Transport. They are a set of internationally agreed standards, directives and guidelines for the electronic interchange of standard computerized data.



- Make a preliminary Profit or Loss Statement (this applies to communal enterprises only)

### **Procedure for Inventory of Assets, Debts and Claims**

At the end of the fiscal year budget users are obliged to form a Commission for Inventory of Assets, Claims and Debts. Any changes in inventory must be recorded through respective accounts and have supporting information in the accounting books.

The following regulations on the Entity level strictly prescribe all necessary activities regarding this issue:

- Rulebook on Accounting of Budget Article 74, FBiH OG 56/02
- Rulebook on Modes and Timeframes of Inventory and Harmonization of Accounting Records with Actual Records RS OG 37/00

### **The Balance Sheet as a Result of the Annual Budget Process**

The balance sheet is completed after the account status has been reconciled with the real status. This is then confirmed by the control of assets, claims and debts, and upon conducting all accounting related to the distribution of revenues and expenditures and distribution of surpluses resulting from revenues versus expenditures; conducting an accounting of the deficit resulting from expenditures higher than revenues, and a simultaneous closure of income and expenditure accounts.

The quality of the balance sheet is directly related to the effectiveness of a municipality's internal control. If the procedures for recording and reconciling basic resources, financial resources, assets and liabilities are not followed then the balance sheet will not provide an accurate snapshot of the municipality's financial position.

Therefore, the Finance Department should first review procedures prescribed by the *Rulebook on Inventory*. Often the failure to do a proper inventory stems from lack of preparation of an inventory plan with defined tasks, deadlines and a final inventory report. This creates delays in finalizing the balance sheet, or provides unreliable or inaccurate information, which creates an unrealistic or false representation of the municipality's financial health.

### **The Legal Framework for Budget Accounting**

The legal framework for budget accounting is established at the Entity level. The FBiH and RS Legal framework includes laws, decrees, rulebooks and accounting standards, listed below.

### **FEDERATION OF BOSNIA AND HERZEGOVINA**

- Law on Budget in FBiH (FBiH OG 20/98)
- Law on Treasury (FBiH OG 58/02)
- Law on Accounting (FBiH OG 2/95 and 12/98)
- Decree on Accounting of Budget in FBiH (OG 47/98)
- Rulebook of book keeping budgets in FBiH (OG 56/02)

- Rulebook on Financial Reporting and Annual Financial Statement for the Budget in FBiH (OG 30/99; 54/99;17/05)
- Rulebook on Account of Budget FBiH (FBiH OG 56/02)
- Accounting Standards in FBiH (FBiH OG 50/98; 52/99; 54/00)
- International accounting standards No. 27 (Previously BiH did not issue accounting standard for accounting of budget users. The legal framework for this issue is international accounting standards)
- Also, in accordance with legal regulations in FBiH (The Guidelines on Establishment and Strengthening of Internal Control of Budget Users, (FBiH OG 19/05), municipal authorities have to establish internal accounting policies for budget users (whose business operation includes specific relations and business changes that require additional rules for their use, having in mind that these should not deviate from laws and other regulations)

### **REPUBLIKA SRPSKA**

- Law on Budget System of the RS (RS OG 96/03; 14/04;/05)
- Law on Treasury (RS OG 16/05)
- Law on Accounting (RS OG 18/99 and 62/02)
- Rulebook on the Content of Certain Accounts in the Chart of Accounts for Budget Beneficiaries (RS, municipalities, towns, budget and public funds), (RS OG 86/02 and 01/04)
- Rulebook for Accounting Policy for Budget Beneficiaries in RS (RS OG 109/03 and 07/05)
- Rulebook on Financial Reporting for Budget Users of the Budget of RS, municipalities and towns and funds (RS OG 56/04; 62/04; 11/05)
- International Accounting Standards for the Public Sector
- Accounting Standards of the RS (RS OG 18/99)
- Rulebook on Implementation International of Accounting Standards for the Public Sector (RS OG 06/05)
- Rulebook on Methods and Deadlines for Implementation of Inventory and Harmonization of Registered and Actual Situation (RS OG 37/00)

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On the Budget and Finance Guide CD for this Chapter, you will find:

Municipal Accounting Policies for Budget Users

Accounting Classifications Reference Document published by PADCO

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## Budget Planning and Budget Preparation

Planning and preparation of the budget is one of the most important phases of the budget cycle. Budget users are expected to plan their respective activities for the forthcoming year(s) and identify the costs associated with implementation. Revenues are estimated based on the previous year's revenue collections and forecasting of increases based on tax and non-tax revenues. The municipality's priorities are identified and funds are allocated based on those priorities. The budget is a political document and financial assessment of municipal plans for the following year. If it shows positive and appropriate use of funds, created in a professional, transparent and cost-effective manner, the budget can help improve the citizens' trust in the administration.

After reading this chapter you should understand:

- When the planning process starts
- How budget users participate in the planning and preparation process
- The importance of timelines
- Budget Structure

## Preparation of Budget

The budget process includes many activities that should be completed within a precisely determined period of time, outlined in the "*Budget Calendar*". The *Budget Calendar* is a timetable of various activities necessary for preparation, planning and adoption of the budget. The Calendar sets forth a timetable for various phases and procedures within each phase. It clearly identifies the participants are and their responsibilities (see Chapter 2 Laws on Budget).

## Role and Function of the Municipal Finance Department

The municipal department in charge of budget and finance (hereinafter: *Finance Department*) has significant duties.

**An Information Provider:** The Finance Department should provide high-quality and accurate information on budget policy goals; informing all budget users of the same and what expectations and obligations are made in support of this policy. In addition, the Finance Department delivers necessary information to the MC/MA and its committees and commissions.

**A Decision Maker:** The Finance Department has to identify priorities among budget users' requests and advise the Mayor.

**Promoter of Fiscal Responsibility:** Many budget users demand more funds than are actually needed. The Finance Department should motivate budget users to plan realistically and cost-effectively, demonstrating savings capability and professionalism. This can be achieved only through open

communication and purposeful analysis, establishing control mechanisms and monitoring budget execution.

**Promoter of Public Accountability:** The Finance Department has a responsibility to educate municipal councilors and citizens on a variety of fiscal issues, including presentation of the budget proposal to the community.

### Basic Phases of Budget Preparation

Budget preparation should follow these basic phases:

- Development of budget guidelines
- Preparation of a revenue assessment
- Collection of budget requests from budget users, review and analysis of requests, follow-up discussion with users, and adjustment of requests in line with the restriction of planned budget funds
- Organization of public hearings on the draft budget

### Budget Guidelines: Budget Framework Paper/Document FBIH and RS

In compliance with *Law on Budget of FBIH* and the *RS Law on Budget System*, the Ministry of Finance prepares the *Budget Framework Paper/Document (BFP/BFD)*. The main purpose of this document is to provide an overall framework of resources including budgetary and extra-budgetary funds that are expected to be collected in the following year in the FBIH and for the following 3 years in the RS. Actual domestic revenues, including tax revenues, non-tax revenues and revenues of extra-budgetary users constitute the most important part of this resource framework. Another purpose of this document is to improve coordination among Entity, canton and municipal governments when preparing a public spending program. These guidelines are also related to budgets of social funds (health, employment, retirement).

Key areas in Fiscal Guidelines:

- Macroeconomic assumptions
- Anticipation of revenues, based on expectations related to the realistic growth of GDP
- Anticipation of expenditures adjusted to the framework of anticipated revenues

Based on these guidelines and instructions, municipalities must provide guidelines to their budget users and create their own budget plan proposals.

*The Law on Budget* and the *Law on Budget System* precisely define deadlines regarding the procedure on budget preparation and budget planning through the *Budget Calendar*.<sup>3</sup> After the municipalities receive the BFP/BFD each must prepare its own guidelines for its budget users. These guidelines consist of the following:

<sup>3</sup> Articles 15-18 of the Federation Law on Budget (OGFBIH 20/98) and Articles 22 and 23 of the RS Law on Budget System (OG RS 96/03; 14/04; 67/05) define creation of a municipal budget draft and the budget proposal. For more detail on both laws, and a Calendar of Budget Activities, please see Chapter 2.

- Basic economic assumptions and guidelines for preparation of the draft budget
- Description of the planned policy for the municipality
- Assessment of budget funds and municipal expenditures
- Proposed estimate of expenditures for each municipal budget user
- Procedure for budget preparation

Proper guidelines provide a common basis from which budget users can plan and ensures that all budget users understand the priorities of the administration.

### **Budget User Requests**

Pursuant to *Article 17 of Law on Budget FBiH* and *Article 20 RS Law on Budget System* budget user's requests should contain the following:

- Revenues (including those considered budget users' revenues) and expenditures covered by all revenue sources; planned expenditures for the budget year per categories as prescribed by the consolidated budget plan
- A short overview of the staff structure, as well as the number of staff to be funded
- An explanation of anticipated needs, so that the Finance Department can review and analyze all budget user proposals
- Proposed requests related to future obligations and long-term expenditures, including investment projects, should be submitted separately from the expenditure assessment for the following year
- Capital projects with an assessment of amounts that will be charged against the budget in the few years after the end of the project

### **Municipal Budget Revenue Sources**

The budget preparation process starts from the assessment of available revenues, which means that planned spending must be adjusted to the limits of available funds.

Basic budget revenues include:

- Tax revenues as stipulated by law
- Non-tax revenues, such as revenue from entrepreneurship, revenue from property, revenue from administrative fees and fines
- Revenue from performance of budget user's basic activity, in compliance with special regulations
- Domestic and foreign grants in cash and in-kind

Pursuant to the Charter of Local Self-Governance adopted by the State (BiH OG 31/94 ratified 12 July 2002:

- Ceded public revenues (tax revenues)
- Primary-source public revenues (non-tax revenues)

- Financial support as additional funds from a higher level of government (grants)

In **FBiH**, revenues that have been collected in the territory of a municipality are allocated between the canton and the municipality in accordance with the respective canton law on allocation of public revenues. These laws vary among cantons, except Canton 9 (Sarajevo), which does not have a law regulating such allocations.

In the **RS**, the *Law on Budget System* forecasts a change, transferring from an expenditure based budget into a revenue-based-budget.

The foundation for a revenue-based budget is:

- Financial analysis by the Finance Department
- Analysis of the revenue structure, and potential legal changes
- Revenue assessment for the next year

It is of utmost importance that basic budget revenues (sales tax, tax on property) are assessed on an individual basis, including mandatory analysis of trends (at least for the previous 2 years). Revenues that are of a lesser value are usually calculated and then assessed through an annual average, or in some other manner.

The Law regulates the allocation of funds among municipalities and cities, in accordance with the level of municipal development. The main goal of fund allocation is to supplement a municipality's own sources of financing, in order to ensure efficient performance of duties and tasks. Fund allocation on this basis is more stable and easier to plan by a municipal administration.

### **Budget Revenue Assessment**

There is more than one method of effectively assessing future budget revenues. For discussion purposes and to highlight the importance of properly assessing revenues, a four-phase process is used as an example.

#### **Phase 1**

The main goal of Phase 1 of revenue assessment is to identify which revenues were the most stable in the past, because these revenues represent a baseline for anticipating future revenues. After that the relationship between specific revenues is analyzed to identify the factors, which influence their sources. The following revenue groups are analyzed:

- Current revenues, which include:
  - Tax revenue
  - Non-tax revenue
  - Other revenues (fees, compensations for use of funds of general interest, fines, penalties and confiscated material gain, revenue from property, revenue from selling goods and services etc.)
- Grants received from a higher level of government
- Funds from loans

**Phase 2**

Phase 2 of revenue assessment analyzes initial resources, examining:

*Accuracy:* The correctness of data used for an analysis; the data must be in accordance with current economic and financial regulations (formal accuracy of data), and must be correct and objective (material correctness of the data).

*Harmonization:* The constancy of financial data means that data must meet a *Continuity Test* which requires in-advance-determination of all phases and methods for collection of information. The data collected should not be altered or modified. Data users must use data as received.

Having examined the data for accuracy and harmonization, the analyst identifies the structure of the overall planned budget revenues, starting from those that have the biggest impact or significance in relation to overall resources, which are collected from:

- Sales tax on goods and services
- Tax on own incomes
- Tax on property
- Local utility taxes
- Compensations for use of city construction land

**Phase 3**

In Phase 3 of revenue assessment, the municipality then looks at the BFP/BFD to review calculations and determine if there have been any oversights, given external factors. The BFP/BFD pays special attention to the following indicators:

- Increasing rate of gross domestic product
- Increasing rate of prices
- Inflation rate
- Rate of nominal growth of budget revenues

**Phase 4**

In Phase 4 of revenue assessment, revenues anticipated for the future should be planned in line with historical data collected on revenues from the previous period. The following issues are taken into account:

- Possibility of increasing the number of tax payers or expansion of the tax base
- Percentage of public revenue collection (taxes-fees-compensations)

**Assessment of Budget Expenditure**

After the projection of budget revenues has been completed, the budget preparation process is continued through an assessment of budget expenditures. This complex process is carried out in cooperation with budget users. When creating guidelines, the Finance Department has to again follow basic macroeconomic and fiscal goals of the entities, cantons, municipalities and cities.

Measures for achieving budget policy goals in the area of public expenditures are as follows:

- Cost-effective spending of public revenues including a review of expenditures
- Examination of the economic justification for expenditure
- Provision of better and more efficient human resource management
- An employment policy which limits hiring and uses resources for incentives, rather than increased number of staff

The expenditure projection is the basis for budget creation and a baseline for budget users to create their own financial plan proposals and to complete requests for allocation of funds, in line with all procedures and deadlines. Requests should be harmonized with the anticipated revenue framework. In the final stage, these requests are incorporated into the draft budget.

### **Request for Financing Current Expenditures**

Requests for financing current expenditures contain information on businesses and services that the budget user is able to finance from the proposed amount of funds and other funding sources. The request shows an organizational structure, qualification structure, number of staff, jobs and the services which staff provide. Included in the request are the following:

**Staff costs** include the net salary, (based on a payroll list, which contains the name, position coefficient, basis for salary calculation and other compensations on a monthly basis) plus the total tax and contributions, as well as the other staff costs, provide the information for determining the annual **gross salary amount**.

**Request for additional funding** offers a budget user the opportunity to request additional funds for financing future activities that cannot be covered by the limited funds covering current expenditures.

**Request for financing capital costs** provides a budget user with an opportunity to request funds for the purchase of equipment, realization of ongoing projects and initiating new capital investments.

**Purchase of Fixed Assets**, those with a mid-term duration of usage, such as vehicles and equipment (computers, printers, etc) can be a line of either the current or capital part of the budget. Purchase of assets with long-term usage, such as land, buildings and infrastructure, with a value exceeding 25.000,00 KM are planned and requested as a part of a capital budget request.

### **Request for Capital Investment**

As part of the budget user request, the capital investment request should contain:

- The economic code
- The type of capital expenditure
- The budget expenditure related to actual capital expenditure in the previous year or a previous period, as well as what is anticipated for the current year
- Expenditure from own revenues and donations dating from a previous year, or a previous period, as well as the expenditure assessment for the current year



A **decision on request for capital investment funds** includes the following: degree of urgency of the project, goals of the project, impact of the project on the financial position of the budget user and readiness of citizens to support such a project. Based on these criteria, a determination can be made if there is a need for such a project. A list of priorities should be drafted, with the anticipated start and end dates of the project included. After the list has been completed, a mid-term plan of capital investments is prepared, with a timetable and project costs, for projects that are under consideration.

### **Submission of Financial Requests for Consideration and Allocation of Funds**

Budget users are obliged to submit their requests for allocation of funds to the Finance Department within the prescribed deadline. If a budget user fails to submit its request, the Finance Department is obliged to create and allocate revenues on behalf of that budget user in line with expenditures from the previous year. If the Finance Department determines that the amount of available revenues is not sufficient to cover realistic budget user requests, the Head of Finance will propose a reconsideration of requests (reduction) by asking each budget user to establish priorities. If there are still deficiencies in revenue for covering all requested expenditures after this step, other possibilities will be considered (grants from higher levels of authority, loans/borrowing).

### **The Draft Budget**

The draft budget should contain matching data for the previous fiscal year, new or amended assessments for the current year, and anticipated amounts for the following fiscal year. An overall breakdown of expenditure should be clear and understandable, not only to the elected councilors, but also to ordinary citizens.

As budget realization is a political process, the level and quality of services have to be determined by the elected officials who are, ultimately, responsible to citizens. Municipal officials need to consider the balance of services provided by the municipality, including those budget users that need to be funded during that budget year.

The Mayor approves the proposed financial plans, decides on amendments to the draft budget, with advice from the Head of Finance, determines the proposed budget and submits it to the MC/MA.

Questions the Mayor and Head of Finance should ask:

- Why do we need this budget line or program?
- When is this required?
- Why is this required at this particular time?
- Which is a direct, indirect and compensatory expenditure?
- What is the goal of that budget line?
- Are additional staff costs included?
- What is the time duration of that program?
- How many and what kind of employee trainings will be needed?
- What kind of additional equipment will be necessary?
- What kind of requests may “crop up” if the program is not approved?
- What is its priority in relation to other priorities?
- Who will benefit from this program?
- Which budget user might have to sacrifice funds?

- Can these goals be implemented in some other way?
- What are other good practices for implementation of this program?
- Has the expenditure analysis been suitably completed?
- What alternative approaches in service delivery have been considered?
- How did we operate in the previous period, without this program?
- What consequences might we face if the program is not financed?

When these questions are answered, the Finance Department will have the necessary information to draft a balanced budget, because some proposals will have been rejected, some will have been reduced, others may create new revenues, or other revenues may have been increased to cover costs.

Over the long-term, a municipality can spend only what the municipality possesses. Since demand always exceeds fund availability, it is necessary to establish priorities and create a balance between expected revenues and planned expenditures.

### **Budget Structure**

In order to improve transparency, the budget document presented to the public and submitted to the MC/MA must be more detailed. The budget lines should be broken-down (in accordance with the structure of the Chart of Accounts) and proper economic codes should be appropriately used. This means that all public expenditures should be represented by economic classification, organizational classification (combined with economic codes) and functional classification. These are:

- Current expenditures such as salaries, compensations, material and service costs, current transfers and interest rate payments
- Capital expenditures such as the purchase of property, capital transfers
- Loans and shares in registered capital, reduced for the amount of loan repayment

The organizational classification (combined with economic codes) should provide a detailed breakdown of the expenditures of all municipal units and budget users.

The budget plan should include comparative data and trend indices for comparison, showing the current budget plan and realization from the previous period.

A narrative to support the budget must be drafted. The budget narrative outlines the administration's vision for the municipality, but more than that, the narrative is not simply a re-statement of the financial figures, in paragraph form, but an explanation that clearly justifies and clarifies all significant discrepancies (item-by-item) between the actual realization in the previous period and the planned figures for the next budget year. The narrative provides explanations for significant increases or decreases in the budget, and an explanation of how the budget will be achieved.

Finally, the capital part of the budget must be separated and broken down by specific projects with an estimate of specific costs for each.

### **Presentation and Elaboration of the Budget to Citizens**

Once completed, the proposed draft budget should be shared with the public. The MC/MA, with support of the Finance Department, should organize public hearings to share the administration's ideas for the budget and receive input from citizens. The budget can then be modified, based on citizens' priorities, taking into consideration the mandates of a municipality, as stipulated in law. (For more information on this process, see Chapter 5: Citizen Participation).

### **Acceptance and Adoption by the MC/MA**

The final stage of budget planning and preparation, presenting and elaborating the budget to MC/MA, requires the executive and MC/MA to take a decision which is in the interest of all citizens.

The technical procedures must be satisfied; eight days prior to the MC/MA session, complete materials must be delivered to all councilors, to give them enough time to review all documents properly. When presenting and elaborating the budget to the MC/MA, the Head of Finance should create a graphic presentation of the budget, including an illustration showing previous years' trends. This presentation enables the councilors to visualize certain financial values through a graph and to see the dynamics of budget development.

If there is a *Budget and Finance Committee* monitoring the planning, preparation and implementation of budget, this body is also obliged to submit its own opinion of the budget proposal.

The Committee is obliged to state in their report whether:

- Legal procedures have been complied with
- Accounting classification has been complied with
- Budget deadlines have been met
- There has been proper transfer of funds to budget users
- Budget implementation and report submissions were done properly

The Budget and Finance Committee is the link between the Head of Finance and the MC/MA because members of the Committee are councilors and the Committee reports and advises the MC/MA as a whole. The members usually, but do not necessarily have an economic background. One of the duties of the Committee is to present the entire budgeting process to the MC/MA through its reports. It is also in a position to provide the MC/MA with significant financial information, if the Committee is working properly. A fully functional and professional Budget and Finance Committee, through its collaborative work with the executive, should increase the trust between the legislative and executive powers.

