



MONTENEGRO
MINISTRY OF FINANCE

**Public Finance Management Reform Programme
2016-2020**

**November
2015**

Table of Contents

Table of Contents	2
1. Background to the Public Finance Management Reform Programme	3
2. Brief situation analysis	5
3. Key overall objectives of the PFM Reform Programme	12
4. Objectives and key reforms	15
4.1. Sustainable fiscal framework, public expenditures planning and budgeting ...	15
<i>4.1.1. Medium-Term Budget Framework (MTBF), including the fiscal strategy</i>	15
<i>4.1.2. Annual budgeting</i>	17
<i>4.1.3. Capital budget</i>	21
4.2. Budget execution	23
<i>4.2.1. Revenue collection</i>	23
<i>4.2.2. Public procurement</i>	25
<i>4.2.3. Reform of the Debt Management Division, analysis of debt levels, cash management and foreign cooperation</i>	28
4.3. PIFC development	29
4.4. Transparent financial reporting and accounting	32
<i>4.4.1. Transition from the cash-based to the accrual accounting and financial reporting</i> ..	32
<i>4.4.2. Alignment with the ESA 2010</i>	34
4.5. The SAI capacity to meet the INTOSAI standards	37
5. Budget Transparency	41
6. Monitoring, reporting and evaluation	44

1. Background to the Public Finance Management Reform Programme

In line with the European Commission's Enlargement Strategy 2014-15, the **public administration reform is defined as one of the pillars of the enlargement process**, together with the rule of law and economic governance.

The need to further improve public finance management (PFM) is set as one of the key areas of the existing as well as the future public administration reform (PAR) strategic documents in Montenegro, recognizing the importance of the PFM reform on the for further development of all sectors of the economy and better quality of life for the citizens. This Public Finance Management Reform Programme (PFM Reform Programme) sets down **Montenegro's key reform plans in this area for the upcoming period** aimed at increasing accountability and ensuring sound financial management and good governance by improving the economy, efficiency and effectiveness in managing public resources. Furthermore, the Programme will ensure **better coordination and inter-institutional cooperation** for planning, implementation and monitoring of the policies related to macro fiscal stability, allocation and use of public resources. The Programme should also secure **improved transparency** of the PFM system and **sequencing** of the activities. Additionally, the Programme translates at national level the efforts of the EU member states to safeguard macroeconomic and fiscal stability in the EU, thus ensuring that Montenegro will be able to join the EU as a state with strong public finance and good economic governance. Therefore, **PFM reform is needed to ensure fiscal sustainability and sound management of public finances in line with EU legislation**. It is expected to result in significant advancements in the functioning of the budgetary system, managerial accountability, budget execution and internal and external audit.

Adopting a PFM reform programme is also key criteria for further technical support and a **prerequisite for sector budget support through the IPA**. In the coming years, the plan is to use the direct budget support mechanism in various sectors, including integrated border management, public finance and PAR. In addition, the PFM Reform Programme is relevant for coordinating the national efforts for the opening or closing benchmarks in a number of negotiation chapters, particularly: 5 - Public Procurement; 16 - Taxation; 17 - Economic and Monetary Policy, and 32 - Financial Control.

Based on the above, the Working Group of the Ministry of Finance (MoF), in cooperation with the State Audit Institution (SAI), Tax Administration (MTA) and the Public Procurement Administration (PPA), defined the **priorities** for the PFM Reform Programme. Close cooperation has been established with the Ministry of Interior and the working group in charge for preparation of the new PAR Strategy. The priorities from this Programme which are more related to other PAR issues will be reflected in the new PAR strategy as well.

Given that over the previous period the Government adopted a set of sector-based PFM strategies, the priorities in the current PFM Reform Programme are partly based on the strategies already in place, which have undergone public discussions and alignment with the European Commission. These include: the Strategy for Further Development of the PIFC in Montenegro; the SAI Strategic Development Plan; the Strategy for the Implementation of the ESA 2010 Methodology in Public Finance Statistics; the Strategy for the Transition to the Accrual-Based Public Accounting; and the Anti-Fraud and Irregularities Prevention Strategy to Protect the Financial Interests of the EU 2015-2017 and the Action Plan for Chapter 22. On the other hand, some of the reforms are prescribed for the first time in this Programme. Therefore, monitoring of the implementation of this Programme will give an added value to the coordination of the mutually interconnected activities and provide additional synergy which is needed for the better quality of the planned results. In parallel with drafting the PFM Reform Programme, a new PAR Strategy covering the same period and the Public Procurement System Development Strategy are being drafted.

The PFM reform programme has a wide scope, covering all areas of PFM, including medium term and annual resource planning, budget execution, accounting and reporting, public internal financial control and external scrutiny.

The key actors for the PFM Reform Programme are the MoF, the PPA, the MTA and the SAI. It also concerns all direct budget users in the public sector. Some activities and training are planned to be co-funded through the IPA, particularly where expertise from the EU Member States is needed:

- IPA 2014 project “Support to the PFM policies”;
- IPA 2014 project “Implementation of the e-Procurement”;
- IPA 2014 Multi-beneficiary project “Strengthening Economic Management and PFM” to be implemented by the IMF.

The implementation of the PFM Reform Programme within the timeframe envisaged will greatly depend on the timely commencement of the above projects which are essential source of the knowhow needed for the transfer of the best international practice. It is noteworthy that budget assessments given in the PFM Reform Programme are only provisional and will be revised depending on the allocations within the abovementioned projects for certain activities.

The PFM reform programme has been prepared by a designated working group, composed of key directorates of the MoF, the PPA, the MTA and the SAI. It has been consulted with the civil society organisations through regular public consultation process.

The PFM reform programme outlines priority objectives for the Government, identifies indicators to measure progress towards the objectives, sets specific targets

for 2017 and 2020, defines sequenced activities for each objective and estimates the additional resource needs of the administration to carry out the planned activities.

2. Brief situation analysis

Responsible fiscal policy management has been and remains a strategic goal of Montenegro. Fiscal stability is not only a precondition of overall economic stability and long-term economic growth, but access to international financial markets also depends on it. Stable public finances of Montenegro are also significant in the context of EU membership negotiations. The strategic long-term goal of Montenegro in the area of public finance still remains the reduction of public debt, i.e. its share in GDP. This strategic goal may be achieved through the mixture of trends of these two macroeconomic categories. The Government of Montenegro is confident that this goal is targeted in a more qualitative way through creation of conditions for and encouragement of accelerated economic growth, which under Montenegrin conditions implies significant infrastructure investments.

The priorities in the PFM Reform Programme rely, in part, on previous reform experiences, but also take into account the results from the public consultation process and the need to align to EU best practices. The brief situation analysis is a result of the assessment of the current situation and best European and international practice made by the Governmental institutions. Furthermore, the analysis took into consideration the weaknesses identified in the World Bank 2013 PEFA Assessment, SIGMA 2015 Baseline Measurement, and SIGMA 2014 PAR Assessment as well as screening reports for the relevant negotiations chapters.

The Government has established a robust annual budget process. The timetable set in the legislation is respected, and budget information at aggregate levels is regularly available to the public. However, the existing public expenditure management practices are characterised by a lack of medium-term financial planning, and, in most cases, the focus of the administration is on compliance with rules and procedures rather than on value for money. Developments in public internal financial control (PIFC) are in the early stages, with systems and rules in place but implementation not yet ensured in a consistent manner. The Montenegrin legislation clearly specifies the role of the Government, the Parliament and the Ministry of Finance (MoF) in the budget process. The Parliament adopts the annual budget proposed by the Government and the final statement of the budget (the final accounts). Parliamentary committees examine the macroeconomic background, general fiscal policy and the detailed estimates of revenue and expenditure. The Parliamentary Committee on Economy, Budget and Finance considers audit reports within two months of receiving them and endorses the SAI's recommendations. The Parliament has the power to amend the Budget without specific legally defined limits.

In practice the changes introduced to the annual budget by the Parliament are limited. Montenegro observes a well-defined annual budget timetable.

Yet, some public expenditure management practices remain weak. With a view to improving the overall system of public finances in Montenegro, as well as harmonizing the regulations with the EU *acquis*, the Parliament of Montenegro adopted the *Law on Budget and Fiscal Responsibility* (Official Gazette No 20/14 from 25.04.2014 and 56/14 from 24.12.2014) introducing numerical fiscal rules and medium-term budget framework. Fiscal rules are in place and the Ministry of Finance has started publishing information in relation to these rules on a regular basis. In addition, the State Audit Institution has prepared the first report to analyse within their annual reporting to the Parliament the Government's fiscal policies in line with the fiscal rules.

