



# GUIDEBOOK TO BUDGET PROCESSES

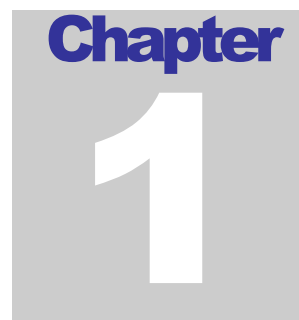
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## TABLE OF CONTENTS

1	INTRODUCTION AND PURPOSE .....	4
1.1	<i>Background and Purpose</i> .....	4
1.2	<i>Content</i> .....	7
2	THE CONCEPTUAL FRAMEWORK AND GOOD PRACTICE IN THE PLANNING AND BUDGETING PROCESS .....	9
	<i>Background to Budgeting</i> .....	9
	<i>Conditions Required for Successful Budgeting</i> .....	13
	<i>Preparing the National Budget</i> .....	15
	<i>Strategic Planning</i> .....	22
	<i>Budgeting and Medium Term Budget Framework (MTBF)</i> .....	25
3	THE CROATIA'S STRATEGY OF GOVERNMENT PROGRAMS AND THE MEDIUM TERM BUDGET FRAMEWORK (MTBF).....	31
	<i>Strategic plans of ministries and other state bodies</i> .....	32
	<i>Picture 1: Strategic planning process diagram</i> .....	34
	<i>Strategy of Government Programs</i> .....	37
	<i>Medium term Budget Framework</i> .....	38
4	BUDGET INSTRUCTIONS AND DETAILS OF THE BUDGET PROCESS .....	40
	<i>Instructions for the Preparation of the State Budget Proposal</i> .....	42
	<i>Due dates and activities of the state budget preparation and drafting</i> .....	43
	<i>Budgetary user limits</i> .....	44
	<i>Financial plan structure of the budgetary users, including budget classifications</i> .....	45
	<i>Table 2: example of organizational classification</i> .....	46
	<i>Table 3: An example of economic classification</i> .....	47
	<i>Table 4: An example of functional classification</i> .....	48
	<i>Table 5: An example of location classification</i> .....	48
	<i>Table 6: An example of program classification</i> .....	49
	<i>Figure 3: Sources of financing in the Republic of Croatia's State Budget for 2010</i> .....	51
	<i>Financial plan justification</i> .....	51
	<i>State budget amendments and addendums (supplementary budget)</i> .....	53
	<i>Temporary measures for state budget balancing</i> .....	53
	<i>Reallocation of state budget funds</i> .....	54
	<i>Transfer of unused budget funds into the next year</i> .....	55
5	KEY PERFORMANCE INDICATORS .....	56
6	BUDGET USER RESPONSIBILITIES .....	59
	<i>Connections between the Strategy of Government Programmes, MTBF and the annual budget/ financial plans of budget users</i> .....	59
	<i>Budget User Budget Submissions</i> .....	61
	<i>The Recurrent Budget</i> .....	64
	<i>Capital Budgeting</i> .....	65
7	THE BUDGET ANALYST'S RESPONSIBILITIES .....	68
	<i>The Historical Context of Budget Analysis in Croatia</i> .....	68
	<i>The Role of a Budget Analyst</i> .....	70
	<i>Ethics in Budgeting</i> .....	79
8	THE KEY STAKEHOLDERS IN THE BUDGETARY PROCESS.....	80
	<i>The Ministry of Finance</i> .....	80
	<i>Bureau of Macroeconomic Analysis and Planning</i> .....	81
	<i>The State Treasury</i> .....	82
	<i>Croatian Tax Administration</i> .....	84

	<i>Customs Administration</i> .....	85
	<i>The Government and the Office of the Prime Minister</i> .....	86
	<i>The Parliament</i> .....	87
	<i>International Organisations and Donors</i> .....	87
	<i>Non-Governmental Organisations (NGOs), the Press, and Civil Society Organisations</i> .....	88
9	<b>BUDGET EXECUTION</b> .....	90
	<i>Single Treasury Account</i> .....	91
	<i>Figure 5: State Treasury Account</i> .....	92
	<i>Steps in the execution of the State Budget</i> .....	92
	<i>Foreign Currency Account</i> .....	94
	<i>Managing the State Budget's financial flow</i> .....	95
	<i>Monitoring and reporting on state budget execution</i> .....	96
10	<b>MONITORING, EVALUATING, AND REPORTING RESULTS</b> .....	98
	<i>Roles of Monitoring and Evaluation</i> .....	100
	<i>Monitoring and Evaluation in a Government</i> .....	102
	<i>Reporting</i> .....	103
	<i>Auditing of Reports</i> .....	108
	<i>Strengths and Shortcomings of Monitoring and Evaluation</i> .....	110
	<i>Types of evaluation</i> .....	110
	<i>Outline of Process Steps for Conducting a Programme Evaluation</i> .....	111
	<b>ANNEX 1: A GLOSSARY OF PLANNING AND BUDGETING TERMS</b> .....	116
	<b>ANNEX 2: THE 2008 BUDGET LAW</b> .....	140
	<b>ANNEX 3: SAMPLE INSTRUCTIONS FOR PREPARING STRATEGIC PLANS FOR THE PERIOD FROM 2011-2013</b> .....	141
	<b>ANNEX 4: ORGANOGRAM OF THE MOF</b> .....	142
	<b>ANNEX 5. BUDGET ANALYST'S COMPETENCY MODE</b> .....	144


 Chapter  
1

## 1 INTRODUCTION AND PURPOSE

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### 1.1 Background and Purpose

Budget Users in Croatia have been operating under an integrated budget process for several years, and the Ministry of Finance (MOF) has been providing leadership to that process. However, due to several factors – the ongoing maturation of the public sector in Croatia, Croatia’s movement along the path to EU membership, the increasing number and sophistication of the Laws and Regulations that govern in Croatia - it is important that the individuals and organizations involved in the budgetary process understand how its various elements fit together, and how they each contribute to the development of the annual budgets for recurrent and capital expenses and activities. This importance is heightened as a result of Croatia’s most recent Budget Law<sup>1</sup>, which contains requirements which are consistent with the budget practice of other EU Member States but which may be new for many organizations in Croatia. The concepts underlying that Law should bring greater consistency, accuracy, and transparency to Croatia’s previous budget process.

The intended purposes of this Guidebook are to:

- Present and describe the role of the budget process within the overall process of government in Croatia;
- Improve the quality of analysis that goes into the development of the annual budgets so that decision-making on resource allocation by all parties is timely and enhanced;
- Help Budget Users develop and maintain an effective internal budget process and a linkage between that process, strategic plans, and MOF requirements;
- Serve as a collection of How-to-do descriptions of processes and procedures (manuals), and as a training and reference tool that can be used by staff in Budget Users who must respond to MOF requirements;
- Keep users current on MOF’s requirements since they may change from year to year;
- Ensure consistent documentation to support budget requests in the Budget Users, and
- **Emphasize that the budget process cuts across all government activities and thus it is important for all relevant government employees should have a basic understanding of it.**

Further, this Guidebook is based on certain assumptions:

- **The planning and budgetary systems in Croatia continue to evolve rapidly, and in addition, changes occur among the executives and staff of Budget Organizations who are responsible for program management and for the**

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<sup>1</sup> Narodne novine, br. 87/08

**budget processes. As Croatia moves closer to EU membership, some of the traditional roles and responsibilities which have previously been fulfilled by people in management and budget jobs will be changing as well, and new roles and responsibilities will emerge which should be consistent with practices found in other nations' governments. (For example, this is especially true regarding the concept of greater accountability for management of ministry programs, and thus the role of "program manager" will evolve closer to the EU concept, which is based on active involvement and greater oversight regarding program activities.) Therefore, in order to coordinate and focus this evolution in a consistent way, a common "reference" tool – this Guidebook – will be essential.**

- Many users of the Guidebook have been focused mostly on the narrow or technical aspects of the budget process, and they have had only partial exposure to the theories and policies upon which the budget process is built;
- Many users have had exposure to the budget processes in their own organizations, and they have received copies of MOF Budget Instructions, but they have not had significant exposure to a comprehensive guide to the overall environment within which Croatia's budget process operates;
- Many users have not had experience in the budget process before assuming their new roles as Budget Analysts (or as new program managers who have budget implementation responsibilities), and their roles as Budget Analysts (or program managers) have not been exercised in the comprehensive ways which are described in the Guidebook;
- Most users have received on-the-job training and little or no comprehensive training in the budget process, and they operate without suitable job descriptions or career-development aids;
- Many users are aware that related responsibilities are being performed in other parts of the budget or planning process, but they do not have complete knowledge of those other responsibilities or of how those responsibilities relate to their own responsibilities;
- The Guidebook can serve as a permanent reference tool for Budget Analysts as well as those who use the budget process, and it will be kept up to date and revised as needed by the MOF;
- Individual Budget Users will use the Sections of the Guidebook which were initially developed as manuals to contain precise processes and procedures in developing their own internal budget processes, as a way to strengthen their management of funds;
- The existence and use of the Guidebook will help Croatia's budget process to become more connected to the government-wide and organization-wide planning processes, and thus the budget process should become more transparent, relevant, useful, accurate, and timely;
- The management and evaluation of programmes will become more effective, based on a stronger budget process relying on performance information and a greater understanding and use of such information by executives and programme managers; and
- Croatia's funds will be spent more effectively and efficiently and can be put to use in better ways, for supporting Croatia's future development.

Although this Guidebook contains a significant amount of policy and procedural guidance and instruction, it is not possible for the Guidebook to contain every bit of

information that is relevant to the budget process in Croatia – every effective government-wide budget process is flexible and fluid, and some factors may (and should) change from time to time. Therefore, users of this Guidebook should take other things into consideration when learning about and conducting their responsibilities under the Croatia budget process, including:

- The most recent Budget Law and the subsequent Decrees and Bylaws that are issued;
- The annual Budget execution Law under which Hrvatski Parliament appropriates funds for each year;
- Specific legislation which is relevant to the user’s own organization and programmes;
- Other publications of the MOF, such as manuals, guidelines, and instructions;
- Government-wide policy documents, such as the Croatia Strategy of Government Programs ;
- Relevant publications of donors (such as the World Bank, the International Monetary Fund (IMF), the European Union (EU)); and
- Plans, policies, and procedures which control the Budget User and programmes.

This Budget Guidebook has three different but related audiences, and for that reason, the Guidebook contains both basic and advanced information. The audiences are:

- **Budget Analysts:** first and most immediately, the Guidebook is directed at the budget analysts in the MOF and in budget users who have day-to-day responsibility for the government-wide budget process that is used each year to develop the Budget. This Guidebook is intended to lead these users through the planning and budget process and provide important instructions to help all of them carry out their duties in accordance with current policies and procedures, while moving closer to international standard practices and EU standards. The Guidebook contains the policy and general guidance information that will help these analysts do their jobs. Also, there are parts of the guidebook which are more step-by-step descriptions of how to do things (manuals). Therefore, the Guidebook should be useful to both experienced analysts (who can use it as a reference document) and new analysts (who can use it as learning and training tool).
- **Programme Managers:** The second audience consists of officials who have major day-to-day responsibilities for the management of public programs. Because of the crucial role that budgeting plays in that management, these individuals must understand the budget process and how to perform their responsibilities regarding it (even when they have no direct control over the budget itself). Such people are referred to as “programme managers” throughout this Guidebook, although the role and concept of “program management” as it is exercised in other nations is not yet fully implemented in Croatia. (In other nations, a “program manager” is a senior and knowledgeable official who has the responsibility for overseeing all aspects of program implementation. This is a pro-active responsibility which requires good knowledge of the program’s technical activities as well as significant knowledge of key management practices including:
  - planning,
  - policy development and analysis,
  - budget formulation and execution,
  - financing (alternative financing mechanisms, use of donor funds),
  - procurement ,
  - capital budgeting and
  - other management functions which are necessary for operating in the public sector in the 21<sup>st</sup> century.)

The Guidebook assumes that the international concept of “program manager” will gradually become more commonplace in Croatia and that programs, program recipients, and the planning/budget systems will benefit from it. Therefore, in order to avoid confusion in this Guidebook, Croatian readers should define “program managers” in this way. In summary, this audience includes Budget User officials (and their advisors) throughout the government, and others who have some responsibility related to the budget process, for such functions as:

- Day-to-day programme management and execution;
  - Decision-making regarding priority-setting and resource allocation; and
  - Programme planning, reporting, monitoring, and/or evaluation.
- **Citizens of Croatia:** Finally, this Guidebook is directed to the citizens of Croatia and representatives of the civic society, so that they might better understand how the government allocates limited resources. Additionally, by better understanding the budgeting process, individual citizens will be better able to make their positions known to decision makers and have an influence on the Croatia budget.

In summary, like much in Croatia, the budget process is evolving. To keep up with the changes, maintain a high quality product, and allocate resources according to Croatian priorities, this Guidebook has been developed.

## 1.2 Content

This Guidebook contains **nine** chapters including the Introduction, and it is laid out as follows:

- **Chapter One:** Introduction;
- **Chapter Two:** Provides the underlying framework for the budgeting policies and procedures that are discussed throughout the rest of the Guidebook, based on international standard practices. Because of its fundamental role in supporting the rest of the Guidebook, this Chapter will be referred to frequently throughout the Guidebook in order to provide an explanation of activities and circumstances that are found in Croatia;
- **Chapter Three:** Describes the Croatia Strategy of Government Programs and process and the Croatia Medium Term Budget Framework (MTBF), and explains how they relate to each other and to the budget process in Croatia;
- **Chapter Four:** Describes the framework of the Croatia budget process as shaped by budget instructions from the MOF;
- **Chapter Five:** Describes the importance of key performance indicators in budgetary process
- **Chapter Six:** Provides detailed instructions on how to prepare a budget request for the budget of Croatia and the responsibilities of Budget Users (Budget Requests Preparation Manual);
- **Chapter Seven:** Describes how a budget analyst views/analyses budget requests;
- **Chapter Eight:** Describes the various stakeholders in the Croatia budget process and how they interact in that process, as well as a description of the role that the Treasury plays in the budget process;
- **Chapter Nine:** Describes the importance and methods of budget control;
- **Chapter Ten:** Describes the processes of programme monitoring and evaluation, and how they can be developed and applied; and

- **Annexes:** Provides some reference tools for the use of those involved in the budget process.
  - **Annex 1** is a Glossary of terms and concepts that are used in the Guidebook
  - **Annex 2** provides a copy of Croatia's most recent Budget Law (2008)
  - **Annex 3** shows a sample of annual budget instructions for Budget Users from the MOF
  - **Annex 4** contains an organogram for the MOF
  - **Annex 5** contains a budget analysts' competency model, which focuses on the skills that public sector budget analysts should have



## 2 THE CONCEPTUAL FRAMEWORK AND GOOD PRACTICE IN THE PLANNING AND BUDGETING PROCESS

The purposes of this Chapter are to:

- Serve as a common reference point for the rest of the Guidebook's technical discussions. This Chapter's contents are drawn from international standards which have been developed and implemented over time by a number of countries and/or international organizations such as the World Bank, International Monetary Fund, and the European Union, as well as bi-lateral organizations such as the British Department for International Development (DFID), Germany's GTZ, and the US Agency for International Development (USAID).
  - Providing the information and technical descriptions in this Chapter will mean that they do not need to be repeated at length in subsequent Chapters. Therefore, Guidebook users are reminded to take relevant parts of this Chapter and related parts of subsequent Chapters into consideration together, in order to get a full picture of the specific topic they are interested in.
- Provide a summary of standard budget processes used around the world and discuss their characteristics. (This will help to describe the framework within which Croatia's budget process was developed);
- Summarise Croatia's budget process and the steps which are included in it;
- Introduce key topics of planning and budgeting which will be described in more detail in subsequent chapters, such as strategic planning, the Medium Term Budget Framework, budget controls, and other subjects; and
- Generally familiarise users of the Guidebook to the topics and flow of information which are contained within the Guidebook.