Accountability of the Heads of Department must be reflected through a continuous process of communication between the executive and legislative bodies, so that those in charge of creating financial policy are informed about the full impact of their financial decisions

The MC/MA and the Mayor are held most accountable for the success or failure in the way a municipality operates. This is why provision of timely and relevant information by the Head of Finance is necessary, so that the executive and legislative can make sound decisions and develop a productive business policy.

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On the *Budget and Finance Guide CD* for this Chapter, you will find:

Municipal Instructions on drafting a Budget

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## Citizen Participation in the Budget Process

Citizen participation is a democratic practice whereby the public influences the way in which a government makes decisions. Most municipal decisions have financial implications and municipalities use public funds to implement these decisions. Citizens have a right to express an opinion about how public funds are spent and discussions about the budget can help to generate greater public involvement in local decision-making.

After reading this chapter you should understand:

- The importance of involving citizens in the budget process
- Various methods to include citizens
- How to conduct public hearings as part of the budget process

Municipalities should regard the involvement of citizens as an asset, not a threat to their work. If a municipality understands citizens' priorities and their views on the services provided, it increases the likelihood that public funds will be allocated to areas of greatest need. Establishing mechanisms for citizen participation in the budget process is therefore essential in order to bring citizens into the decision making process. Having public hearings not only provides citizens with greater knowledge about what local government is doing for the community, but it can help foster a sense of ownership, if their views are taken into consideration in developing the budget plan.

### Legal Regulations

MC/MAs should not only open their doors to citizens for municipal sessions, but also municipal statutes should reflect the need for public hearings. This is a crucial step towards the goal of making public participation a legal obligation for municipal staff, regardless of who holds office.

### Responsibility of the Mayor

It is the Mayor's responsibility to support public hearings on the budget. Any public participation action plan should be endorsed by the Mayor. In addition, the Mayor and the relevant Heads of Department should be active participants in developing a public information strategy and presenting the budget to the public.

### Organization of Public Hearings

There are different approaches to holding public hearings and providing information to the public. As municipal staff gain more experience on how hearings and meetings are held, their plans may well evolve. The following is offered as a suggestion and focuses on three main steps in the process:

1. Planning
2. Implementation

### 3. Follow up

#### ***Planning***

The planning phase starts with the appointment of a public hearing team and continues with the development of a strategy and action plan. The general approach, places and times of public hearing sessions, manner of informing citizens about public hearings and other relevant issues are developed in this phase.

#### ***Public Hearing Team***

The Mayor must first identify who will take overall responsibility for the public hearing process. Some municipalities establish a team to oversee the public hearing process. The composition of this team will vary; however, in the case of public hearings on the budget, the participation of the Finance Department is essential. The selection of the remaining members depends largely on whom the Mayor has confidence and what tasks need to be done. If the municipality has a staff member dealing with public relations, he/she should also be on the team. In addition, consideration should be given to involving members of the community for specific activities.

The task of the team is to develop an action plan and prepare a presentation on the budget document.

#### ***Action Plans***

An action plan should contain all the basic information necessary for organizing and coordinating municipal activities for public hearings, including:

- The phase of budget development when the hearing will take place (near the end of the draft stage of the budget is recommended)
- The goal of the public hearing
- Activities (instruments of public participation)
- Timetable
- Person responsible for each activity
- Possible external support, if needed

It is important to name those employees directly responsible for each task. Making individuals responsible for implementation provides for more accountability and greater assurance that the tasks will be done on time.

#### ***Location is Important***

A municipality may choose to have one or several hearings, but in determining locations for public hearings, it is better to use the existing territorial division of local communities. This provides an opportunity to take advantage of community representatives who can assist in motivating and informing people within their area. Large municipalities can address more than one local community at a public hearing.

It is recommended that municipalities should hold at least one hearing in the town's center, in addition to visiting local communities. A public hearing should be held on municipal property such as a school or community center. It is important that the venue is close to the center of the area for which the hearing is being organized and that it has enough space.

### ***Timing of a Public Hearing***

There are three main issues related to timing that should be considered when developing an action plan for public hearings on budget:

- **The best time to hold a public hearing**

If a public hearing is held on a weekday, then evening hours are best, ideally between 18:00 or 19:00, but for obvious reasons, timings should be determined according to when is most convenient for the public. Municipal employees working the event should arrive ahead of time and the event should start within 15 minutes of the scheduled time.

- **When to inform the public about the hearing or hearings**

Public hearings should be announced well in advance, giving 10 days notice is advisable. This should allow enough time to launch a public information campaign, distribute any materials before the meeting, and contact individuals through local community representatives. This will ensure that people are informed in good time, although not too early to forget about the meeting.

- **The best time in the budget cycle for holding a public hearing**

Legally, municipalities should have their budgets approved by MC/MAs by the end of December. Therefore, unless there are extenuating circumstances and a municipality is forced to use temporary financing into the new year, public hearings for the budget draft should occur well before the approval of the budget so the public's views can be incorporated.

### ***Pre-Hearing Information Campaign***

The information campaign running up to the budget hearing will vary, depending on the financial resources available. Ideally brochures should be produced, invitations issued, and public announcements made. The latter is the most important.

Municipalities should use local media to inform citizens about the budget development process and to raise people's awareness of the importance of participation and how municipal budgets influence their daily lives. Relevant information to explain the purpose and importance of the public hearing can lead to a smoother and more productive process. It is important to encourage attendance from a representative cross section of citizens.

### ***Equipment***

It is important that the public hearing presents the proposed budget as clearly as possible and that a record is kept of citizens' views and opinions. If a computer projector or electronic recording equipment is available, they can assist in ensuring that the presentation of the budget is clear and that an accurate record of the hearing is kept.

### ***Implementation***

The implementation phase represents the realization of the action plan, the presentation of the budget by relevant municipal representatives and recording citizens' input.

### ***Selection of Municipal Representatives***

Municipal representatives, including the Mayor, Heads of Department, and other relevant municipal officials should be present at public hearings on the budget to provide clarification

answer questions and add expert and informed comment. The presence of senior municipal officials gives the public hearing a higher level of importance and demonstrates the administration's commitment to receiving public input on key municipal issues.

### ***Presentation of the Budget***

The budget should be presented by a representative of the Finance Department (ideally the Head of Department). It is important that the hearing remains focused on the objective of obtaining public comment on the draft budget. Discussions on other issues should be resisted since this can deflect the hearing away from its primary goal. For example, if a Mayor or municipal official wishes to give his opinion on almost every question raised during the meeting, the session will be less of a public hearing and more of an open meeting.

A good presentation includes not only tables of figures, but also graphs and diagrams to illustrate key aspects of the budget and to highlight trends, revenues and expenditures. The speaker should focus on highlighting the key issues, rather than becoming bogged down in detail. This will also mean that the presentation is not too long.

When preparing and presenting keep in mind:

- What is relevant?
- What should be explained in more detail?
- What can be skipped?

Budget brochures and a copy of the complete draft budget should be available during the session.

### ***The Use of Moderators***

A moderator should be appointed to run the public hearing session. His/her role is especially important during the discussion after the presentation when public input is collected. The moderator should be a member of the public hearing team and preferably not the Head of Finance. The moderator needs to be a person in whom the public will have confidence. When the moderator's skills are in doubt, he/she should be supported by the Mayor or another official. Finally, the moderator has to be strong enough to direct participants, even the Mayor, back on to the topic if the discussion moves away from the goal of the hearing.

At the beginning of the meeting, the moderator should welcome everyone and open the meeting by introducing the participants. The moderator explains the purpose of the meeting and sets the ground rules. During the discussion, the moderator listens to the opinions of the participants and makes sure that they have been recorded. An assistant should record all input.

### ***Duration of Hearing and Conclusion***

The duration of a public hearing will vary, but preferably, it should not be more than two hours. The duration largely depends on the time needed for the presentation of the budget and the discussion that follows. The moderator should announce the planned end time at the beginning of the meeting and then determine when the discussion session is finished and the meeting closed.

Summarizing and closing the hearing will leave a lasting impression on those present and is therefore crucial. Without providing some reflections or summary of the discussion, such as key issues discussed, acknowledgements of the concerns raised, etc, citizens will leave



dissatisfied, with a negative impression of, not only the process, but also the municipal administration.

### ***Follow-up***

It is important that citizens see that their input has been taken seriously. Not all comments can be incorporated into the budget, but the distribution of brochures on the adopted budget is the most obvious method of demonstrating that citizen input given during the public hearings has been taken into account. These brochures should be available at municipal citizen service centers, 'one stop shops', or other citizen information desks in a municipality and local community centers.

Other methods, such as media presentations, the distribution of public hearing reports can also be used and these are useful to show that those inputs not reflected by the budget have also been taken into account. Some municipalities use multiple methods of providing feedback to citizens: making a separate public hearing report, printing and distributing brochures on the adopted budget, press conferences and radio shows.

### ***Some Ideas, Tips and Lessons Learned***

#### *Planning and preparation*

- Have the following people in the team for public hearings on budget:
  - Head of Finance
  - Head of General Administration
  - 2 assistants for taking notes
- Send written invitations to individuals and groups (if finances allow)
- Inform citizens of the public hearing schedule in written form (through notices)
- Conduct a survey before the first budget draft is developed
- Develop a form for citizens' suggestions
- Include all the Mayor's assistants in the process of preparing public hearings
- Utilize NGOs in preparing public hearings
- Determine which budget items may be interesting to specific citizens groups, such as youth or women, in order to encourage them come to the hearing.
- Be creative in reaching out to citizens and distribute public hearing notices in places target groups visit frequently
- Have hearings regularly, to develop a habit for people to participate in public hearings
- Be aware of the importance of team work during the planning and preparation process
- Provide enough time for preparing public hearings
- Have regular meetings with local community representatives
- Have copies of the complete budget draft available to citizens prior to public hearings
- Consider the option of delivering invitations attached to utility bills
- Have all preparation elements detailed

#### *Presentation of budget information*

- Be sensitive to peoples' reactions
- Make presentation understandable to ordinary citizens

#### *Moderating feedback, Recording and Gathering Comments*

- Train a moderator or get a trained moderator for the job
- Provide blank paper for citizens so they can write down their comments
- Set a clear and reasonable time limit for the public hearing session.
- Be aware that a good introduction speech by the moderator is crucial for success
- Provide and distribute the rules and structure of the public hearing in written form
- Do not make strict general rules; adjust them to individual participants
- Have a tape recorder along with a flip chart

#### *Incorporating feedback in budget draft and completing the cycle*

- Deliver feedback to individual citizens at their home address
- Determine a deadline for delivering feedback to citizens
- Make sure that people are informed about the results of the public hearings
- Make a good quality report on citizens' suggestions

### **Other Forms of Public Participation**

There are other forms of public participation that municipalities can use prior to and after the completion of the budget development process, in addition to public hearings. It is important to determine the sequence of events and identify which forms of public participation should come before the budget development process, the timing of public hearings in particular, and which should come after. Having too many meetings on the same issue (especially if conducted in a short time period) can be counterproductive and people will lose interest. Other forms of encouraging public participation include:

#### ***Public meetings***

Public meetings can be used prior to beginning budget development. The goal is to inform citizens about upcoming activities on budget development (surveys, public hearings etc...) The Mayor and/or Heads of Department can be present. Meetings usually have a short agenda, unless the information on budget development is tied to a discussion on another issue.

#### ***Surveys***

Surveys are commonly used to collect data on various issues related to the municipal budget before its development. In the budget development process it is important to distinguish between data collection from budget users, which is a legally prescribed practice (information on funding needs), and more general data collection (surveys). NGOs and other civil society organizations or interest groups can often be used for conducting public surveys. In this way, the municipal staff can be tasked with analyzing the collected data and producing a final report, which is a better distribution of time and effort than having municipal workers do everything themselves.

#### ***Focus Groups***

Focus groups are a type of public meeting but with a specific group of people. For the purpose of budget development, these meetings can be held with local entrepreneurs, displaced citizens, school boards, agricultural associations, etc. The goal is to obtain specific input on a specific issue; for example, planning subsidies for agricultural production, the allocation of funds for student transportation to schools, etc.

### ***The Forum of Responsibility***

The Forum of Responsibility is an approach to public participation that is usually used during the implementation of an adopted budget, after the entire budget process has been completed and adopted. It is usually a single meeting. It can be used for presenting other significant issues, such as a forecast of planned activities of municipal officials (Mayor, Speaker), a review of completed activities, or the status of capital program development. In terms of the budget, the Forum of Responsibility is used for presenting budget figures after the completion of one period of the fiscal year (such as quarterly reporting). This type of gathering can be politically sensitive because it opens municipal officials to public criticism. Therefore, a strong political will to have such a meeting must be in place before these types of forums are organized.

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On the *Budget and Finance Guide CD* for this Chapter, you will find:

Guidebook for Best Practices in Budget Public Hearings by PADCO

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## Internal Control and Audit

Internal control is a process adopted by management, (the Mayor, Heads of Department, and Municipal Secretary), to provide a reasonable assurance that municipal public administration meets its objectives, such as efficient and effective operation; reliable financial reporting; compliance with established policies, laws and regulations; safeguarding assets and ensuring the integrity and reliability of information and data.

Audit, on the other hand is an examination and verification of the financial activities of the public administration. Internal audit is conducted by the administration's own employees to assess the financial and operational health of the municipality in order to improve the system. External audit, done by an independent body, examines the same thing and takes a more detailed look at the legal implications of, for example, errors and potential fraud and provides a list of the corrections required.

After reading this chapter you should understand:

- Who is responsible for internal control
- A broad overview of an internal control system
- The differences between internal control and internal and external audit

The aim of this chapter is to provide a broad overview of internal control. The budget is the framework for all municipal administration activities. By establishing an internal control system, the Mayor and other municipal officials are proactively managing the events and activities that are a consequence of budget execution. This should improve municipal managers' ability to meet their budget plans and to use the limited resources available to municipalities in a more cost effective and efficient manner. (More comprehensive guidance on establishing internal control can be found in the forthcoming Guide to Internal Control to be published by the OSCE Mission to Bosnia and Herzegovina).

### Responsibilities for Internal Control

Municipal managers, starting with the Mayor, have ultimate responsibility for establishing and maintaining adequate and effective internal control in municipalities. After internal control policies and procedures have been established, management sets the ethical standard for operations and sets an example, guiding proper behavior in all municipal activity.

The Mayor establishes the policies and objectives of the municipality in accordance with the administration's strategy, plans and the approved budget. The Mayor is ultimately responsible for ensuring that all these procedures and policies are being complied with, through the delegated authority he gives his Heads of Department. He/she must be confident that all municipal resources are competently managed and are being used effectively, efficiently, and economically.

The Heads of Department are responsible for implementing policies on internal control and risk management, monitoring control implementation, conducting regular reviews of risks and controls, and proposing remedial actions. It is the responsibility of these managers to ensure that adequate information is available to all staff in the department and that staff are able to do their jobs. The head of each department should also ensure that proper reporting processes are in place, upwards and downwards.

All employees, according to the duties that they have been assigned within the municipality, bear some responsibility for internal control. Employees work according to applicable laws, policies and procedures and the roles and responsibilities assigned to them by management. Employees are skilled in their job and/or should seek training to meet the demands of their job and to remain competitive. As part of their work, employees should contribute to the review and revision of internal controls and should safeguard municipal assets.

### **The Elements of Internal Control**

Internal Control is a management tool. It is a comprehensive system designed to improve a municipality's effectiveness and efficiency. There are five interrelated internal control components, which we will briefly discuss in this section:

- The control environment
- Risk assessment
- Control activities
- Information and communication
- Monitoring

### **Control Environment**

The control environment involves the overall attitude, awareness and actions of the management and municipal employees regarding internal control. The personal and professional integrity and ethical values of management and staff, together with management's philosophy and operating style, help to strengthen or weaken the control environment. It is simply not sufficient to have an internal control rulebook. Management must act in a manner that supports the effective implementation of internal control procedures. Other factors that have an impact on the control environment include the organizational structure, methods of assigning and delegating authority and responsibility and human resource policies and practices.

### **Risk Assessment**

A risk is a threat or the possibility that an action or event will negatively affect the ability of the municipality to meet its objectives. Municipal managers must be aware of the threats that their municipality faces, in order to modify municipal operations and to decrease the levels of threat in an environment that is ever changing and uncertain.

### **Control Activities**

After a municipal self-assessment has been completed and the risks have been identified, management needs to examine the options available to control the risks. Typically, there are three types of controls.

- **Detective controls** are designed to identify undesirable events
- **Preventative controls** are designed to minimize the occurrence of an undesirable event

- **Corrective controls** are designed to improve adverse conditions that have been identified

In this chapter you will find descriptions of some of the more commonly used control activities, such as documentation, approval and authorization, verification, segregation of duties, personnel policies and practices, supervision, safeguarding assets, reporting and getting the math right.

### **Information and Communication**

Internal control requires reliable information systems to provide timely, comprehensive information and efficient channels of communication to ensure that relevant information reaches the appropriate employees. Effective communication should also occur in a broader sense, flowing down, across and up. A municipality may have developed excellent internal control policies and procedures but these will not be effective unless communicated to the employees who perform these duties.

### **Monitoring**

The internal control process needs to be monitored and modifications made, if necessary, so that the system can react dynamically to changing conditions within and outside the administration. Monitoring is a part of daily management activities and includes regular supervision, management reports, and periodic evaluations.

### **Types of control activities**

#### ***Documentation***

Documentation involves preserving evidence to substantiate a decision, event, transaction or system. All documentation should be complete, accurate, and recorded promptly. It should assist managers in controlling and analyzing municipal operations. For example, documentation of transactions should enable managers to trace each transaction from its inception through to its completion.

#### ***Approval and Authorization***

Management should ensure that the conditions and terms of the authority given to individuals to approve and authorize are clearly stated and communicated to responsible employees. Significant events and transactions should be approved and executed only by persons acting within the scope of their authority. For example, a manager may be authorized to approve purchase requests, but only up to a specified amount.

#### ***Verification***

Verification is the determination of the completeness, accuracy, authenticity and/or validity of transactions, events or information. Management should determine what needs to be verified, based on the risk to the municipality if there was no verification. For instance, during the hiring process a candidate's qualifications should be verified to minimize the risk of hiring someone who is not capable of doing the job, or who does not meet the required standards. Another example of verification might be in purchasing equipment. Someone must verify that there is a need for the purchase, that a fair price has been obtained by means of a

tendering procedure, (please see Chapter 13), that funds are committed to pay for the purchase, and that the equipment was delivered according to the agreed contract.

### ***Segregation of Duties***

Segregation of duties is the division of key tasks and responsibilities among various employees and municipal departments. Segregation of duties aims to reduce the opportunity for any one person to be in a position to both make and conceal errors or irregularities in the normal course of their work. In any transaction cycle, another employee always checks, or has complementary activities that minimize the chance of error or reduce the possibility of fraud.

### ***Personnel***

Procedures should be established to ensure that personnel have the necessary capabilities in line with their responsibilities. Management should ensure that the municipality's workforce is effectively trained to achieve results and that staff performance is periodically assessed. (See Chapter 14, on Human Resource Management for more information).

### ***Supervision***

Any system of internal control should include competent supervision by responsible employees. Routine transactions and operating procedures should be monitored. Errors or failures in the system should be corrected and employees warned if they fail or ignore control procedures.

### ***Safeguarding Assets***

To safeguard assets means to restrict access to resources and information to help reduce the risk of unauthorized use or loss. Such controls involve procedures and security measures designed to protect the municipality's assets, files, documents and other resources that could be wrongfully used, damaged or stolen.

### ***Reporting***

Reporting is a means of control through monitoring a department's activities, particularly when it includes issues related to budget status, timeliness of activity implementation and achievement of goals.

### ***Getting the Math Right***

Mathematical and accounting controls include accuracy of records, maintenance of and checking totals, reconciliations, and verifying that all documents are available and accurate. The recording function should include verification that the transactions to be recorded and processed have been authorized and are correctly processed and accurately recorded.