Sustainable fiscal framework, public expenditures planning and budgeting

Development of a stronger **medium term budget framework** has started by establishing specific sectoral budget ceilings for all ministries in the medium term budget planning instrument – Guidelines for Macroeconomic and Fiscal Policy (adopted each spring by the Government). Nevertheless, further weaknesses exist **since sector policy plans are not linked with the medium-term financial planning** and line ministries and other budget organisations do not provide systematic input to medium term financial planning. **Financial departments of line ministries do not hold the necessary skills for mid-term planning.** Therefore, implementation of the best practices of the EU and implementing medium term budgetary framework and amendments to the current procedures is needed. In addition, the Law on Budget and Fiscal Responsibility requires that the Government prepares a Fiscal Strategy for the first time after the next parliamentary elections. **PEFA 2013 report** recognize that some sectoral strategies have been prepared but also underline that they are not made with reference to the projected availability of funds and do not systematically include associated operating and maintenance costs of existing and new projects. In PEFA 2013 multi-year perspective is rated with C+, while the budget process received more advanced B+ grade. **SIGMA 2015** states that the MoF should develop a system for sectoral inputs from line ministries for the MTBF, including the preparation of the necessary secondary legislation and of the other underlying rules and guidelines for sectoral (at ministry level) medium-term financial plans. The MoF needs to prepare training programmes for budget and policy staff in ministries and independent state authorities. These should examine the elaboration of medium-term expenditure plans within the system of strategic planning.

In order to establish basic principles of good fiscal management, reflecting in clear linkages between budgeting and government policies, Montenegro will need to **improve programme budgeting**. This will be a necessary step to **improve accountability and reporting on performance of public administration organisations**. Although the basic programme structure is in place, **the system has not been fully developed, performance indicators were not introduced, and linkages between performance based budgeting and government policies were**

not thoroughly established. PEFA 2013 underline that units prepare their budgets by programme, but these do not include any data about planned and achieved outputs and outcomes. **SIGMA 2015** reports that the MoF should improve performance information provided in the MTBF and other budget planning documents.

Capital budget represents an integral part of the annual budget law which is implemented by the Directorate for Public Works and Directorate for Transport. **Process of planning and realization of the capital projects have to be improved through: enhancement of project classification, improvement of decision making process related to definition of the priority projects, increase in transparency of the realization of the investments of public interest and better linkage of capital spending and governmental development goals**, as well as sectoral budget programmes. **SIGMA 2015** underlines that annual procedures for capital investment planning are separate from budget planning by the ministries and assess that are less transparent.

Budget execution

Regarding **taxation**, the recent period, accompanied with a large number of bankruptcy proceedings, economic crisis and lack of solvency of companies, has caused the accumulation of a certain amount of unsettled tax liabilities (tax arrears), representing a burden for the Tax Administration. In order to highlight the relevance of resolving this issue, the Tax Administration has published lists of the largest tax debtors quarterly. This issue has also been stressed by the Ministry of Finance, which adopted legal regulations for its resolution, for the realization of which the Tax Administration has been in charge of. The Tax Administration has achieved its public revenue collection tasks during the crisis, even exceeding the Budget plan. Such results have been, among other, contributed by tax audits and activities in the combat of the grey economy (especially with regard to the large taxpayer segment), as well as by efforts and commitment of the MTA staff. **A dynamic development of Tax Administration e-services is a step forward towards reduction of administrative barriers for voluntary tax compliance. E-services cover online and internal filing of VAT and corporate income tax returns, financial statements and VAT refund claims.** However, it is still necessary to harmonize and integrate IT systems, to enable the follow up of development of IT system capacities, relevant to the EU accession process and other international obligations but in the medium term also to simplify procedures for citizens and businesses, as well as the tax administration itself. **PEFA 2013** report that legal framework and procedures for tax and duty administration are clear and the tax and customs administrations have well-developed channels for educating taxpayers and keeping them informed. Taxpayers are registered in databases but linkages between them and with the national identification database and other sources of information on potential taxpayers are not yet electronic. PEFA 2013 report grades tax collection with D+ while tax registration and assessment is rated with B.

In the area of revenue collection, the **Customs Administration** is achieving **good results in continuity, measured by all relevant indicators, while reforms and transformation of institution into a modern service are carried out in the**

planned dynamics. The strong step forward was made in regards to strengthening of integrity. In addition, the customs cooperation with customs services of the region and EU member states, with international organizations and institutions, as well as with business environment was also strengthened. **Commitment and efficiency in fight against grey economy is reflected through increased customs controls which resulted in increased revenue collection.** Since January 2015 was successfully conducted the migration of competencies in the area of excises, stopped the trend of decline of excise revenue collection and we increased the revenue collection. The Customs Administration has postured itself as service to the economy and has prepared following electronic services which are operational: electronic submission of declaration, TARICG and monitoring of available amounts on guarantees. Also, the Customs Administration enabled certain public authorities, e.g. Police Administration, Tax Administration etc. the access to its reporting system via electronic reports, while at international level it performs electronic exchange of information with other custom services of the region through SEED system and with IRU –International Road Union, regarding TIR Carnets. The harmonization of legislation with the EU *acquis* and strengthening of administrative capacity is also conducted in the planned dynamics; however, **the biggest challenge in customs area is the development and connection of all needed IT systems in order to have their interconnectivity and interoperability with the EU IT systems.** The implementation of these IT systems through projects was planned within the support from IPA II funds.

As for **public procurement** the coordinating bodies and remedies institutions are established in line with EU Directives and are operational. Montenegrin *Law on Public Procurement* (PPL) provides an adequate level of alignment with the *acquis*. However, as the EU legislation is undergoing substantial changes, **further legislative modifications will be needed.** In this context further simplification of redundant public procurement rules is needed to allow stronger focus on value for money in public procurement. Regarding electronic procurement, current Montenegrin *Law on Public Procurement* provides an adequate legal framework for the introduction of e-procurement in practice. Currently, **the main need is the development of the electronic infrastructure that would allow the technical management of the procurement process by electronic means.** With the implementation of a modern e-procurement system, Montenegro will address the recommendations of the European Commission as regards implementation capacity, increase in transparency, reduction of irregularities while ensuring the implementation of the EU legal provisions on public procurement. A systematic law for PPP and concessions has been prepared, including implementing provisions that would establish central capacity for steering and scrutiny of proposed PPP projects. **PEFA 2013** report grades public procurement with grade B. **SIGMA 2015** assesses that further alignment with the EU *acquis* is required to bring the PPL and its implementation fully in line with the new EU Directives. It is also stated that the PPA should start implementation of e-procurement, in line with the principles set out in the 2014 Directives.

In relation to the **debt management** IT system needs to be upgraded with control and reporting functionalities. Trading in bonds and T-bills should be simplified with an electronic IT system. The organisational activities regarding public debt and cash management in the MoF should follow clearly defined and delineated responsibilities on the duality principle. **SIGMA 2015** report states that, in Montenegro, the risk of excessive public debt is high in the medium-term, although debt management is well structured and planned and has demonstrated positive results in 2014. **SIGMA 2015 report assess that the MoF needs to prepare a medium-term plan for public debt management.** **PEFA 2013** report grade Cash, debt and guarantees with B.

PIFC development

An important segment of reforms in the public finance area is the further implementation of the **Public Internal Financial Control (PIFC)**, according to the EU requirements. In the upcoming period, the system of internal financial control will be implemented to ensure budget funds spending to be in line with the Budget Law. **Key weaknesses in the area of PIFC are currently lack of managerial accountability in the public sector organisations, compliance oriented financial management and only basic capacities of expertise in some internal audit units, in terms of the number of auditors and their professional competence.** **Risk management** is an integral element of an internal control system and should be further developed so that it is systematically implemented across all the public sector. The system for internal audit (IA) is established in accordance with the requirements of Chapter 32 of the EU accession negotiations, but capacities for good-quality audit work need further development. The Ministry of Finance (Central Harmonising Unit for PIFC) has recently strengthened monitoring of PIFC practices in budget organisations by carrying out specific quality control of both FMC and IA rules and procedures in individual budget organisations but this analytical work needs to be strengthened and the lessons learned need to be fed into overall PFM and PIFC procedures of the Government. **PEFA 2013** report states that the number of trained internal auditors is inadequate and that their reports have not yet achieved the impact of those previously produced under the centralized regime. Report grades internal audit with grade C+. **SIGMA 2015** report informs that implementation of FMC at an institutional level is lagging behind the development of the policy framework. Objectives are not established in a systematic manner in many public organisations, including ministries; risk management procedures are not implemented; and there is a lack of delegation of decision making authority in financial management beyond the level of the secretary of ministry. The MoF should develop the capacities of IA further, as an advisory service to management with a clear focus on ensuring that FMC systems are operational and effective. MoF needs to establish quality assurance arrangements in accordance with international standards.

Transparent financial reporting and accounting

The **accounting standards** are defined, although these **do not enable provision of data compliant with the European Union's regulations ESA2010**. Public sector accounting in Montenegro does not follow the international accounting standards i.e. it is **modified cash-based and does not provide enough information for efficient public finance management**. Montenegro does not have balance sheet, profit and loss accounts or data on state assets. In Montenegro there is no training for public accountants in line with the IPSAS standards and the IT system supports only the cash-based accounting with the additional functionality of recording commitments. **Introduction and implementation of ESA 2010 in the public finance system in Montenegro** will: create methodologically comparable statistical framework, increase the credibility and transparency of public finances and more practically and comprehensively show the public financial results. **SIGMA 2015** assesses that the MoF needs to plan funding for IT development to ensure that the Treasury accounting systems can provide data on an accrual basis. It states that the accounting standards are defined, although these do not enable provision of data compliant with the European Union's ESA2010 regulations. The existing Chart of Accounts does not provide adequate details of budget revenues and expenditures to make it possible to generate data that translates the budget lines from the national classification into the European System of Accounts (ESA) classification.