### Background to Budgeting

#### Introduction to Planning and Budgeting

Planning and budgeting are inextricably linked. Within a government financial management system, the planning/budgeting process identifies total resources to be mobilised, (including assistance from foreign sources of financing, such as EU), borrowing and debt strategies, priorities, resource utilisation decisions and ultimately budget allocations to operating units at the central and local level. Planning and budget processes need to be closely linked, so that operational plans are reflected in the financial plans, and vice versa.

#### Planning

Planning is a process of preparing short, medium and long term plans. Medium and long term plans are strategic in their nature, i.e. they discuss and present choices which

potentially have a fundamental impact on how a sector or an organization operates. These plans contain statements of government objectives and policies, strategies or measures for achieving objectives, a resource framework for the plan period (projections of revenues and expenditure), a programme of activities to be implemented during the period, and a method for measuring whether a plan's objectives have been met. There is requirement for the budget users to produce annual plans in Croatia.

### **Government Budgeting**

The budget should be a management tool for prioritisation and allocation of financial resources and achieving, controlling and monitoring of these so as to ensure they meet stated government objectives.

Government budgeting differs from private sector budgeting in three key areas:

- Government budgets are not only about managing government activities; they are also tools of national economic management;
- Budgets are not always linked directly to revenue raising; and
- The budget is the legal authority to spend, with limits that may not be exceeded without further parliamentary authority.

### **Bottom-up or top-down budgeting**

There are two basic directions that can be taken to government budgeting: bottom-up or top-down.

Under the **bottom-up or incremental approach**, Budget Users estimate their expenditure requirements and make requests within the established budget process for this funding. These requests are aggregated and compared to expected resources, and the government sets priorities to bring requests within resource constraints.

Under the **top-down or resource restriction approach**, the estimated resources available (the "resource envelope") are allocated between organisations according to spending priorities. Organisations then prepare their budgets within their resource allocation limits. Executives should ensure that allocations are consistent with their own priorities.

Bottom-up budgeting makes it easier for managers to make resource allocation decisions, while the top-down approach sets a maximum budget limit to guide managers in making their resource allocation decisions.

At present, the budget process in Croatia – like many governments -- uses both types of budgeting. Budget Users have to prepare their budgets on a bottom-up basis but these are constrained by a top-down budget ceiling.

### **The Budget Process**

The national budget of any country is the amount appropriated by the government to the collective Budget Users. Managers of those Budget Users should set their medium term and annual objectives and related program performance indicators within available resource parameters as set forth in the budget Instructions that also reflect national priorities.

However, this budgetary approach is an ideal model which is rarely 100% achieved in practice. In reality, political decisions may intervene in budget and program decisions, and in addition, organization managers may take a “short-cut” in setting budget allocations within their organizations by simply using historical financial data, rather than by conducting rigorous re-examinations of their true needs. This may lead them to only increase budget allocations to accommodate known changes in programmes and activities, rather than to examine true needs which may be changing.

Many governments have found that this approach is unsatisfactory for several reasons: including:

- It fails to identify managerial responsibility, especially responsibility for achieving performance targets;
- Since managers have budgets imposed on them, and do not necessarily accept the performance targets, the budget does not motivate them to achieve those targets;
- It encourages spending rather than saving;
- Performance targets and resources are not always matched in any visible manner;
- It makes performance monitoring more difficult, since output targets are not set always by those responsible for achieving them; and
- It does not provide an adequate framework for evaluating and discussing budget decisions at either national or municipal government levels.

In order to eliminate or reduce the impact of these factors, governments have undertaken different approaches to budget setting, and some practical lessons have been learned from them. Two of the main alternate approaches to the traditional top-down/bottom-up process are:

- Programming Budgeting System (PBS); and
- Zero Based Budgeting (ZBB).

### **Programming Budgeting System (PPBS)**

Under PBS, the various activities of government are seen as “programmes”. Each programme has related benefits and costs. Also, most programmes have alternative ways of achieving the same end, which can also be subjected to a cost-benefit analysis.

In PBS, benefits need to be defined in terms which describe how things should or ought to be, how to value them, which things are good or bad, and which actions are right or wrong). PBS identifies government objectives, describes the impact of programmes on those objectives, and provides a rational framework for selecting the programmes that best meet government objectives.

Despite its advantages, PBS has two major difficulties. The first is that it defines output in a way that does not allow comparison between alternatives on anything other than a subjective basis. A second difficulty is that measurable information about many government activities doesn’t exist or isn’t collected readily, and so governments often struggle to implement the essential data-oriented part of PBS. For these reasons, PBS has not proved to be the sole answer to government financial management.

### **Zero-Based Budgeting (ZBB)**

Zero Based Budgeting is also a comprehensive budget approach. There is no automatic guarantee for receiving any specific level of funding for any specific programmes or organisations, hence the term, ”zero-based” – each budget request starts from a zero level of funding. It requires that the activities and objectives of government are

identified, and turned into a series of “decision packages”. Each decision package is a programme under the control of one manager with defined and measurable impacts and objectives. These are categorised, ranked and evaluated to assist the government make informed decisions.

One advantage of ZBB is that it forces programme managers and implementing agencies to constantly review their programmes and programme results and to ensure that the programmes remain effective and consistent with national/organisational priorities. This can facilitate decision-making (especially regarding decisions about retaining programmes or programme resource levels). However, the disadvantage of ZBB is that it is very time and other resources expensive, and in addition, it often results in a re-affirmation of the status quo (usually because that status quo shows positive results or because political realities make it difficult for deep changes to be made), and hence it is not the sole answer to a government’s budgeting needs, either. However, this approach is useful to apply to certain sectors and/or at specific points in time, to challenge the existing allocation of resources and to develop more effective or efficient solutions for organizing public service provision or program delivery.

### Summary

Although, both PBS and ZBB are rarely used in their pure forms as complete solutions, the ideas derived from them have gained wide international acceptance and they provide important tools in the budget process.

In particular, these two approaches provide some important principles:

- Focusing on the **outputs and results** to be produced by government spending;
- Recognising that there is **more than one way** to achieve any desired output;
- Identifying **ranking** of different projects in their importance to meeting government objectives, and;
- Both approaches have very practical applications within the operating level of some organisations, especially regarding the **choices** of which programmes to continue, to change, and to eliminate.

Although neither is used in their pure form in Croatia at present, both have the potential to contribute some of their positive features to Croatia’s budget process. Of the two, ZBB is likely to be the more useful to new governments that are experiencing static revenues but increasing demands for government services, and where the long-term shape of the government is still under consideration. Instead, Croatia uses a combination of Incrementalism (whereby the starting point is last year’s budget which is adjusted up or down in the light of changes in circumstances since that budget was prepared) and Resource Restriction (whereby a ceiling is set which must not be exceeded). The definition, advantages and disadvantages of these methods (together with those of PPBS and ZBB) appear in Table 1 below.

**Table 1: Approaches to Budgeting**

<b>MODEL</b>	<b>DEFINITION</b>	<b>ADVANTAGES</b>	<b>DISADVANTAGES</b>
<b>INCREMENTALISM</b>	<p>Last year's budgets considered as "given"</p> <p>Decision makers debate only the incremental amount in excess of previous year's budget</p>	<ul style="list-style-type: none"> <li>• Focuses on "controllable" items</li> <li>• Easily understood and operated</li> <li>• Self contained on annual basis.</li> <li>• Minimises "shocks"</li> </ul>	<ul style="list-style-type: none"> <li>• Short Run. Difficult to reprioritize due to changes in objectives</li> <li>• Current items often "built in" automatically, e.g. payroll budget for vacant posts</li> </ul>
<b>PROGRAMME BUDGETING (PBS)</b>	<p>Long term budget related to strategic objectives - offers costed package on policy options</p>	<ul style="list-style-type: none"> <li>• Objective</li> <li>• Participative</li> <li>• Strategic</li> </ul>	<ul style="list-style-type: none"> <li>• Analysis intense, requires good capacity</li> <li>• Time Consuming</li> <li>• Requires support from short term budgets</li> </ul>
<b>ZERO BASED (ZBB)</b>	<p>Construction of budget from first principles - "blank sheet of paper" approach</p>	<ul style="list-style-type: none"> <li>• Objective</li> <li>• Questions "base" budget</li> <li>• Avoids ongoing patterns associated with incremental-ism</li> </ul>	<ul style="list-style-type: none"> <li>• Time consuming</li> <li>• Complex</li> <li>• May contradict political reality</li> </ul>
<b>RESOURCE RESTRICTION</b>	<p>Key resource(s) are limited – individual budgets designed to fit overall restriction</p>	<ul style="list-style-type: none"> <li>• Tight control at macro level</li> <li>• Questions priorities at operational level</li> <li>• Predictable in terms of distribution of resources between sectors</li> </ul>	<ul style="list-style-type: none"> <li>• Inflexible towards new or changed needs</li> <li>• Can produce conflict</li> </ul>

### Conditions Required for Successful Budgeting

#### Advantages of Sound Budgeting

Benefits do not automatically arise from the sound budgeting process. "Bad" budgeting systems (that is, systems which are poorly planned, managed, evaluated, calculated, and/or are not timely), or good systems which are badly applied, will have a negative effect. Specifically, the failure of a nation to have a good government-wide system, or

the failure of a Budget User to have an effective internal budget process, can lead to such major problems as ineffective and inefficient spending, poor controls of spending, poor programme results, and potential fiscal crises for the government or organisation.

The following conditions are necessary for successful budgeting:

- **Top Management: the full involvement, support, and informed decision-making of top management;**
- **Defined Goals:** clear-cut definitions of the long-term aims within which the budgeting system will operate
- **Sound Structure:** a realistic organisational structure with clearly defined responsibilities. The manager should have responsibility for **all** elements of his/her budget, including being able to “hire and fire” staff. The process of budgeting makes it necessary for the organisation to be divided into areas of functional responsibility or programmatic budget centres with clear statements of the responsibilities of each manager who has a budget. Each Budget User’s accounting officer should know exactly for what services and for what money he/she is responsible. This highlights the importance of accountability on the part of programme managers and organisational executives, and it further illustrates the fact that the budget acts as a “contract” between the government and the taxpayers. Under the terms of this “contract”, a certain amount of money will be provided to a certain organisation for a certain purpose, objective and time period, and in return, the programme managers and the organisation are responsible or accountable for delivering a certain level or quantity of a product or service;
- **Involvement:** genuine and full involvement of the line managers in all aspects of the budgetary process. This is likely to include a staff development and education programme in the meaning and use of budgets. When conducted effectively, the full budgeting process involves liaison and discussions during preparation and execution phases between all levels of management in all Budget Users. The budgeting process provides for an important form of vertical and horizontal communication. “Vertical” communication being within an organization, from the most junior to the most senior officer, and “horizontal” communication being between officers of similar ranks in different divisions or ministries, as well as outside groups which are interested in the Budget User. In addition, there should be opportunities for involvement by stakeholders, taxpayers, and others (including representation from related programmes, where appropriate);
- **MIS:** an appropriate Management Information System (MIS) which will include records of expenditure and performance related results, a prompt and accurate reporting system showing actual and committed expenditure against a planned budget, the ability to provide more detailed information or advice on request – in short, the system should be user-oriented and comprehensive.
- **Revisions:** regular revisions of budgets and targets, where necessary; and
- **Flexibility:** budgets should be administered in a flexible manner. Changes in conditions may call for changes in plans and the resulting budgets. Rigid adherence to budgets that are clearly inappropriate for current conditions will cause the whole budgetary system to lose credibility and effectiveness. Indeed, if budgets are not subject to revision, they are effectively **decisions - not plans**.
- **Co-ordination:** the budgetary process requires that feasible, detailed budgets are developed covering each activity, department or function of the organisation. In this way, the budgeting process provides for the co-ordination of these elements so that each aspect of the operation contributes to the organization’s overall plan of action.



### Restrictions and Challenges Involved in Budgeting

While well established budget process has many advantages, and while they are a vital aspect of the management process of any organization, they may also present challenges in some situations:

- **Restrict Initiative:** someone may have a good idea but it cannot be implemented for lack of budget resources, or it cannot be implemented quickly enough to have the greatest positive impact on the problem at hand;
- **Slow Process/Long Lead Time:** in order to have an orderly and deliberative process that provides for adequate transparency and sufficient time for the necessary analyses and calculations to be considered, most governments find that one full year (or more) may be required, between the time that the budget cycle starts and the year's eventual appropriations are provided. As a result, circumstances regarding a problem or a programme often change during this time<sup>2</sup>;
- **Jobs Uncompleted:** tasks are not finished because the budget allocation runs out;
- **Unnecessary Expenditure:** funds are expended (especially quickly and on lower-priority items at the end of the year) by the Budget User, to try to show that the entire appropriation is needed, and to ensure that the budget is not reduced for that Budget User for next year;
- **Cash Flow Problems:** managers may try to spend as much money as possible at the start of the year (if and when there is a history of reducing the budget later in the year), thus resulting in uneven expenditure patterns.
- **Other Disadvantages:** there are few incentives or rewards for spending less than the appropriated amount or for finding ways to save money; budgets are not always flexible in the face of emergencies or changed circumstances; managers are often dependent on other government systems (procurement, human resources, etc) for information (or other organisations' actions) that is necessary for programme implementation and monitoring and for decision-making; and budgets may be difficult to monitor if expenditure is uneven.

### Preparing the National Budget

The table below indicates an outline of the budget preparation process followed by many governments, including Croatia. The stages are not all directly sequential and several might be going on at the same time. Because of practical and political realities, some stages may be performed with greater effectiveness and efficiency, and some may be performed with less. There then follows an explanation of each of the stages.

**Table 2: Stages in Budget Preparation<sup>3</sup>**

Stage	Title	Outline
1	Prioritisation Stage	The Government should determine the broad medium-term policy and spending priorities based on its social, economic and developmental priorities. These may be contained in a document such as the Government Strategy

<sup>2</sup>This is a strong argument for some extent of budget flexibility.