### ***Municipal rules and procedures***

Once the risk assessment is completed and the required controls have been identified, the municipality should draft and adopt a Rulebook on Internal Control. This is the primary municipal document establishing the internal control system within the municipality. It is intended to raise awareness of municipal staff and formalize the importance of internal control within the municipality, but it is certainly not the only rulebook that identifies control procedures. In addition, various other municipal rulebooks and procedures establish elements of internal control, including, but not limited to the following:

- Rulebook on Internal Organization and Systematization of Working Posts
- Rulebook on Labor Relations

- Rulebook on Education and Professional Development of Employees
- Rulebook on Disciplinary and Material Responsibility of employees
- Rulebook on Salaries, Compensations for Salaries and Other Material Rights of Employees
- Procedures for Access to Information
- Rulebook on Office Business Operation
- Rulebook on Store and Use of Stamp
- Procedures related to Assigning, Sorting out and Archiving Working Documents
- Procedures and Rules of Usage, Security and IT System Data Protection
- Procedures of Cash Management
- Procedures of the Way of Record and Payment of Incoming Invoices
- Procedures for Creation of Liabilities
- Instruction on Circulation of Accounting Documents
- Procedures on Conditions and Way of Official Vehicles Use; Rulebook on Compensation of Travel Expenses of Employees
- Procedures on Way of Use of Mobile and Fixed Telephones
- Rulebook on Inventory list, Receivables, Stocks and Liabilities
- Rulebook on Presents and Representation
- Code of Conduct

## **Audit**

### **Internal Audit**

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes. Internal audit is not responsible for the establishment and maintenance of internal control.

In order to be effective, internal audit must be independent and operate within an appropriate legal and organizational framework and in accordance with high professional standards. A new approach to the function of internal audit, distinct from inspection, is already being developed in various laws in BiH. However, there is still a lack of clarity about the respective roles of internal audit and a number of other review agencies. Although there are budget inspectors (referred to in Chapter 7 on Budget Control), and municipal inspections for a variety of activities, there is no law currently defining an internal audit function for municipalities.

### **External Audit**

External audit by the relevant Supreme Audit Institutions extends to the municipal level. The objectives, scope, and functions of the external audit are set out in the relevant Supreme Audit Institutions laws.<sup>4</sup> It is the obligation of a municipality's management to ensure proper follow-up on the recommendations of external audit reports.

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<sup>4</sup> At Entity level, the powers of the Supreme Audit Institutions (Ured za reviziju budzeta u Federaciji Bosne i Hercegovine; Glavna sluzba za reviziju javnog sektora Republike Srpske) are regulated in the Law on Audit of the Budget in FBiH (Zakon o reviziji budzeta u FBiH) (FBiH OG 48/99) and the Law on Audit of the Public Sector of RS (Zakon o reviziji javnog sektora RS) (RS OG 18/99 and 39/03).



An audit gives an organization a detailed view of the problems within the system and areas that need improvement. A municipality, which has been audited, has an obligation to take corrective measures to ensure that it complies with all laws and regulations. Developing a formal internal control system will help improve performance, compliance with regulations and financial reliability.

### **Budget Auditing in FBiH and RS**

According to the *Law on Budget (FBiH Art 65-71)* *Law on Budget (RS OG 96/03, 04/04, 67/05)* and *Law of budget Accounting and Audit (RS OG 67/05)* and the *Law on Auditing the Budget of the FBiH* and the *Law on Auditing the Public Sector of RS*, audits of budget and financial reports are conducted by certified auditors in accordance with international standards. Audits of all bodies of all ministries, courts, municipal authorities, public funds, and other public institutions are conducted by the Supreme Audit Institutions in both entities.

A municipality is obliged to submit all relevant documentation requested at any time by an Auditing Office and provide access to all municipal properties and premises. The tasks of the Supreme Audit offices are to audit annual reports and other relevant budget documents and to give an opinion on those reports. Specifically, audits will consider the following:

- Do the reports give an exact and accurate picture of business transactions conducted during the year and status at the end of the year?
- Are they in compliance with the law?
- Have the municipalities used their finances economically, successfully and effectively while performing their duties

Upon completion of an audit, the Audit Office drafts a report on the findings of the audit and issues instructions to correct any failures. The Audit Office is obliged to send the completed report to the municipality and consider any objections lodged by the municipality. The Audit Office reviews the objections of the budget user in light of the factual situation in order to determine if the failure was corrected or the finding inaccurate.

The report should be submitted within 30 days from the completion of the audit to the FBiH Parliament or the National Assembly of the RS. At the same time the Audit Office is obliged to submit a report to the Ministry of Finance and the competent Ministry, as well as to the canton, town or municipality.

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On the *Budget and Finance Guide CD* for this Chapter, you will find:

Proposal of procedure for Cash Handling

Procedures for Registration Manners and Payment of Incoming Invoices

Instructions on Material Business Operations

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## Budget Control

The budget system is the process of planning and executing the budget. Budget control is a part of the overall process and should ensure that the budget plan is fulfilled. Proper budget control means that the realization of the budget plan is in accordance with adopted criteria and standards for efficient and effective budget implementation.

After reading this chapter you should understand:

- The principles of budget control
- Internal versus external budget control

It is important to note the difference between budget control and internal control. Internal control is a broader process that includes all control activities, which support the management objectives of a municipality. Budget control is a specific activity and it has its own chapter in this *Guide* because proper fulfillment of the budget plan and ensuring that municipal activities are consistent with the budget is essential for sound municipal financial management.

### Budget Control

Budget control is a process established by municipal management to ensure proper execution of the budget. Municipalities operate with public funds, through the budget process (budget planning and realization); however, this process can be influenced both positively and negatively, by external and internal factors. Externally, macroeconomic factors, including inflation, GDP growth, and foreign trade exchange can have an impact on municipal budgets; internally, factors such as having a local economic plan and implementation of an appropriate economic policy.

Just as with internal control, municipal authorities, starting with the Mayor must see budget control as tool for efficient and effective management for realizing the budget. This in turn, influences most municipal activities and the ability of the municipality to achieve key objectives, such as:

- Efficient operation
- Compliance with management policies
- Enforcement of laws, regulations, rules and procedures
- Safeguarding assets and investment against loss, abuse, mismanagement, fraud and corruption
- Integrity and reliability of information, accounts and data, and fair disclosure of data in timely reports

### Control of Budget Execution

Control of budget execution is the most important aspect of the budget process and one where the municipality can have the greatest impact. Budget execution is under the direct control of municipal authorities and is managed through the process of budget control. Budget Execution is addressed in detail in Chapter 8, but it is important to note here that the process has two aims:

- **Promoting Efficiency** through rational spending and control of expenditures
- **Promoting Effectiveness** through ensuring that maximum benefit is gained from the funds spent

### **Principles of Budget Control**

Efficient budget control rests on four basic principles:

- Appropriate distribution of duties
- Qualified personnel
- Clear procedures for authorizing, recording and reporting transactions
- Performance monitoring

#### ***First Principle: Appropriate Distribution of Duties***

Appropriate distribution of duties means that no one person or department handles a given transaction from beginning to end. As a basic principle, responsibilities in the area of government finance, handling revenues and expenditures, should be separated. If one person performs two or three functions, there is no independent check for mistakes. Errors are very likely to go undiscovered for a long period, which creates the opportunity for fraud.

#### **Examples of Principle 1**

In cash management there should be a segregation of duties between individual staff responsible for cash management (disbursements/receipts/cash transfers) and staff performing general ledger accounting and bank reconciliation functions.

Payroll is another area where segregation of duties is recommended. In this case the segregation is between departments. Employment procedures should be handled by general administration; review and approval of time sheets should be done by Heads of Departments; preparation of payroll by the Finance Department and payment by the person responsible for municipal payments.

#### ***Second Principle: Have Qualified Personnel***

Positions should be filled with the most qualified and competent people possible. Duties will be performed much better if staff have a good understanding of their duties and responsibilities and of other staff members' responsibilities. Job descriptions for each position must be established as a framework for identifying areas of responsibility for each employee. A detailed job description should include relevant education and professional qualification requirements, a detailed description of tasks, subordination, and reporting lines.

Municipal management should encourage and promote ongoing education through seminars and workshops and should ensure that periodicals and other materials are available as a professional resource. Employee professional development plans should be developed with staff and periodically updated. Selected staff should attend training and then transfer the knowledge gained to other employees through reports/information about the seminars/trainings attended. (Human resource management issues are further discussed in Chapter 14).

***Third Principle: Clear Procedures for Authorizing, Recording and Reporting transactions***

Procedures must ensure the flow of data not only to make the system more efficient, but also to provide necessary information for proper monitoring of activities. Written procedures must also detail the duties to be performed; how they are to be performed and who (job position) is to perform them.

Procedures should address the following:

- Use and control of pre-numbered forms within the accounting process
- Periodic reconciliation of supporting records
- Appropriate distribution of duties, consistent with the size of staff and their skills
- Proper authorizations for transactions
- Timely reporting of transactions
- Measures for safeguarding assets
- Appropriate and efficient documentation flow
- Reasonable verification system for the review of others' work

**Example of Principle 3**

All orders for business trips must be numbered and recorded in the Book of Orders for Business Trips. The Order must include name of traveler, date, destination, purpose of trip, means of transportation, duration of trip, and any amount of advanced payment. Unless the Mayor determines otherwise, the orders are signed by the head of the relevant department (for employees) and the Mayor for Heads of Departments. An employee receive can only receive an advanced payment on the basis of a completed Order. The employee is required to submit a travel report for the work done within seven days of returning from a business trip. The second part of the Order, for money spent and all bills and receipts for food and accommodation must be presented to the head of the relevant department and to the Mayor for signing within the same seven days. When all steps have been completed, the cashier reviews the documents, compares the total expenditure with any payment advance made and reimburses the difference to the employee, or charges the employee if the advance was greater than the expenses incurred. The cashier forwards the Order plus all other related documentation to the accountants for bookkeeping.

A new business trip Order should not be issued to an employee who has not provided necessary documentation to justify expenses for a previous trip. Any employee who fails to supply the relevant business trip documentation must return all monies from the advance payment. The municipality should seek compensation for material damage if the money is not repaid by the employee.

***Fourth Principle: Performance Monitoring***

Performance monitoring of the first three principles is constant and requires training and support. New tasks, new procedures and processes have to be designed and implemented as the needs of the municipality change. All staff must be provided with relevant written procedures and manuals. Further, it is necessary to ensure that all employees understand all policies and procedures affecting their duties and responsibilities. There should also be an appropriate flow of information upward to the appropriate level of management, downward to

all levels of staff and across the municipality so that information that one department has, is shared with other departments.

#### Example of Principle 4

When a municipal department issues a permit to a legal person, the Finance Department must obtain a copy of that document. The Finance Department should record it as a claim in the accounting ledger. When the person pays his/her obligation (communal fees, etc), the Finance Department should record the payment and inform the respective department, which issued the permit, that payment has been received. If the person ceases his/her activity, the respective department must inform the Finance Department. Only in this way, can the Finance Department stop recording new claims toward that person.

### Control of Revenues

Control of revenues should include realistic budget planning based on revenue realization from previous years and the calculation of revenue collection.

Budget imbalance can be caused by:

- Unrealistic (poor) revenue planning
- Miscalculated and uncollected revenues
- In-valid documentation
- Political obstacles

In order to establish effective control of revenues it is necessary to:

- Segregate the duties of staff (i.e. the responsibilities for calculation of revenues are separated from responsibilities of recording revenues)
- Calculate and collect revenues in accordance with applicable laws and decisions
- Ensure that the department responsible for all permits and decisions registers the same in the auxiliary ledgers of that department and forwards copies of the documents to the Finance Department
- Ensure that all auxiliary ledgers are updated and harmonized with the ledgers of the Finance Department regularly
- Ensure that the Finance Department provides information on paid receivables of issued permits and decisions to all departments
- Find a different way of payment (warning, court decision) when obligations based on registered permits and decisions have not been paid
- Allocate earmarked revenues according to determined purposes, outlined in the budget plan

### Control of Spending

The spending system should provide conditions for managing the approved budget; and the approved budget should correspond to realistic revenue collections and planned expenditures

as much as possible. However, the reality of budget implementation is such that there will be unexpected events (low inflow of revenues, excessive spending of budget users, etc...)

Budget imbalance can be caused by:

- Poor budget preparation
- Undisciplined budget users
- “Special agreements” made outside the budget plan
- Political reasons

### **Realistic Planning**

The first step to having a balanced budget is having a proper budget planning process, as outlined in Chapter 3). The budget plan should be prepared on time, following the budget calendar and in accordance with applicable laws, regulations and procedures. The budget must be realistically planned and the planned revenues increased or decreased based on a realistic estimate or forecast of the inflow of revenues. Finally, the Head of Finance should properly educate the MA/MC on its role and responsibility in adopting the budget. It is important that MC/MA members and citizens understand that grants from higher levels of government cannot be planned if there is no guarantee from the higher level that the funds will be disbursed. Expenditures cannot be higher than actual funds received and increasing **planned** revenues is not the solution to passing a budget, especially when there is no hope of meeting that level of revenue.

### **Budget Users Discipline**

Budget users are required to submit requests for funds for the next fiscal year, monthly spending statements and quarterly budget execution reports. Monthly statements with adequate supporting documents should be provided to the Finance Department. Quarterly reports, which include a list of priorities for each department along with a detailed breakdown of execution, is checked for compliance with the approved budget to ensure that the budget user is using funds for the purpose and in the amount planned. If there is excessive spending recommendations and corrective measures should be given to the budget user and the situation monitored to ensure that improvement occurs.

### **Control of Purchasing, Procurement and Payment**

Duties are segregated to prevent an employee from ordering goods/services, receiving, and authorizing payment for them. Procurement procedures are followed to ensure that the requested goods/services are of an appropriate standard and quality, and an acceptable competitive price. In this way, the possibility of corruption is minimized. Only invoices addressed to the municipality for goods/services relating to its activities are approved for payment. Payment orders are only processed on the basis of original documents approved by authorizing officials. (Public Procurement is addressed in Chapter 13).

### **Summary of Internal Budget Control**

An effective budget control system will enable timely and preventive detection of discrepancies and mistakes so that the municipality can take corrective actions. The budget control process must include mechanisms to identify why irregularities are appearing in some activities and how to resolve those irregularities if they occur. The municipality’s budget

control procedures should be established primarily by the Finance Department and managed by Head of Finance. In addition, municipal authorities must harmonize budget control with all municipal activities affected by the budget plan and execution, including reporting. With well-established budget control, municipal operations will proceed within the legally prescribed framework and the budget will be kept within its planned limits.

### **External Budget Control**

External budget control is the process of controlling budget users by external authorities and must be conducted in accordance with legal frameworks adopted in both FBiH and the RS. Each set of legal regulations has established mechanisms for the control of budget users through their respective Ministries of Finance. Below we discuss the different roles each Entity plays in budget control at the municipal level.

It is important to note that external control is an activity performed after the event and, unlike internal control procedures, cannot act preventively. In other words, the findings of external control and audit are a review of events and procedures which have already taken place. Irregularities can only be recorded and suggestions for future corrective action provided. This does not diminish the value of external control because, regardless of the system of internal budget control established in a municipality, auditing contains a dimension of impartiality and objectivity.

### **External Budget Control by the Ministry of Finance (MoF) in FBiH, Department of Treasury; Group for Internal Audit and Control**

According to the *Law on Budget FBiH Article 45*, the Ministry of Finance also has the right to supervise and control the budget of cantons, cities and municipalities including budget beneficiaries. However, according to the *FBiH Ministry of Finance Rulebook of 21 July 2005 (407/05)* the Ministry Group of Internal Audit and Control only reviews the control systems for extra-budgetary funds for municipalities and cantons.

### **External Budget Control by the RS Ministry of Finance Budget Control Department**

In accordance with the *Law on Budget System of RS (articles 65, 66, 67, 68 and 69)* the RS Ministry of Finance controls the accounting documents of budget beneficiaries, budgets of municipalities, towns and funds.

The Minister of Finance issues a formal Decision on Control of Material and Financial Transactions of Budget Beneficiaries for a certain period. An inspector from the Budget Control section will visit the municipality and examine relevant documentation. After the control has been conducted, the inspector makes a report based on his findings in that municipality. If the report states that there has been a breach of the law, or irregularities in the implementation of the law, the inspector is obliged to issue a decision, within ten days, ordering the breaches of law or irregularities to be corrected. The inspector also sets a deadline for their correction and prescribes other measures stipulated by the law.

An appeal can be filed against an inspector's decision to the Minister of Finance-Budget Control Department, within eight days. The Minister's decision, made upon the appeal, is final. If the identified irregularities are not eliminated, the inspector must:

- Bring a decision which bans the use of funds from the Single Treasury Account, business accounts and special purpose accounts of the budget beneficiaries
- Bring a decision which bans allocation of tax revenues and incomes from the public revenue account to the account of the municipality or town
- Submit the decision to the Ministry-Treasury, or banks at which a budget beneficiary has open business and special purpose accounts
- Ban the use of funds until the identified irregularities are eliminated.

### **Budget Auditing**

Budget auditing is discussed in Chapter 6 on Internal Control and Audit.

### **Tax administration**

According to the Law on Tax Administration, the tax authorities of FBiH and the RS are a part of the Ministry of Finance. The Tax Administrations controls the implementation of tax laws, laws on contributions and laws on fee rates. As such, they are responsible for accounting, recording and receiving payments of taxes and interest, detecting and preventing criminal offences and violations of tax regulations, and detecting and preventing corruption. Tax inspectors oversee all taxpayers (including municipalities and towns) which are, under the tax laws, obligated to pay tax, penalties and interest.



## Budget Execution

Budget execution, also referred to as budget realization, is the final phase of the budget process when funds are collected and disbursed in support of municipal activities, which ultimately serve the community at large. Budget execution is the implementation of the budget plan.

After reading this chapter you should understand:

- The legal framework for budget execution
- Areas of budget execution
- The process of budget execution (internal and external factors)

## Legal Framework

Budget execution is based on the legal regulations detailed in the *Law on Budget of FBiH (FBiH OG 20/98)* and *Law on the Budget System of RS (RS OG 96/03)*. They provide the framework for all budget activities including those undertaken by the MC/MA. Legally speaking, budget execution starts with the MC/MA's decision adopting the budget plan for the year ahead, or a Decision of the MC/MA for temporary financing, in addition to the Decision of Budget Execution, which has to be adopted by MC/MA at the same time as the budget plan. This means that the budget is an act of the Mayor, which is confirmed by MC/MA and, after its adoption, the Mayor has the authority to execute that plan.

## Areas of Budget Execution

In order for a municipality to execute the budget in an efficient and effective manner, the budget plan must have been prepared realistically. The municipality has to establish an adequate internal structure and efficient procedures for proper budget execution. In addition, the municipal administration must give the same importance to both aspects of the municipal budget: revenue collection and expenditures.

## Revenues

Budget execution involves not only payment of costs and expenses, but also the collection of revenues. Revenues include all funds that come into the municipality through bank accounts or in cash. Revenue collection is based on the implementation of revenue sharing laws, laws on taxes and the implementation of the municipality's decisions that regulate the collection of locally generated revenues.

Annual revenues in the budget plan represent an estimate of the funds that the municipality anticipates it will collect during the course of one fiscal year.

A municipality has two main sources of revenues:

- Tax revenues
- Non-tax revenues

Other types of revenue, often included in budgets are:

- Grants from higher levels government
- Donations
- Loans

### **Tax Revenues**

A significant portion of tax revenues are realized through higher levels of government and therefore the municipality has little to do with the management of their collection. However, the municipality can influence improvements in collection of these revenues. Whether in FBiH or the RS, a municipality should maintain official communication with either its Canton Ministry of Finance or the RS Ministry of Finance that is responsible for the transfer of tax revenues through the Treasury Single Account for confirming proper tax distribution.

Estimates of tax revenues for the next year's budget plan should be made based on the previous year's collection. After the budget plan is passed, the municipal Head of Finance should monitor tax revenue deposits and notify the Mayor if significant deviations from the planned amount are detected, even if this is outside the monthly reporting cycle. Based on the Mayor's instructions, the Head of Finance should contact the Canton Ministry of Finance or RS Tax Authority regarding transfer of money to the municipality. The municipal authority (Head of Finance) should check, together with authorities of the tax office, the level of collected revenues that belong to municipal budget and amount of funds to be transferred to the municipality.

### **Non-Tax Revenues**

Non-tax revenues are the only source of income that municipalities can directly collect. Yet many municipalities have yet to make the collection of non-tax revenues a priority. For planned non-tax revenues, a municipality has to ensure that there is an appropriate system of monitoring and collection.

Municipalities must identify all possible sources of non-tax revenue. This may include a review of current sources to determine whether all revenues are being collected adequately. The municipality must then ensure that there are appropriate mechanisms for the collection of fees and that there is a proper system for recording collected revenues. Monitoring revenue collection must be a regular activity and any deviation between the planned and collected fees should be addressed immediately. In order to mitigate lapses in collections, the Mayor and Head of Finance should identify all critical points in the chain of fee collections, provide instructions on proper collections and warn the responsible department or person (in written form) that a correction in job performance is necessary.