In accordance with the obligations set forth by the laws, guided by the principle of transparency of public finances, the Ministry of Finance **submits the reports to the public on the implementation of Central budget or public finances on a monthly, quarterly and annual basis**: (1) On a monthly basis, the Ministry reports on the implementation of revenue and expenditure of the central budget including national funds that is consistent with the previously discussed reform in public finances. On this occasion, the Ministry, using the method of time adjustment, reports on the modified cash principle which, in the case of Montenegro, implies adjustment of the main expenditure items (gross wages and social benefits) to the accrual concept of accounting. Revenues of the central budget, as well as the other expenses, are disclosed on the cash method. (2) On a quarterly basis, the Ministry of Finance is preparing a report on the implementation of revenue and expenditure of the public finances, taking into consideration the obligation of local self-governments to quarterly report to the Ministry on the implementation of their budgets. The information is also disclosed on the modified cash method. (3) On an annual basis, through the preparation of the Law on Final Budget Accounts, for the purpose of calculating the deficit of public finances and the central budget item, the Ministry of Finance includes the net increase in liabilities, which belongs to the accrual concept of accounting, and represents the difference between the outstanding liabilities at the beginning and end of the period. Overall, the system of public reporting on budget implementation is in place but includes weaknesses, such as the fact that some in-year reporting provides data only at aggregate levels (not for each ministry or budget organisation).

The SAI capacity to meet the INTOSAI standards

In the **external audit** area, the constitutional and legal framework of the State Audit Institution (SAI) fulfils international requirements that guarantee its independence, mandate and organisation. The SAI has established methodological guidance for audit work and its quality control. **Montenegro needs to further improve organizational structure of the State Audit Institution (SAI) focusing on development of professional skills of its audit staff** by assessing training needs and developing the Human Resources Management Strategy and the Training Programme. **It is also necessary to enhance audit capacities for performing a broad range of audit types, including financial and performance audit work.** Montenegro needs to further ensure an efficient mechanism for reporting and monitoring of implementation of recommendations of the SAI. **PEFA 2013** report underline that audits are primarily focused on the reliability of financial statements and the compliance of transactions with applicable regulations: there is as yet only limited experience in performance audit. External audit is graded with C+. On the other hand, **SIGMA 2015** report emphasize that SAI should develop and adopt updated audit manuals to provide practical guidance to auditors regarding the new methodology for financial and performance audits. Furthermore, the SAI needs to develop and implement a human resource management strategy and a training strategy to ensure the continuous professional development of audit staff. The SAI needs to develop and implement a communications strategy.

IPA funds

The management and control systems for **the indirect management of IPA** funds have been established based on the COSO framework, which is also the basis for the PIFC policy. The current system of IPA management is to a large extent separate from the national financial management and control systems. Today the structures and capacities have been established and practical work for procurement, contract management and financial control is starting. The system is however established and needs firstly practical experience before further reforms can be possibly determined. Furthermore, Montenegro has set up a national anti-fraud coordination service (AFCOS) for the cooperation with the European Commission's Anti-Fraud Office (OLAF) within the Ministry of Finance. Besides cooperating with the Commission, AFCOS is coordinating the work of administrative, investigative and judicial institutions, which are part of the national AFCOS network.

Municipalities

Municipalities in Montenegro have a high degree of independence for their expenditure as well as possibilities to borrow to a limit of 10% of the realized current revenues in year that precede the year of borrowing, with prior approval of the Government. Taking into account negative indicators of the public finances on local level, the Government in the previous period undertook several measures in order to improve the situation: 1) rescheduling of the tax arrears in the total amount of 89,07 million €. Out of this amount 74,45 million € is rescheduled on 20 years for the

municipalities that use Equalization Fund, while 14,62 million € is rescheduled on 5 years for the municipalities with fiscal capacity is above the average level; 2) contracts on rescheduling of the tax arrears with 13 municipalities, which include the obligation of the municipalities to define the dynamics for resolving the problem of redundant employees in accordance with Public Sector Reorganization Plan. Furthermore, the contracts contain the obligation for the municipalities to obtain the positive opinion of the Ministry of Finance before any new employment; 3) issuing of the guarantees for credit arrangements for municipalities which will allow payment of the obligations and arrears, refinancing of existing credits and rationalization of the administrations in total amount of 107 million €. Taking into account that state guarantee represent collateral for credits, the municipalities can borrow under much better conditions in comparison to previous period.

Roles and responsibilities for current legally defined PFM functions are established in Montenegro and the key institutions generally have the minimum resources to carry out their tasks. The capacities for planning and implementing reforms in PFM are not however sufficient without external support. Second, there are no designated roles and resources for the coordination of PFM reforms in across the state authorities. The main systematic weakness lies in the limited capacities of line ministries and other budget organisations that mostly do not have staff skilled for financial analyses, planning and advising operational managers.

Based to the results of the analysis, the focus of the Programme is central government level. Public enterprises and local self-governments are outside the scope of this Programme.

3. Key overall objectives of the PFM Reform Programme

The public finance management reform of the country has a two-fold objective. One is to make Montenegro capable of identifying, preventing and managing fiscal risks, excessive fiscal deficits and harmful macroeconomic imbalances. On the other hand, it must ensure that public spending is structured in the way that maximizes the development impact on the national economy and ensures better quality of life for the citizens.

Based on the analysis of the situation and weaknesses in different PFM sub-sectors, the priority objectives are defined and grouped under the following PFM areas:

- 1) Sustainable fiscal framework, public expenditures planning and budgeting;
- 2) Budget execution;
- 3) Development of the PIFC;
- 4) Financial reporting and accounting;
- 5) The SAI capacity to meet the INTOSAI standards.

Within the first area, *Sustainable fiscal framework, public expenditures planning and budgeting*, **the medium-term budget framework has to be strengthened**. A new approach to planning is needed by development of a credible mid-term budget framework to serve as a basis for annual planning. The focus will be on improving medium-term budget planning with a view of better correlation between sector-based strategies and medium-term financial planning, i.e. the Government's strategic goals and the goals of budget programmes. **Furthermore, the Government remain committed to introducing programme budgeting in line to international best practices**. In this respect, it is necessary to develop the detailed programme structure of budget users, define the goals of individual programmes and create performance indicators or other methods to measure results achieved in meeting the programme goals. Efficient system of performance measurement of budget users is needed with a view to increase public spending efficiency and transparency. **Additionally, capital budgeting has to be strengthened and more transparent**. The improvements are needed as regards its project structure, the overview and description of capital projects, as well as reporting on the status of the projects being implemented. This will improve budget transparency and comprehensiveness of budget documents. In order to fully implement above-mentioned activities and meet the set of goals, the administrative capacities and the IT for budget planning and execution need to be improved.

When it comes to *Budget execution*, the focus is on improving revenues management, establishing an efficient, transparent and competitive public procurement system, and better public debt monitoring and reporting. **The Tax Administration has been successful in increasing tax efficiency, but further efforts are needed to reducing administrative barriers for tax compliance**. It is also **necessary to harmonize and integrate IT systems, to enable the follow up of development of IT system capacities, relevant to the EU accession process and other international obligations. Montenegrin Law on Public Procurement should be fully aligned with the acquis securing increase in transparency and reduction of irregularities**. With introduction of the e-procurement competition will be increased, duration of the procedures will be shortened and procurement costs will be reduced. **Debt management requires improved monitoring and reporting through further capacity building, implementation of the new IT solutions and better strategic planning**.

The Public Internal Financial Control (PIFC) has to be implemented in line with EU requirements that would support positive development in effectiveness, economy and efficiency. Therefore, in the third area - *PIFC development* further progress is needed in **strengthening managerial accountability based on the principles of delegating responsibilities and authorities, as well as strengthening the internal audit capacities**. In addition to this special focus will be on the PIFC as a tool to detect and combat irregularities, fraud and corruption through comprehensive internal rules and procedures. Activities are going to be fully in line with the requirements stemming from Chapter 32, which is one of the more important and horizontal negotiations chapters.

National accounting standards and reporting should be in line with best international practices. A responsible management of public finances, as one

of the preconditions for better value for money, requires high-quality financial information, which is essential for decision-making in public finances, both at the state and local self-government levels. Therefore, chapter *Financial reporting and accounting* includes further reforms related to the introduction of the elements of accrual-based accounting and ensuring the harmonisation with the European System of National and Regional Accounts (ESA). Substantial changes in the budget accounting and financial reporting systems, accounting legislation, the IT system as well as the training of public accountants are needed.

In the external audit area, the constitutional and legal framework of the State Audit Institution (SAI) fulfils international requirements that guarantee its independence, mandate and organisation. **It is necessary to enhance audit capacities for performing a broad range of audit types.** Therefore, the fifth area refers to building SAI capacities to meet the INTOSAI standards, i.e. the standardisation of the processes of financial audit, compliance audit and performance audit in line with the ISSAI standards.