<sup>3</sup>For full budget calendar of Croatia see Section 4.2

		Statement.
2	Review of the macroeconomic and fiscal framework	A technical analysis of the current and likely future macro-economic and fiscal framework for the MTBF budget period. This would also take into account any Budget Revision (re-balancing) process which takes place in mid-year.
3	Ascertain the total of revenue available	Partially on the basis of Stage 2 and partially on the basis of detailed discussions with lenders (if any) and the Revenue Agencies (Tax Department and Customs Administration), ascertain the total spending ceiling for the budget round.
4	National Priorities Statement (integrated MTBF document)	Based on Stages 1 and 3, the Government's broad medium-term (3 yr) policy and spending plans are considered by Cabinet and used as the basis for the annual budget and included in the MTBF document. Good practice of certain EU countries suggests that such an MTBF document should be adopted by the parliament, as well.
5	Send Budget Instructions to each Budget User	During the course of a year, the MOF sends each Budget User a series of Budget Instructions detailing the policies to be followed, the procedural criteria to be used, the schedule to be followed in preparing their requests, the ceiling amounts to which they should adhere, and the format to be used for their submissions.
6	Budget Users submit budget requests (Financial Plan)	Based on their plans and the Budget Instructions, each Budget User responsible for its own budget should draft its request in accordance with the MOF's Instructions. The requests should make use of the results of programme monitoring and evaluation activities that have been conducted.
7	Review and budget negotiations between the MOF and individual Budget Users; Cabinet Review and decisions	If, as will usually be the case, the Budget User submission exceeds the amount available, there will be discussions to resolve the issue. MOF may possibly be able to identify a small amount of extra funds it can release if a ministry makes a good case. If cuts are necessary they must be "real" (e.g. cutting a service; closing an office) and not simply allocating inadequate resources for all proposed activities. The MOF makes recommendations regarding the requests to the Cabinet, which reviews them and submits the overall budget request to the Parliament.



8	Budget Appropriation process (Decision stage)	Based on the results of Stage 7, the final proposed appropriations for each Budget User are determined by the Parliament. Results of any mid-year budget reviews are included in the proposed appropriations.
9	Government submits budget proposal to the Parliament	The Budget, which contains indicative figures also for the next 2 years, is submitted to the Parliament.
10	Budget is approved by the Parliament	The draft budget law, in its original form, or as amended becomes law.

The highlights of this annual process are shown in the following diagram, which emphasizes the cyclical nature of it – the results of each step, and the results of each year’s budget and programme results, lead into the next step and the next year.

### Stage 1: Prioritisation Stage

Any modern state should have a long term “vision” of what it wants to be like in future. It should also have medium and long term plans in place as to how this is to be achieved. This can be provided through a vehicle such as the Strategy of Government Programs or other strategic document that the Government may prepare. In addition, this stage provides the first opportunity for consultation with representatives of outside organisations to have input into the process, in support of the need for constant transparency in the development of the year’s budget.

Similarly, every Budget User should have its own Strategic Plan or other similar document that aligns with the nation’s strategic document (such as the Strategy of Government Programs) and it should produce “progress reports” on how it is succeeding, or otherwise, in implementing the Plan. These should also form part of the input for the Prioritisation Stage process.

### Stage 2: Review Macro-economic and Fiscal Framework

There are basically two elements to the process:

- **Macro-economic Framework:** the overall economic framework within which the government has to operate and over which it has limited control; and
- **Fiscal Framework:** the financial framework of the government and over which it has some degree of control.

#### Macro-economic Framework

The rationale for macroeconomic forecasting relates to fiscal discipline, that is, the budget process must be conducted within the overall limits established between revenues, needs, and expenditures. The analytical framework should comply to the extent possible with standard practices for international modeling and with the existing capacity, both in terms of manpower and data requirements.

The macroeconomic and fiscal planning models should be constructed such that they can further the establishment of baseline and policy option forecasts, so that the models will provide decision-makers with sufficient information and flexibility. In Croatia, the MTBF is the vehicle used for performing this function, and the Bureau of Macroeconomic Analysis and Planning in the MOF has the lead responsibility for

developing the necessary models.

Developing useful models and forecasts will require liaison within the MOF and between the MOF and the National Bank, and other relevant agencies (including Tax Administration, Customs Administration, donor organisations, as appropriate) to ensure that fiscal data used as a basis for fiscal modeling and forecasting are reliable, timely, accurate, acceptable, and cover the sector comprehensively. It is necessary to co-ordinate macro-economic forecasting on the important economic aggregates and to examine the expectations and realistic/desired scenarios for these aggregates.

Further, for fiscal forecasting to be as accurate as possible, it is essential to ensure that policy assumptions used for fiscal modeling are systematic, realistic and appropriate.

### **Fiscal Framework**

Table 3 (below) details the areas to be covered in this process. As with the budget generally, these are concurrent, not consecutive, steps.

**Table 3: Steps in preparing Fiscal Framework Data**

<b>Step</b>	<b>Action Required</b>
<b>1</b>	Prepare forecast for the MTBF budget period.
<b>2</b>	Co-ordination of preliminary forecasts indicators, including inflation rate and exchange rates for MTBF budget period.
<b>3</b>	Review tendencies in allocations of financial resources and analyse budget expenditure by main economic categories.
<b>4</b>	Prepare forecast of domestic debt for MTBF period.
<b>5</b>	Estimate resources required to service internal and external debt during MTBF budget period.
<b>6</b>	Analyse capital investment tendencies financed from the budget and assess their volume for the MTBF budget period.
<b>7</b>	Analyse fiscal policy and tax and customs administration and set objectives in these areas for the MTBF budget period.
<b>8</b>	Prepare review of salary policy for MTBF period.
<b>9</b>	Analyse the tendency of employment and wage bill in the public sector and assess the impact of any wage reform policy.
<b>10</b>	Adjust wage bill policy to the general resource framework in order to assure corresponding financial support.

11	Prepare and present social insurance policy for MTBF budget period.
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### Stage 3: Ascertain the Total of Revenue Available

It is extremely important to have sound, realistic, government revenue forecast, because it improves predictability and credibility, thereby reducing the need to cut expenditure during the Fiscal Year. The medium-term budget framework is only as valid as the first year's forecast, since if the first year has not been prepared accurately, the two outer years will be "off course" by default. Technical improvements to revenue forecasting are therefore essential to giving decision makers the budget predictability needed to manage effectively. It is clearly impossible for effective multi-year budgeting to be undertaken in the absence of authoritative indicative figures of future years' revenue flows.

Revenues consist of domestic and foreign funds. Domestic revenues are made up of tax and non tax revenues, including Own Source Revenues.

Foreign funds are comprised of loans and grants provided through budget support, project support, or other means. The biggest source of foreign funding comes from the EU and this share is likely to further increase in the coming years. Quite often, EU funds are only released upon the completion of the projects, which is why the state may have to bear a portion of the expenditures from its own sources.

Forecasting of tax revenues should be carried out by the MOF in collaboration with the other appropriate agencies, while non-tax revenues forecasts should be undertaken by relevant organisations which forecast revenue accruing from their own sources.

The exercise of forecasting is based on the underlying macro-economic assumptions obtained in Stage 2 covering the following variables for the three year period:

- Nominal GDP growth rate;
- Estimated inflation rate;
- Estimated changes in the exchange rate;
- Import growth rate.

Other important information used in forecasting includes:

- The Government's recent revenue collection by major tax category; and
- Information on expected non-tax revenue collections by other organisations.

While a large proportion of domestic revenues come from taxes, the non-tax category forms an important part of the overall resource envelope. Therefore, organisations are required to prepare non-tax revenue estimates covering areas under their mandate. The estimates have to be submitted to the MOF in time, using prescribed forms in the Budget Instructions.

The MOF will also have to have detailed discussions with relevant lenders to determine:

- **Direct Budgetary Support:** the amount of direct budgetary support that donors will provide; and
- **Individual Project Support:** full details of all donor funded individual projects, both cash and in-kind, and the amounts to be provided.

#### **Stage 4: National Priorities Statement**

The Minister of Finance should present a National Priorities Statement to the Cabinet, so it can be debated and affirmed. This Statement is a significant step in public transparency and accountability, as it should have benefited from public input, and it is based on the MOF's medium-term macroeconomic and fiscal expectations and its broad policy and spending priorities over the next three year period, several months before the detailed budget is formulated. In Croatia, the MTBF document provides the fiscal basis for the National Priorities Statement.

The MOF should be responsible for drafting the Statement, taking into account the medium-term macroeconomic and fiscal expectations and the Government's broad policy and spending priorities. The Minister of Finance should review the draft Statement and table the revised document before the Government for further consideration.

#### **Stage 5: Send Budget Instructions to each Budget User responsible for its own budget**

At the start of the annual budget cycle and at appropriate points during that cycle, the MOF will send out a series of Budget Instructions to all Budget Users that receive government funding.

Cumulatively, this series of instructions will contain discussions of the MOF's policies regarding various aspects of the budget process, information that Budget Users require in order to participate fully in the process, procedural requirements that are to be followed by Budget Users (including their budget ceiling, which is the maximum amounts that the MOF believes the Budget User should request), and very detailed forms and instructions for the completion thereof. It is essential that a detailed record is kept of the dispatch of the documentation to the organisations and its receipt back from them.

Until the MOF is confident in the abilities of Budget Users to follow the written Budget Instructions properly, there will be a continuing need for detailed training sessions in how to conduct various aspects of the budget process and how to complete the forms. (In addition, supporting this training and providing day-to-day assistance is an important role for MOF Budget Analysts.) These training sessions could also be used to discuss spending priorities within the spending unit.

#### **Stage 6: Budget Users submit Budget Requests (Financial Plans)**

The Budget Users must complete the necessary documentation regarding their budget requests (Financial Plans) and return it to the appropriate analyst in the MOF by the date required and in the format required in the MOF's Instructions. Effective Budget Users should always conduct their own internal budget process on a year-round basis (as a parallel to the government-wide process), so that they are readily able to respond to MOF requirements on a timely and accurate basis.

The MOF Budget Analyst must check the submission against the Budget Instructions and identify any differences. To formalise this process, they could use a check list covering all keys aspects of the proposed budget.

Although the MOF will issue budget limits (ceilings) in its Budget Instructions, it is not uncommon for Budget Users' requests to exceed the figures in the Instructions. The Budget User's overall request, which highlights important policy and spending issues, as well as any differences between the budget limit and the organisation's request, are

discussed at Budget Negotiations with the MOF (see Stage 8).

### **Stage 7: Review and Negotiation between MOF and Budget Users**

As stated, it is not unusual that the budget requests Budget Users will exceed the amount allocated to them in the budget limits.

It is up to the organisation to justify any spending it wishes to make in excess of the limitation that has been communicated to them in the Budget Instructions. This negotiation meeting is an important activity and it is the Budget User's opportunity to present its case to the MOF, so it is mandatory that senior members of the Budget User attend and participate in the meeting.

The MOF Budget Analyst will examine the whole proposed spending request, including excess spending, and comment on it for reasonableness and make suggestions where other savings could be made.

When deciding the original allocations, the MOF may have kept a relatively small amount as a "reserve". If the excess budget request is minor, the MOF can release a suitable amount to cover the excess (after all Hearings have been concluded).

If the extra amounts requested are too large to be covered by the "reserve", the organisation must be asked to prioritise services that will have to be cut or curtailed if the additional funds are not forthcoming.

### **Stage 8: Budget Allocation process (Decision stage)**

The MOF must prepare a summary report for the Cabinet indicating which organisations are requesting additional funds and containing recommendations on proposed funding levels.

The Cabinet should be advised on the effects that these changes will have on the overall resource envelope available for the budget.

They should be given a range of options if additional funds are available or if cuts have to be made. Any potential cuts should be accompanied by the expected reduction in expected service delivery levels.

Also at this time in the annual Budget Cycle, the MOF and the Budget Users are conducting any mid-year review of the budget, which is used in making necessary adjustments and transfers in Budget Users' planned and actual spending for the balance of the current year. It is possible that changes made as the result of this review will result in changes to an organisation's request for the coming year, and if so, the changes should be made before the overall budget request is sent to the Parliament in final form.

At this stage of the Budget Cycle, the Cabinet should be responsible for:

- **Identifying spending risk items that are not accommodated within the budget submissions** (such as increases in pensions, family allowances, unemployment benefits etc) but which pose potential claims on available resources; and
- Compiling Budget proposal to the Parliament, given Government's medium-term policy and spending priorities.

The better the policy and budgetary information submitted by Budget Users to the MOF

and to the Cabinet, the more effective will be the Cabinet in the budget allocation process. In turn, the Cabinet will be able to improve the quality of information submitted to the Parliament. This contributes to more robust budgetary decision-making at the political level. Also, it helps to avoid unpleasant surprises in later stages.

## **Strategic Planning**

### **Definition of Strategic Planning**

Strategic planning is essential to the long-term success of both public and private sector organizations, but for both it and the annual budget process to be effective, they must be conducted harmoniously. In this Chapter of the Guidebook, the essential components of Strategic Planning are introduced (especially for users of the Guidebook who may be somewhat new to this topic), but because of their fundamental importance and their relative newness in Croatia (i.e., as requirements in the 2008 Budget Law), their specific implementation may continue to evolve, and annual detailed instructions for the planning process will be issued by the MOF.

**Strategic Plans** are multiyear documents which focus on important policy and management issues and how they will be dealt with. Strategic plans of the ministries should cover also the business of Budget Users which are subordinate or attached to the Ministry. Apart from strategic plans, it is likely that organizations have an annual plan to conduct their activities, sometimes also called a Business Plan. However, regardless of the name, the planning process is similar. Although strategic planning is not yet conducted within Croatia's Budget Users as widely as it is conducted in other nations' ministries (both because it is a new requirement set in the 2008 Budget Law, and for other reasons) this section of the Guidebook will describe it, in order to reinforce the practice within those organisations where it does exist, and to present the strategic planning concept and approaches to those organisations that seek to begin to apply it more effectively.

The MOF fully supports the concepts of strategic planning and goal-setting, and of identifying key performance indicators and linking them to the budget. For this reason, the MOF provided and supported seminars and trainings in these topics in 2009 and 2010, so that ministries and Budget Users could increase their capacities in these topics. The MOF recognizes that in Croatia and other countries, strategic planning and the development and use of goals and key performance indicators as ongoing management tools will take a number of years to fully become effective and thus they should receive constant reinforcement. In addition, in view of the relative newness of these topics and of ongoing changes in the composition of the civil service, the MOF is aware that such constant reinforcement will remain an essential aspect of its relationship with ministries and Budget Users.

**Strategic Planning** is a process that charts an institution's broad direction forward. The process helps an institution decide and to communicate about what it wishes to achieve and the main actions it will need to undertake in the future in order to realize those achievements. When conducted successfully, Strategic Planning is a collective, transparent, and participatory process, involving senior management, employees, and consultation with a wide range of stakeholders. It looks at the big picture from a longer-term perspective. A strategic plan clarifies institutional priorities and unifies the organization's staff in the pursuit of shared objectives. It also provides an opportunity to address fundamental questions, to focus away from day-to-day operations, and to take



initiatives to improve performance.

Some organisations seek to operate without strategic plans. Such organisations are rarely effective in the long run, for reasons that are made clear below. Further, organisations without strategic plans may operate under the control of an individual or group, or policies and procedures, which do not necessarily adhere to the most desirable courses of action or decisions.

### **Purpose of Strategic Planning**

**Strategic planning** focuses on the larger issues. It answers the following questions:

- Why does an institution exist? (What is its mission?);
- What strategies will it use to attain its mission?
- What do its clients and stakeholders (in public sector – taxpayers) expect?
- How will it measure its own performance? (How will it measure whether it is attaining its mission?); and
- How will it use this information to make improvements?