If contracted claims are not collected in an appropriate timeframe, the Head of Finance should investigate and identify where the problem lies. This may include more aggressive collection, a change in the system, or disciplinary action. A delay in correcting the problem could have a long-term negative impact on the budget.

### **Grants**

A grant is a specific kind of revenue provided by a higher level of government. Unlike loans which must be repaid with interest, grants do not have to be repaid. A municipality can be allocated grants as a support for its administration (in case of a poor municipality) or earmarked for special projects.

A municipality can apply for grants from higher levels of government when it cannot fund essential municipal tasks. The municipality must provide a project proposal, in written form, for funding in accordance with budget procedure. In other cases, a municipality may be responsible for maintenance of roads or cultural monuments that should actually be under the competency of a higher level of government. The higher level of government transfers authorization to a municipality to organize activities that should be supported with grants to fulfill those tasks.

## Donations

Donations are usually collected by a municipality with the help of domestic or foreign donors. Although a municipality cannot accurately forecast this type of revenue, it can help to attract financial support from donors by developing general municipal policies, strategic and capital planning and investment programs.

Donations may be planned, in which case they are considered “ordinary”, or given by a donor unexpectedly, in which case they are termed “extra-ordinary”. If the donation has been included in the budget plan when the funds are received, they should be recorded under title “ordinary revenue”. “Extra ordinary” revenues are not planned and are received during the budget year. This unexpected revenue must be offset on the expenditures side. “In kind” donations must also be included in budget execution reports. These donations must be correctly valued and entered in the municipality’s books. (“In kind” donations might be a project vehicle, handed over to the municipality after a project has ended, or a fire brigade vehicle given to a municipality by an organization, computer equipment, etc...)

## Loans

There are strict legal regulations which provide guidelines for municipalities applying for loans and how the money can be spent. An IMF Decree<sup>5</sup> sets the limits and restrictions for borrowing. The legal framework<sup>6</sup> allows municipalities to borrow<sup>7</sup> from a commercial bank or Entities (FBiH or RS). There are also current draft debt laws for the Entities; however, at time of publication, these laws have yet to be passed. Borrowing from a domestic or foreign commercial bank is possible for capital projects in accordance with special criteria, including the amount borrowed. If a municipality has a short-term deficit, it can borrow from FBiH or RS during a single budget year, but the municipality has to repay that debt completely within the year.

The municipal administration prepares all documents required for a loan application and ensures that conditions necessary for borrowing and repayment are met. The MC/MA must then issue a decision for borrowing in accordance with legal regulations.

## Expenditures

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<sup>5</sup> Bosnia and Herzegovina—IMF Letter of Intent, Supplementary Memorandum of Economic and Financial Policies, and Supplementary Technical Memorandum of Understanding Sarajevo and Banja Luka, Bosnia and Herzegovina April 24, 2003 and IMF Country Report 05/198 June 2005.

<sup>6</sup> FBiH Law on Budget Articles 38, 39 and RS Law on Budget System Articles 53-57

<sup>7</sup> Exceptions for borrowing from USAID, KFW and World Bank.

Using budget funds or creating expenditures is the last step in realizing the municipal budget plan. The municipal Head of Finance is responsible for controlling this process. The Head of Finance ensures accurate and proper transfer of budget funds and is obligated to follow the planned budget and to ensure that:

- Are budget funds transferred to planned users in a timely manner?
- Is the transferred amount in accordance with the plan?

The Head of Finance must warn the Mayor and budget users in writing that any kind of transfer, which is not in accordance with the budget plan, is illegal.

Expenditures and other payments from the municipal budget consist of:

- Current expenditures, such as salaries, compensations, material costs, current transfers and interest payments, and all services and activities for the fiscal year
- Capital expenditures for financing procurement and improvement of major community facilities and structures (capital budget) and
- Lending and equity participation, less loan repayments

Priorities in execution of budget expenditures must be scrutinized, in line with the revenues generated. When the revenues collected are less than what was planned the Mayor and Head of Finance have to decide which expenditures are priorities. A distinction between expenditures which could jeopardize the functioning of the municipal administration and expenditures which jeopardize service to citizens must be made, based on a general estimation of what budget execution should be in that period, taking into consideration any previous deficits, which should have been included in the budget plan. If a municipality has different types of debts and obligations to suppliers, and there is a possibility that liquidity will be adversely affected, the municipality has to identify its priorities, including electricity bills, contract obligations, transfer to budget users (library, kindergarten, fire brigade etc...)

Municipal authorities responsible for budget execution determine priorities based on the following criteria and in the following order:

- **Internal obligations** including salaries, taxes and contributions as a legal obligation
- **Debts** which the municipality is under obligation to pay including capital investments, services, goods, or works
- **Transfers** to budget users and users of grants

The Mayor or Head of Finance must then inform budget users and users of grants about the situation and should provide some estimation of how the problem is to be solved. Municipal authorities should provide relevant information to budget users regarding the transfer of funds to budget users in the next period. Late transfers could jeopardize regular business of budget users and they must be able to identify their priorities when shortfalls occur.

## The Process of Budget Execution

### Timeline

Although budget execution does not start until a decision on budget execution is adopted by the MC/MA, the end of budget execution is defined by legal regulations. The fiscal year corresponds to the calendar year, 31 December being the last day for execution of budget revenues, while budget expenditures continue to be processed until 31 January of the next

year. All invoices received until the end of January should be processed as budget expenditures. The municipality must closely monitor funds in this period in order to pay all obligations.

### **When the Budget is not Adopted on Time**

In F BiH when the MC/MA does not adopt a municipal budget plan it must adopt a decision for temporary financing for no more than the first three months of the year. Temporary financing must be planned and executed for no more than the same amount planned in the 3 months of the previous year on the expenditures side, regardless of revenue collections. During that first quarter (1 January – 31 March), the municipal administration must correct unacceptable items in the budget plan. Suggested budget items must be realistic and justified. If the MC/MA does not adopt the Budget Plan before the end of the quarter, the municipality cannot legally disburse any funds for any expenditure after 31 March.

In the RS, regulations are slightly different; the MC/MA may pass a decision on temporary financing for up to 6 months (1 January – 30 June). Temporary financing, must be planned and executed for no more than the same amount used in same period of the previous year, up to a maximum of one half of the total revenue allocated in the budget of the previous fiscal year.

### **Notification**

After adoption of the Decision of Budget Execution for Temporary Financing or a Decision on Budget Execution, the municipality must inform all budget users and grant users in written form regarding the amount of authorized funds in accordance with adopted budget. Once budget users have been notified, all the conditions have been met for actually executing the plan.

### **Monitoring Execution**

The Head of Finance has to establish a financial plan that ensures municipal liquidity because cash flow for each month is not the same. The municipality must reconcile its revenue collection with the budget plan and realized services on a monthly basis.

The Head of Finance must ensure that there are procedures in place to manage internal and external documents, which create obligations for payment (expenditures). Every payment activity must have written documentation as a basis for payment, and the same must be authorized by a designated official in accordance with municipal procedures.

The municipal administration must also define the technical aspects of transferring budget funds to budget users and users of grants. There are usually two options: one is to transfer funds directly to a supplier who provides services to budget users or users of grants, the second option is that the municipality transfers funds to budget users and users of grants and they then pay invoices.

Some budget execution activities are fairly simple and straightforward to implement, such as the transfer of funds to budget users and users of grants that are considered permanent and on going. But even regular transfers must be properly documented and monitored to ensure that budget users are using funds for the purposes outlined in the budget plan. Budget users and users of grants must provide written requests in a timely manner on a monthly basis and

provide monthly reports on realized expenditures in a form provided by the municipal Finance Department, in accordance with procedures established through an internal control system.

Expenditures based on contracts deserve special attention, when suppliers deliver invoices or other financial documents for payment. Verification and a system of internal control should be established to ensure that payments are made **based on verified fulfillment of contracts to ensure that there are no cost overruns and that the expenditures remain within budget plan limits.**

### **Reporting**

Although reporting is discussed in detail in Chapters 9 and 10, the intention in this section is to highlight the importance of reporting on budget execution as tool for successful implementation of the budget plan and for sound and effective financial management.

The municipal administration must develop a proper bookkeeping unit, which records all budget transactions as a basis for accurate and effective reporting. The bookkeeping unit, given proper and accurate information, can ensure quality and meet the legal obligations in the process of monitoring budget execution and reporting. In addition, the municipality must develop a system of reporting to the MC/MA at least quarterly, but ideally, monthly. Only in this way does the MC/MA have the ability to monitor budget execution in accordance with the planned budget. This is also essential for the preparation of the following year's budget, as monthly reports provide a concrete picture of budget execution on all revenues and expenditures.

Further, special attention should be paid to the narrative in drafting a budget execution report. The narrative must clearly justify, clarify and explain all differences between plan and realization, item by item. Paid and unpaid obligations should also be included in execution reports.

### **Budget Surplus and Deficit**

Addressing budget surpluses and deficits is one of the most important aspects of budget execution. The legal framework allows a municipality to rebalance the budget in the process of budget execution in order to correct revenues or expenditures, but all financial managers should ensure that the budget plan is followed as closely as possible. Municipal authorities can balance expenditures when there are inadequate budget revenues. As discussed earlier, if there is lower than expected revenues, a municipality can seek a loan or decrease expenditures.

### **Budget Reserve**

According to regulations, a municipality must have a reserve fund. This fund is used for unexpected situations, urgent and unforeseeable expenses that arise throughout the year. The budget reserve corresponds to 5% of revenue in FBiH and 2.5% in RS. The Mayor is authorized to determine the use of reserve funds but must report on how they were used on a quarterly basis to the MC/MA.

### **Inter-departmental Communications**

In order to improve overall budget execution, both in revenue collection and efficient and effective use of funds, a municipality must establish good communication between municipal departments. Although municipal departments do not manage financial funds in the scope of their work, all of them have an impact on budget realization. Every deviation or failure in application of the rules and procedures for collection or spending of funds can cause shortfalls in budget execution, which can lead to a long-term negative impact on the financial health of the municipality. While communication may not be the most important area of execution, it is essential for developing an overall municipal budget policy and a coordinated approach to a wide range of issues, including planning, procurement, reporting and control.

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On the *Budget and Finance Guide CD* for this Chapter, you will find:

Explanation of the Report on Budget Execution

Example Collection of Receivables

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## Financial Reporting to the Ministries of Finance

Reporting is an essential part of maintaining transparency and control over public funds. In Chapter 10, financial reporting to citizens and MC/MAs is discussed. However, no less important is reporting the Ministry of Finance.

When reading this chapter, keep in mind the strong correlation between Chapter 3 on Budget Accounting and activities related to reporting in this chapter. Budget accounting is a process and a system that enables reporting of executed activities.

After reading this chapter you should understand:

- How to prepare reports to the Ministry of Finance
- Types of forms and key information that must be included

## Legal Framework for Financial Reporting to the Ministry of Finance

In order to report accurately to the Ministry of Finance a municipality must have an efficient accounting system based on current legal regulations and accounting standards. Municipal Finance Departments are obliged, in terms of deadlines and methods of preparing and delivering financial reports, to follow the instructions of their respective Ministries of Finance and other ministries at all levels, just as budget users are obliged to ensure application of laws and regulations in the field of tax policy, working relations, salaries, contributions and compensations. Therefore, the Finance Department must monitor changes in legislation and keep up to date on developments in accounting standards.

## Who is Responsible for Reporting?

Responsibility for preparing financial reports rests with the municipal Head of Finance, those responsible for accounting, and the Mayor. Financial reports are signed by the person/s authorized for the budget and the person authorized for financial management, such as the Head of Finance or Chief of Accounting, with the appropriate license (Accounting License issued by Union of Accounting Persons in FBiH and RS).

## Periodic and Annual Reporting

The aim of financial reporting is to provide information on the financial status and transactions of budget users, with a special emphasis on:

- Resources, obligations, and net assets (capital)
- Revenues, expenditures, and realized financial results
- Cash flow
- Capital financing

Financial reports provide information on the quality of the management of a municipality's financial resources. They also provide the basis for determining the municipality's financial capacity to meet its long and short term financial obligations. Below is a more detailed explanation about periodic and annual reports, as well as consolidated reports and other prescribed forms.



## Periodic Reporting

Periodic reports cover a period shorter than one year and are prepared and submitted using the prescribed forms, listed below. The forms are completed on a cumulative basis and serve as the foundation for preparation of budget execution (realization) reports. Starting from 1 January of the current year to the end of each reporting period, the timeframes for each periodic report are:

- Three-month report: (1 January – 31 March of the current year)
- Six-month report: (1 January – 30 June of the current year)
- Nine-month report: (1 January – 30 September of the current year)

According to the FBiH Rulebook on Financial Reporting, municipalities must submit reporting forms to the Mayor and to the Ministry of Finance within 30 days from the reporting period. RS municipal and city agencies submit their forms within 20 days from the reporting period to the Mayor and the Ministry of Finance.

## Narrative (analysis) of the Periodic Report

Preparation of the narrative required for periodic reports is prescribed by provisions of *Articles 27 and 29 of the Rulebook in Financial Reporting for the FBiH and in RS the Rulebook on Financial Reporting of Budget Beneficiaries, Article 23*. The narrative is an explanation, clarification and analysis of the indicators in the periodic report forms, and should provide:

- An explanation of the reasons planned targets in the annual plan have not been met, viewed over a three month period
- An assessment of the expected results until the end of year
- An assessment of cash inflow and outflow (from the end of the reporting period to the end of the year)
- An explanation of the discrepancy in realization for the current period, compared with the same period of the previous year

Below is a list of the necessary forms, which have to be completed and submitted to the Mayor and the Ministry of Finance (in FBiH the Canton Ministry of Finance).

### Periodic Report Forms (FBiH)

Form 1	Overview of Revenues, Receipts and Financing
Form 2	Consolidated Overview of Revenues, Receipts and Financing per Economic Categories
Form 3	Expenditures and Allocations from Budget by Economic Categories
Form 4	Expenditures by Economic Categories
Form 5	Special Data on Salaries and Number of Staff
Form 6	Special Data on Current and Capital Grants
Form 7	Cross Classification of Budget Expenditures per Economic and Functional Classification

Form 8	Registry of Allocations from the Current Reserve
Form 9	Registry of Grants to Political Parties, Social Organizations and Public Media
Form 10	Registry of Unpaid Liabilities
Form 11	Cumulative overview of revenues and expenditures per economic categories

#### Periodic Report Forms (RS)

Form 1	Cumulative overview of revenues and expenditures per economic categories
Form 2	Budget expenditures by functional classification
Form 3	Overview of unpaid liabilities
Form 4	Special data on salaries and number of staff
Form 5	Overview of allocations from the budget reserve
Form 6	Special data on current and capital aid

For more details of these forms, see the Rulebooks on Financial Reporting for both FBiH and the RS.

### The Annual Report

The Annual Report consists of all reports for the year and includes the following:

- Accounting report
- Consolidated accounting report
- Narrative report

The Annual Report is prepared after completion of the Annual Financial Statement and, at the latest by the end of February of the year following the budget year. All budget users are obliged to submit their annual reports to their municipal Finance Department, which reviews, harmonizes and consolidates all budget user reports.

### The Annual Financial Statement

The Annual Financial Statement is actually several documents:

- Balance sheet
- Revenue and expenditure account
- Cash flow balance
- Report on capital expenditures and financing
- Annual report on realization of budget
- And in the RS the Special Data on Salaries Form (which must also be sent to the Statistical Institute)

Because of the importance of the Annual Financial Statement, below is a more detailed explanation of the each component.

### **The Balance Sheet**

The balance sheet is an overview of the results at the end of a calendar year (31 December of the reporting year). This provides information on everything of value (assets) and everything owed (liabilities) and the difference between the two, or the amount remaining if all the liabilities were paid (equity). Each category (assets, liabilities, and equity) has its own sub-category that is further broken-down to provide more detailed information. The balance sheet form is the same for both FBiH and RS.

Special attention should be paid to the last two lines of the balance sheet, which present accumulated non-distributed surplus of incomes and accumulated and uncovered expenditures on 31 December of the reporting year. The column marked “AOP” can be found in the middle of the balance sheet form in two rows (216 and 217) which present the results of budget execution as a surplus or deficit. Municipalities present a surplus in the accumulated amount on code AOP 216 and the accumulated deficit on the same date on code AOP 217. These directly correlate to the general ledger and the economic code in the Chart of Accounts 590000. The information on surplus and deficit must be reconciled with data in the budget execution report for the same reporting period.

### **Report on Revenues and Expenditures Account**

This accounting report presents information on revenues and expenditures, or surplus and deficits of revenues and expenditures that have occurred in the process of accounting for the fiscal year. It does not take into account revenues and expenses related to capital financing transactions. Because the balance sheet does not include capital inflows and outflows (class 8) financial results, the report on revenues and expenditures account differs from the financial results presented in annual report on budget realization (where capital inflows and outflows are calculated).

### **Cash Flow Balance**

The cash flow balance provides data on cash flow as well as data on the flow of cash equivalents within the reporting period. The status of financial resources (which at the end of the year make a total circulation of cash flow during the year and status of the amount of cash and cash equivalents at the beginning of the year) matches the status of cash flow in the general ledger and the cash shown in the in the balance sheet.

### **Capital Expenditures and Financing Form**

The report on capital expenditures and financing is filled on the basis of transactions on account class 8, which represent a closed system of accounts, and does not show an accounting balance at the end of the year. Account 810000 registers the received amounts for capital investments, received installments of given loans, return on participation in capital investments and received amounts on the basis of given long-term and short-term loans. Account 820000 registers paid out investment amounts, amounts for supply of fixed assets, given loans, given participation in capital investments and expenditures for payment of debts.

## Budget Realization Annual Report Form

The Budget Realization Annual Report Form highlights information about the approved planned revenues, expenditures and data on financing, as well as the same data obtained in the course of the reporting year. The form includes comparative elements of differences between the amounts planned and what was actually achieved.

Revenues and expenditures are presented according to the economic classification in the financing section of the form, together with data on received long and short-term loans, as well as the payments of the same. Expenditures are also presented according to functional classification. At the same time, the options available to cover the deficits incurred are presented at the end of the form (loan agreements, surpluses from previous years or alternative sources).

### Forms from A to F (FBiH)

Budget users are obliged to submit 'additional financial data' that provides more details on specific financial report lines. These reports are compiled by 31 December of the reporting year and serve as the basis for:

- Preparation for the report narrative
- Consolidation of the annual report

Form A	Fixed Assets: Items and Rights
Form B	Other Long-term Assets
Form C	Status and Transactions with Other Governmental Bodies
Form D	Long-term Obligations
Form E	Potential Obligations
Form F	Extraordinary Items and Post Balance Events

### Notes Associated with Financial Reports

Notes or brief descriptions and analysis of certain lines shown in the balance sheet, the incomes and expenditures balance, the cash flow balance, the report on capital expenditures and financing should also be attached. Notes provide essential explanations on the structure and content of certain financial lines when information in a report is not enough. In the notes, it is necessary to publish at least the information outlined in international and local accounting standards and information that is important for proper understanding.

### Accounting Policies

The Head of Finance should revise the department's accounting policies, adopting a new rulebook harmonized with current regulations and accounting standards. When developing accounting policies special attention should be given to incomes and revenues, fixed assets, correction value of fixed assets, estimation of fixed assets, the memorandum journal, long-term transfers (credits and loans), sources of assets, stock of material and petty cash for the

purpose of equal treatment of assets and sources of assets and comparability of financial reports in the public sector.

### **Consolidated Financial Reports**

Consolidation of financial reports is the result of a procedure in which accounting documents of the same type for all budget users are compiled in one single document. However, it is important to stress that the consolidated document does not present a simple sum of all budget users' accounting documents. In the process of consolidation, it is necessary to eliminate amounts that originate from the relation between participants in consolidation including claims and obligations; credits and loans; incomes and revenues and so on.

The obligation for preparing consolidated financial reports is defined by the legal framework for FBiH and the RS and is explained in detail in the Accounting Standards. In order to achieve proper and accurate consolidation and to prepare a correct consolidated financial report the following principles should be followed:

- Principle of Economic Unity
- Principle of Unique Consolidation Deadline
- Principle of Continuity in applying methods of consolidation
- Modified Evolution of Event Principle (principle of unique position assessment and unique chosen accounting base of presenting business events)

#### *Principle of Economic Unity*

This Principle stresses that consolidated financial reports embrace all financial reports of mutually related users; at the same time the information should be presented as if it is prepared for one budget user.