Taking into account that central government budget represents about 90% of the public finances, the PFM Reform Programme is focussing on achieving improvements in PFM systems related to the central government, including all ministries and other state authorities that are users of state budget. Based on the results achieved on the central level, decision will be taken on the inclusion of the local governments in the following period. Furthermore, municipalities are autonomous in the exercise of the local self-government functions and their rights may not be denied or limited by any decisions of state authorities, with the exception of the cases and under the terms set in the law, in line with the Constitution. Within its mandate, the MoF already offers its assistance to individual municipalities in financial difficulties.

As regards financial reporting, introduction of MTBF, the programme budget and the accounting standards will lead to the improvements in this area. The MoF is currently involved in the project to enable the monitoring of all contracts by budget users through the SAP system, and thus also of the commitments, as well as to monitor the pertinent public procurement processes in all stages. This will provide for better commitment control and liquidity management since the information on commitments will be available in the SAP much sooner than when due for payment. Taking into account that the biggest challenge in customs area is the development and connection of all needed IT systems in order to have their interconnectivity and interoperability with the EU IT systems, those priorities are not included in the PFM Reform Programme. Those actions are planned in the IPA Sector Planning Document for sector Democracy and Governance.

Regarding IPA funds, given that the FMC has been developed in such a manner to require least amendments to the existing legal framework, and such a system has been recognised by the EC auditors as adequate for the use of IPA funds, it is not

necessary to have any major changes or reforms. Improve the quality of the regulatory impact assessment will be covered by the PAR strategy.

The Parliament does not have its own capacity building activities in the PFM Reform Programme, however many of the proposed activities, including improved programme budgeting, stronger capacity of the SAI, contribute to more effective public and Parliamentary scrutiny. Providing that the objectives are achieved, also transparency in general will be improved.

4. Objectives and key reforms

4.1. Sustainable fiscal framework, public expenditures planning and budgeting

4.1.1. Medium-Term Budget Framework (MTBF), including the fiscal strategy

Objective: *The MTBF reflects Government policies and policy goals and contains fixed spending ceilings for all first level spending units*

Currently MTBF does not reflect completely mid term goals and priorities of the Government. The main reason for this situation is absence of the uniform approach for preparation of sectoral strategies, especially in relation to the minimal requirements for content and quality and absence of institution which is explicitly in charge for the management of planning documents. Therefore, it is necessary to improve the monitoring of implementation of the planning documents. Planned activities have a goal to define the uniform requirements for sectoral strategies and to enable better alignment of the strategies with the priorities of the Government and budget programmes. Those are preconditions for a credible MTBF which reflects the governmental goals in each area.

Indicators	Baseline (2014)	2017	2020
Share of new medium-term sector strategies that include estimates of implementation costs, including potential donor funding	60%	80%	100%
Average deviation between MTBF budget ceilings and actual annual budget expenditure limits	9%	7%	5%
Number of staff trained for top-down medium-term budget planning	0	52	72

Activities:	Implementing agency	Commencement date	Planned completion date	Cost estimate	Source of funding
<i>Develop the Fiscal Strategy in line with the Law on Budget and Fiscal Responsibility</i>	MoF	2016	2016	40.000 €	Budget and the IPA 2014 Action
<i>Preparation of the plan of fiscal policy measures in case of deviations of main fiscal aggregates from the levels set in fiscal rules</i>	MoF	2016	2016	35.000 €	Budget and the IPA 2014 Action
<i>Training of staff with a view of improving medium-term expenditures planning</i>	MoF	2017	2019	100.000 €	Budget and the IPA 2014 Action
<i>Training for multi-year budget planning with a view of better alignment of the budget programme goals with Government policies</i>	MoF	2017	2019	20.000 €	Budget and the IPA 2014 Action
<i>Drafting guidelines for better alignment of policy goals and budget planning focusing on medium-term financial plans of spending units</i>	MoF	2017	2018	15.000 €	Budget and the IPA 2014 Action
<i>Definition of the minimal requirements in relation to the content of the sectoral strategies as well as key quality requirements</i>	GSV MoF	2015	2016	5.000 €	Budget and SIGMA
<i>Improvement of planning and presentation of multiannual commitments in the budget</i>	MoF	2017	2019	20.000 €	Budget and the IPA 2014 Action
<i>Develop and upgrade current budget planning IT to enable medium-term planning</i>	MoF	2016	2020	400.000 €	Budget and the IPA 2014 Action

Activities:	Implementing agency	Commencement date	Planned completion date	Cost estimate	Source of funding
<i>Develop the Budget Circular in the section on planning multiannual commitments</i>	MoF	2017	2017	15.000 €	Budget and the IPA 2014 Action

Risk assessment and mitigation of risks:

- **Identified risks:** Sectoral strategies do not contain information on the estimated funds needed for their implementation in the medium term or such costs are quite unrealistic; Sectoral strategies do not contain information on the consistency between the costs for the implementation of activities and the spending envisaged by the MTBF; Lack of staff capacities in line ministries for planning and monitoring the fiscal impact of planning documents on the Budget; Absence of a central body for assessing alignment of goals in different policy areas with the strategic goals of the Government.
- **Risk Mitigation:** Preparation of the Guidelines for preparation of the strategic documents in order to define a minimal requirements for sectoral strategies i.e. quality, assessment of the financial means needed for implementation and alignment with governmental priorities. Capacity building in the institutions which are in charge for the preparation of strategic documents. Formal responsibility for the coordination of the management of planning documents is needed for better monitoring of implementation of strategic documents.

4.1.2. Annual budgeting

Objective: Creating an efficient system for measuring the impact of budget programmes with a view of increasing efficiency and transparency of public expenditures.

The main principle of good fiscal management is linkage of the budget with governmental policies in all the sectors. One of the methodologies needed to achieve this goal as well as to increase transparency of the use of public resources is programme budgeting based on performance management. In the previous period Montenegro developed a variation of programme budget having in mind that total funds of the spending units are divided in different programmes. However, the main elements of the programme budget i.e. programme definition, goals and indicators at first place are still missing. Taking into account abovementioned it is not possible to monitor implementation of the goals and their connection with strategic governmental goals i.e. it is not possible to monitor successfulness of the implementation of the programme activities. Implementation of the new Law on Budget and Fiscal Responsibility, which prescribe the obligation to adopt the Fiscal Strategy and Fiscal

Policy Guidelines which comprise the spending limits which are obligatory for the first year and indicative for the following two years, create preconditions for further development of programme budget based as a tool for performance measurement of the planned programmes. The planned activities have as a main goal full implementation of the programme budget in Montenegro.

Indicators	Baseline (2014)	2017	2020
Share of first level budget organisations that provide comprehensive performance information with their annual budget requests	40%	75%	100%
Level of performance information included in budget planning	Programme headings are defined by all budget organisations	Programme structure is developed in all budget organisations, including their mission statements, programme descriptions and goals	A set of performance indicators are developed for all programmes in order to monitor the attainment of programme goals
The number of staff trained for planning and monitoring expenditures in line with programme budgeting principles	0	100	130

Activities	Implementing agency	Commencement date	Planned completion date	Cost estimate	Source of funding
<i>Review current budgeting legislation and procedures and based on the findings and the best practices and experiences in this field, amend national legislation with a view of putting in place the assumptions for the full implementation of</i>	MoF	2016	2017	15.000 €	Budget and the IPA 2014 Action

Activities	Implementing agency	Commencement date	Planned completion date	Cost estimate	Source of funding
<i>programme budgeting</i>					
<i>Prepare a detail plan of work for Implementing the Programme Budgeting, with the accompanying Activity Plan</i>	MoF	2016	2017	35.000 €	Budget and the IPA 2014 Action
<i>Draft a Manual/Handbook for programme budgeting</i>	MoF	2016	2016	15.000 €	Budget and the IPA 2014 Action
<i>Review current programme structures to identify the necessary changes by introducing/abolishing programmes or sub-programmes</i>	MoF	2016	2017	10.000 €	Budget and the IPA 2014 Action
<i>Define missions, goals and descriptions of programmes or sub-programmes</i>	MoF	2016	2017	20.000 €	Budget and the IPA 2014 Action
<i>Define performance indicators for programmes or sub-programmes</i>	MoF	2018	2020	30.000 €	Budget and the IPA 2014 Action
<i>Review and amend the budget circular to reflect the amended programme structure and introduce non-financial elements of the Programme Budget</i>	MoF	2017	2019	15.000 €	Budget and the IPA 2014 Action
<i>Organise training for the staff of the MoF and the budget organisations that will be involved in the implementation of the Programme Budget</i>	MoF	2016	2019	125.000 €	Budget and the IPA 2014 Action
<i>Review and improve the functionality of the existing IT system for budget planning</i>	MoF	2016	2020	See Develop and upgrade current budget planning IT to enable	Budget and the IPA 2014 Action

Activities	Implementing agency	Commencement date	Planned completion date	Cost estimate	Source of funding
				medium-term planning in the section above	
Improve budget transparency by providing better visual presentation	MoF	2017	2020	20.000 €	Budget and the IPA 2014 Action
In accordance with the best international standards explore and implement measures for the improved presentation and visualisation of the in year reports (monthly and quarterly)	MoF	2017	2020	15.000 €	Budget and the IPA 2014 Action
Improve resources for better management of the EU's own resources	MoF	2017	2020	35.000 €	Budget and the IPA 2014 Action

Risk assessment and mitigation of risks:

- **Identified risk:** The budget requests of spending units do not contain comprehensive and qualitative data regarding the non-financial elements of the budget

Risk mitigation: Budget requests which do not include adequate data on non-financial elements of the programme budget will not be considered i.e. budget programmes which not comprise all the information needed will not be approved.