**Strategic Planning** forces institutions to think about the future. This is extremely important since many institutions (especially in the public sector) are inward thinking and ad hoc based in their approach to making decisions. (In the public sector, this is often caused by the one-year aspect of the traditional budget process.) Organisations which have articulated strategies and follow them throughout the organization outperform those that do not do so. It helps them to exercise greater control over their own future.

The main purposes of **Strategic Planning** are:

- To improve performance;
- To create more relevant institutional structures;
- To increase levels of institutional, departmental, and individual accountability;
- To improve transparency and communication between management, employees and stakeholders (in public sector – taxpayers); and
- To establish priorities for efficient and effective resource allocation.

### **Qualities of a Good Strategic Plan**

A product of the strategic planning process is the document itself as well as a commitment to implement the plan. Even though the planning process itself is highly valued in many organizations, strategic plans in the public sector need to be prepared to increase transparency of the planning process and to communicate with the stakeholders.

A good strategic plan is:

- **Challenging:** it aims to motivate the institution to strive to achieve its vision and mission;
- **Change-oriented and creative:** a good Strategic Plan should be a product of some creative thinking and innovativeness (“thinking outside the box”). In this regard a few good ideas addressing essential issues is preferable to a long and elaborate presentation;
- **Clear and simple to understand:** a Strategic Plan should not be overly technical because it functions as a broad means of communication, both within the organisation itself and between the organisation and the outside world;
- **Analytical:** Strategic Plans should be based on a clear assessment of the current

- situation as well as possible risks and uncertainty;
- **Time Focused:** covering a defined period of time;
  - **Prioritised:** targets contained in the Strategic Plan should be prioritised, with adequate resources assigned to them and sequenced in relation to time;
  - **Participatory with Ownership:** the planning process should be participatory, involving consultation with key outside stakeholders (including related public sector organizations), thereby providing for transparency and broadening ownership; and
  - **Flexible:** The Strategic Plan should be capable of being changed, updated, or reviewed to reflect changing circumstances.

### Preparation

Draft **Strategic Plan** components (described below) should be prepared in a participatory manner but at a high level within the institutions, compiled, and then widely circulated internally for comments. Once a draft final version has been produced, it should be widely circulated to key stakeholders (including those external to the organisation, such as the MOF as well as other Budget Users which have related programs), for their comment. This may or may not be done in a workshop format. When a final version is produced, it should be posted on the institution's web site.

### Format of a Strategic Plan

The precise format of a Strategic Plan matters less than its content does. Each year, the MOF will issue instructions regarding the preparation and format of the Strategic Plans to be developed by Budget Users. However, a generic format is provided below:

- **Preface:** Statement by the Minister, head of the local government, etc;
- **Executive Summary:** This discusses the vision, mission, and goals and objectives, and outlines the broad strategies to be undertaken and focus of the plan;
- **Chapter 1: Introduction.** This should include a short description of the approach adopted in developing the plan, the purpose of the plan, and the background of the institution preparing it. It should describe the layout and structure of the document;
- **Chapter 2: Situation Analysis.** This chapter describes the environment within which the organization operates and the circumstances and constraints within which its programs function. It is important to limit this chapter to "big issues" and thus to avoid long detailed matrices of findings. Among other things, this chapter should describe the assumptions that are used in describing the situation as well as the obstacles to be overcome and risks to be addressed in facing the situation. Special attention should be paid to describe what stakeholders said, and how the plan will accommodate their expectations. The last section of this chapter should summarise critical issues arising from all aspects of the Situation Analysis;
- **Chapter 3: Vision, Mission Goals and Objectives.** (In the strategic plans of Croatia's ministries, these are usually referred to as General Goals and Specific Goals). These should be described together with any additional information to help the reader;
- **Chapter 4: Strategies, Programmes, and Targets.** The purpose of this chapter is to explain to readers the logic behind the strategies which will be followed in pursuing the organisation's Goals and Objectives, the programmes which will be used, and the development of performance targets to be focused upon. This is best done on a departmental basis, with each department forming a sub-section;
- **Chapter 5: Performance Indicators.** This chapter should identify and describe the Key Performance Indicators which are used in the plan, why they were chosen, and how they relate to the attainment of Goals and Objectives. This chapter should also



outline the general strategy for Monitoring and Evaluation and describe how and when the Strategic Plan will be monitored.

- **Annex 1:** Organisational Chart (including a Table of Staffing);
- **Annex 2:** Summary of the Core Elements of the Strategic Plan; and
- **Annex 3:** Key Performance Indicators.

## **Budgeting and Medium Term Budget Framework (MTBF)**

### **Background**

The **Medium Term Budget Framework (MTBF)** is a bridge between the long-range strategic planning process and the 1-year annual budget process. **Because of the fundamental importance and far-reaching purpose and impact of the MTBF, it is briefly introduced in this Chapter, but it is discussed in more detail and in ways that directly apply to Croatia in Chapter 3.**

Government budgets are prepared according to an annual cycle, but to be formulated well and contribute to high quality and sustainable services, they must take into account events outside the annual cycle, particularly the macro-economic realities, the expected revenues and the longer-term needs of programmes and government spending policies. A medium-term outlook is also necessary because the time span of an annual budget is usually too short for the purpose of adjusting expenditure priorities. At the time the budget is formulated, most of the expenditures of the budget year have already been committed. For example, the salaries of permanent civil servants, the pensions to be paid to retirees, debt service costs and the like, are not variable in the short-term. In the majority of developed countries, the margin of manoeuvre or real discretionary decision-making is typically around 5 to 10 per cent of total expenditure. This is why annual budgeting cannot be performed properly in isolation but has to be linked to planning in the context of a multiyear framework.

An MTBF should be framed within a multi-year macro-economic framework that takes into account an estimate of overall expenditure and government revenue. A good MTBF considers both recurrent and capital investment expenditures that can be expected over the period.

The MTBF starts with the review of performance of the previous year and of the current mid-year budget. (The latest revenue and expenditure figures for the current year should be used.) It takes cognisance of available resources, both local and foreign, and estimates the cost of implementing activities that will meet medium term objectives. In addition, in Croatia, the preparation of the MTBF is required by the 2008 Budget Law.

### **Purpose of the MTBF**

The MTBF is a resource management tool that aims at:

- Improving the predictability of budgets by producing better information about domestic resources, extending the integration of donor financing and/or loans into the budget framework, and ensuring compliance with the agreed priority-based allocations;
- Enhancing budget sustainability by ensuring that the costs of implementing activities to attain set targets are affordable within the medium-term resource envelope;
- Improving flexibility of allocations across investment and other expenditure; and

- Strengthening an output-oriented approach to budgeting that focuses on service delivery improvements.

### **Key Features of the MTBF**

The MTBF is characterised by a number of features as outlined below:

- It operationalises the strategic plans of Budget Users;
- It forces Budget Users to prepare their budgets within known resource ceilings in a three year timeframe;
- It requires that relevant activities be phased over a three year time frame instead of attempting to implement all activities in one year;
- It moves Budget Users towards performance budgeting and away from the “shopping list” approach (input based budgeting) to an output-based budgeting approach;
- It places an emphasis on the need for Budget Users to prioritise between competing demands and on service delivery to key stakeholders; and
- It requires the involvement of managers at all organisational levels throughout the budget process, in order to ensure a greater degree of ownership.

**Relationship of the Strategic Plan to Medium Term Budget Framework** The **Strategic Plan** serves as a planning tool. As such it explains the reasons why an institution has selected a particular course of action. It provides the context for decisions made regarding the organization’s strategic direction and it outlines their logic.

On the other hand, the **MTBF** takes the objectives and targets developed in the Strategic Plans of the budget users and uses this information to prepare operational activities and budgets. The operation of the MTBF is described in detail in other parts of this Guidebook.

This link between the **Strategic Plan** and the **MTBF** assures that resources are allocated according to the **Strategic Plan** and thus the MTBF reflects the priority needs derived by the institution and its stakeholders.

## **Introduction to Budgetary Control**

### **Introduction**

Simply stated, in the public sector, Budgetary Control is the process of ensuring that organisations do not spend more than they are allowed to spend by law. This also corresponds to the Budget Execution aspect of the overall budget cycle. Budget Control follows and depends on many of the policies and practices of accounting, and the process of Budget Control is shared between each Budget User and the Treasury. For that reason, this Guidebook includes “by reference” the policies, procedures, and requirements of the MOF’s Treasury Department. Further information about Budget Execution is also contained in Chapter 8 of this Guidebook.

### **Definition**

Budgetary control is defined by the UK’s Institute of Cost and Management Accountants (CIMA) as:

*“The establishment of budgets relating the responsibilities of executives to the requirements of a policy, and the continuous comparison of actual with budgeted results, either to secure by individual action the objective of that policy, or to provide a basis for its revision”.*

The key elements of this definition are:

- **Responsible Executive:** each part of the budget is the responsibility of a manager, who is accountable for its control and results;
- **Requirements of a Policy:** the budget must be made in accordance with a policy, which should be produced in written form, such as the Strategy of Government Programs;
- **Continuous Comparison of Actual Results to Budgeted Amounts:** there must be a timely and regular comparison of what the Budget Users expected to spend/collect by this date and what they have actually spent/collected. This is called variance analysis and it should identify differences between budgeted amounts and actual amounts, and the effect that this is having on achieving the policy objectives;
- **Individual Action:** the variance analysis will either indicate that the amounts spent/collected and objectives achieved are in line with the budget (in which case no action is required) or that there are variances and action is required; and
- **Revision:** if revision is required, the nature of the variance will determine the action required.

### Overview of Budgetary Control

Producing information for budgetary control is expensive in terms of the time and effort involved. It will be very wasteful if the information, once produced, is not put into effective use.

There are seven parts to an effective budgetary control system. These are:

1. **Preparation** of budgets;
2. **Communicating** the budgets to responsible officers;
3. Having a **warrant-based system of budget execution**;
4. Having an **accounting system** that will record all **commitments** and **actual costs**;
5. Preparing **statements** that will **compare actual costs with budgets**, showing any **variances**;
6. Analysing and determining the **reasons for any variances**, and
7. Taking any **appropriate action** based on the analysis of the variances in 5) above.

Inherent in a successful process of budget control is an effective treasury process supported by an active accounting system.

Variances revealed are historic, that is, they show what happened last week, month or last quarter and no amount of analysis and discussion can alter that. However, they can be used to influence managerial action in future periods.

The sooner a variance is discovered, and the smaller it is, the easier it is to take corrective action. However, even if a variance is identified very early, it is not always possible to take corrective action, but at least the Government will have been warned of the coming danger.

The section below describes effective practices that are followed in many governments, regarding each of the above areas.

### Good Practice in Budgetary Control

As cited above, the seven steps for budgetary control are:

1. Budget Preparation;

2. Budget Communication;
3. Budget Execution;
4. Commitment Integrated Financial Management Information System;
5. Budget execution Reports;
6. Financial Analysis; and
7. Take Action.

This section describes effective practices in each area.

### **Step 1: Budget Preparation**

As discussed elsewhere in this Guidebook, the budget process must be based on a strong foundation, or else the amount of funds available may not be appropriate to the work that must be done and there will be less chance that the desired programme results can be achieved. For an effective budget preparation process, it is important that the figures in it are:

- realistic;
- linked to specific outputs;
- profiled over the year; and
- the responsibility of a named individual.

### **Step 2: Budget Communication**

It is essential that every manager knows exactly for what budget he/she is responsible and what he/she is supposed to achieve with it. Thus, there must be a sound communication system not only between the MOF and the Budget Users but also within the Budget Users themselves and between the budget staff and program managers.

### **Step 3: Budget Execution**

It is also essential that there is a sound system of Budget Execution in place. The relevant Treasury instructions from the MOF contain detailed technical information about the operation of the Treasury system in Croatia.

The best method of Budget Execution is by use of different Warrants. The use of Warrants is found within the Treasury instructions in most countries.

A Warrant is a certificate signed by the Minister of Finance or his/her designee. A good Warrant system usually includes:

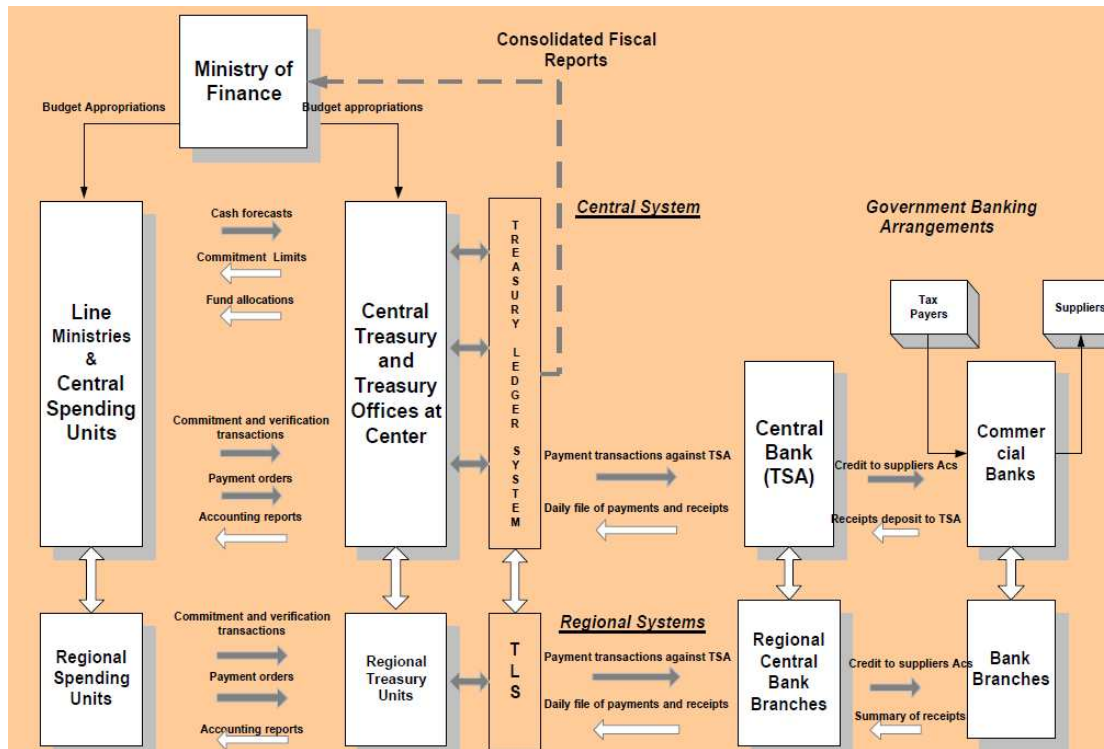
- **Budget Warrant:** for the total appropriated by the Parliament;
- **Budget Release Warrant:** issuing funds to Budget Users;
- **Reservation Warrant:** freezing the ability of Budget Users to spend appropriated funds;
- **De-reservation Warrant:** unfreezing previously frozen funds;
- **Transfer Warrant:** for transfer of appropriated funds; and
- **Contingency Warrant:** authorizing expenditure in advance of appropriation.

### **Step 4: Commitment-Based Integrated Financial Management Information System [IFMIS]**

For the purposes of accuracy, timeliness, consistency, and transparency, there should be one fully integrated financial management system for the whole of government.

Figure 1 below shows a generic model of how this should work.