#### *Principles of Unique Consolidation Deadline*

This Principle necessitates that all consolidated reports are prepared by the same date (31 December of the current year). In practice, it means that municipalities, as budget users, must submit their consolidated financial reports by the deadline defined in legislation. Upon receipt of the consolidated reports from all budget users, the Ministry of Finance prepares its annual budget report.

#### *Principle of Continuity in Applying Methods of Consolidation*

When preparing consolidated financial reports all budget users are obliged to apply the same accounting policies for the same types of financial transactions. It is essential that all budget users follow the same accounting policies in the process of consolidation, in order to compare individual consolidated reports, and prepare the consolidated financial report as a whole and to track overall financial movements over a longer period of time.

#### *Modified Evolution of Event Principle*

During the making of a consolidated report, it is important to strictly respect the Modified Evolution of Event Principle. According to this accounting method revenues are recognized in amounts that are realistically payable. This means that revenues must be measurable and accessible. Revenues are measurable only if they are calculated at a certain value i.e. if they are recorded in cash, as cash is a reliable measure. Availability of revenues refers to their real ability to be paid within the accounting period; in other words, that funds are available for paying off financial obligations. On the other side, the Modified Evolution of Event Principle

assumes registering and deregistering of all expenditures within the accounting period regardless of whether the payment of the occurred expenditures was done during that accounting period.

The aim of consolidation is always the same: elimination of data of mutual relation i.e. mutual transactions between participants in the process of consolidation. As with annual accounting reports, a set of consolidated accounting reports is really a set of the following reports:

- Consolidated balance sheet
- Consolidated revenues and expenditures account
- Consolidated cash flow balance
- Consolidated report on capital expenditures and financing
- Consolidated annual report on realization of budget

In order to have a properly prepared consolidated report, the regular Annual Financial Statement must have been done correctly and accurately. If this precondition is not met the process of consolidation will not provide correct and valid information about the budget as a whole.

The Consolidated Annual Report for the municipal budget is submitted at the latest by the 31 March to the Ministry of Finance.

### **Consolidated Balance Sheet – Form K-BS**

The foundation for preparing the consolidated balance sheet (K-BS) is a correctly prepared individual balance sheet. Similarly, the balance sheet and K-BS are prepared on the same date (31 December) and gives an overview of the available property and the resources from which that property is financed. Reconciliation and harmonizing of liabilities and claims of individual budget users in the process of consolidation must be done. The difference between individual and consolidated balance sheets is that the K-BS entirely eliminates mutual claims and liabilities between linked budget users including credits, loans, capital transactions, etc.

According to legislation and accounting standards, claims on one side in the process of consolidation must fully match financial obligations on the other side. However, in practice this often creates problems for a variety of reasons: one side does not recognize obligations although the other side has already created outstanding liabilities in their accounting; or it may simply happen that one linked unit does not inform the other unit of the creation of an outstanding account/liability.

In FBiH, while preparing a consolidated balance sheet the following accounts are consolidated: 160000 financial and accounting relations with other linked units (claims) and 360000 financial and accounting relations with other linked units (liabilities).

In the RS, consolidation of the balance sheet is conducted according to the same principle in accounts: 260000 financial and accounting relations with other linked units (claims) and 360000 financial and accounting relations with other linked units on the side of the liabilities.

### **Consolidated Revenues and Expenditures Balance (K- PR)**

Similar to individual revenue and expenditure balance, the consolidated revenue and expenditure balance (K-PR) shows consolidated revenues and expenditures as well as information on surplus and deficit. This is presented in the accounting form for the fiscal year without taking into consideration receipts and expenses related to capital financial transactions.

The difference between the consolidated revenues and expenditures account and annual revenues and expenditures account is in the totals of certain items, which must be eliminated in the process of consolidation. These are allocations from the budget (expenditures of the provider of funds) and revenues from budget (revenues of the recipient).

In the process of consolidation, all expenditures and revenues that occurred between the municipality and the higher level of government are eliminated in consolidation. In accordance with the Chart of Accounts, while preparing the individual revenues and expenditures balance, revenues and expenditures are registered under code 680000, allocations to lower consumer units (expenditures of higher levels in the process of consolidation) and 780000 revenues from the budget (revenues of the municipality in the process of consolidation or received allocations).

Legislation requires reconciliation and consolidation of these revenues and expenditures at the synthetic level. Although the structure of these two categories in accordance with the Chart of Accounts is identical, the law does not require reconciliation of each individual item within the structure but only consolidation of overall revenues and expenditures at the main category level.

### **Consolidated Cash Flow Balance**

The consolidated cash flow balance is submitted on the prescribed K-NT form and highlights the movement of cash flow, revenues and expenditures, and payments between units linked in the process of consolidation as well as movement between the system and its environment.

In order for consolidation to succeed, two basic preconditions must be met. First, it is necessary to reconcile individual cash flow forms for those cash transactions taking place between budget users in consolidation and the second precondition is timely submission of data related to mutual receipts and expenses between all budget users in the consolidation. Simply, in the process of consolidation all cash flow between participants at the same level is eliminated.

### **Consolidated Report on Capital Expenditures and Financing K-KIF**

Analogous to the consolidation procedures during the drafting of other consolidated reports and the K-KIF, capital receipts (revenues) and expenditures, realized between individual participants in the consolidation process, cancel each other out. Prior to the preparation of the K-KIF capital receipts and expenditures should be reconciled at the municipal level in the process of consolidation.

Similar to the individual KIF, which registers class 8 accounts, the consolidated KIF registers only accounts 810000 and 820000. The difference between the individual status of capital expenditures and financing and the consolidated status of capital expenditures and financing is kept in accounts 810000 and 820000, which registers the flow of capital transactions (expenses and receipts) that have taken place between budget users in consolidation. The K-KIF does not contain the status of the capital transaction accounts carried out between individual participants in the consolidation.

### **Consolidated Annual Report on Realization of Budget K-GIB**

The last financial report necessary to prepare is the consolidated annual report on realization of budget which is submitted on the K-GIB Form. This form contains columns with realizations on revenues and expenditures for the previous and current year; a column for the current year plan, deviation from realization and an index column of realization in comparison to the plan. The report gives a full picture of the budget. Therefore, K-GIB presents the most important financial report of the budget.

Having in mind all the above, while preparing K-GIB it is necessary to do the following operations:

- Reconcile data between the individual report on realization of budget (GIB) with the revenue and expenditures account (PR) and KIF data
- Reconcile data from individual the GIB of budget users with own data on realization of budget
- Compare data of individual GIB with consolidated K-PR and K-KIF forms

While preparing the consolidated K-GIB the preparatory steps described above should be strictly followed. Practice in BiH indicates that there are municipalities where the consolidated K-GIB reports are identical to the regular annual statements on budget execution. If there has been activity on account classes 68 and 78 this is impossible because it presents a control mechanism for consolidation correctness. From the point of view of the budget this situation creates the illusion of total revenues and expenditures and the budget realization will look as if it was more than actually realized. Therefore, elimination of data from positions 680000 and 780000 depends on the level on which consolidation is taking place. Through the process of consolidation, regardless of the level at which it is taking place, the status of account 680000 is eliminated because it is annulled with the accounts belonging to category 780000.

A list of current legal regulations can be found in Chapter 3, Budget Accounting.

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On the *Budget and Finance Guide CD* for this Chapter, you will find:

Budget Expenditures by Function Classifications

Overview of remittances from Budget Reserve

Specific Data on Salaries and Number of Employees

Summary of Revenues and Expenditures per Economic Categories

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## Reporting To Citizens

Because municipal budgets include financial resources, tasks and projects that are of vital interest to citizens there is a need for periodic reporting on budget implementation to citizens and decision makers. The *FBiH Budget Law and the RS Law on Budget System* stipulates the framework contents of reports the MC/MA and the competent Ministry of Finance (please see *figures 3 and 4*).

After reading this chapter you should understand:

- The importance of reports to the MC/MA
- Why citizens should have access to reports

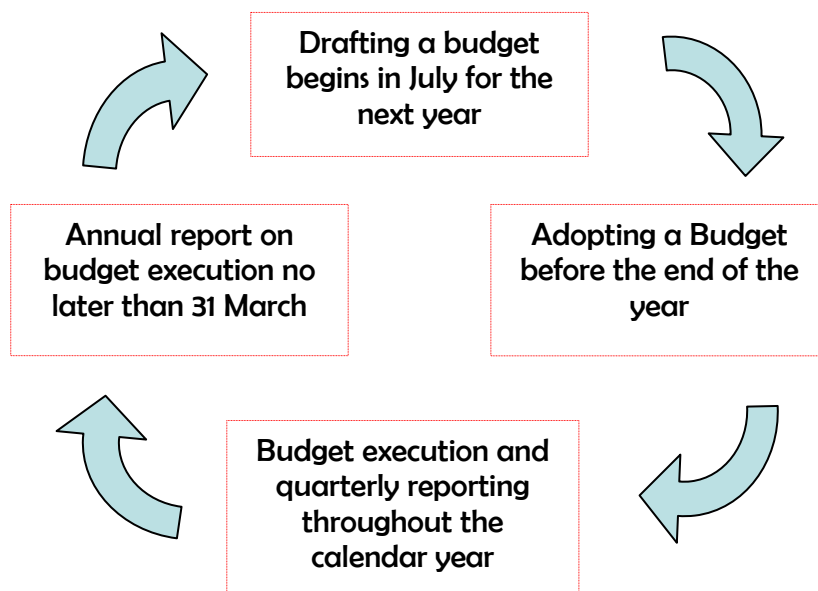
## Transition into Democratic Society

There is a basic conceptual distinction between undemocratic and democratic systems when referring to the involvement of citizens in the process of decision making and reporting by government to citizens on proposals and decisions. In undemocratic systems, decisions and plans are made by specialized institutions. Citizens remain out of the information loop when it comes to the use of public funds. The decision making process is quicker because it is not necessary to involve others in the process. However, fundamental problems arise when the decisions taken do not correspond to the actual needs of the population. In a democratic system more time is 'invested' in the decision making process to include more people in it. The process of consultation and decision-making should be an integral part of the budget process, from drafting through to reporting on budget execution to both the MA/MC and citizens.

There are four phases in the budget cycle and, there should be some form of public participation in each:

1. Drafting a budget
2. Adopting a budget
3. Budget execution and
4. Reporting on the budget execution

*Figure 1: Budget cycle*

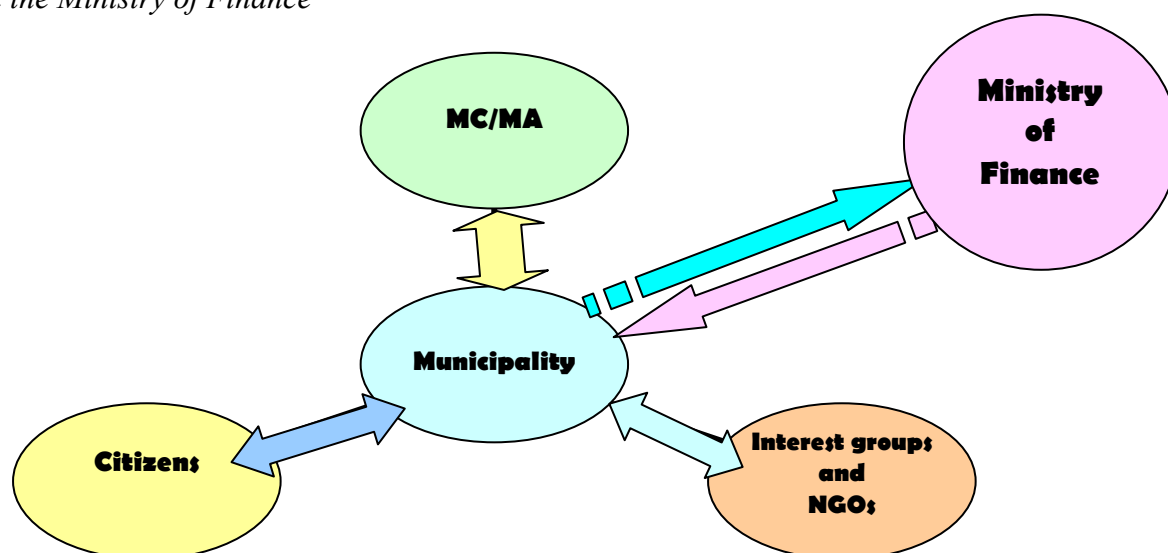


## Reporting During Budget Drafting

The municipal Finance Department should consult all involved parties during the budget drafting process: The competent Ministry of Finance, municipal councilors, budget users, business associations and civic organizations. Drafting a budget requires adequate information to support decisions on budget. The budget can be seen as the result of harmonization of decisions made by the local authority and based on needs expressed by citizens. This is why communication with citizens cannot be one-way.

The mechanisms that citizens can use to create an impact on municipal decision-making must be interactive. The municipal administration should make decisions based on the priority needs of its citizens, taking into consideration mandated legal obligations. It should report on successes and failures and fine-tune plans each year. This is the opportunity to reach joint decisions on the best possible solutions for issues that the municipality is facing.

Figure 2: *Two-way communication of the local self-government with the MC/MA, the public and the Ministry of Finance*



## Reporting During Budget Execution

Municipalities are not legally bound to inform citizens about budget execution unless this is regulated locally by a decision of the MC/MA. This explains why there is still a need to emphasize **the significance** of periodic reporting to MC/MAs, citizens and civic groups.

Reporting on budget execution is a way to provide the public with **feedback** on how the municipality and its representatives (including councilors) understood citizens' needs during budget drafting and subsequent adoption. Municipalities should be providing the MC/MA with quarterly, if not monthly, reporting on budget execution and these reports should be made available to the public.

## Monthly Reporting

The Finance Department provides the Mayor with up-to-date monthly and sometimes more frequent overviews of expenditures and revenues according to budget classification and provides explanations of any deviations from the budget plan. This allows the Mayor and Heads of Departments to monitor activity and make necessary changes to spending. These reports also allow the Mayor to inform the citizens about the status of the municipal finances.

### Quarterly Reporting

Quarterly budget execution reports, not only keep the Mayor and Heads of Department informed, but also provide the MC/MA with regular information about the activity of the municipal administration. The reports are also distributed to the relevant Ministry of Finance. These reports should contain:

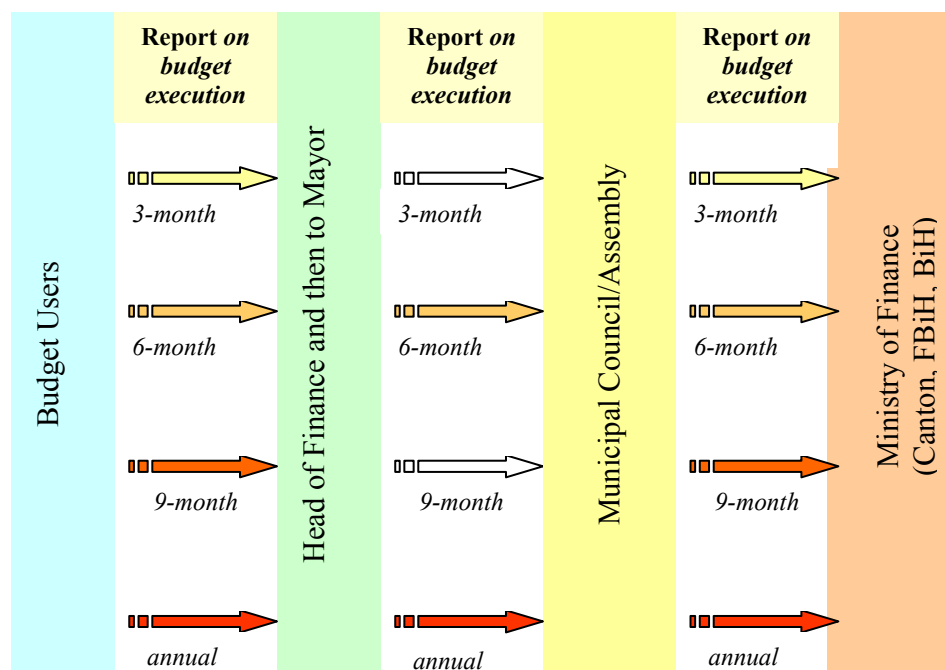
- Municipal financial status during the reporting period
- Comparative review of the planned and realized revenues and expenditures, status on grants and financing, and an explanation of any discrepancies
- Recommended measures for improvement if deviations are identified

Quarterly reports also provide a solid base for review of seasonal impact on certain types of revenues and expenditures by comparisons over time. This can be useful when budget lines fluctuate significantly during a budget year.

### Budget Execution Reporting FBiH

The *FBiH Law on Budget and the FBiH Rulebook on Financial Reporting (31 March 2005)* regulates reporting to the Ministry of Finance and requires that budget execution reports of towns and municipalities are submitted quarterly (please see Chapter 9 Reporting to Ministries of Finance for further Details). They should be submitted to the competent canton Ministry of Finance within 15 days following budget execution report adoption.

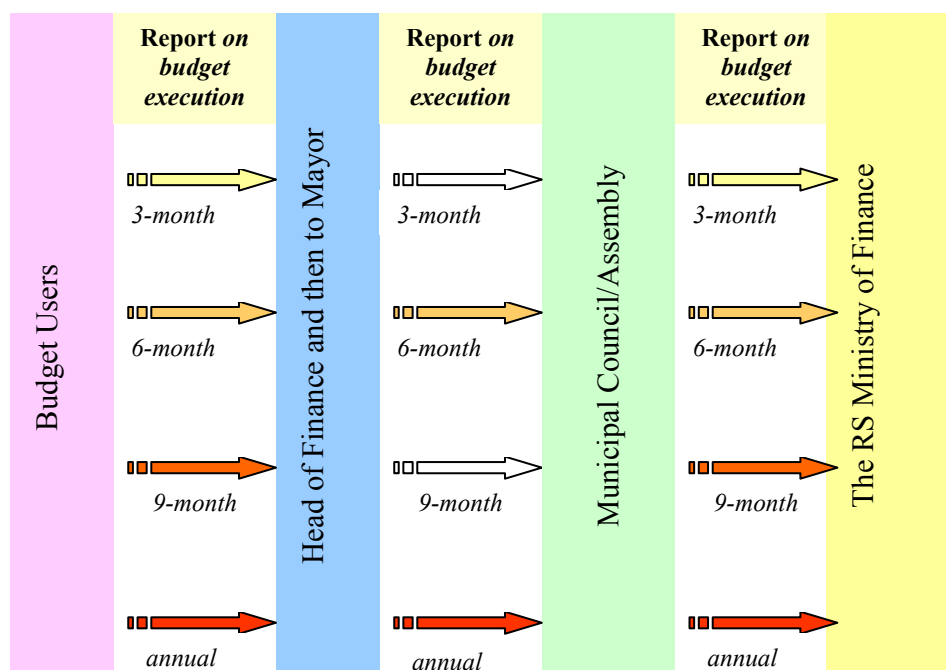
Figure 2: Dynamics of reporting on realization of the municipal budget in FBiH



### Budget Execution in the RS

According to the *Law on Budget System in the RS*, reports on budget execution of municipalities and towns should be forwarded to the Ministry of Finance quarterly for the current fiscal year within 15 days following their adoption. (Please see Chapter 9 Reporting to Ministries of Finance for further details).

Figure 5: *Dynamics of reporting on realization of the municipal budget in the RS*



## Annual Reports

Annual reports are needed for monitoring budget execution and should be shared with citizens prior to forwarding them to the MC/MA and the competent Ministry of Finance. These reports should clearly contain:

- Budget revenues and expenditures approved and assigned to the municipal budget during the previous and current year by the MC/MA
- Budget revenues and expenditures realized during the previous and current fiscal year clearly presented in order to distinguish the approved budget from its execution
- Explanation on major discrepancies between the planned and realized budget items
- Information on debt accumulation and managing that debt
- Information on the use of the budget reserve

The Annual Report should indicate the impact of legal changes or regulations adopted during the fiscal year and its estimated impact in the near future. Citizens should have access to these reports with clear explanations. This can be provided at Citizen Service Centers (One Stop Shops) or other municipal information desks, through an official web site of the municipality, or via civil society organizations. The execution of one year's budget provides a reasonable start point for planning the following year's budget.

### Questions That Should Be Asked

The MC/MA and citizens need to be **informed** in a timely manner on all discrepancies that have occurred regarding the revenues collected and expenditures allocated during the budget year. Information should also be provided when unexpected events occur, which have a significant impact on execution of the budget and planned activities. There are different ways of providing answers to such questions:

- Why the planned project for road reconstruction between point A and point B has not been realized?
- Why place C still does not have drinking water in accordance with valid standards, although reconstruction of the water supply network has been completed?
- Why administrative costs, particularly for official trips, have increased?
- Why the construction of the sports center hasn't started in place D, although it was planned in the budget, while at the same time, sports center in place E was finalized, although it was never planned in the budget?
- Why information on the expenditures of the Communal Company has not been presented for this year?
- Why did sports club 'AS' receive double the amount planned in the budget?