- **Identified risk:** Underdeveloped staffing capacities of financial units in line ministries

Risk mitigation: Trainings for employees in the financial units of the line ministries.

- **Identified risk:** Lack of funding for training of staff and new software solutions

Risk mitigation: MoF will investigate possibilities for alternative sources of support.

- **Identified risk:** Delays in the provision of expert support for the training of staff and software development.

Risk mitigation: Precise timeframe and defined activities for experts.

4.1.3. Capital budget

Objective: Improve capital budget planning and progress reporting for capital projects

Capital budget is integral part of the annual law on budget and comprise the list of the capital project to be realized in the each fiscal year. However, the planning process for capital budget is separate from the rest of the budget planning and capital projects are not linked to sector programmes in the budget. The reason is because this part of the budget is implemented by special directorates. Planning of capital projects has not been accurate, with 70% of all planned investment actually spent in 2014. Complete budget reform therefore requires enhancement of the planning of the capital projects through enhancement of the selection process, improvement of the presentation and scope of the information on planned projects as well as on monitoring and reporting on its implementation.

Indicators	Baseline (2014)	2017	2020
Level of detail in public presentation of capital budget	Projects in the Capital Budget grouped by area (education, health, culture, sport...)	Presentation by individual projects implemented in the given budget year	Presentation by individual projects and stages of implementation
Actual capital spending in the current year as a share of the amount of capital budget planned by the given Budget	70%	80%	90%

Activities	Implementing agency	Commencement date	Planned completion date	Cost estimate	Source of funding
Improve capital budget planning in the medium term as a part of the MTBF	MoF	2017	2020	30.000 €	Budget and the IPA 2014 Action
Introduce stages of capital projects in the preparation and planning of capital	MoF	2017	2020	25.000 €	Budget and the IPA 2014

Activities	Implementing agency	Commencement date	Planned completion date	Cost estimate	Source of funding
<i>budgets (preparatory stage and construction stage)</i>					<i>Action</i>
<i>Improve the overview of projects in the capital budget through detailed presentation of individual projects by project and economic classification</i>	<i>MoF</i>	<i>2017</i>	<i>2020</i>	<i>25.000 €</i>	<i>Budget and the IPA 2014 Action</i>
<i>Improve the capital budget's statement of reasons as regards the overall estimated project value and schedule</i>	<i>MoF</i>	<i>2017</i>	<i>2019</i>	<i>15.000 €</i>	<i>Budget and the IPA 2014 Action</i>
<i>Establish a public register of all the projects which are financed from the capital budget</i>	<i>MoF Public Works Directorate Transport Directorate</i>	<i>2016</i>	<i>2017</i>	<i>25.000 €</i>	<i>Budget and the IPA 2014 Action</i>
<i>Training of staff in line ministries involved in planning and implementation of capital projects with a view of better planning of investment project costs in the medium term</i>	<i>MoF</i>	<i>2016</i>	<i>2019</i>	<i>30.000 €</i>	<i>Budget and the IPA 2014 Action</i>
<i>Improve the overview of capital projects by separating the new ones from the ones already being implemented</i>	<i>MoF</i>	<i>2017</i>	<i>2018</i>	<i>10.000 €</i>	<i>Budget and the IPA 2014 Action</i>

Risk assessment and risk mitigation:

- **Identified risk:** *Delays in capital projects implementation;*

Risk mitigation: *Enhancement of the procedures for the selection of the priority projects.*

- **Identified risk:** *Delays in provision of expert support.*

Risk mitigation: *Precise timeframe and defined activities for experts.*

4.2. Budget execution

4.2.1. Revenue collection

Objective: Strengthening the administrative capacity of the Tax Administration of Montenegro to increase tax collection thus contributing to maximising the government's fiscal revenues.

Planned adoption of the legislative and administrative measures shall contribute to the fight against fraud, detection of VAT (Value-Added-Tax) fraud and avoidance and prevention of money laundering. Taking into account that tax revenues account for almost 40% of annual GDP and represent the major share of revenues of central authorities, special attention shall be paid on prevention of tax loses, including creating precondition for fair and transparent market processes and regular market competition. In that sense it is important to improve voluntary compliance and thereby achieve a greater number of submitted e-returns (Profit tax, VAT). Further strengthening of capacities related to the collection of revenues and introduction of e-audit for the purpose of fight against corruption and tax frauds is necessary. Furthermore, implementation of amended tax legislation aligned with the EU acquis and implementation of e-control is needed. Harmonization of the Law on Tax Administration with the Savings Directive shall contribute to the improvement of technical capacities of the tax authority to facilitate efficient exchange of information between public authorities and the EU countries. Montenegro also needs to ensure that the exchange of information among Member States related to the special scheme for e-Services provided by non-EU traders to EU citizens is in place and inter-connected with EU systems, as well as for refund of VAT as envisaged by Council Directive 2008/9/EC. Interoperability and interconnectivity of the IT systems on the state level and IT systems supporting the exchange of EU and internationally relevant information is therefore one of the most important horizontal tools to increase the efficiency in implementation of the tax policy in Montenegro.

Indicators	Baseline (2014)	2017	2020
Share of submitted e-returns (Profit tax, VAT) in comparison to total number of submissions	27%	50%	80 %
EU VAT regulations concerning EU common market successfully implemented	Screening process finished	Chapter 16 opened	Planned activities in the Accession Program from the Chapter 16

Indicators	Baseline (2014)	2017	2020
			implemented
Number of training workshops/seminars delivered and number of trainers and experts trained in relation to EU standards which improve business operations	0	At least 8 training workshops/seminars delivered and minimum 5 trainers and 5 experts trained	Tax Administration ready to implement <i>acquis</i>
Share of collected tax revenue compared to the planned tax revenue in the annual budget law	100%	100%	100%
Share of collected VAT revenues in GDP	13,5%	13%	13%

Activities	Implementing agency	Commencement date	Planned completion date	Cost estimate	Source of funding
Further improvement in efficiency, taxpayer services and tax compliance through capacity building and systems improvement in MTA.	MoF Tax Administration	2018	2019	1.000.000 €	Budget/proposal for the national IPA
Enhancement of the Tax Administration administrative and institutional capacities in the field of application of VAT EU common system	MoF Tax Administration	2019	2020	2.000.000 €	Budget/proposal for the national IPA

Activities	Implementing agency	Commencement date	Planned completion date	Cost estimate	Source of funding
Upgrade capacity of the Tax Administration and its IT systems in the area of risk analysis and inspections control (e-control)	MoF Tax Administration	2017	2018	1.000.000 €	Budget/proposal for the national IPA

Risk assessment and mitigation of risks:

- **Identified risk:** IT and administrative capacities of the Tax Administration should be significantly strengthened

Risk mitigation: MTA high-level management introducing changes and innovation into practical management, qualified employees with good administrative and language skills and significant investments in the IT infrastructure and capacity building.

4.2.2. Public procurement

Objective: Align the public procurement system with the pertinent EU acquis with a view of setting an efficient, transparent and competitive public procurement system in Montenegro.

In the area of public procurement, further activities are needed that are related to the implementation of the EU rules. This will inter alia include harmonization of the legislation, support to monitoring of the public procurement through training to procurement officers, development of manuals and procedures, etc. Furthermore, development of a modern e-procurement system in the classical sector in Montenegro is needed, which means development of an Action plan for the practical introduction of e-procurement in Montenegro; development of the e-procurement infrastructure; implementation of a training program for the system users and administrators and media campaign for raising awareness on e-procurement policies.