Figure 1: Typical Design for an IFMIS



### Step 5: Budget execution Reports

IFMIS must be able to produce budget execution reports which enable the Budget Officer in every Budget Organization to monitor spending against the budget. These reports must be produced and checked on a regular basis.

In addition, budget execution reports of the appropriate level of detail, and with a frequency which is useful to the organisation's management, should be sent to key managers so that they can exercise their responsibilities for oversight and control.

Ideally, the budgeted figures will be profiled over the year so that a comparison of actual to planned spending is made on an appropriate basis.

IFMIS should enable organisations to define parameters to monitor actual expenditure against budgeted (or planned) expenditure. Thus, if an item is over-spent by a specified percentage (taking into account both the time of the year and the spending profile) the system will **identify** it as a variance.

### Step 6: Financial Analysis

The reasons behind the variance need to be examined in detail. Whilst these will vary in each case, they can be grouped into three broad categories:

- **Unforeseen Event:** something so totally unforeseen that could not have been budgeted for it. This would include catastrophic natural disasters such as earthquakes in unusual areas, but it would **exclude** normal cyclone or flood damage in regions prone to those types of disasters. In those regions, whilst the advent of a **specific** flood cannot be predicted, it is statistically certain that within a given period that there **will be** a flood at some point, so the responsible ministry should be taking

suitable measures such as stockpiling tents, food, and other necessary supplies. If there is an existing appropriate budget line, it is much easier to appropriate or transfer money or use budgetary reserves in contingency funds.

- **Bad Budgeting:** not enough work was undertaken during the budget development process to ensure that the budget contained enough funds to do the work that is required for the year. This could either be at the budget preparation stage or during the budget hearing stage, if funds were reduced without a corresponding reduction in the services intended to be provided by those funds; or
- **Bad Financial Management (or ineffective controls):** there was sufficient budget but the money has been spent on non-essential items or has been spent wastefully by paying too much for certain purchases.

### Step 7: Take Action

Whatever action is to be taken must be taken **before the money runs out.**

If the Budget execution Reports and Analysis show that the remaining funds available are not likely to last the year, there are three choices:

- **Stop Spending:** if there is little or no money left, it is necessary to stop spending immediately whilst action is taken;
- **Slow Down Spending:** if there is still some money left, spending should be slowed down whilst action is being taken; or
- **Find Money Elsewhere:** locate other sources of funds for this item of expenditure. (In cases such as totally unpredictable natural disasters, the Minister of Finance (or the Prime Minister) may have budgetary reserves which can be used, after meeting the necessary conditions which are contained in the Budget Law.)

If it is clear that neither stopping nor slowing down spending will achieve the required result, then additional funding must be sought. This can be done by three main methods:

1. **Reallocation:** transfer of funds under budget items by state budget users or between state budget users;
2. **Budgetary Reserves:** budget funds planned for unpredicted purposes;
3. **Amendments and addendums:** used for rebalance of the state budget revenues/receipts and expenditures/expenses.

### Monitoring and Evaluation

The processes of gathering financial and programme information regarding ongoing activities in each Budget User, and of assessing the results of those activities, is an essential aspect of both budget control and of responsible programme management and oversight. These processes are essential to fulfilling the responsibility that every Budget User has to the citizens, regarding the organisation's stewardship of public funds. The processes of monitoring and evaluation will be described in subsequent chapters (especially Chapter 9) of this Guidebook.



### 3 THE CROATIA'S STRATEGY OF GOVERNMENT PROGRAMS AND THE MEDIUM TERM BUDGET FRAMEWORK (MTBF)

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#### Introduction

Every effective government should operate within an overall framework which sets policies and priorities over the long- and medium-term, and which allocates resources to those policies and priorities, in order to provide for the best future of the citizens of that country. The Strategy of Government Program (SGP) and the Medium Term Budget Framework (MTBF) can serve those purposes for Croatia, when linked together and when they provide the framework for the annual budget process. Both the Strategy of Government Programs and the MTBF have been introduced previously in this Guidebook and were described according to general international practice, but in this Chapter they will be discussed in more detail and from the perspective of their implementation in Croatia.

At the end of 2007 the Croatian Government adopted the Strategy for the Development and Modernization of the State Treasury from 2007 to 2011. The goal of the Strategy is to improve and upgrade the public finances management system. The improvement is planned to be carried out on several levels.

On the state level, there is a tendency to ensure an overall fiscal discipline which is the basis of macroeconomic stability. This task, alongside others, requires comprehensive and thorough macroeconomic analyses, as well as the preparation of a multiannual budget framework to achieve the sustainability of existing programs and the public debt policy.

On the inter-sectoral level (ministry level) – ensuring an efficient inter-sectoral allocation of resources, i.e. an allocation of resources that is in line with the national strategic priorities. Top-down budgeting and the development of the multiannual framework are basic institutional solutions and tools used to reinforce the strategic allocation of resources.

On the program/managing level – coordinate budgetary authorizations and operative effectiveness. To achieve this, it is necessary to strike the right balance between flexibility during the execution phase of the Budget and budgetary restraint.

Implementation measures of this goal have to be focused on strengthening fiscal controls, improving inter-sectoral allocation of resources and providing greater flexibility for effective management and the development of accountability mechanisms.

The strategy defines the measures to be used in order to attain the stated goals. The following goals are especially emphasized: the introduction of a t+2 budget framework,

the request to redefine a program, the introduction of program monitoring and evaluation procedures, as well as of performance indicators.

In order for such reform steps to be introduced into the public finances management system, certain changes in the legal framework were needed. In mid-2008 a new Budget Act was adopted and it entered into force on 1 January, 2009. The new Act introduced:

- a mandatory drafting of strategic plans and a three-year strategy of government programmes, in order for the strategic priorities and goals of the government policies to directly affect the allocation of resources within the budget;
- a multiannual budget framework that contains not only the budget for one budget year, but also the projections for the following two years;
- greater flexibility in budget execution, since the Parliament, i.e. the representative body (on the local level) adopts the budget on a less detailed level;
- preparation and implementation of training and professional development for financial officials in the public sector, because the Strategy envisages the building of administrative capacities needed to implement the measures for the modernization of the budget process.

Common reform principles related to budget processes generally always include a higher quality of providing public services, a more efficient and better ear-mark usage of resources and higher accountability for the implementations of strategic priorities. All changes brought about by the Budget Act stem from the need of clearly determining the strategic goals, ensuring the impact of the stated goals and priorities on budget allocations and on the way results achieved are measured. The indicators of achieved results must be reciprocally linked to the process of decision-making on the strategic level.

The strategic planning process, already rather developed in the private sector, is being introduced in order to establish priorities and allocate the limited resources in variable conditions. However, it should be avoided that strategic plans, i.e. the entire three-year Strategy of Government Programs, are treated as mere “documents”. Strategic planning is a continuous process that requires a constant monitoring of progress in relation to goals set out; it requires constant re-examining of whether the methods for the attainment of goals and programs are proper and whether they work. Performance measures provide the public sector with the necessary information. Strategic planning is focused on the goals that are to be achieved, on the future, whereas performance measures focus on the past, i.e. on the achievements accomplished. Strategic planning, combined with performance measures, makes a full circle, i.e. makes a continuous process of result-orientedness.

### **Strategic plans of ministries and other state bodies**

Until the year 2002 there were very few strategic documents in the public sector. Since then, over 150 strategies have been drafted, including national strategies, programmes, national programmes and similar documents from the following sectors: statistics, health, agriculture, forestry, fisheries, animal-raising, economy, environmental protection, social policies (the largest number of documents), science and education, transport, tourism, customer protection, national minorities, computerization, safety and defense. However, these strategic documents often remained planning documents of a ministry or another state administration body with no clear links or hierarchy. Their adopting procedure was



also not unique. A part of the strategic documents was adopted by the Government, whereas others were adopted by the Parliament. The implementation of the listed strategies was, in a large number of cases, conditioned by individual institutional needs exclusively.

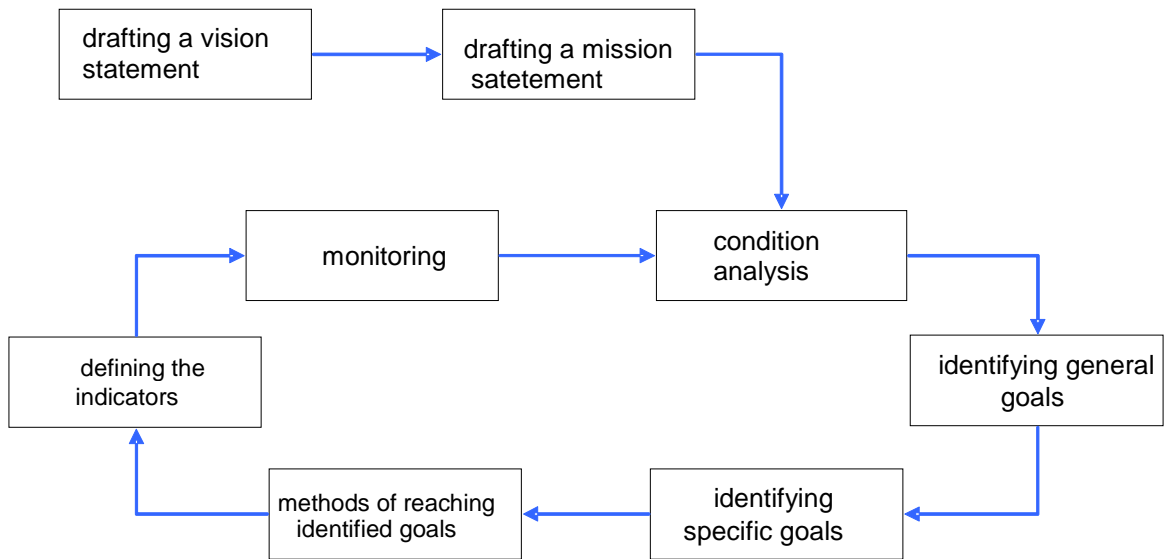
What was meant to be achieved by linking the strategic planning process to the State Budget was to make a connection between the existing strategic documentation and the budget as the tool for their implementation, through strategic plans of ministries and other state administration bodies. **Strategic plans, that have been drafted for the first time in 2009, are not a substitute for the existing strategic documents and planning acts, but are rather drafted on the basis of existing ones in a way that they take into account the identified goals, but also the changes in the environment (e.g. reduced financing possibilities, different priorities, etc.).**

The strategic approach to planning is based on understanding the broader context in which a ministry or another state body functions, together with its internal advantages and short-comings, as well as problems that will have to be tackled within the sector. A ministry, or another state administration body, uses strategic planning to identify their priorities and strategies that would enable it to reach the established goals in the future, as well as to define the measures for performance evaluation in the process of attaining these goals.

In order to provide guidance to ministries and other state bodies in drafting the first strategic documents, Guidelines for the drafting of strategic plans for the period 2010-2012 were drafted. The document is available on the official website of the Croatian Ministry of Finance (<http://www.mfin.hr/hr/stratesko-planiranje>).

A ministry or another state body, drafts a three-year strategic plan which ranks the identified specific goals and establishes clear guidelines for future development in line with the government priorities. A Strategic Plan is a document that represents a general action plan of a ministry or another state body, and it comprises the following:

1. Scope of activities of a ministry or another state body
2. Vision and mission statement
3. General goal(s)
4. Specific goals
5. Means of reaching (method of attainment) the identified goals
6. Performance indicators

**Figure 2: Strategic planning process diagram**

The strategic planning process starts by determining a strategic framework, i.e. by drafting a vision and mission statement. In order for the strategic framework to be completely defined, the ministry or another state body, also needs to determine strategic goals (general and specific), which is not possible without an analysis of the condition of the sector for which the strategic plan is being drafted.

An analysis of the condition will help the body to realize what their potentials are, as well as to define their positive and negative traits and realistically determine the strategic goals for future development and actions.

First, a general goal is set out, followed by specific goals that need to be reached in order for the general goal to be attained. Also, the means through which specific goals are to be reached are determined.

The next step in the strategic planning process is to identify performance indicators. Performance indicators are used to monitor and measure how successful we were in the process of reaching the established goals. The last stage in the process, monitoring, is implemented continuously throughout the period for which the strategic plan was drafted. This stage helps to determine whether and how the identified goals were met.

Just like the Strategy of Government Programs should define the Government's priority goals taking into consideration **all sectors**, a strategic plan needs to be the result of the work of **all administrative units** (directorates/sectors) within the ministry and other state bodies responsible for the formulation of strategic issues. The stated directorates (sectors) are obliged to cooperate with financial and budget directorates when drafting strategic plans, because these directorates can provide them with the assessment on the sustainability of the established goals in relation to the fiscal framework. The stated obligation ensures further implementation of these documents. This is precisely the reason why it is important that a three-year budget planning process is introduced alongside this process, as this is needed for the directorates to be provided with a necessary fiscal framework.

The Ministry of Finance has also, for the second cycle of strategic plans for the period 2011-2013, drafted an instruction that ensures a uniform and unified approach to drafting strategic plans of all bodies. The Strategic Plan Instruction for the period 2011-2013 brings certain changes regarding the methodology applied in the previous year (2009).

Strategic plans for the period 2011-2013 are related to the budget in their entirety, whereas their implementation is to be measured and monitored.

Ministries and other state bodies drafted strategic plans for a three-year period for the first time in 2009 and it was thus important to define the framework of the strategic plan – vision and mission with its key elements – specific and general goals. Performance indicators were put on the backburner together with the monitoring and reporting system. That is why it was important to take a more serious approach plan to identifying performance indicators in the second round of strategic plans for the period 2011-2013. It is precisely the performance indicators that form the basis for the establishment of a monitoring system, as well as for the attainment of the established goals. They also ensure information for the regular semi-annual and annual reporting on the goals achieved.

Performance indicators are objectively measurable or specific signs that something has been realized and they need to be defined in a way that they enable the monitoring of the realization of activities undertaken. While defining performance indicators in strategic plans, two types of indicators are used: outputs and outcomes.

Outputs refer to produced goods and services created through various activities. In the strategic plan, these indicators are set at the level of the means of achievements oriented towards production or rendering a unique service, i.e. towards a specific result. Each achievement method must be related to at least one and maximally three outputs.

Considering that this type of indicators does not provide any information on the efficiency, long-term results or social and economic changes achieved by the attainment of specific goals, it is necessary to use the so-called outcome indicators. Outcome indicators are set at the level of specific goals. For each specific goal, it is necessary to determine one outcome indicator.

Indicators should be expressed in figures by using the existing strategic documents, analyses, statistical reports and other potential sources (such as the Croatian National Bank reports, Central Bureau of Statistics reports, etc.).

For the purposes of internal monitoring of the execution of activities, a ministry or another state body can define several indicators, but in the strategic plan, they need to choose the maximum of three key performance indicators (outputs) for each method of attainment and one performance indicator (outcome) at the level of a specific goal in the following three-year period.

For a strategic plan to be implemented it is necessary to perform monitoring and measuring regularly and systematically. The purpose of monitoring is to notice any deviations from the plan in a timely manner, as well as to evaluate whether the planned activities will have the desired effect on the identified goals.

The monitoring system may, to a great extent, be established through a system of internal financial controls in line with the methodology prescribed by the Act on the Public Internal Financial Control<sup>4</sup>. Ministries and other state bodies are obliged to establish such a system.