Reports forwarded to the MC/MA and citizens should be in an acceptable format and illustrated appropriately to provide objective and accurate information on the status of municipal finances and realization of planned tasks.

## Strategic Planning

Strategic planning is an organized way of moving an organization from where it is today to where it wants to be in the future. It is a process of establishing goals and developing and implementing plans to reach those goals. Although this Chapter is near the end of this *Guide*, a municipality, or any organization, should have a strategic plan as a starting point, so that it can take a proactive approach to managing resources and providing services. A strategic plan provides the foundation from which a project, the budget or other activities proceed. A municipal strategic plan will enable municipal departments to develop work plans and provide municipal employees with direction and clear targets against which their performance can be assessed.

After reading this chapter you should understand:

- What strategic planning is
- Who should initiate a strategic planning process
- How the strategic planning process works

### What is strategic planning?

Strategic planning is a management tool to help a municipality focus its efforts. The process is designed to ensure that all employees are working towards common goals. Strategic planning should be a continuous process, so that a municipality can review and, where necessary, adjust its targets in response to changing circumstances.

A strategic plan, with clear targets, will assist the municipality in identifying priorities, taking difficult decisions about what is essential, and what can be omitted. It is an essential tool in deciding where to allocate resources. Strategic plans can be developed for different purposes. A strategic plan can be produced for the municipality as whole; it can focus on a particular community, or a particular sector of activity, such as developing a solid waste management system for the municipality or regionally for a group of municipalities.

The most effective form of strategic planning is participatory.

Strategic planning:

- Provides focus for future goals
- Harmonizes local and, sometimes, conflicting interests
- Identifies discrepancies between current and desired activities
- Provides a base against which progress can be measured
- Provides guidance on the allocation of scarce municipal resources
- Identifies and defines responsibilities
- Strengthens the sense of ownership in municipal action

The strategic planning process is designed to enable municipal planners to develop a plan based on an analysis of past experiences; the current situation of the municipality; and likely future trends, by anticipating the environment in which the municipality will be working in the future. Or more simply, the process is about making fundamental decisions about:

- What to do
- Why to do it
- How to do it

The budget is the one of the key instruments in making the strategic plan a reality by providing resources necessary to carry out the activities necessary to achieve the goals set in the strategic plan.

### **Starting the Strategic Planning Process**

There are many different approaches to strategic planning; the following is an overview of one possible strategic planning process.

### **Gaining Understanding and Commitment**

It is important that before starting the strategic planning process there is an understanding and, ultimately, ownership of the process by those who will be affected by the plan. Whoever initiates the strategic planning process must explain its purpose, the role of the participants, the commitment expected and the costs and benefits of participation.

### **The Strategic Planning Working Group or Committee <sup>8</sup>**

A Strategic Planning Committee (SPC) is a formal, official, body, approved by the MC/MA formed to undertake strategic planning in partnership with citizens. A participatory approach to planning is essential because it enables the municipality and citizens to work together to develop a shared vision for the municipality and a multi-year development plan. In this way, citizens will become more aware of the constraints under which municipalities operate and the municipality will develop a greater understanding of the needs and priorities of citizens. As a result, priorities can be determined which reflect the real needs of the community. The municipality can make educated decisions about community development that are genuinely in the interest of its citizens and can then allocate resources to achieve the goals of the plan.

Over 60 municipalities in BiH have formed strategic planning working groups or committees, known by various names. This *Guide* will simply refer to 'the Committee'. Ideally, committees should consist of up to 15 people, but municipal authorities will make a final decision regarding number of members. The Committees should be a formally constituted body within the municipality. There should be a good balance among representatives reflecting a cross-section of interests and levels from within and outside the municipal administration.

The Committee should work to an agreed timetable. Whatever timetable is set, time should be allowed between meetings for the working group to reflect on content, verify facts and seek input from others. The Committee should report periodically and verify their work with the MC/MA and local counterparts. The completed strategic plan will be discussed and agreed by the MC/MA and presentations made to the public.

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<sup>8</sup> OSCE use the word Municipal Development Planning Committee (MDPC); USAID/SIDA GAP uses Capital Development Planning Committee (CDPC).

## The Role of the Mayor and other Municipal Staff

The Mayor, with the support of the Heads of Department and other staff, must provide all necessary technical support and assistance to the Committee in developing the municipal strategic plan. Municipal departments are a primary information source for the Committee providing all relevant data, plans and documents vital for the development of the strategic plan. They should also ensure that the appropriate environment is created, encouraging a transparent process that includes citizens and business representatives.

### Assessing the Current Situation

Assessment is an essential stage in the strategic planning process. Without examining the current situation it is nearly impossible to change or improve the community. Analysis involves gathering data and information from a variety of sources and verifying that the information is accurate and based on sound assumptions. Relevant information, not necessarily in order of importance could include:

- Geographic position
- Demographic trends and labor market
- Economy and business
- Environmental protection
- Infrastructure
- Education
- Health and social welfare
- Culture and sports
- Political processes
- NGOs

The information gathered should then be organized and analyzed through a process called “SWOT Analysis.” This is the analysis of a municipality’s strengths, weakness, opportunities and threats, in order to identify the municipalities’ comparative advantages.

SWOT Analysis Box:

<p><b>Strengths:</b></p> <p>Skilled staff Resources Location</p>	<p><b>Weaknesses:</b></p> <p>Low inter-departmental cooperation Leadership style</p>
<p><b>Opportunities:</b></p> <p>Growing market Investor interest in forestry</p>	<p><b>Threats:</b></p> <p>Changing higher level government policies Lack of infrastructure</p>

### *Identifying Strengths and Weaknesses*

In this part of SWOT analysis, the strengths and weaknesses or the factors internal to the municipal administration and management, over which they will have some control, are



identified. These factors include issues, such as skill levels of staff, resources, structure, shared values, open communication networks, inter-departmental cooperation and leadership style. It is important to discuss what impact these factors have on the ability of the municipality to carry out its work or accomplish its mission.

### ***Identifying Opportunities and Threats***

In this part of the SWOT analysis the opportunities and threats, or external factors which the municipality has little control over, are assessed. These can be both positive and negative and include issues such as government policies, environment, market, economy, social/cultural factors and changing demographics. As before, the impact on the ability of the municipality to carry out its work or accomplish its mission should be assessed.

### ***Identifying Critical Issues***

The critical issues for the municipality should emerge from the SWOT analysis and can be both positive and negative. These issues must be addressed by the Committee; if not they will become barriers to the municipality in fulfilling its mission.

### **Creating a Vision for the Municipality<sup>9</sup>**

The municipal vision is essential to form an idea of how the municipality should be in the future. In order to develop a municipal vision, the Committee should ask:

- How do I want the community to look in 5 years?
- How do I want the municipal administration to be perceived?
- What do citizens expect from this municipality?

The purpose of the vision statement is to develop a clear description of what the municipality should look like after implementing its strategies and achieves its full potential. The vision should include core values, basic strategies, performance criteria and ethical standards; emphasizing the important social purpose the municipality serves and which justifies its existence.

#### Vision Statement Examples:

“[Municipality] will be recognized as a diverse, progressive city; celebrated as the most desirable place to live, learn, work, and play”

“To modernize [the municipality] in line with cleanliness and beautification and consequently become an example town in all aspects on the national level”

### **Developing a Municipal Strategy**

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<sup>9</sup> Some strategic planning methodologies use the term mission statement or a vision and mission statement. The point is that without a target to strive for, the municipality lacks direction. Resources can be squandered on activities and plans that fail to meet the needs of the community. Moreover, working on an *ad hoc* basis, leaves little room for long-term planning, developing clear targets and measuring success.

After all the information has been collected, an assessment made and the SWOT analysis completed, the Committee will develop a strategy, through the identification of the strategic goals, which are expressions of what the municipality must achieve in order to realize its vision.

Examples of strategic goals:

“To stimulate citizen participation in municipal decision-making processes and to increase the flow of communications between the municipality and its residents”

“To increase public awareness and understanding of the functions of municipal government, resources, events, activities and issues under discussion”

“Identify and promote new attractions and developments that can be used to further solidify and build upon the pre-eminent role of tourism in the region”

“Preserve open space, vistas, and farmlands”

“Nurture a vibrant downtown”

“Enhance revenues and/or operational efficiency”

The Committee must consider the possible courses of action to meet the goals of the plan. In each case, barriers such as lack of resources (economic or professional), physical constraints, conflict with other municipal goals and objectives, must be identified. Having considered different courses of action, those that **have the best possibility of being realized, should become part of the strategic plan.**

### Planning for Action

In order to implement a strategic plan, it is necessary to plan activities to meet the goals of the municipal strategy. Then the planned activities must be checked to make sure that they are consistent with the municipality’s vision, that they are not in conflict with any legal regulations and that there are sufficient funds available. Each of the proposed activities must be broken down into manageable tasks. Things to include:

- What will be done
- Who will do it
- What resources are needed (time, money, expertise)
- When they will be done
- How will progress be monitored
- How will success be measured

### The Final Document

The strategic plan must be presented to the MC/MA for adoption and shared with the public. Below are some suggestions for the format of the plan, keeping in mind that this is a living document, which must be updated and adapted in line with changes in the environment. Below is a suggested format for the final document:

- An introduction (including the purpose, process and participants)

- A summary assessment of the current situation (with maps and schematics to illustrate key points where relevant)
- A summary of the SWOT Analysis
- Vision statement
- Strategic directions: goals and activities
- Priorities
- The monitoring and evaluation plans

### **Implementing and Evaluating the Plan**

Once the plan has been developed and resources have been allocated through the budget plan or an adopted Capital Investment/Improvement Plan, (see chapter 12), the municipality and local counterparts are responsible for implementing the plan. The following steps are recommended as a means of ensuring that the plan is implemented:

- Activities should be set in order of priority with both short- and long-term time lines
- The plan, or highlights of the plan, should be shared with those involved to gain support and help with implementation
- The municipal vision statement can be used as a marketing tool for the municipality
- Determine who will monitor the municipality's progress in meeting the strategic plan
- Review the plan's progress with in the municipal administration regularly
- Have a 6 month review with the Committee or other relevant committees and evaluate progress, sharing results with the MC/MA
- If changes are required, make adjustments at the same time as above and present to the MC/MA
- Continue to implement, review and evaluate the plan on an on-going basis

### **Final Note**

It is important to reiterate that, once the final strategic plan has been adopted by the MC/MA, it is not fixed like a law. Municipalities and the conditions in which they work are constantly changing. The strategic plan must be reviewed regularly by the Committee and changes made accordingly, using the same process described above.

## Capital Investment/Improvement Planning

This chapter offers guidelines on how to develop and implement a Capital Investment/Improvement Plan (CIP). It is assumed that a CIP, whether part of a larger strategic plan or not, supports the long-term goals of a municipality. Further, the CIP should be reflected in the capital section of the annual budget, broken down by individual project.

After reading this chapter you should understand:

- How to develop a capital investment/improvement plan
- How to implement a capital investment/improvement plan

The municipal executive (Mayor and Heads of Department) needs the same modern management tools as any other organization: strategic planning, financial management, human resource management and quality control. By using the methodology of a Capital Investment/Improvement Plan (CIP) including a Capital Planning Committee or Coordination Team (CPC/CT), citizens' real needs can be identified and the municipality's limited resources used more efficiently.

Both USAID/Sida GAP and OSCE DPARD provide technical services for developing capital investments. Like most things, there is more than one methodology and or definition of how certain activities are done. This chapter provides a broad overview of the key points of CIP and the *Budget and Finance Guide CD* contains all supporting documentation for each organization's methodology. It is hoped that each municipality will take what is most useful for them, in developing the right plan, to meet the needs of the community.

Competition between investment prospects in a municipality will never disappear, because there will never be enough funds for all municipal needs. Municipal management must use available funds in the most efficient way possible. Practice shows that the CIP is an efficient instrument in this respect. Whether through self-financing, loans, donations or "co-financing" between a citizen group and the municipality, a CIP provides the tool for "shopping" a plan to potential funding sources and illustrates to a community what actions the municipality is committed to take, given the funding available.

In planning for capital investments, a local government is centralizing capital investment plans and prioritizing projects to ensure that funds are distributed to the most relevant projects, which should benefit a higher percentage of citizens. Municipalities must then monitor project implementation and periodically update capital project priorities as the needs of the municipality change.

### Who Participates in Capital Planning?

Ideally, all community stakeholders, at some level, should participate in defining how the municipality spends the public's money. Local governments should be accurately identifying citizens' priorities; providing information on the financial health of the municipality and establishing a more trusting relationship between government and citizens.

### **The Mechanism: Capital Planning Committee/ Coordination Team**

The purpose of a Capital Planning Capital Committee/Coordination Team (CPC/CT)<sup>10</sup> is to bring all the contributors (Municipal Councilors, Mayor or delegated authority, representative from Finance Department, budget users and citizens) together. The CPC/CT prepares the CIP and presents their recommendations to the Mayor for approval.

The CPC/CT will get the best results if they work according to a Rulebook adopted by the Mayor or the team itself and by using simple and standardized project selection criteria. Because there are often conflicting views within the team, establishing a clear and consistent working methodology will help members overcome potential obstacles.

Below, find a detailed breakdown of each group involved in the process (Municipal Councilors, Mayor, Finance Department, Budget Users and Citizens).

#### **Mayor**

The Mayor provides overall leadership and vision during tenure in office and is directly accountable to the public. In this capacity, the Mayor provides the framework for the CIP process and makes the proposal for establishing the CPC/CT. The Mayor also reviews the ranking lists and proposals made by the CPC/CT and presents the CIP to the MA/MC for adoption.

#### **Municipal Councilors**

Municipal councilors represent the community and provide oversight of the executive side of government. They adopt the plan support the capital investment policy overall.

#### **Finance Department**

The municipal Finance Department develops and advises the Mayor and MC/MA on fiscal policies, monitors revenues and expenditures, and reports on all financial activities. Staff of the Finance Department support the CPC/CT developing the CIP and are often members of the group.

#### **Budget Users**

Budget Users provide services to the community. They may be involved in the planning and participate to some degree in a capital project and/or be a member of the CPC/CT.

#### **Citizens**

Citizens not only use services, through taxes and fees they actually pay for the municipality. Part of that “ownership” is the right to provide input into what the municipality does with the community’s money.

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<sup>10</sup> OSCE terminology is Capital Planning Committee while USAID/SIDA GAP uses Coordination Team.

## Proposal Form

It is necessary for the development of the CIP to determine the forms for proposals and the subjects of new investment projects.

Having standardized forms for capital projects helps not only the CPC/CT assess but applicants develop projects in a more transparent manner, more informative with a descriptive narrative justification and the costs properly detailed. With explicit instructions and a detailed format, reviewers can more easily analyze the content. Comparisons are simpler because each request provides similar supporting documentation; and because all documentation is collected in one place, tracking and having historical data are easier.

Proposal forms and instructions should be made available in municipal offices, schools, cultural centers etc... Municipalities should also consider a public awareness campaign and publishing information in the local newspaper.

## After Proposals Have been Collected

There are three major phases of activity for a CPC/CT after proposals have been submitted for review:

- Identifying areas for investments
- Establishing financial parameters
- Establishing a capital fund

## Identifying Areas for Investments

If a strategic plan or strategic directions are prepared, the CT/CPC has guidelines that can be integrated into the criteria for prioritizing projects.

Some suggested criteria for prioritizing:

<b>Length of Project</b>	Is it worth the time to undertake this project? By the time it is completed will it still be of value or useful to the community?
<b>Cost of the Project</b>	Given the current financial situation, is it feasible to implement this? If another project costs less and is a little less important, which one should be chosen?
<b>Percentage of Population that would Benefit</b>	If this project is paid from all taxpayers, will this project benefit all taxpayers? If not, will a large number benefit? If not, how can we justify using general tax funds for this project?
<b>Operating Budget Impact</b>	Will this project/service pay for itself or will it need to be subsidized?
<b>Revenue Generating Project</b>	Can we anticipate that this project will eventually pay for itself? If we need to make repairs on this project, how will they be paid for?
<b>Strengthen the Economy</b>	Jobs may increase during construction, but will this project generate jobs after it is completed? Will it help make the community more competitive? In the short-term? In the long-term?
<b>Availability of Funds</b>	Are grant/loan programs available? Is there the opportunity to split costs? Is there a capital fund? Can we share for a service to pay for the capital project?
<b>What other Options</b>	Are there two projects identified that accomplish similar tasks but have different costs? Instead of demolishing and rebuilding what

	about refurbishing and reconstructing?
<b>Commitment to Funding 1 vs. many Projects:</b>	If there is an option to fund just 1 project, such as a sewage system, or numerous projects, such as an emergency clinic (ambulanta) and lighting the main street, which should have higher priority? Once a project is started, the municipality must be committed to seeing it finished.

Applicants should understand that their project requests must help meet the goals of the municipality in terms of priorities and those proposals will be judged of the basis of the criteria established by the CPC/CT.

### Establishing Financial Parameters

It is important that the municipality establish financial parameters not only to improve credit-worthiness, but also to create more stability and sustainability. Municipalities need to start planning long-term. Part of long-term planning is looking at the operating revenues now and what will be expected. A minimum level of current municipal services and the associated costs should be set.

Debt capacity limits should also be set if not already done and any and all debts should be accounted for and included in budget documents. A repayment plan should be established and implemented fully.

### Establishing a Capital Fund

Because current lending is limited for municipalities, donations significantly decreasing and some revenues sources unstable, it is suggested that the MA/MC establish a Capital Fund to set money aside to meet capital investment goals.

### Rating Projects<sup>11</sup>

After establishing criteria for the evaluation of municipal capital investment/improvement projects each category must be given a value or “weight”. There are a variety of models for weighting. Whatever the project’s selection and ranking criteria it should be adopted by the CPC/CT.

The list should not contain more than ten criteria; excess criteria make for a dispersed investment policy. After adoption, the criteria must be published, preferably along with the proposal instructions so applicants know how their requests will be judged and what types of projects will be considered. The criteria should also be sent to the MC/MA Speaker.

### Sector and Additional Criteria

In order to appraise how much a project satisfies the main criteria a rating system should be developed. Functional criteria cannot be used (individually for each group of projects) without taking into account the main criteria. All proposed projects must be appraised

<sup>11</sup> For examples on Rating, Criteria and Scoring please see the *Budget And Finance Guide CD*.

according to the same criteria at the very beginning of the ranking and the investment policy should be followed in selection.

### Scoring

First, the proposals should be divided into sectors (groups) according to previously adopted principles of division (the best way to do this is according to budget classification. If the proposals are classified according to similar criteria (i.e. project for development of roads), it will be much easier to assess different aspects of these projects. Making decisions about how many points are awarded for fulfillment of certain criteria takes less time and usually gives better results. In developing scoring guidelines, it is important to consider the Finance Department's involvement.

No one knows or understands the financial situation in a municipality better than the Finance Department. The Finance Department sees the bank account balance; knows which budget users over spend their budgets; sees unanticipated expenditures; and has historical revenue trends.

When a budget user, department or citizen(s) group submits a request for capital investment project, the Finance Department should perform an administrative review and verify that all supporting documents are there. If the package is incomplete, it should be returned to the department (or other applicant) to rectify or clarify any errors or omissions. If the packages are complete, the Finance Department should prepare the following for the CPC/CT:

- A summary spreadsheet of all capital project requests
- Copies of the individual project requests
- Historical and current financial reports/multiyear financial plan
- Recommendations for funding capital projects

This will facilitate immediate evaluation of all capital project requests and provides financial information to assist in the decision making process.

After the CPC/CT has received all the documents from the Finance Department, the CPC/CT members must apply the rating system. The rating system, to review, provides defined criteria to rate individual capital project. Thus, **each project must be rated on the same scale and each project should be scored uniquely**. Because the criteria are set, the justification and rationalization for determination is much easier, more transparent and projects are more easily prioritized.

The last activity in this phase is to make a list of investment projects, divided into sectors, based on the results of point awarding. The CPC/CT sorts the information by total score in order to develop the Preliminary Priority List.

It is important to mention that following factors outside the evaluation criteria should be considered in the prioritization process:

- Outside factors (the investment is mandatory, urgent, desirable, acceptable or deferrable)
- Municipalities ability to pay (various financing policies and funding options)

When a complete prioritization list is finished, the CPC/CT presents it to the MC/MA with an analysis of the ability to pay and funding scenarios.