Indicators	Baseline (2014)	2017	2020
Level of harmonisation and completeness of the procurement framework in line with	Chapter 5 opened for	Chapter 5 opened for	Planned activities in the Accession

Indicators	Baseline (2014)	2017	2020
the EU acquis	negotiation	negotiation	Program from the Chapter 5 implemented
Average number of bidders received per procurement procedure	3.1	3.2	3.8
Share of e-procurement of all procurement contracts awarded during the year.	0% (No e-procurement system)	0 % (No e-procurement system)	70%

Activities:	Implementing agency	Commencement date	Planned completion date	Cost estimate	Source of funding
<i>Review of the public procurement legislation, i.e. amendments to the PP Law (OGM 57/14) and relevant secondary legislation with a view of harmonisation with the EU acquis.</i>	MoF, PPA	2016	2016	20.000 €	Budget and the IPA 2014 Action PPA
<i>Make the table of concordance to assess the level of harmonisation of the amended PP Law (OGM 57/14) and relevant secondary legislation with the EU legislation (Directive 2014/24/EC and Directive 2014/25/EC)</i>	MoF, PPA	2016	2016	20.000 €	Budget and the IPA 2014 Action PPA
<i>Draft the PP Law and implementing legislation (including the forms, standard tender documents, contract templates, and procurement handbook)</i>	MoF, PPA	2016	2017	50.000 €	Budget and the IPA 2014 Action MoF PPA
<i>Provide training for civil</i>	PPA	2017	2017	35.000 €	Budget

<i>servants involved in public procurement (as PP officers, members of Tender Opening and Evaluation Commissions, as well as for inspectors, prosecutors and judges)</i>					<i>and the IPA 2014 Action PPA</i>
<i>Training material for special target groups involved in public procurement</i>	<i>PPA</i>	<i>2017</i>	<i>2017</i>	<i>50.000 €</i>	<i>Budget and the IPA 2014 Action PPA</i>
<i>Awareness raising campaign</i>	<i>PPA</i>	<i>2017</i>	<i>2017</i>	<i>40.000 €</i>	<i>Budget and the IPA 2014 Action PPA</i>
<i>e-Procurement</i>	<i>PPA</i>	<i>2016</i>	<i>2020</i>	<i>1.650.000 €</i>	<i>Budget and the IPA 2014 Action</i>

Risk assessment and mitigation of risks:

- ***Identified risk:*** *Lack of funding for training of staff and new software solutions*

Risk mitigation: *PPA will investigate possibilities for alternative sources of support.*

- ***Identified risk:*** *Delays in the provision of expert support for the training of staff and software development.*

Risk mitigation: *Precise timeframe and defined activities for experts.*

- ***Identified risk:*** *IT and administrative capacities of the PPA should be significantly strengthened*

Risk mitigation: *Qualified employees with good administrative and language skills and significant investments in the IT infrastructure and capacity building.*

4.2.3. Reform of the Debt Management Division, analysis of debt levels, cash management and foreign cooperation

Objective: Better public debt monitoring and reporting, definition and adoption of clear debt management procedures and debt analysis, cash management and debt repayment transactions management.

Debt management requires further capacity building and implementation of the new IT solutions which is needed for better monitoring and reporting. Implementation of new software would enable gathering of all the information on one place, better data processing, debt analysis and debt amortization planning. Additionally, this would allow improved preparation of debt projections for the following period and consequently ensure undertaking of the measures which are needed for better debt management. A new medium-term strategy, including a sensitivity analysis is also needed. A new strategy would define current debt situation, risks for the following period and, therefore, ensure planning of the future borrowings and borrowing models as well as measures and activities which are needed for control of the debt level. Furthermore, reorganisation of the debt management department is needed in order to establish and divide the workload between front and back office. This would allow clear management of tasks related to debt management, debt amortization and cash management.

Indicators	Baseline (2014)	2017	2020
Public debt servicing costs as a share of GDP	2.2 %	2.5 %	2.3 %
Difference between planned and achieved level of public debt	1.5%	1.5%	1.5%

Activities	Implementing agency	Commencement date	Planned completion date	Cost estimate	Source of funding
Restructuring of the Debt Management Division, debt analysis, liquidity management and foreign cooperation as front and back office	MoF	2015	2016	-	-
Training of staff at the Debt Management Division regarding different financial operations, awareness and training for different financial	MoF	2016	2017	50.000 €	Budget

Activities	Implementing agency	Commencement date	Planned completion date	Cost estimate	Source of funding
<i>derivatives, debt preparation and analysis, better debt management</i>					
<i>Implementation of the new software tool for public debt and cash management</i>	<i>MoF</i>	<i>2015</i>	<i>2016</i>	<i>200.000 €</i>	<i>Budget</i>
<i>Upgrade of the software tool for public debt and cash management</i>	<i>MoF</i>	<i>2016</i>	<i>2017</i>	<i>500.000 €</i>	<i>Budget</i>
<i>Analysis of the weaknesses in the existing and drafting the Public Debt Management Strategy 2018 - 2020</i>	<i>MoF</i>	<i>2017</i>	<i>2017</i>	<i>30.000 €</i>	<i>Budget</i>

Risk assessment and mitigation of risks:

- **Identified risks:** *Delay in the implementation of the new software tools, the risk associated with preparing and drafting new projects, hence the project preparatory stage needs to be done well.*

Risk mitigation: *To avoid this risk, MoF will have constant and regular communication with software company and will provide all necessary conditions for timely implementation.*

- **Identified risks:** *External shocks which can result with new borrowing and increasing of public debt and increasing of cost*

Risk mitigation: *To mitigate this risk MoF will continue with fiscal consolidation and activities for decreasing the expenditures and deficit, on one side, and, on other side, activities on increasing FDI, economic growth and revenues. MoF will continue to improve communication with subjects on international and domestic market, to better distribute latest information on improvements in fiscal and economic area.*

4.3. PIFC development

Objective: *Individual public organizations manage public finance in an efficient, economic, effective and transparent manner*

Implementation of FMC at the level of each public organisation varies. An annual review of progress shows significant disparities among different organisations. While most now have FMC managers, only a third have FMC action plans. While senior managers generally have policy responsibility, there is little financial delegation below the level of secretary of ministry. Reporting and dealing with irregularities and possible fraud has been overcome with the establishment of the budget inspection under the Ministry of Finance as a centralized department where suspected fraud and irregularities in public sector entities can be reported. It is also necessary to strengthen the role of financial services that would provide support to other organizational units to achieve their objectives in the area of data analysis and preparation of detailed reports on the level of organizational units. A key issue with each public organisation implementing internal audit is the significant shortfall in the number of staff. Some internal audit units prepare strategic and annual internal audit plans, which vary considerably in quality as well as with audit where variations in the style and quality of the reports exist. Employment and capacity building need to be continued and stepped up.

Indicators	Baseline (2014)	2017	2020
The percentage of ministries that formally delegated responsibilities and authorities to the line managers which improve managerial accountability	6,25%	30%	90%
Percentage of the budget users on central and local level submitting annual FMC reports	69%	80%	95%
Average number of internal auditors per unit	1,76	2	2,7
Percentage of appointed certified internal auditors	60%	75%	90%
Percentage of appointed certified internal auditors which did CPD	0%	70%	90%
Percentage of implemented and partially implemented recommendations given by internal auditors in the previous year that were implemented by the end of the current year	48%	55%	70%
Share of first level budget organisations that report annually in compliance with the	0% (methodology)	5% (pilot)	95%

Indicators	Baseline (2014)	2017	2020
Government methodology for monitoring performance	does not exist)	organisations)	

Activities	Implementing agency	Commencement date	Planned completion date	Cost estimate	Source of funding
<i>Situation analysis for financial reporting in the public sector in pilot institutions</i>	<i>MoF-CHU, Treasury</i>	<i>2016</i>	<i>2017</i>	<i>6.000 €</i>	<i>Budget and the IPA 2014 Action</i>
<i>Situation analysis for managerial accountability in the public sector in pilot institutions</i>	<i>MoF -CHU, Budget Department</i>	<i>2016</i>	<i>2017</i>	<i>9.000 €</i>	<i>Budget and the IPA 2014 Action</i>
<i>Establish the mechanisms for delegating responsibilities and powers</i>	<i>MoF -CHU, Budget</i>	<i>2017</i>	<i>2017</i>	<i>15.000 €</i>	<i>Budget and the IPA 2014 Action</i>
<i>Develop methodologies for monitoring and reporting on performance</i>	<i>MoF -CHU, Budget</i>	<i>2017</i>	<i>2017</i>	<i>12.000 €</i>	<i>Budget and the IPA 2014 Action</i>
<i>Conduct training for managers</i>	<i>MoF - CHU and HRMA</i>	<i>2016</i>	<i>Continuous</i>	<i>10.000 €</i>	<i>HRMA Budget or Action</i>
<i>Training for newly appointed internal auditors</i>	<i>MoF- CHU and HRMA</i>	<i>2016</i>	<i>Continuous</i>	<i>10.000 €</i>	<i>HRMA Budget</i>
<i>Organise and deliver training to improve the skills of existing</i>	<i>MoF - CHU and HRMA</i>	<i>2016</i>	<i>Continuous</i>	<i>20.000 €</i>	<i>HRMA Budget</i>

Activities	Implementing agency	Commencement date	Planned completion date	Cost estimate	Source of funding
<i>internal auditors</i>					
<i>Improve work methodology of internal audit</i>	<i>MoF- CHU</i>	<i>2016</i>	<i>2017</i>	<i>5.000 €</i>	<i>MoF</i>
<i>Strengthen the CHU capacities for assessing the FMC and IA quality</i>	<i>MoF- CHU</i>	<i>2016</i>	<i>2017</i>	<i>15.000 €</i>	<i>Budget and the IPA 2014 Action</i>

Risk assessment and mitigation of risks:

- **Identified risk:** *Lack of awareness regarding the importance of financial management and internal audit*

Risk mitigation: *The risk will be mitigated with specific training for managers, employees and internal auditors*

4.4. Transparent financial reporting and accounting

4.4.1. Transition from the cash-based to the accrual accounting and financial reporting

Objective: *Improve the quality of the public finance management and reporting by introducing the main preconditions for key elements of accrual-based accounting*

Implementation of the Strategy for the public sector transition to accrual accounting will ensure transit from cash based to accrual accounting and financial reporting in order to increase effectiveness of the public sector management and provision of services. This will require change of the existing chart of account, modification in the financial reporting, education of the accountants and monitoring and evaluation of the transition to the new system. Most accountants in public sector do not have skills for more elaborate accounting standards. Survey done on the sample of 70 budget users showed that only 37% of accountants hold any accountancy certificates. Therefore the MoF has initiated a training programme in cooperation with CEF and CIPFA to provide basic training on accrual accounting to most accountants employed in first level budget organisations.