An important component of the monitoring system is the reporting. Reports on the goals met are based on high-quality monitoring and contain assessments that need to provide answers to following questions:

- Can it be expected with a reasonable level of certainty that the implementation will go according to the plan until the end of the year? If not, why and what is necessary for the plan to be realized?
- Do the activities planned have the expected effect on the specific goals?
- Have all resources been ensured (administrative, financial, and organizational)?
- How is implementation coordinated with other stakeholders?
- Are specific and general goals being realized as expected?
- Are specific goals still relevant for general goals, i.e. will their contribution to the realization of general goals be in line with the results expected?

Well defined outputs and outcomes make the monitoring system easier because it is based on reporting on whether the target values have been realized. A ministry and other state bodies should, in line with their specific traits, establish a monitoring system and determine the reporting dynamics in order to ensure the information on the achievement of goals established.

Following the drafting of the strategic plan, each body is required to appoint officials responsible for the monitoring of the strategic plan for the period 2011-2013 at the level of each specific goal and method of attaining (by name and function). Following the adoption of the Strategy of Government Programs for the period 2011-2013, the head of the ministry or another state body is to make a decision on the appointment of said officials and make it known to the Ministry of Finance within a 15-day deadline.

Based on data collected, ministries and other state bodies report to the Ministry of Finance on how successful the implementation of goals from the strategic plan really was. The report on output, set at the level of the method of attainment, is to be delivered to the Ministry of Finance on an annual or a semi-annual basis. At the level of the ministry or another state body, such reports may be used for the purposes of monthly or quarterly reporting.

Outcome target values do not necessarily have to be determined for a one-year period. They may be set for two or three years, depending on the availability and complexity of information gathering. Reports on outcomes, that are determined on the level of specific goals, are drafted on an annual basis and it contains only those specific goals that have an established target value for that year.

In case there are any major deviations from the plan, especially those that jeopardize the realization of outputs in the current year, it is necessary for the Ministry of Finance to be notified, without delays and regardless of the deadlines determined.

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<sup>4</sup>Official Gazette, no. 141/06

## Strategy of Government Programs

The first „umbrella” strategic document named Strategic Development Framework 2006-2013 was drafted in 2006. This document provides an integral vision and an overview of the priorities for the economic development of Croatia for the period 2006-2013, through defining the general strategic goal, priority areas of action and tools and activities necessary for them to be realized.

Strategic Development Framework is based on existing sectoral strategies, is drafted on the consultation process with the representatives of the state administration, business and academic community, as well as the civil society and the wider public. Main strategic goals are growth and employment on the competitive market economy that functions within a European social state in the 21st century. Tools and actions for the realization of strategic goals are described in the Strategic Development Framework 2006-2013.

The first Strategy of Government Programs, drafted for the period from 2010-2012, took over the main strategic goal from the Strategic Development Framework 2006-2013, whereas its realization was envisaged through reaching twelve general goals.

The Strategy of Government Programs for the period 2011-2013 ensures the continuity of the implementation of strategic goals established by the first Strategy. These goals point to the direction of the Government’s actions over a longer period of time. Since these are long-term Government priorities, strategic goals are not changed significantly in relation to the prior year. However, the crucial contribution of strategic planning lies not only in setting the goals or defining the activities through which goals are reached. Strategic planning also enables constant re-examining of whether we are moving in the right direction, whether the established goals should be revised, whether there are better and more efficient ways of reaching them.

The Strategy of Government Programs has made a large step forward in relation to the prior year, as it defined performance indicators and target values. Performance indicators, as objectively measurable and specific signs that something has been accomplished, have been established in the Strategy in a way that they enable the monitoring of the realization of activities undertaken. This reinforces the system of accountability for the set goals and their methods of realization. What is meant to be achieved are budget resources allocations towards those goals that will have the largest impact on the priority areas. In order to achieve this, it is crucial to properly define the indicators and to have a well-established system of monitoring the implementation of ministries’ strategic plans, as well as of the entire Strategy of Government Programmes that stems from the strategic plans.

Strategy of Government Programmes for 2011-2013 has encompassed operative programmes that are financed from EU pre-accession programmes, but has also pointed to the beginning of the usage of Cohesion and structural funds. The strategy wants to emphasize that resources obtained from EU funds and programmes financed through the same means are an integral part of the State Budget. In the following period, these resources will have an increasingly significant share in the financing of public needs, due to which, they should be observed complementarily with the part that is financed from the original budgetary revenues.

As was emphasized previously, the implementation of strategic plans, i.e. the Strategy of Government Programmes for the period 2011-2013 will be measured and monitored systematically. The monitoring system has, to a great extent, been established through the system of public internal financial controls, but also through the system of reporting to the Ministry of Finance. By appointing the official responsible for the monitoring of the strategic plan at the level of each specific goal and individual methods of realizing them (by name and function) additionally reinforces the system of the responsibility for the implementation of the strategic plan, as well as of the Strategy of Government Programmes.

### **Midium term Budget Framework**

Stated in the simplest terms, an MTBF links the top-down process of policy-making and priority-setting with the bottom-up process of budget formulation, and it does this on the basis of medium-term (usually 3-year) projections of revenues, expenditures, and trends (demographics, political changes, etc.) that may have an impact on program activities.

Midium term Budget Framework, due to its longer overview of the budget, has become a tool of obtaining a better control over fiscal risks. By reinforcing the process of strategic decision-making, it also enables a more efficient allocation of resources. Apart from that, it is a process that will be repeated on an annual basis and that focuses on reducing the discrepancies between what is available and what is requested by the State Budget Users. MTBF links the defined policies (goals) and budget planning at an early stage in the budget cycle and adjusts to the changes in policies, where required. A good MTBF should:

- a) link government's priorities with the budget within a sustainable level of consumption;
- b) emphasize the concessions made among competing goals of the Government;
- c) link the budget to the policies, programmes and laws passed;
- d) improve the results of the programmes by increasing transparency, accountability and predictability of financing.

The MTBF that stems from the new Budget Act comprises the following elements:

- 1) a macroeconomic projection of revenues, expenditures, deficit and debt for the long-term period;
- 2) strategic plans that set the Government's policies and priorities for the long-term period;
- 3) a top-down approach;
- 4) an impact measuring system that determines goals and reports on the results expected and reached, it also informs on the allocation of resources and on ministries' decisions;
- 5) a budget that provides an overview of the Government's spending plans for the next year and that represents the first year of the MTBF.

In the Republic of Croatia the MTBF is established in line with economic and fiscal policy guidelines for a three-year period. These guidelines are proposed by the Ministry of Finance and are adopted by the Croatian Government. The MTBF is determined for a three-year period, as well as the Strategy of Government Programmes and the economic and fiscal policy guidelines.

While drafting an MTBF for the following three-year period, the following is taken into consideration:

- current year's expenditure level
- additional expenditures needed to maintain the same level of quality and quantity of services (e.g. if the current number of pupils per classroom is to be maintained, whereas an increase in the total number of pupils is expected - this would require additional resources for additional classrooms, teachers, school equipment, etc.)
- additional expenditures or additional savings in case the level or type of service is changed, based on the decision already made by the Government (e.g. cancelling a ceiling value for maternity allowances in the course of regular maternity leave - the first 6 months - as a new state policy it lead to increasing the expenditures for maternity allowances).

In order for an MTBF to be able to monitor the existing and newly-adopted government policies, economic and fiscal policy guidelines for a three-year period are drafted on the basis of the Strategy of Government Programmes for a three-year period, as they comprise:

1. Croatia's economic and fiscal policy strategic goals;
2. Croatia's basic macroeconomic indicators;
3. Croatia's fiscal policy indicators;
4. an assessment of revenues and expenditures, as well as of receipts and expenses of all levels of the general budget;
5. a proposed financial plan ceiling per organizational classification division that contains the last budget year's financial plan ceiling, along with the proposed financial plan ceiling for the next budget year and the next two years, and;
6. a projected change in the public debt and the public debt management strategy.

Until now, the guidelines presented the first step in the process of planning the State Budget, by providing economic and fiscal assumptions that are the basis for its further development. By applying the new Budget Act, the Guidelines have, for the first time, been drafted taking into account the Strategy of Government Programmes for the period 2010-2012 that was adopted by the Government in a session held on 10 September 2009.

The Strategy of Government Programmes in the strategic planning process has enabled the Government to identify their most important goals and priorities. The Guidelines have established a stronger link between the priorities and the budget and have placed strategic planning within a three-year budget framework. Therefore, an MTBF provides the budget system with an additional dose of transparency, as it sheds light on the impact of policy decisions on the budgets for the following years.



## 4 BUDGET INSTRUCTIONS AND DETAILS OF THE BUDGET PROCESS

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### Introduction

This Chapter contains detailed information about the policy actions and technical procedural steps that the MOF requires of the Budget Users each year, including details related to information requirements and the legal timeline of the budget process. These topics were introduced in Chapter 2 but they are discussed in this Chapter in more detail regarding their specific implementation in Croatia, and in fact, this Chapter is intended to serve as a background discussion to the annual budget guidelines that issued by the MOF to Budget Users each year. This chapter contains material which initially was developed to be a separate Budget Preparation Manual, but was integrated into this more comprehensive guidebook to present it in a more useful and relevant context. The timeline is based on the requirements of the 2008 Budget Law and is re-affirmed in the MOF's annual Budget Instructions. The timeline provides details of the **latest** date by which an action must be completed, but it does not prevent an action from being completed earlier. Budget Users and their budget analysts must follow the stated requirements and the timing in order for Croatia's budget process to be an effective one. Therefore, these requirements, and the detailed instructions that they contain, constitute the heart of the budget analysts' job.

Indeed, as Chapter Two makes clear, it is essential for Budget Users to develop their own internal budget process and schedule, consistent with good budget practice and with the requirements issued by the MOF, so that they are able to start the budget preparation well in advance of the legal timetable. In fact, the MOF always recommends that Budget Users should develop and follow their own internal budget calendars (which are consistent with the MOF's requirements), for this purpose. Effective Budget Users in Croatia and other nations recognize that the planning and budgeting cycle is an ongoing one, and so the requirements of this cycle are built into the organization's regular activities and the key managers of the organization are accountable for performing their roles within it. In addition, doing this will enable effective Budget Users to participate more actively and successfully in the government-wide budget process during the full course of the budget cycle.

The steps of the annual budget process in Croatia (based on the 2008 Law) and their corresponding dates of key steps appear below. The exact dates of the steps are affirmed each year in the Instructions for the Preparation of the State Budget Proposal<sup>5</sup> and may be subject to revision during the course of the year. The model steps for Budget Users to use in conducting their own internal budget processes, that can enable them to

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<sup>5</sup> Later on Budget Instructions

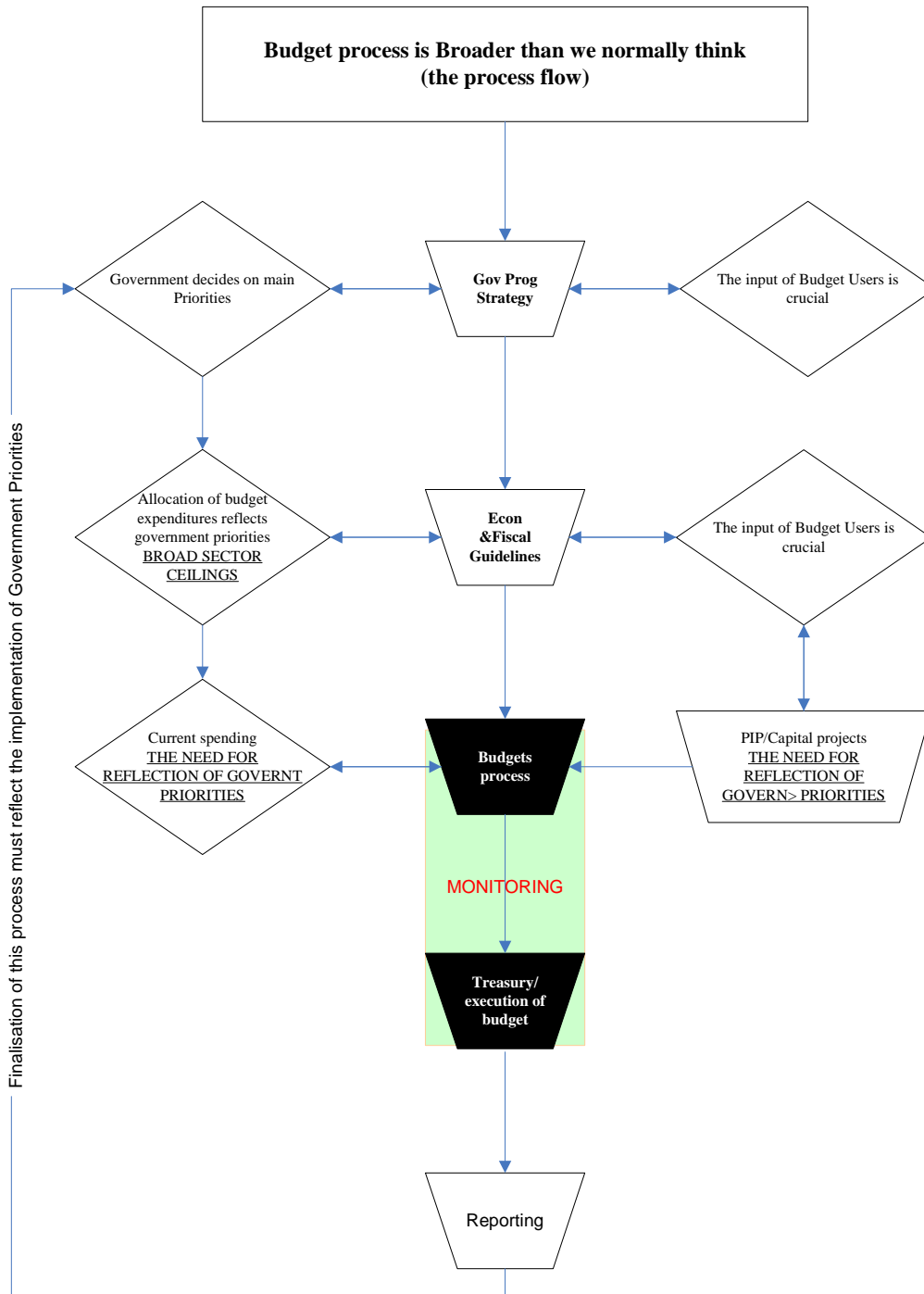


participate effectively in the government-wide process, are contained in Annex 3.

### Overview of the Budget Process

The diagram below gives an overview of Croatia’s current budget formulation process:

**Figure 3: Overview of the Budget Process**



## Instructions for the Preparation of the State Budget Proposal

### Introduction

Budget Instructions are sets of policy, format, and technical instructions from the MOF to the Budget Users advising them on what steps they must take and what schedule they must follow, to draft their portion of the upcoming year's budget (In many nations, these are also called the "annual budget request" or the "annual budget justification". Further, in some nations, the term "financial plan" refers to something quite different than it does in Croatia – it refers merely to the monthly or quarterly detailed plans for cash expenditures.).