## **Public Awareness**

A public awareness campaign is an important tool for the municipality in the process of developing, accepting, implementing, and improving a CIP. Coordinated by the CPC/CT, the campaign's goal should be to is an increase level of understanding of the community and participants in the CIP process.

The more citizens are reached and understand that the municipality is encouraging and welcoming of citizens input, the citizens' level of trust in municipal authorities will increase. A public awareness campaign, if done correctly, will also show citizens the long-term prospects for municipal development. Creation long-term vision and discussion about it will create a better atmosphere in relations between citizens and local governments. This vision creates the basis for a successful and attractive marketing strategy for the municipality, and the strategy itself improves the chances of finding additional funding sources for the Plan.

## **Review and Adoption**

Given the above, the MC/MA must review the financial policies provided by the CPC/CT to determine which policies can be implemented immediately, next year or never and then formally adopt that policy or a non- CPC/CT related policy.

Based on the input from the public hearing/awareness campaign, local communities might contribute to specific projects. Once the CIP Priorities have been adopted, the MC/MA should prepare a summary of all the information in a Capital Project Document.

## **Capital Investment/Improvement Plan Update**

The CIP determines the investment process in the municipality from a long-term perspective based on the development and finances of the municipality. Long-term investment and financial plans are rational under one condition: if there is a regular yearly update. The update has to be made by municipal decision since it is related to allocation of funds. Therefore, the mayor, in cooperation with CPC/CT recommends to the MC/MA the procedure for CIP updates.

A yearly update of the CIP enables modification of development concepts, efficiency in realization of projects, efficiency in spending, and the analysis of the relation between investment projects and its aims.

## **Techniques to Facilitate Capital Investments**

The CIP process needs to be supported by long-term planning see Chapter 11 on Strategic Planning for more information. This will contribute to improved creditworthiness as investments will follow long-term objectives and the financial capacity becomes more transparent.

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On the *Budget and Finance Guide CD* for this Chapter, you will find:

Capital Improvement Planning in Municipalities by GAP

Capital Planning Committees by OSCE DPARD

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## Public Procurement for Municipalities

Although public procurement isn't a budgetary process *per se*, proper procurement of goods and services, with the goal of the "best value for money" can have a significant impact on budget execution. Cost savings made in procurement can make funds available for other municipal priorities. There are also costs associated with proper procurement, which must be included in the budget plan for the next year.

Public procurement refers to procurement of goods, services and works which are conducted by 'contracting authorities'<sup>12</sup> in accordance with the Rules established by the Law on Public Procurement and its associated by-laws. These legal regulations provide detailed instructions, which municipalities must respect during the public procurement process. Fully implementing this law will pose significant challenges to municipalities.

A municipality as a unit of local self-government is responsible for transparent and efficient administration of public funds. It is essential that all public institutions establish mechanisms for transparent spending, reducing costs and serving citizens' needs. European Union initiated legislation on procurement including the *Law on Public Procurement (BiH OG 49/04)* and the *associated Instruction on Application of Law on Public Procurement (BiH OG 03/05)*<sup>13</sup> provides precise and transparent rules to support more accountable spending of public funds.

The purpose of this chapter is to discuss the legal regulations of the Law on Public Procurement when implemented at the municipal level. The focus is on the impact of the law on municipal administrations, although the law itself addresses all levels of government and public companies.

After reading this chapter you should understand:

- The overall framework for public procurement
- Key internal organizational structure for efficient procurement at the municipal level
- Key elements of the procurement process

The Procurement Law, together with associated regulations and instructions, at first glance looks complicated, but with guidance and use it will provide a transparent and effective way of spending public funds. The regulations related to public procurement will also have an impact on other activities in public administration, in terms of promoting better and longer term planning and increasing the cooperation between municipal departments through coordination of tasks that have to be completed before a procurement process can be initiated.

### Organizing for Implementation

All municipalities in BiH must develop or amend their existing decisions and rulebooks to include the basic principles of public procurement. The basic principles include:

- Ensuring procurement efficiency

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<sup>12</sup> The Law defines the term 'contracting authority' as the authority obliged to implement the legal regulations. For more details on contracting authorities, please see OG BiH 2 November 2004 49/04 Article 3.

<sup>13</sup> For more information on the law, a more detailed guide and new developments in public procurement, please see [www.javnenabavke.ba](http://www.javnenabavke.ba)

- Transparency of procurement procedures
- Impartiality toward bidders
- Equal relations to all parties
- Competitiveness

The Mayor must establish a *Procurement Commission*. This Commission should consist of municipal employees who would work on the Commission as part of their regular duties. It is essential that the Commission remains neutral and objective. Selection of members should take into consideration all relevant activities which must be done by the Commission.

The Mayor is ultimately responsible for the public procurement process and ensuring that contracts awarded to the chosen supplier, on the basis of a transparent procurement process, are followed correctly. In fact, the Procurement Commission Chairman and Secretary serve as agents of the Mayor in realizing particular budget items through the process of public procurement. This means the Mayor is ultimately responsible for errors, mistakes or poor work, which might result from Commission activity. Thus, the Mayor must ensure all necessary procedures have been established and that the guidelines for efficient and responsible participation in the public procurement process are provided to all relevant municipal staff.

A contract is the final document that confirms the result of a public procurement. A contract can only be issued by an authorized person in the municipality. Execution of the contract should be coordinated within the municipal administration and all contracts should be kept in one location.

### **Public Procurement Commission**

In order to conduct any public procurement procedure the contracting authority, represented by the Mayor as stated above, appoints a Public Procurement Commission. Based on the Instructions for Application of the *Law (BiH OG 03/05)* that regulate the competencies, tasks and affairs of the Commission, the contracting authority defines and assigns tasks and competencies to the Commission in written form. The Commission cannot act outside of defined tasks and assigned competencies.

The Commission has **at least three members**, and at least five in the case of an international tender. The number of members with the right to vote is always an odd number. The Chairman of the Commission, who directs the Commission's work, ensuring compliance with provisions of the law and instructions, the Commission Secretary and members are appointed by the Mayor.

The Commission Secretary, who does not have the right to vote, performs administrative tasks including preparing minutes and reports and other tasks requested by the Chairman of the Commission. The Commission Secretary must coordinate all activities between the municipality (as the contracting authority) and bidders and coordinate within the administration between departments and Commission. All activities related to the public procurement process must follow legal regulations.

When appointing the members of the Commission, the Mayor must make sure that the selected members know the regulations on public procurement well and that at least one panel member has special qualifications in the area of public procurement. If the subject of procurement requires specific technical or other specialized knowledge, a person outside of the contracting authority can join the work of the Commission, bearing in mind that such a

person does not have the right to vote when decisions are made and is employed on a temporary service contract. In that case the chairman will, in written form, address the Mayor (through the Commission Secretary) with a request to provide an expert who will be able to address the specialized nature of a requested procurement. The Mayor can also appoint permanent external professionals who can participate in procurements that may be repetitive in nature, such as an engineer or architect for water projects, the installation of street lighting, or road construction.

External professionals must register with the municipality through a public advertisement procedure carried out by the municipality i.e. the Commission Secretary. The Mayor as a representative of the contracting authority then approves a list of appropriately qualified experts available to the Commission in areas where a specialist is needed for specific procurement.

The legal instructions specifically describe when a person cannot be appointed to the Commission, examples include, but are not limited to persons prosecuted for corruption, money laundering and persons involved in abuse of position or giving wrong information on documents related to public procurement.

All Commission activities must be documented through meeting minutes, recommendations and reports that are presented to the Mayor on a regular basis by the Chairman of the Commission.

### **Framework for Commission Action**

Before the Commission can take action, the municipality must issue procedures defining a specific procurement. In accordance with the budget plan, or other municipal documents, a Head of Department requests the Mayor to start the process of public procurement. Heads of Departments must ensure that the documentation provides basic data regarding goods, works or services, which will be procured. This requires Heads of Department to prepare projects or plans that provide accurate information regarding value of the object of procurement, service or work and the length of contract, in accordance with their department's regular activities.

### **Why Value is Important**

The value of the object being procured determines how the Commission or Mayor (on the basis of a Commission proposal) arranges the public procurement procedure. There are a variety of public procurement procedures to consider and they are briefly examined below.

There are two basic value ranks for public procurement:

1. Local value rank, with two sub-ranks:
  - Value of the contract equal or higher than 30.000,00 KM for goods and services, or 60.000,00 KM for works
  - Value of contract lower than 30.000,00 KM for goods and services, or 60.000,00 KM for works
2. International value ranks when the value of a contract for goods and services is equal to or higher than 500.000,00 KM for state bodies or 700.000,00 KM for local bodies or public subjects, or when the value of works is equal to or higher than 2.000.000,00 KM.

The Public Procurement Agency can by Law, start an initiative for changes and amendments to local value ranks, in reasonable instances, especially when there is a:

- Significant change in the inflation rate
- Significant changes in the economic conditions in BiH
- Changes in the European Union Law on Public Procurement

Initiatives for changes and amendments to value ranks must be submitted to the Council of Ministers of Bosnia and Herzegovina.

### **Determining the Value of a Contract**

The estimated value of a contract on goods, services, or works should contain the total amount of payments to be made by the contracting authority. For determination of contract value an estimation of price is made after the public procurement has been announced (if announcement is necessary), or when the contracting authority initiates the procedure (if announcement is not necessary).

If goods, services or works have been divided into several lots, each lot being the subject of a separate agreement, the overall estimated value of all such lots is used for determination of value rank for each contract.

Contracts for leasing, rent or hire, purchase of goods, or proposed contracts of services, which do not mention the total value to be the contract calculation base, value is determined accordingly:

- Total contract value, including estimated value at local market, in case of closing a fixed-term contract
- Monthly value multiplied by forty eight (48), for a contract on an indefinite period or when the duration of contracting period cannot be determined

Accepting alternative offers (offers providing different specifications to the subject of the contract compared to those specified in the tender documentation based on the "can also" principle) can be made only if minimum criteria of the contract subject has been met and only in the case when the criterion for contract awarding is economically the most favorable offer and certainly not the lowest price. The base for determining the estimated value of a contract is the highest possible overall amount of purchase, leasing, rent or hire, including all the collectible amounts due for implementation of the alternative offer clause.

For insurance services, the collectible premium could be used for value estimation, in banking services the cost of interest, commissions, and other types of compensations, and for the development of project design the amount of expenses or remuneration.

### **Procurement Procedures**

Before beginning a public procurement procedure, the Commission must meet to discuss all relevant data and documents already prepared by the municipal administration to announce a public procurement notice. The Commission must prepare all necessary data which will be published and then prepare a report about the session with concrete conclusions which should be delivered to Mayor and Head of Finance for approval. The Head of Department must have authorization to pay for the public procurement notice through *Sluzbeni List* and press or other media (press and other media are not mandatory). The Commission Secretary should

coordinate all activities between the Commission and Mayor, and between the Commission and Heads of Departments.

The Commission must take into consideration all conditions and needs which could be important for the public procurement process. The Commission has to decide what it is going to do and explain all relevant factors, which influenced its chosen activities. The Commission must have a professional approach in communication with potential suppliers and bidders and must be confidential in exchanging information.

### **Contents of a Public Procurement Notice**

The contracting authority publishes all public procurement notices, contract award notices and cancellation notices in the *Sluzbeni List*. Notices can be published in other publications or on web pages, but not before the date of their publication in the *Sluzbeni List* and the contents in all publications must be exactly the same. Depending on the type of procedure, the number of days a notice must be published changes. Legally speaking the minimum information in public procurement notice must contain 12 items; however, the following bear particular significance:

- The venue for submitting tender documentation
- Type of contracting procedure
- Alternative tender (yes or no)
- Criteria for tender valorization (the lowest or the economically most favorable tender)
- Amount of fee to be charged for takeover of the tender documentation

### **Tender Documentation**

In the tender documentation, the contracting authority must disclose complete information on the terms of the contract and contracting procedures sufficient for bidders to prepare their offers on truly competitive terms. Tender documentation must contain at least the following information:

- Information on the contracting authority, including: name, address and telephone and/or fax number and/or the contact persons' e-mail addresses
- Deadline for delivery of goods and services, and end of works or duration of contract
- Minimum requirements that alternative bids must meet, if alternative bids are acceptable
- Criteria for selection of bidders
- Sub-criteria for valorization of the economically most favorable offer
- Terms of contract provided to bidders by the contracting authority
- Time and place of opening the tenders
- Information on prices in the tender, and the exchange rate if bids have been submitted in foreign currency
- Information related to the method and the manner of calculating the price, so that the price includes all necessary taxes

- Information on bank guarantees or other instruments of insurance in accordance with giving a guarantee for the bid or for execution of the job
- Closing a sub-contract (when sub-contracting is allowed)
- Requirements in terms of language

### **Technical Specifications for Tenders**

Good quality technical specifications must be prepared because the quality of procurement depends on accurate technical specifications. Although municipalities should rely on their own resources, if there is no municipal employee with the required expertise to draft technical specifications for the object of procurement, it is better to engage an external expert to help develop the technical draft.

Some of the key features of technical specifications include:

- Must be clear and detailed
- Should refer to BiH standards, internationally accepted standards, technical regulations and norms or other standards which are substantially equivalent to the specified references
- Must be non-discriminatory with respect to suppliers and ensure fair and active competition
- Should not specify a make or source, or a particular process, trademarks, patents, or a specific origin or production with the effect of favoring or eliminating certain suppliers
- Only in the case that the municipality is unable to give a description of the subject matter of the contract which is sufficiently precise and fully intelligible by using objective technical specifications, the contracting authority must specify that it will accept products, services or methods that are equivalent in terms of their properties by adding the words “or equivalent”

### **Exchange of Information**

Exchange of information between the contracting authority and the bidder is done in written form and should provide protection of integrity as well as protection of confidentiality (if confidentiality of certain information is included in the offer or request for participation in procurement). The legal instruction explicitly details communication when electronic means are used for exchange of information. The contracting authority has the right to choose the medium for exchange of information, making sure that the selected medium is available to all parties interested in procurement procedures and does not limit access of bidders in any phase of the procurement process.

### **Types of Procedures for Contracting**

Contracts on public procurement of goods, services or works can be made by one of the following procedures:

- Open procedure

- Limited/restricted procedure with preliminary qualification
- Negotiated procedure with public procurement notice
- Negotiated procedure without public procurement notice
- Design contests

### **Open Procedure**

Open procedure is a procedure in which any interested supplier can submit a tender. The contracting authority is obligated to prepare tender documentation; publish a public procurement notice inviting all interested suppliers to request tender documentation, and prepare and submit tenders that meet the requirements of the tender documentation; provide suppliers with tender documentation; organize and conduct a public opening of timely received tenders; verify bidders' qualification by selection criteria laid down in the tender documentation; grade the tenders submitted by the qualified bidders based on contracting criteria laid down in the tender documentation and award the contract to the bidder who delivered an acceptable tender with the lowest grade; inform the bidders on the decisions made about tenders' grading; and offer the contract to the most successful bidder.

The contracting authority concludes a contract based on an **open procedure**, except where there are large and complex procurements, which require a preliminary qualification procedure, and then a limited/restricted procedure can be used.

### **Limited/Restricted Procedure**

Limited/Restricted Procedure is a procedure in which any supplier wishing to become a candidate can request participation and where only the qualified candidates invited by the contracting authority can submit their tenders. For conducting a limited procedure, the contracting authority is obligated to prepare tender documentation (tender documentation can be prepared in two parts, corresponding to the preliminary qualification and tender phase of the procedure); publish a procurement notice inviting all interested candidates to request documentation for preliminary qualification (if the latter is provided separate from the procurement notice) and to submit a request for preliminary qualification enclosing necessary information and documents; give candidates documentation for preliminary qualification (if the latter is provided separate from the procurement notice); make a selection of candidates to be invited to submit their tenders; inform candidates on the decision made with regard to preliminary qualification (informing selected candidates can be done at the same time as inviting them to submit tenders); give tender documentation to all selected candidates at the same time inviting them to prepare and submit a tender that meets the requirements laid down in the tender documentation; organize and conduct a public opening of timely received tenders; grade and compare open tenders by the contracting criteria laid down in the tender documentation and award a contract to the bidder who submitted an acceptable offer with the lowest evaluated compliant tender; inform the bidders on the decision made in regard to grading of tenders; offer the contract to the most successful bidder.

Contracts for consultation services shall be made on the basis of limited/restricted procedure.

### **Framework Agreements**

The contracting authority can make a framework agreement only after open or limited/restricted procedures have been conducted in accordance with provisions of the law.



Based on the framework agreement, the contracting authority will consequently have the right to conclude contracts during the entire contracting period with the successful bidder without implementing the procedures prescribed by this law for each contract awarded by the framework agreement. The contracting authority can consider the awarding of a framework agreement only when there is one or more of the following circumstances:

- Subject of contract are everyday services or consumables, not classified as permanent assets
- Subject to contract are goods or services whose prices and conditions of delivery are frequently changed
- Subject to contract are constant repairs or maintenance works
- When the contracting authority has to award several identical contracts within a period of one year and the framework agreement would enable reduction of acquisition costs

Once the contract has been made it is not possible to change its provisions. The contracting authorities are not allowed to use the framework agreement contrary to regulations or in a way preventing, limiting or endangering competitiveness.

### **Negotiated Procedure With or Without Procurement Notice**

Applying a negotiated procedure with a public procurement notice can only be applied in exceptional and extreme cases and must meet the following criteria:

As a follow on to a pre-qualification procedure, according to the restricted procedure guidelines, a minimum of 3 qualified candidates are invited to submit tenders and participate in negotiations on a contract. Based on the results of the negotiations, the contracting authority invites participants to submit their final tender and selects a successful bidder from among them.

When applying negotiated procedure without public procurement notice:

In the event that more than one candidate is invited to negotiations, the contracting authority must verify if the candidates' qualifications are in accordance with the criteria stated in the invitation, negotiate on the technical, economic, legal and other aspects of the contract and, based on the results of the negotiations, invite participants to submit their final tenders and select a successful bidder among them. In the event that only one candidate has been invited to negotiations, verify if the candidate's qualifications are in accordance with the criteria stated in the invitation, and negotiate on the technical, economic, legal and other aspects of the contract in order to reach most economically favorable tender.

In the course of the negotiation procedure, the contracting authority adheres to the following requirements:

- Negotiations are conducted with each candidate separately
- No information received from the candidates and information on solutions proposed by the candidates must be revealed to third parties without the candidate's previous consent
- All candidates / bidders will face the same requirements and will be given the same information

- Equal treatment of all candidates / bidders must be ensured
- Minutes and reports on the negotiation procedure are made in accordance with the law

### **Design Contests**

Design contests enable the contracting authority to acquire a plan or design proposed by a selection board, after a competitive tender has been issued. This procedure is usually conducted in areas such as urban design, urban development, architecture, civil engineering or data processing. The same transparency principles apply as in other public procurement procedures. Evaluation criteria are set out in the tender documents and a jury or selection board is appointed that has no connection to any of the participants in the contest. All projects are presented to the board anonymously. The selection board then records its proposals, based on the merits of each project and each board member signs the record. Candidates remain anonymous until a decision is made public. The contract awarded includes the total amount of prizes and payments; and an award notice is published as in the case of other procedures.

### **Direct Agreement**

Direct agreement is a procedure in which the contracting authority collects a cost proposal or tender from an individual supplier, service provider or contractor, and negotiates or accepts the costs as a condition of final agreement. This procedure should be described in an internal rulebook of the contracting authority, which defines it in compliance with the model prepared by the Public Procurement Agency.

### **Types of Contracting Procedures below the Local Value Ranks**

Contracts for the procurement of goods, services or works which value is estimated by the contracting authority lower than local value rank can be awarded only in one of the following procedures:

- Through one of the procurement procedures stated in the Law, (open procedure, limited/restricted procedure, etc.)
- Through a competitive request procedure (for submitting a tender in accordance with the provisions)

A contract for procurement of goods, services or works with a value estimated by the contracting authority of equal to or less than 3.000,00 KM can be awarded by direct agreement. The contracting authority is obligated to ensure that the overall annual worth of such purchase does not exceed 10% of its total annual procurement budget.

The contracting authority prepares and submits a report to the Public Procurement Agency on every contract awarded in accordance with provisions of the Law and Instructions (and as highlighted in this chapter) in the reporting format established by the Public Procurement Agency.