Indicators	Baseline (2014)	2017	2020
Public sector accountants trained for accrual accounting (based on the CIPFA methodology)	0	40	80
Property register and double entry book-keeping system for the property implemented	Beginning of the development of the property register	Property data entered into the register	Property register and double entry book-keeping system for the property implemented

Activities	Implementing agency	Commencement date	Planned completion date¹	Cost estimate	Source of funding
<i>Provide general training of on accrual accounting for public accountants</i>	<i>MoF</i>	<i>2016</i>	<i>2020</i>	<i>In line with the AP</i>	<i>Budget and donors</i>
<i>Develop new accrual-based accounting policies</i>	<i>MoF</i>	<i>2016</i>	<i>2020</i>	<i>In line with the AP</i>	<i>Budget and donors</i>
<i>Adapt the Chart of Accounts to new accounting requirements</i>	<i>MoF</i>	<i>2016</i>	<i>2020</i>	<i>In line with the AP</i>	<i>Budget and donors</i>
<i>Develop the IT system to support double-entry bookkeeping</i>	<i>MoF</i>	<i>2016</i>	<i>2020</i>	<i>In line with the AP</i>	<i>Budget and donors</i>
<i>Develop new implementing legislation and</i>	<i>MoF</i>	<i>2016</i>	<i>2020</i>	<i>In line with the</i>	<i>Budget and</i>

¹ In this case 2020 does not mean the date for introducing full accrual accounting but the ending year for this Programme

Activities	Implementing agency	Commencement date	Planned completion date¹	Cost estimate	Source of funding
reporting templates				AP	donors
Provide training for public sector accountants on new implementing legislation, templates and the IT system	MoF	2016	2020	In line with the AP	Budget and donors

Risk assessment and mitigation of risks:

- **Identified risk:** Lack of funds for implementing the Strategy, which may lead to the postponement of certain activities and affect the project impacts.

Risk mitigation: Ministry of Finance will plan these funds in the yearly Budget for certain phases. In the case of the lack of funds there are international organisations which are interested for financing certain parts of the project because of its significance and its impact on other parts of public finance in Montenegro

4.4.2. Alignment with the ESA 2010

Objective: Ensure harmonisation of the data with the European System of National and Regional Accounts (ESA 2010)

Montenegro uses cash-based accounting of revenues and expenditures and current institutional classification and coverage of reporting does not comply with the ESA methodology. Furthermore, the existing Chart of Accounts does not provide for adequate details of budget revenues and expenditures to be able to generate sheets that translate the budget lines from the national classification into the ESA classification. There is room for improvement of methodology and current financial reporting procedures. Proposed set of activities will ensure implementation of ESA methodology in public finances (revision of institutional classification, economic classification, functional classification and reporting procedures for state sector, with special focus on dynamics of regular reporting within Eurostat procedures).

Indicators	Baseline (2014)	2017	2020
Institutional classification arranged	Current	Institutional	Institutional

Indicators	Baseline (2014)	2017	2020
according to ESA 2010 methodology	institutional classification in national accounts is not aligned with the ESA 2010 methodology	classification in line with the ESA 2010 rules	classification in line with the ESA 2010 rules (this requires constant updating in cooperation with Eurostat)
Chart of Accounts reviewed	The economic classification in certain segments does not allow for a full transmission of data in line with the Chart of Accounts envisaged by the ESA 2010	Budget process will be carried out in accordance with the revised Chart of Accounts	The economic classification is in line with the Chart of Accounts envisaged by the ESA 2010
Defined reporting procedure within different sectors in line with the reporting schedule for the Eurostat	Existing reporting procedures are applied in line with the current institutional framework and are of such coverage which is not compatible with the requirements of the ESA 2010 methodology	Reporting procedure within the state sectors in line with the reporting schedule for the Eurostat	Actual reporting procedure within the state sectors is fully in line with the reporting schedule for the Eurostat (according to the revision of the institutional classification, new economic entities will assume the financial reporting obligation to

Indicators	Baseline (2014)	2017	2020
			the relevant institutions)

Activities	Implementing agency	Commencement date	Planned completion date	Cost estimate	Source of funding
<i>Institutional classification</i>	<i>Monstat MoF Central Bank</i>	<i>2015</i>	<i>2016</i>	<i>4.275 €</i>	<i>Budget</i>
<i>Economic classification</i>	<i>MoF Monstat</i>	<i>2016</i>	<i>2016 (the amended Chart of Accounts would be used first for drafting the 2017 Budget)</i>	<i>2.925 €</i>	<i>Budget</i>
<i>Functional classification</i>	<i>Monstat MoF</i>	<i>2016</i>	<i>2016</i>	<i>3.000 €</i>	<i>Budget</i>
<i>Define the reporting procedure for the state sector</i>	<i>Monstat MoF Central Bank</i>	<i>2016</i>	<i>2016</i>	<i>900 €</i>	<i>Budget</i>
<i>Changes to the regulatory framework</i>	<i>MoF Monstat Central Bank</i>	<i>2016/17</i>	<i>2017</i>	<i>675 €</i>	<i>Budget</i>

Risk assessment and mitigation of risks:

- **Identified risk:** Lack of human capacities for the implementation of the given strategy;

Risk mitigation: Through various IPA funded activities Statistical Office is working on increasing knowledge and awareness about specifics of ESA 2010 methodology and its implementation in public finances

- **Identified risk:** No presence of experts during certain stages of the project may cause delays in implementing the activities;
Risk mitigation: Planning of the visits in advance and planning of the activities along with the expert will significantly mitigate the risk of delay of project phases
- **Identified risk:** Insignificant human capacities for implementation of the methodology itself might lead to postponement of project phases.
Risk mitigation: Constant education and expert help provided from IPA funds.

4.5. The SAI capacity to meet the INTOSAI standards

Objective Standardisation of financial audit, compliance audit and performance audit processes in line with the ISSAI standards

The development and strengthening of the SAI is based on strategic development plan. Future activities will be focused on strengthening of the human resources management in the SAI and improving the professional skills of audit staff. Further strengthening of audit capacities to perform different types of audits is needed, especially financial audit, aligned with International Standards of Supreme Audit Institutions (ISSAI). Furthermore, development of the horizontal functions within the sectors is also necessary. It is necessary to draft guidelines on conducting performance and final budget accounts audit. Application of audit methodology and manuals for different types of audits will provide a sound foundation for co-ordinated programme of institution-building and capacity-strengthening. Focus is also needed on enhancing the communication policies with the Parliament, especially in relation with monitoring the realization of recommendations given in the audit reports.

Indicators	Baseline (2014)	2017	2020
Coverage of the Audit report of Final State Budget Account and individual audit reports improved	70%	75%	85%
The number of planned audits per year	18	20	23
Number of organized trainings/seminars/workshops for audit staff and number of trainers for training audit staff	-	Organized minimum 5 trainings and 5 trainers trained	Full application of ISSAI standards
Extent to which the SAI uses standards to	3 (of 5)	4 (of 5)	5 (of 5)

Indicators	Baseline (2014)	2017	2020
ensure quality of work (SIGMA)			

Activities	Implementing agency	Commencement date	Planned completion date	Cost estimate	Source of funding
Analyse the Methodological Instruction for Financial and Regularity Audit and develop the Manual for Financial and Regularity Audit	SAI	2016	2017	24,000 €	Budget and the IPA 2014 Action
Deliver training to auditors regarding the Manual for Financial and Regularity Audit	SAI	2017	2018	6,000 €	Budget and the IPA 2014 Action
Carry out 1 pilot financial audit and regularity audit to test the Manual	SAI	2018	2018	12,000 €	Budget and the IPA 2014 Action
Develop the guidelines for auditing Final Budget Accounts	SAI	2016	2017	12,000 €	Budget and the IPA 2014 Action
Deliver training to auditors regarding the application of the guidelines for auditing Final Budget Accounts;	SAI	2017	2017	3,000 €	Budget and the IPA 2014 Action
Analyse the Methodological Instruction for Performance	SAI	2016	2017	9,000 €	Budget and the IPA 2014

Activities	Implementing agency	Commencement date	Planned completion date	Cost estimate	Source of funding
<i>Audit and develop recommendations for improving the performance auditing methodology;</i>					<i>Action</i>
<i>Analyse the practice of monitoring the implementation of the SAI recommendations in light of the good practices in the EU Member States and develop guidelines for monitoring the implementation of the recommendations given in audit reports</i>	<i>SAI</i>	<i>2016</i>	<i>2017</i>	<i>12,000 €</i>	<i>Budget and the IPA 2014 Action</i>
<i>Develop the HRM Strategy</i>	<i>SAI</i>	<i>2017</i>	<i>2018</i>	<i>12,000 €</i>	<i>Budget and the IPA 2014 Action</i>
<i>Develop the manuals for taking the exams for state auditors and develop Training programme for auditors</i>	<i>SAI</i>	<i>2017</i>	<i>2018</i>	<i>12,000 €</i>	<i>Budget and the IPA 2014 Action</i>
<i>Develop quality control procedures at the institutional level in line with SAI internal documents</i>	<i>SAI</i>	<i>2018</i>	<i>2019</i>	<i>15,000 €</i>	<i>Budget and the IPA 2014 Action</i>

Activities	Implementing agency	Commencement date	Planned completion date	Cost estimate	Source of funding
Develop the Communication Strategy	SAI	2017	2018	12,000 €	Budget and the IPA 2014 Action
Provide adequate necessary premises for work of the SAI with aim to increase audit capacities	SAI	2016	2016	2.000.000 €	Budget

Risk assessment and mitigation of risks:

- **Identified risk:** SAI does not have sufficient number of audit staff due to inability to ensure adequate premises for the work of the SAI.