These Instructions are often considered the day-to-day tools through which the guidance and requirements of this Budget Guidebook are implemented. Therefore, they form the basis upon which the overall budget formulation process rests, and so following them closely and successfully will allow Budget Analysts to fulfill vital parts of their roles and responsibilities effectively.

The MOF endeavors to issue the Instructions at an early stage in the budget process to maximize the time available to the Budget Users. Budget Users must have this ceiling information as soon as possible, in order to produce realistic budget projections. Budget Users desiring to start their budget development processes early can at least begin by using the previous year's final approved budget tables for preliminary guidance, since they provide indicative estimates for the coming year.

But as stated often in this Guidebook, Budget Users have a clear interest in fulfilling their requirements under the budget process, regardless of the dates on which the MOF instructions are issued. Therefore, effective Budget Users will always establish and maintain internal budget planning calendars in order to ensure that their programs' needs are represented as effectively as possible in the national budget process.

Pursuant to the Budget Act, the Ministry of Finance delivers the Instructions for the Preparation of the State Budget Proposal to budget users and extra-budgetary users of the State Budget, where said Instructions are based on Economic and Fiscal Policy Guidelines. The deadline for the delivery of the MOF's Instructions for the Preparation of the State Budget Proposal is 30 June.

In the first part of the Instructions, there is a list of changes created during the budgeting process (especially regarding previous practices), and in the legal framework, there are newly adopted strategies, other relevant documents, and other new responsibilities of budget users.

The second part of the Instructions provides a general background and economic conditions of the state budget situation and presents the basic economic indicators from the Guidelines in order to provide complete information to the users. The basic economic indicators include macroeconomic projections, basic fiscal policy guidelines, and factors that determine revenues and expenditures of the state budget for the coming period.

In the third part of the Instructions there is:

- a detailed explanation of the methodology to be used in preparing financial plans

- expenditure limits for first level budget users
- instructions regarding revenue and expenditure planning for budget users
- the method used for planning programs that are financed from the EU pre-accession aid funds, method for planning state subsidies etc.
- technical instructions for entering data into the State Treasury information system
- instructions regarding the drafting of the financial plan's justification
- a list of the bodies that are responsible for drafting financial plans and delivering them
- due dates

Along with the Instructions, budgetary users also receive various materials, tables, forms and codes that aid them with the drafting of financial plans.

In addition to these annual Instructions from the MOF, the MOF also recommends that budget users should establish and maintain their own internal budgeting process and schedule (see for template in Annex x), so that they are able to ensure effective financial management and to participate effectively in the state budget process. This is one of the most useful ways to ensure effective representation of their programs in the state budget.

When drafting the annual financial plan proposal, budgetary users follow the Instructions as well as regulations of the Budget Law and bylaw acts that regulate the implementation of the Law. Ministries and first level budget users compile internal instructions for their subordinate organizations and budget users who then draft their financial plans. Ministries and first level budget users compile an integrated financial plan proposal based on the collected financial plan proposals prepared by the subordinate budget users and then submit it to the Ministry of Finance.

### Due dates and activities of the state budget preparation and drafting

This chapter contains details on activities and steps in the process of preparing and drafting the State Budget that the MOF requires from the budget users, as well as the relevant deadlines. All deadlines and activities are prescribed by the Budget Law and form an integral part of the MOF's Instructions for the Preparation of the State Budget Proposal that are delivered to budget users every day. Budget users must respect the activities and deadlines prescribed in order for the entire budget process to be efficient.

It is very important that Budget Users develop their own internal budget process and agenda, in line with the MOF's requests and good practice, in order for them to be able to start the preparation of the Budget prior to the deadlines delivered.

**Table 4: shows deadlines, activity holders and all activities carried out in the budget preparation process.**

DUE DATE	BODY	ACTIVITY
Before March 15th	Ministry of Finance in cooperation with the Central Office for Development Strategy and Coordination of the EU Funds	Prepare instructions for development of strategic plans and deliver them to the budgetary users
Before April 15th	Budgetary users	Draft strategic plans for a 3 year period and

		deliver them to the Ministry of Finance
Before April 30th	Ministry of Finance in cooperation with the Central Office for Development Strategy and Coordination of the EU Funds	Draft Strategy of Government Programs for a 3 year period and propose it to the Government of the Republic of Croatia
Before May 15th	Government of the Republic of Croatia	Adopts Strategy of Government Programs for a 3 year period
Before May 31st	Ministry of Finance	Creates Economic and Fiscal Policies Guidelines for a 3 year period and proposes it to the Government of the Republic of Croatia
Before June 15th	Government of the Republic of Croatia	Adopts Economic and Fiscal Policy Guidelines for a 3 year period
Before June 30th	Ministry of Finance	Prepares Instructions for Preparation of State Budget Proposal to the state budget and extra budgetary users
Before July 15th	Budgetary users	Deliver state budget proposals to ministries and other 1 <sup>st</sup> level budget users
Before July 31st	Ministries and other state bodies	Deliver harmonized financial plan proposals to the Ministry of Finance
Before October 15th	Ministry of Finance	Makes budget drafts for the budget year and projections for the next 2 years, and delivers it to the Government of the Republic of Croatia
Before November 15th	Government of the Republic of Croatia	Approves budget proposal and forecasts and submits them to the Croatian Parliament
Before the end of the year	Croatian Parliament	Delivers budget for the next budget year and projections for the next 2 budget years

### Budgetary user limits

A key element of the budgeting process is establishing limits for budget users which participate in the budgeting process. Limits<sup>6</sup> are the reality of life for every government: they confirm that there is never enough money for everything they wish to do. That is the reason that limits have to be established within the context of the available budget funds and to ensure that the government does not spend more money than it has at its disposal.

After the limits have been established, budget users can determine their priorities within the overall envelope of resources assigned to them. Budget limits are an instrument to instill fiscal discipline.

For the purpose of a fiscally and socially sustainable budget for the coming period, ministries and other first level budget users must follow the established limits. In performing the complex calculations which are used in setting the limits, estimates are made for all sources of financing that have impacts on the deficit level. They include: general incomes and revenues, contributions, and receipts from borrowing. Establishing the limits is an important precondition of quality budgeting. Limits for other sources of financing are determined by the budget users themselves with the approval from the Ministry of Finance.

<sup>6</sup> In some nations, these budgetary limits are called “budget ceilings”

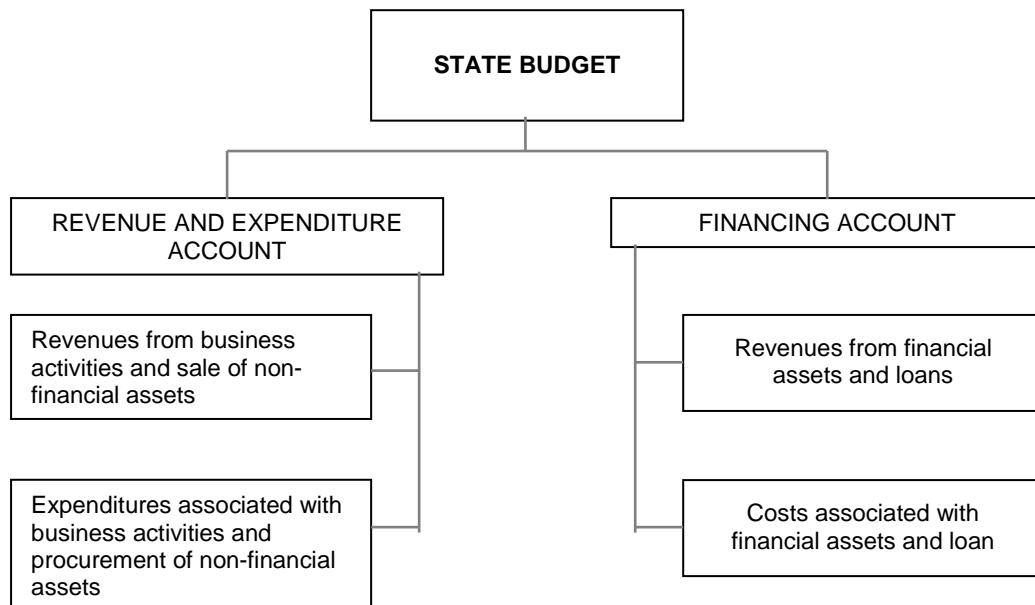
In addition to overall limits for budget users, specific limits for budget users are also established on the following types of expenditure:

- employee expenses
- material expenses
- financial expenses
- subsidy expenses
- expenses associated with personal and household benefits
- other expenses (aid, other expenses and expenses associated with procurement of non-financial assets)

### Financial plan structure of the budgetary users, including budget classifications

The state budget (as it is enacted by the Parliament in the Annual Budget Law) consists of a general and a specific part. The general part includes the revenue and expenditure account and the financing account, and the specific part consists of the budget users' expenditure plan, organized by types of expenditure (see Section 4.2) and allocated to programs that consist of activities and projects.

**Figure 4: State Budget Structure**



In the revenue and expenditure account, the state clearly classifies annual revenues and annual expenditures in specific ways. Since revenues do not equal expenditures very often, the state has a specific financing account from which additional necessary funds can be secured. It is used to both register what the state does with a possible surplus of funds when the revenues are greater than expenditures, and how it finances a possible deficit when expenditures are greater than revenues. The structure of the Croatian state budget has been harmonized with the recognized methodology of the International

Monetary Fund associated with public finance statistics which allows our budget to be compared to budgets of other countries.

As stated, budget users prepare annual financial plan proposals based on the MOF's Instructions for the Preparation of the State Budget Proposal as well as the Budget Law and its bylaws. Financial plan proposals contain: revenue and income estimates based on recognized financing sources; estimated expenditures and costs based on programs or activities and projects for the upcoming three year period; and justification of the annual requests that will be discussed in more detail in part 4.5 of this chapter. Financing sources are established for every activity and project. Financial plans are prepared taking into consideration goals of each budget user's strategic plan for the upcoming budget period. Expenditures financed from financing sources that do not have established limits (i.e., own revenues, special purpose income, aid and donations) are planned by budget users up to the level of revenues that were approved by the Ministry of Finance.

Expenditure and cost plan proposals are prepared according to the Budget Classification Rulebook. The 6 main types of budget classifications are presented here:

*1. organizational classification* represents mutually connected and harmonized budget units and budget users (hierarchically, according to rights and responsibilities), whereby budget users use appropriate material resources to reach the set goals. This organization is established through three levels.

First level is an organizational level established for the purposes of budget planning and execution and it consists of one or more second level budget users. The status of a first level is given to ministries and those State Budget users that are directly responsible to the Croatian Parliament or the President of the Republic of Croatia.

The second level is an organizational level established for the purposes of budget planning and execution and it consists of one or more budget users.

The status of a first and second level is appointed by the Ministry of Finance, i.e. a financial administrative body within a local or regional self-administration unit.

The "Strategy for the Development and Modernization of the State Treasury 2007-2011" helped to harmonize the organizational classification system with legally defined jurisdictions of the various organizations, and to establish criteria for determining what level of organizational classification individual budget users belong to. As a result, in 2009 the MOF prepared a new organizational classification framework for the period 2010-2012 through a Phare 2006 project entitled "Improving Budget Processes.

**Table 5: example of organizational classification**

1st Level	2nd Level	Budgetary User
010		CROATIAN PARLIAMENT
	01005	Croatian Parliament
	01015	Committee for the Decisions on the Conflict of Interest
	01020	Electoral Committee of the Republic of Croatia
075		MINISTRY OF ENVIRONMENTAL PROTECTION, PHYSICAL PLANNING AND CONSTRUCTION
	07505	Ministry of Environmental Protection, Physical Planning and Construction
	07515	Agency for Environmental Protection
	07520	Agency for Property and Real Estate Trade

	07525	State Geodetic Administration
100		MINISTRY OF HEALTH AND SOCIAL WELFARE
	10005	Ministry of Health and Social Welfare
	10008	Budget Users in social welfare
	10025	Croatian Institute for Occupational Health Insurance
	10030	National Institute for Radiological and Nuclear Safety

As can be seen, the first level is established for the purpose of budget planning and execution, and it consists of one or more second level units. More detailed breakdowns are not shown.

2. *economic classifications* represent the various types of revenues and incomes, as well as the various types of expenditures and costs based on the economic purpose they serve. They are organized into classes, groups, subgroups, sections and basic accounts. This type of classification is essential for showing budget information according to the sources and overall purposes of funds. For purposes of international consistency (to enable Croatia to compare and share information with other nations, and to be consistent with practices supported by international organizations such as the IMF, the World Bank, and the EU) Croatia follows the GFS (Government Finance Statistics) classification system regarding economic classifications.

**Table 6: An example of economic classification**

Class	Group	Subgroup	Section	Name
6				Business Revenues
	61			Tax Revenues
		611		Income Tax and Surtax
			6111	Tax and Surtax on Regular Income
			6112	Tax and Surtax on Small Business Income
	62			Contributions
		621		Healthcare Insurance Contributions
			6211	Healthcare Insurance Contributions from the Employed Individuals
3				Business Expenses
	31			Employee Expenses
		311		Wages
			3111	Wages for Regular Work
			3112	Wages In-kind
	32			Material Expenses
		321		Employee Expense Reimbursements
			3211	Business Travels
			3212	Transportation, Field Work and Living Expense Reimbursements

3. *functional classifications* represent budget expenditures that are sorted according to their general purpose. Functional classification is not a budget preparation tool, but a statistical classification which captures expenditures ex-post (after the fact). As such, it is used for information analysis purposes, rather than expenditure control. This includes the standard functions of government, including health care, education, transportation,



defense, etc. For purposes of international consistency (to enable Croatia to compare and share information with other nations, and to be consistent with practices supported by international organizations such as the IMF, the World Bank, and the EU) Croatia follows the COFOG (Classification of the Functions of Government) classification system regarding functional classifications. The functional classification process can be shown at various levels of detail, and in this way, it provides reviewers with basic understanding of public sector spending in all major topics.

**Table 7: An example of functional classification**

Code	Name
0111	Executive and legislative bodies
0112	Financial and fiscal affairs
0113	Foreign affairs
0210	Military defense
0310	Police services
0330	Courts
0421	Agriculture
0451	Road traffic
0473	Tourism
0510	Waste management
0610	Housing development
0750	Research and health development
0820	Cultural services
0912	Elementary education
1040	Family and children

4. *location classification* represents expenditures according to the geographical breakdown of the Republic of Croatia, EU member states and other countries. This information is important for several reasons, especially related to determining the relationships between a location's overall contribution to the budget and the amount of spending that is conducted in that location. Thus, among other things, it is important information for political purposes, to identify governmental spending as a way to examine public investment, and for related reasons.

**Table 8: An example of location classification**

Code	Name
0	Republic of Croatia
01	Zagreb county
05	Varaždin county
08	Primorje-gorje county
17	Split-Dalmatia county
38	France
39	Germany
43	Italy
54	Sweden
92	Islands
G133	Zagreb
G179	Karlovac
G312	Osijek
G359	Pula
G373	Rijeka
G409	Split

5. *program classification* represents programs and their components, that is, the activities and projects defined according to the budget users. "Program" is defined to be a group of independent but closely connected activities and projects used for planning expenditures

and costs associated with the realization of goals that were established by the program. As was true of the *organizational classification* scheme described above, the *program classification* scheme was also simplified on the basis of the „Strategy for the Development and Modernization of the State Treasury 2007-2011”, so that “programs” are redefined in ways that are more consistent with international practices and so that reviewers and decision-makers can understand “the big picture”. This process has not been intended to eliminate any programs, but through simplification and increased consistency, it has helped to decrease their number, harmonize them with the strategic framework, and increase the ease of developing performance indicators for them.