### **Competitive Requests**

A competitive request for tender is a procedure in which the contracting authority, for the purpose of awarding a specific contract, makes a request for submission of tenders for supply of goods, services or works, to a certain number of suppliers, service providers or contractors, the number not being less than three. The contracting authority can publish the appropriate notification in the *Sluzbeni List*. A request for tenders must include adequate and sufficient information based on which suppliers can prepare their tenders on a truly competitive basis. Requests must contain a precise deadline and the venue for submitting tenders. The contract award is exclusively based on the lowest price. Each supplier, service provider or contractor can offer only one price, which cannot be altered after submitting the tender. The offered price is not a subject for negotiations. The contracting authority evaluates the received tenders after the deadline based on the given criteria. If at least three adequate tenders have been submitted the contracting authority awards the contract to the one supplier, service provider or contractor who best meets the criteria mentioned in the request for submitting tenders.

In the event that less than three adequate tenders are collected, the contracting authority annuls the procedure and initiates a new procedure. However, if the contracting authority has decided on publishing the notification, then the repeated procedure is not requested if less than three adequate tenders have been received, and the contracting authority can directly award a contract. The Public Procurement Agency will provide a standard form and/or standard documents used in the procedure for competitive request for submitting tenders.

### **Tender Opening Procedure**

Tenders are opened at a public meeting immediately after the deadline for submission as detailed in the tender documentation. Envelopes are opened by the Chairman of the Commission in front of those in attendance. Tenders submitted after the deadline will not be opened and will be immediately returned to the bidder. Results of the public tender opening are entered into meeting minutes, which are delivered to all bidders within three days at the latest.

For every accepted tender the contracting authority is obligated to inform all bidders of the:

- Name of bidder
- Total price of the tender
- Each discount stated at the tender (if discount is not included it will be disregarded at the evaluation of the tender)

### **Examination, Evaluation and Comparison of Tenders**

In accordance with the minimum required qualifications that candidates and bidders must meet, detailed in the tender documentation, the contracting authority evaluates and examines if the candidate or bidder is competent, reliable, and able to realize the contract. The contracting authority establishes the minimum requirements for a candidate or bidder regarding their personal status, their qualifications and capability for professional work, their economic and financial situation and their technical and/or professional abilities. The contracting authority requests candidates and bidders who have tender documentation, to deliver information and documents proving that their qualifications match those required by the contracting authority.

A tender is considered only if it meets the required conditions set forth in the tender notification and documentation. However, there are some exceptions and the contracting authority can decide that the tender has met the required conditions if:

- It contains mistakes which can be corrected without changing the important requirements
- It contains minor deviations that do not significantly distance it from the requirements of the tender documentation

It is important to point out conversations, notifications and negotiations between the contracting party and the bidder, relating to the tender, are **not allowed**, except for necessary clarifications.

### **Once the Commission Makes a Decision**

The primary documents, generated by the Commission and presented to the contracting authority are the recommendation and the report, taking into account that the final decision on contract awarding is made by the contracting authority. The Mayor as the representative of the contracting authority can accept or reject the Commission's recommendation. In the case of rejection the contracting authority is obliged to give a written explanation of the reasons for rejecting the recommendation report.

### **The Contract Award Notice**

The Contract Awarding Notice must contain a minimum of 11 items, of which the following bear particular significance:

- Type of contracting procedure
- Criteria for tender assessment
- Number of received tenders
- Name and address of contracted bidder
- The price of the selected tender
- Sub-contracting possibility

### **Ensuring Tender and Contract Realization**

The Law prescribes that the contracting authority can work to ensure a **bidder's business credibility and true interest in bidding through a guarantee** bearing in mind that the amount of such a guarantee cannot exceed 2% of the offered price. In addition, a guarantee for contract can be requested, which cannot be higher than 10% of the contract value. The amount of the mentioned guarantees, just as in the case of a competition for project design, cannot be less than 2,000 KM.

A guarantee is kept by the contracting authority in the following cases:

- When the bidder withdraws the tender after the deadline for submission has expired but before the tender validity deadline stipulated in the tender documentation
- When the bidder is awarded a contract but refuses to sign it or does not fulfill one of the conditions stated in the tender documentation necessary to be fulfilled before contract signing.

All the guarantee-related points are laid out in the tender documentation (amount of guarantee, validity period, deadline for submitting the guarantee, statement on conditions for

retaining a guarantee). Conditions under which the contract authority can keep a guarantee are described thoroughly in the Law.

Another kind of guarantee is a **guarantee for good realization of works** (if it is stipulated in the tender documentation). The amount of this guarantee can be a maximum of 10% of the contract worth, and it should be sufficient for indemnity and expenses. This form of guarantee is also returned to the bidder if the situation does not warrant retaining the guarantee, or if the contracted conditions have been fulfilled. This form of guarantee is laid out in the *Instruction on Checks, Bonds, Clean Bank Guarantees or Letters of Credit*.

### **Special Privileges for Local Bidders**

The Law, in principle, provides for the possibility of special privileges for local bidders, clarified in the Instruction. There is a regulation, which stipulates that in the transition period (by the end of year 2010) the contracting authority can give preference to local bidders in the sense of giving them a lower price in the comparison of tenders, as follows:

- in 2005 and 2006 for 15%
- in 2007 and 2008 for 10%
- in 2009 and 2010 for 5%

In order to use this privilege for goods, the participation of the local component should be at least 50%, and for services and works, the participation of local manpower should also be at least 50%. Any use of local preference must be noted in the tender documentation. In the event of tenders for services and works not coming from Bosnia and Herzegovina, the prices of tenders are decreased by 5% if at least 50% of manpower used for contract realization has BiH origins.

### **Maintaining Municipal Records**

Concluded procurement contracts, requests, tenders, tender documents and documents related to the evaluation of requests and tenders must be preserved. All documents should be kept in one place and a single person, such as the Commission Secretary, should be made responsible for the archive. Relevant archiving laws must also be taken into consideration.

### **Suppliers Filing Appeals, and the Public Review Body**

Suppliers who feel that there has been a breach or violation of the law in the process of a specific public procurement procedure can file an appeal with the procuring body, in this case the Municipal Procurement Commission, within 5 days from the day he/she became or should have become aware of the breach, and no later than one year from the alleged occurrence of the breach.

Upon receiving the objection, the municipality will suspend the procurement procedure until the objection has been fully examined. The municipality has a 5-day deadline, from the date of receipt, to examine the appeal and issue a decision with explanation. If the municipality rejects the appeal or fails to examine it within the prescribed time limit, the complainant may file a written appeal with the Procurement Review Body (PRB) within 5 days from the receipt of the first instance decision, or after the 5-day deadline has expired without the municipality

examining the objection. A copy of the Appeal is simultaneously delivered to the municipality.

The PRB can cancel a contested illegal decision of a contracting authority partly or completely and instruct them to correct the infringement. The PRB can also terminate the public procurement and award damages to the supplier harmed by the infringement in the form of fines amounting to 4,000 KM. Further, if fraud or corruption has been found the PRB can notify the Supreme Auditor and/or the Public Prosecutor. The PRB decision can be appealed to a relevant court in BiH within 45 days from the day the decision is dispatched to the complainant.

At the time of publication, the PRB is not completely operational; the Ministry of Finance and Treasury BiH and the Ministries of Finance for both FBiH and RS have competency in this area until the PRB is up and running fully.

### **The Public Procurement Agency**

The Public Procurement Agency (PPA) is an independent administrative body responsible for implementing the Public Procurement Law and reports to the Council of Ministers of BiH. The Agency is responsible for proposing amendments to the Public Procurement Law, and supporting regulations; developing manuals and guidelines for implementation; providing technical assistance to contracting authorities and potential bidders; and monitoring overall implementation of the law, among other activities. At the time of publication, the PPA is not fully functional and functions are carried out by the Ministry of Finance and Treasury of BiH.

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On the *Budget and Finance Guide CD* for this Chapter, you will find:

Allocation of Contracts

Appointment of the Public Procurement Commission

Cancellation of a Public Procurement

List of Forms for Application of Public Procurement

Minutes of Opening Offers

Selection Procedure for the Most Favorable Tenderer

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## Human Resource Management

Municipal administrative costs in BiH are often 60-80% of municipalities' expenditures. Salaries and compensations are 90% of those administrative costs and are therefore a significant part of a municipality's budget. This illustrates the importance of efficient and effective human resource management to hire and retain skilled staff to implement the activities outlined in a municipal budget, to assist the administration in cutting costs, maintain internal control, and continue to improve and increase services. Management of human resources and investment in a skilled work force is essential to make municipalities more economic, effective and efficient.

This chapter provides an overview of the key concepts of human resource management (HRM) and the impact of HRM on planning and executing municipal budgets.

After reading this chapter you should understand:

- What Human Resource Management is
- Why is HRM Important in the Budgeting Process

The traditional management approach focuses only on specific direction and control of employees. The modern approach is centered on the creation of an environment where an employee is motivated and constantly encouraged to perform at the peak of his/her capabilities, accepting personal responsibility for the work he or she has or has not done.

HRM is the process in an organization that guides decisions, strategies, principles and practices related to the management of people. It is focused on productive use of staff, in order to achieve organizational goals while working positively with employees, to keep performance and satisfaction high. This is important because organizational performance depends upon individual performance. Therefore, HRM deals with coordination and direction of every individual's performance towards the realization of established organizational objectives and to shaping an appropriate organizational culture, introducing programs, which reflect and support a municipality's core values.

### HRM in Public Administration in BiH

Generally, HRM capacity in public administrations is limited. Modern approaches to managing staff, setting municipal objectives through strategic planning, and having a depoliticized civil service are just beginning to be implemented. At the same time, there are common aspirations towards EU accession and thus towards EU practices and standards that require public administrations to make changes, introduce improvements and further develop municipal management practices.

Some progress has been made through the enactment of civil service legislation and the establishment of Civil Service Agencies. Unfortunately, the laws are not harmonized. The FBiH Civil Service legislation is applicable at municipal level while, in the RS, administration of municipalities falls under Ministry of Administration and Local Self-governance. None of the employees working in RS municipalities has civil service status, while in FBiH only specific professional positions are considered civil servants.

HRM in public administration is driven by the law and supporting regulations. The approach to HRM is almost entirely one of satisfying the legal minimum. However, proper staff

management, employee motivation, and changes in the staff's attitude, to reflect a municipality's role as a service provider and the guardian of public funds and assets cannot be fully governed by legislation. Municipal managers must develop policies and procedures to address issues of work efficiency, job design, job specification, training and development of staff, compensation and professional conduct.

### **Modern Human Resources Management, in Detail**

There are six major components in modern HRM outlined in greater detail below:

- Human Resource Planning
- Staffing
- Performance Management
- Compensation
- Human Resource Development
- Professional Ethics

### **HRM Planning**

Planning is the process of anticipating and meeting future staffing needs. To make good planning decisions a manager needs easy access to reliable and up-to-date data on people, positions and the organization. The ultimate aim of the process of HRM planning is to ensure that the institution has, at any moment, the right number of people with the right skills, experience and competencies in the right jobs and at the right cost.

Effective HRM planning is essential. Without it, money is wasted on unnecessary recruitment and inappropriate training; the best employees may feel unsatisfied with their career and the organization, and leave. Key positions may remain open for longer than necessary, or are filled with under-qualified or inappropriate staff. This may have a significant negative impact on the ability of a municipality to provide services.

In general, HRM planning in municipal administrations is weak. Personnel plans, where they exist, are usually buried within larger departmental plans. This is a problem if municipalities are confronted with the need to reduce staff, open a new department or meet the requirements of a newly delegated competency.

**To be realistic and effective, planning must consider available financial resources.** Good planning should enable municipal management to deal with staff turnover as a result of retirement, redundancy, resignations or terminations. It is also essential when municipal tasks and needs change, such as an increase or decrease in workload, changes in legal competencies, etc.

Municipal staffing levels and types of staff are outlined in the Rulebook on Internal Organization on Systematization<sup>14</sup>. The Rulebook should represent the actual number of posts that are occupied or need to be filled through internal and/or external vacancy notices. Only those people whose posts are systemized should be on the payroll, unless they are contracted for special services, which have been properly tendered or advertised. The document should also clearly state the job requirements and the job description for each individual position. The Rulebook must prescribe internal coordination and reporting mechanisms as well as a planning requirement for the administration by department. Further, a post table, based on the systemization, should be included with the budget plan.

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<sup>14</sup> The Rulebook on Internal Organization and Systemization is a living document, it is expected that it will be changed as the needs of the municipality change.



## Staffing

The staffing process consists of two main parts: recruitment and selection. Recruitment refers to efforts aimed at providing a sufficiently large group of qualified candidates for a vacant post. Selection is the process by which an organization chooses from a list of qualified candidates, the person who best meets the selection criteria for the position available. **One of the key elements of recruitment and selection is that it focuses solely on merit as the basis of selection** rather than the influence of politics or nepotism.

Much needs to be done especially in the area of **recruitment**, to increase the pool of qualified candidates as well as their ethnic diversity (in line with 1991 census)<sup>15</sup>, to reduce the cost and to speed up the process.

As for **selection**, vacancies should be job-driven rather than being tailored to the qualifications of a specific candidate. Assessment of candidates should be based on prepared questions relevant to the job and work attitude. References must be checked and the interview panel composed of appropriate members (direct supervisor, qualified HR professional, etc).

Initiating the staffing process begins with a written request, providing a clear specification of the type and number of staff required and a clear indication of when they are needed by the department requesting the position filled. This request should only be forwarded in order to fill the vacated/new slot when the post in question cannot be merged with another position, cost-effectiveness being a principal consideration in staffing of municipal administrations.

Typically, the request form should contain a detailed job description with required qualifications, experience and the reason for recruitment. If the post is new, funds should be included in the budget, or funds made available from a position that has closed. This is why planning is extremely important.

### At a Glance: Staffing Process from Start to Finish

- Specification of the type and number of staff required
- Clear indication when needed
- Written request
- Includes detailed job description
- Verify funds are available
- Competitive recruitment (external and/or internal)
- Publication of the vacancy
- Selection panel established and interview questions prepared
- Non-discriminatory, merit based selection
- Decision on employment

Possible staffing mechanisms include competitive recruitment (open to external candidates or not) and internal transfer (with or without promotion). Once the organization has decided it needs additional employees, it has the option of looking at internal and/or external candidates. In both cases the job title and job description should be published (internally for all potential

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<sup>15</sup> Changes and Amendments to the BiH Constitution Imposed on April 19, 2002

internal applicants) or in media for external applicants. The basic objective of selection is to identify a candidate who is most likely to meet the organization's needs in terms of qualifications and motivation. At the same time, the process of selection must be non-discriminatory.

## Performance Management

Performance management includes activities to ensure that goals are consistently being met in an effective and efficient manner. Performance management can focus on performance of the organization, a department, or employees. In the context of HRM, the focus is on performance of individual employees and, thus, performance appraisal.

An effective approach to performance management enables employees and teams to **understand the vision and mission of the municipality and department objectives and to see how their work contributes to the achievement of the same.** This approach identifies or defines performance expectations for individuals and teams that are inherent aspects of their employment. Performance appraisal and feedback assists all employees to understand what work they do well and how they can improve their performance.

### Issues that may hinder improvements in performance management:

- **Absence of proper job descriptions:** Causes confusion over the tasks and responsibilities of the employee; may negatively impact overall municipal efficiency and effectiveness; and create more costs.
- **Lack of employee performance objectives:** With no clear job description and clear departmental work plans, staff and managers do not have a baseline from which to agree on an action plan to overcome performance deficiencies or meet training needs.
- **Inappropriate benchmarks for performance management:** Parameters for judging work performance must be relevant, measurable and realistic. Personality characteristics, political party affiliation, or family situation should not be considered in performance management.
- **Inconsistency in application:** Performance appraisal, as a key element of performance management, must apply to all staff without exception and with the same basic criteria in mind (e.g. teamwork, efficiency, etc).
- **Little importance placed on performance appraisal:** Although mandated by legislation, performance appraisal is often conducted to satisfy regulations without proper assessment or dialogue between staff and managers. Performance appraisal must be concrete and tangible in order to emphasize the importance of the process (e.g. disciplinary action, professional development, etc).
- **No disciplinary measures used:** Disciplinary measures are aimed at establishing employee accountability. Staff should be fully accountable for their actions in the workplace especially if those actions reflect negatively on the organization as whole. Disciplinary action taken against an employee should be understood as a corrective, rather than a punitive measure as its primary purpose is to instill an employee with the core values and norms of the organization and to prevent any further transgression.

## Compensation

Compensation is payment and reward to an employee in return for his/her contribution to the organization by doing his/her job. Organizations should associate compensation/pay ranges with job descriptions in the organization. The ranges include the minimum and the maximum amount of money that can be earned per year in that position. It can include base pay, based on the value of the job in the organization and the market for the expertise required to perform that job, or variable pay, which is based on the performance of the person in that role, for example, how well that person achieved his or her goals for the year. Incentive or bonus plans are also forms of variable pay. Some compensation systems include a combination of base pay and a variable pay.

Compensation in municipalities is established through base pay rates, the co-efficient and other allowances. It is important when assessing jobs that the co-efficient is commensurate with skills, level and merit. The practice of assigning higher pay grades to individuals lacking the necessary skills and qualifications is hazardous to employee motivation and should be avoided at all cost. Compensation will be perceived by employees as fair if based on systematic components. Various compensation systems have been developed to determine the value of positions.

### Components of Compensation System

- **Job Analysis:** The process of analyzing jobs from which job descriptions are developed. Job analysis techniques include the use of interviews, questionnaires, and observation.
- **Job Descriptions:** A critical component of both the selection process and compensation system; job descriptions define in writing the responsibilities, requirements, functions, duties, supervisory role, etc. which should be the basis for pay rate.
- **Job Evaluation:** A system for comparing jobs for the purpose of determining appropriate compensation levels for individual jobs or job elements.
- **Pay Structures:** Useful for standardizing compensation practices. Most pay structures include several grades with each grade containing a minimum salary/wage and either step increments or grade range. Step increments are common with union positions where the pay for each job is pre-determined through collective bargaining.
- **Salary Surveys:** Collection of salary and market data. May include average salaries, inflation indicators, cost of living indicators, budget salary averages. Organizations may purchase results of surveys conducted by survey companies or conduct their own salary surveys.

Significant changes are needed to improve compensation practices at all levels of government. However, there are many constraints, including over-staffing, which limit the possibility of salary increases in cash-poor municipalities; making social benefit payments on time; proper application of co-efficients based on skills; required education; and years of experience rather than *ad hoc* criteria.

## Human Resource Development

Human Resource Development is defined as an **organized, systematic learning experience, conducted in a definite time period, to increase the possibility of improving job performance and growth.** In general, development is the growth of an individual in terms of ability, understanding and awareness. Training is the systematic development of the attitude, knowledge and skills required by a person to perform a given task or job adequately.

There is a common perception that training is a luxury rather than a necessity. In order for employees to remain competitive and have accurate up-to-date information and maintain their skill sets, investment in training of staff should be seen as a priority by municipal management.

Institutions send their employees for seminars and workshops, usually organized by an outside donor. There are often no clear criteria for selecting employees to attend training, nor is there an assessment of various departmental needs. It is important that employees working at all levels in a municipal administration have the opportunity to attend external trainings. In order to maximize the learning experience and create internal cost savings, trained employees can transfer their knowledge to colleagues through internal trainings. A record of the trainings, education and workshops an employee attends should be kept in his/her personnel file.

Funds should be allocated in the budget plan to provide staff with the training required.

## Professional Ethics

Generally, professional ethics define appropriate and inappropriate conduct in the work place. Many people think that ethics, with its attention to "doing the right thing" only asserts the obvious "be good," "don't lie," etc., and thus disregard the negative impact of not having any written ethical standards. Breaches in professional ethics significantly erode citizen confidence in public institutions.

Failures in professional ethics usually fall in the following categories:

Various forms of **professional misconduct** include illegal, unethical, or questionable practices of individual employees (including managers).

**Moral misconduct** includes potential conflicts of interest, wrongful use of resources, mismanagement of contracts and agreements, etc.

Municipal employees deal directly with citizens and their professional conduct directly impacts the perception citizens' form about the administration. Both the executive and legislative sides of local government should be held to a higher standard as they safeguard public funds and provide services to the entire community.

It is hard to say what the current level of unethical conduct in municipal administration in BiH is, but the frequency of complaints from the citizens (published or aired in the media) indicates that there are cases of corruption, nepotism, conflict of interest, etc. These cases only affirm the necessity to adopt consistent norms of ethical conduct in municipalities throughout the country.

Example Codes of conduct include: *Code of Conduct of Employees of the Units of the Local Self-Government of the RS*, issued by the Ministry of Administration and Local Self-Government of the RS (RS OG 37/05 of 8 April 2005) and *Code of Ethics for Civil Servants in FBiH* (FBiH OG 07/05) issued by Agency for Civil Service of FBiH.