Risk mitigation: Ensured necessary financial funds for providing adequate premises for the work of the SAI.

- **Identified risk:** SAI does not have full independence in audit planning due to increased number of legal mandatory audits (annual audit of financial statements of political parties).

Risk mitigation: SAI informs the Parliament and Parliamentary Committee on economy, finance and budget initiates the procedure of amending article 43 of the Law on financing political parties to ensure full independence of the SAI in planning audits and increasing audit coverage.

- **Identified risk:** SAI does not have sufficient number of audit staff due to limited premises.

Risk mitigation: SAI implements HR Strategy and hires necessary audit staff.

- **Identified risk:** SAI is not able to engage external trainers for application of ISSAI standards due to legal limits prescribed by Law on Public Procurement.

Risk mitigation: SAI implements Training Programme and organize internal trainings to ensure high qualified audit staff. SAI carries out exams for state auditors in timely manner and hires professional audit staff.

5. Budget Transparency

In Montenegro the budget process is based on transparent legal provision established in the Constitution, an organic budget law and/or related laws. Montenegro observes a well-defined annual budget timetable. The existing legislation also covers all aspects of good budgeting practice, including the definition of public money, the use of a single treasury account and the Parliament's role. While a good level of transparency and oversight was established, the assessments outlined that some issues remained to be addressed, which are mostly related to comprehensiveness, quality, integrity, and accuracy of budgetary information. These include for example lack of linkages between policy and financial information, lack of transparency in capital budgeting, the fact that only aggregate budget execution information is presented in some in-year reporting, and that there was no clearly articulated PFM Reform Programme published by the Government.

The PFM Reform Programme includes a number of activities that foster budget transparency. Having in mind the concept of the PFM Reform Programme to group the activities under different budgetary phases as well as taking into account the fact that the budget transparency represents a horizontal activity, the related activities are presented in the previous chapters. Summary of the key activities that directly contribute to budget transparency is given in a following table:

<i>Phase of budgetary process</i>	<i>Chapter</i>	<i>Activity</i>	<i>Implementing agency</i>	<i>Commencement date</i>	<i>Planned completion date</i>
Executive budget proposal and enacted budget	4.1.1. Medium-Term Budget Framework (MTBF), including the fiscal strategy	<i>Develop the Fiscal Strategy in line with the Law on Budget and Fiscal Responsibility</i> <i>Improvement of planning and presentation of multi-annual commitments in the budget</i>	MoF	2016	2019
	4.1.2. Annual budgeting	<i>Define missions, goals and descriptions of</i>	MoF	2016	2020

Phase of budgetary process	Chapter	Activity	Implementing agency	Commencement date	Planned completion date
		<p><i>programmes or sub-programmes</i></p> <p><i>Define performance indicators for programmes or sub-programmes</i></p> <p><i>Improve budget transparency by providing better visual presentation</i></p>			
	4.1.3. Capital Budget	<p><i>Introduce stages of capital projects in the preparation and planning of capital budgets (preparatory stage and construction stage)</i></p> <p><i>Improve the overview of projects in the capital budget through detailed presentation of individual projects by project and economic classification</i></p>	MoF	2016	2020

Phase of budgetary process	Chapter	Activity	Implementing agency	Commencement date	Planned completion date
		<p><i>Improve the capital budget's statement of reasons as regards the overall estimated project value and schedule</i></p> <p><i>Improve the overview of capital projects by separating the new ones from the ones already being implemented</i></p> <p><i>Establish a public register of all the projects which are financed from the capital budget</i></p>			
	4.1.2. Annual budgeting	<p><i>In accordance with the best international standards explore and implement measures for the improved presentation and visualisation of the in year reports (monthly and quarterly)</i></p>	MoF	2017	2020

<i>Phase of budgetary process</i>	<i>Chapter</i>	<i>Activity</i>	<i>Implementing agency</i>	<i>Commencement date</i>	<i>Planned completion date</i>
In – year and end year reports	4.3 PIFC development	<i>Develop methodologies for monitoring and reporting on performance</i>	MoF	2017	2017
	4.4.1. Transition from the cash-based to the accrual accounting and financial reporting	<i>Develop new implementing legislation and reporting templates</i>	MoF	2016	2020
	4.4.2. Alignment with ESA 2010	<i>Define the reporting procedure for the state sector</i>	MoF	2016	2017
Audit Report	4.5. SAI capacity to meet the INTOSAI standards	<i>Develop the Communication Strategy</i>	SAI	2017	2018

Furthermore, implementation of some small scale activities will be further explored aiming at improving budget transparency by providing better visual presentation and dissemination of budget information.

6. Monitoring, reporting and evaluation

The PFM reform is an important segment of the overall public administration reform. In such a context, the reforms planned by the present document, as well as by other PFM-related relevant planning documents, constitute an important input in drafting the new PAR strategy, as the umbrella document in this policy area. The PFM Reform Programme is prepared in coordination with the preparations for the PAR Strategy 2016-2020.

The MoF will ensure permanent monitoring over the PFM Reform Programme. **A coordination group will be set up by the end 2015, including the key implementing partners the MTA, the SAI and the PPA.** Also a representative of the Parliamentary service supporting the Committee for Economy, Budget and

Finance will be invited to become a member of the coordination group. The coordination group will be chaired by the representative of the MoF. Close cooperation will be established with the Ministry of Interior which will be in charge for the monitoring of the implementation of the new PAR strategy. Relevant representatives of the coordination group should be included in the structures designated for management, coordination, monitoring, reporting and evaluation of the new PAR strategy.

This group will meet quarterly to deliberate on the progress made in the PFM Reform Programme implementation, draft progress reports, and coordinate activities within pertinent technical assistance projects. **The coordination group will prepare the quarterly reports to the senior management of the Ministry of Finance as well as to the Senate of the SAI, with a goal to timely address eventual deviation from the planning.**

By the end of February each year, starting as of 2017, the MoF will report to the Government on the progress made, together with possible amendments to the PFM Reform Programme. This report will be based on the work of the coordination group, consulted formally with all relevant state authorities. The report will be published after approval by the Government. At the beginning of the each year, the coordination group will prepare more detailed annual plan of implementation. Action plan that is consistent part of the Programme is considered as overall plan of the activities for a five year period and a basis for a annual implementation plans and will be unified by the coordination group. It is noteworthy that the PFM Reform Programme is a living document which may be revised on annual basis in the light of the experience gained in its implementation, and possible amendments to the EU acquis.

twice per year, the Government of Montenegro will inform the European Commission of the progress made regarding the PFM Reform Programme, or the sectoral strategies that the PFM Reform Programme heavily relies on. The progress reports will be done as of 2017, in line with the requirements related to the sector budget support, provisionally planned for first quarter. **The monitoring system will include the following information:** key specific weaknesses identified in diagnostic work, annual objectives, evolution since last annual monitoring report, source of verification, revised objectives to be monitored for the next year, medium term objectives of the PFM reform programme. Separate progress reports will be made for the meetings of the **Special Group monitoring the PAR process in Montenegro** in the light of the EU accession. Also, a regular dialogue on the technical level could be organised on the request of both, the EC and the Government of Montenegro. Progress reporting will continue within the established mechanisms of the European Commission, particularly the annual Progress Reports.

The coordination group should be also used as a platform for the policy dialogue and donor coordination with other relevant stakeholders (IFIs, bilateral donors, civil society etc.). Those meetings should be organised at least once per year to discuss the main issues related to the sector.

A more systematic interim evaluation will be carried out in out in early 2018 in order to determine if the PFM Reform Programme continues to be relevant or if more substantial changes are required. The interim evaluation will be done with the participation of the PFM coordinating group, relying on most recent independent reports (SIGMA, PEFA, IMF, local NGOs and others) and a thorough self assessment of responsible state authorities.