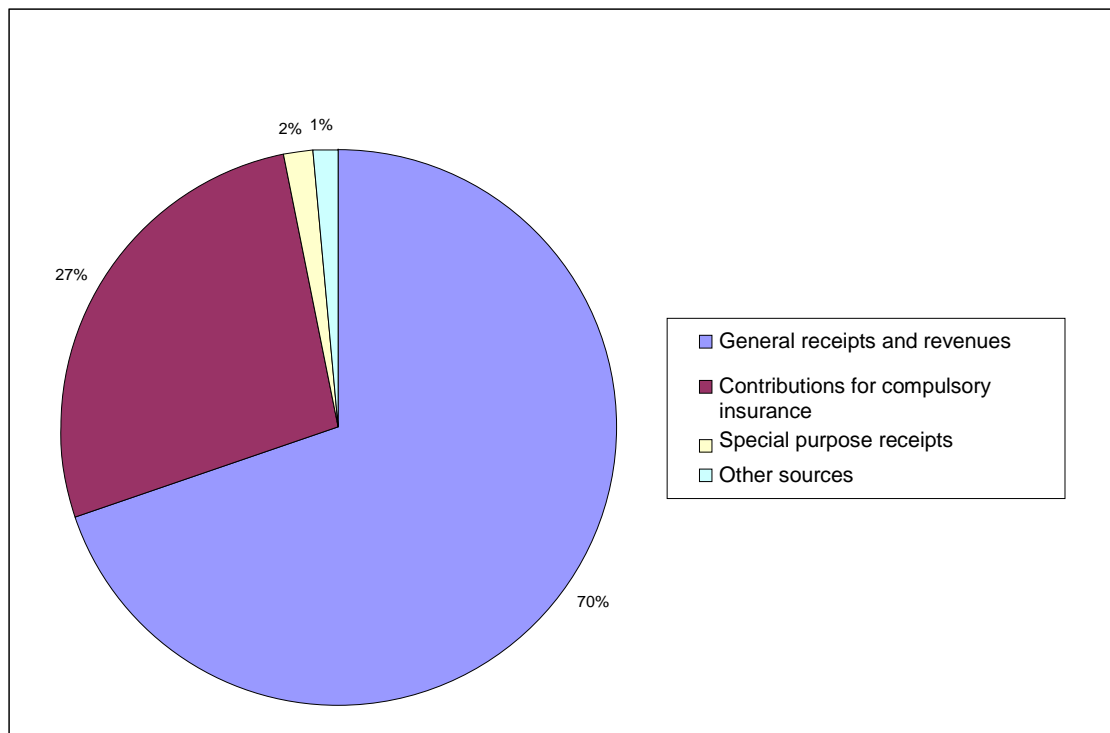
**Table 9: An example of program classification**

1st Level	2nd Level	Main program	Program	Sub-program	Name
075					Ministry of Environmental Protection, Physical Planning and Construction
	07505				Ministry of Environmental Protection, Physical Planning and Construction
		34			Environmental protection and safeguarding
			3402		Environmental Protection
				A576169	Implementation of the Environmental Impact Assessment Process
				A576196	NGOs Supporting Environmental Protection
				A576248	Integrated Pollution Prevention and Monitoring
				K576219	Adriatic Sea Monitoring
				K576225	Establishment of the Air Quality Monitoring and Management System
				T576217	Support for Environment Development and Reconstruction

Programs are generally long-term in nature. Their composition may change, their financing changes, and their objectives change in time, but their purpose remains roughly the same. Program consists of activities and projects. The term “*Activity*” is defined to be a specific component of a program that fulfill a specific purpose and/or that comprises a specific element of that *program*, and that does not have a previously determined duration period. The duration period of a *project* has been determined and it is planned one time only, and it can be conducted through current or capital funds. Activities and projects have to/do not have to cumulatively cover the whole program in terms of expenditures.

6. *Sources of financing used in the budget* presents the sources of funding that are used in the budget. There are specific groups of revenues and incomes that are used to cover specific types of expenditures and costs. The basic types of financing sources are:

- a) *General revenues and receipts* – this includes tax revenues, financial asset revenues, revenues from administrative fees, public administration revenues, revenues from fines, and income from financial assets and loans. This source includes revenues used for financing regular activities of the budgetary users, and therefore it is the largest category of funding as well as the one that is most familiar to the citizens of Croatia.
- b) *Contributions* refer to contributions for pension insurance, health insurance and employment.
- c) *Own-source revenues* refer to revenues gained by performing activities on the market according to market conditions, whereby the said activities may be performed by other entities, as well (rental of premises, food operating services, etc.).
- d) *Special purpose revenues* – this covers revenues whose use and purpose are established by special regulations, such as: lottery revenues, monument annuity revenues and other special purpose revenues that the user receives by performing work that is related to their specific status or profession and is based on a special regulation that determines what the collected revenues can be spent on.
- e) *Aid* – this includes revenues received from foreign governments and international organizations, revenues from other budgets and other subjects from within the state, various forms of pre-accession program aid (CARDS, PHARE, ISPA, SAPARD, IPA and IPARD), aid from local and regional self governing unit budgets and from other subjects from within the state, and foreign aid (deeds of donation) that budgetary users receive from foreign governments and international organizations that are paid through special accounts and are not deposited directly into the budget.
- f) *Donations* – this include revenues from physical persons, non-profit organizations, trade associations and other subjects outside the general state government.
- g) *Revenues from non-financial assets and damage compensation based on insurance* – this includes funds from the sale and/or exchange of long-term non-financial assets, and funds from damage compensation which are based on insurance and which can be only used for capital expenditures. Capital expenditures are: costs associated with the procurement of non-financial assets, maintenance of non-financial assets, capital aid given to trade associations where the state makes decisions regarding the management of procurement of non-financial assets and additional investments in non-financial assets, and investments into shares and stocks of trade associations.
- h) *Special purpose receipts from borrowing* – this include received loans whose purpose has been determined by special agreements and/or regulations. These are: loans that the state budget approves to legal and physical persons from funds that are repayments of loans from previous years; loans from international organizations and institutions that are spent on projects but the payments are executed through the state budget and those where the loan provider additionally refunds the loan in the amount of spent funds; and loans from international organizations and institutions that are spent through projects by assigning them to special accounts and expenses that are covered by direct payments.

**Figure 5: Sources of financing in the Republic of Croatia's State Budget for 2010**

### Financial plan justification

According to the Article 30 of the Budget Law, budget users are obligated to prepare and submit a written justification of the annual financial plan (that is, the annual budget request) along with the financial plan itself. The justification must clearly describe the programs that will be conducted with the funds and must describe the progress that is expected to be made in the coming budget year. This requirement, consistent with the “results-oriented budget” process that is being adopted in a growing number of countries, responds to the recognized need to make a fundamental change in Croatia’s budget process, which will help to move away from a simple focus on the requested funds alone, and move toward a focus on the results to be achieved through the programs’ implementation. Therefore, justifications have to pay special attention to the monitoring of the results of program implementation, that is, their influence on the quality, effectiveness and efficiency of the provision of public goods and services. The MTBF is an essential instrument for the implementation of this approach because it provides a perspective that is longer than the one year which had been used in the past. It helps to see medium-term budget implications of existing policies and programmes and as such, the MTBF provides an early warning if there is a discrepancy between ongoing budgetary needs and revenue forecasts. The MTBF thus helps to increase transparency and predictability of financing.

By introducing strategic planning and a multi-year budgeting framework, specific attention is paid to the established goals and to the monitoring of their achievement. Therefore, in financial plan justifications, special attention is to be given to goals that the programs are striving to fulfill and to the specific performance indicators which will show the realization of those goals. Justifications have to make clear how every program contributes to the realization of a specific goal from the strategic plan or of the special government goals.

Since the year 2010 the State Budget Users must enter justifications of financial plans into a specially designed web application, in order to ensure the uniformity of the justifications.

In accordance with this requirement, justifications of the financial plan proposals have been divided into two parts. The introduction must list the most important work and duties of the organization in the coming period; explain the financial plan proposal considering the total proposed expenditure amount; and explain any deviations compared to the previous periods.

The second part is focused on the program justification, and as already stated, it is based on the organization's strategic plan. This part of the financial plan covers the program descriptions, legislative and other legal basis, program goals, key performance indicators, and the assessment and the sources of funds needed for the programs of higher priority. When describing a program it is also important to connect its goals with the specific goals of the Strategy of Government Programs.

The requirements of Croatia's strategic planning process have been described earlier in this Guidebook, but the main components of the plans are explained again here, to emphasize their importance and their direct connection to the annual financial plan.

*Goals* represent what a program should achieve in a specific period. For every established program goal, one or more performance indicators are cited and described in order to monitor the realization of that goal in a specific period.

*Goals* statements should answer the following questions:

- what we wish to achieve with this program
- how do we strive to realize programs and
- who are the beneficiaries or the people who receive the service

Further, the expected result of the goal is described, as is the period during which the goal would be pursued. It is important to emphasize the savings and benefits that will result from the realization of the goals, and it can be useful to explain the consequences that would occur in case this program is not implemented or if it is not implemented in the necessary scope or period.

In discussing the required funds, it is important to list sources and indicators that are used as the basis for calculating and evaluating the funds required for the implementation of significant activities/projects in the program framework. Budget users must provide projections and justifications of changes within key variables for the calculation of the required funds.

If there have been changes in the projections that were provided in the previous period and accepted by the Croatian parliament, financial plan justifications for the coming budget period will have to provide an explanation of the reason why they occurred. Acceptable reasons are the changes in the macroeconomic environment, unanticipated demographic changes, and changes in the legal framework, and related reasons.

### State budget amendments and addendums (supplementary budget)

If expenditures increase or revenues decrease due to unforeseen or extraordinary circumstances during the budget year, the budget must be balanced by decreasing expenditures or by seeking new revenues. In case revenues are greater than forecast, that gives an opportunity, if so decided, to plan additional spending (or e.g. repayment of loans) this needs to be approved by the Parliament as a supplementary budget.

The flow of amendments and addendums is not regulated in detail. Article 7 of the Budget Law established the fact that budget balancing is an ongoing process that occurs during the budget year through budget amendments and addendums according to the established budget implementation procedures.

The Law also does not regulate the deadline for adopting amendment and addendum proposals. Since the amendments and addendums are adopted for the period up to December 31st and since the current year budget is the basis for the plan for the next year, adoption of amendments and addendums is recommended prior to discussions regarding the new budget. In some budget systems, only negative supplementary budgets have an immediate effect on the next year's budget levels, positive supplementary budgets should not increase the budget basis in order to avoid reckless spending which may or may not be sustainable in the medium term. The table below is an overview of the flow of activities that should be followed in the process of budget amendments and addendums, so that the budget users could properly harmonize, amend and update their financial plans according to the amendments made at the budget level.

Table 10: Flow of Adoption of Budget Amendments and Addendums

RESPONSIBLE ORGANIZATION	ACTIVITY AND SEQUENCE
Ministry of Finance	Prepares amendment and addendum proposals and delivers them to ministries and other state bodies
Responsible Ministries	Communicate with their budget users, provide proposals and comments regarding proposed budget amendments and addendums
Ministry of Finance	Delivers proposed budget amendments and addendums to the government
Government	Establishes the supplementary budget proposal and submits it to the Croatian Parliament
Croatian Parliament	Adopts budget amendments and addendums

### Temporary measures for state budget balancing

Along with the supplementary budget, the Budget Law allows the government to adopt temporary measures to balance the budget. If, during the budget year, due to new budget liabilities or economic changes, there is an increase in expenditures or a decrease in revenues, the government of the Republic of Croatia can, as suggested by the Ministry of Finance, suspend the execution of certain expenditures for up to 45 days (referred to as "temporary execution suspension"). By using these temporary execution suspension measures, the government of the Republic of Croatia can:

- cease taking on financial liabilities,
- propose extension of payment deadlines,

- stop reallocation of budget funds that are required to take over liabilities.

In addition, the government can make decisions that would require the budget users to get permission from the Ministry of Finance to make agreements having financial impacts. Once the decision regarding this is made, the budget users are obligated to inform the Parliament about such agreements.

If the budget cannot be balanced during the period of temporary execution suspension, the government must propose budget amendments and addendums 15 days prior to the expiration of temporary execution suspension.

The temporary budget-balancing measures do not change the amount of individual expenditure items that were established by the budget and allocated based on budget users, programs and sub-programs, but due to the observed expenditure execution deviations, there can be a slowdown or acceleration, depending on the new circumstances. The temporary budget-balancing measures are always finalized by the supplementary budget due to the need to balance revenues and expenditures as well as to maintain the levels of the targeted deficit.

### **Reallocation of state budget funds**

Article 46 of the Budget Law introduced a special mechanism that provides flexibility to the process of budget execution: an option to reallocate budget funds.

Conditions and methods used for reallocation of budget funds are defined by the Budget Execution Law. One exception is that, regardless of the Budget Execution Law, the Budget Law allows reallocation of funds based on budget items of budget users (or between budget users) up to 5% of expenditures of the item, approved by the Parliament, that can be reduced if the Minister of Finance so decides. Complete flexibility with the execution of the law has been provided for budget items that are associated with the repayment of the public debt principal and interest that can be paid off using amounts greater than planned. It is reasonable to introduce complete execution flexibility, since this concerns expenditures that must be executed and since the credit rating and the reputation of the country often depend on its timely execution, and since they can significantly vary compared to the planned amounts due to foreign exchange rates.

Often, reallocation of budget items that changes the item amount by more than 5% is needed. The State Budget Execution Law governs these reallocations. According to this law, the government can, based on a proposal made by the Ministry of Finance, make a decision regarding the reallocation of budget funds for expenditures in the amounts higher than 5%.

One of the positive aspects of fund reallocations is the execution flexibility which has been emphasized, and common criticisms are associated with the fact that the government can use reallocation to amend amounts established by the budget that the Parliament initially approved without Parliament involvement.

Even though reallocation can be used to change the amounts of individual expenditure items established by the budget, reallocation cannot be considered to be “mini



supplementary budgets“, because reallocation cannot change the overall levels established by the budget (budget surplus/deficit), nor can it establish new items.

In case a supplementary budget is prepared after the implementation of reallocation, amendments of the structure and the level of expenditures during the reallocation are included in the supplementary budget.

### **Transfer of unused budget funds into the next year**

According to Article 8 of the State Budget Execution Law, activities and projects financed by the pre-accession aid programs of the European Union and capital projects that are not completed by the end of the current year can be transferred and executed during the next year if the basic preconditions have been met:

- The budget funds allocated in the current year budget for activities and projects that will be transferred are unused and/or have been executed in lower amounts than planned and have not been reallocated during the current year.
- Transferred activities and projects can be executed during the next budget year with the approval of the Ministry of Finance.

## 5 KEY PERFORMANCE INDICATORS

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A more serious approach to strategic planning started in 2003 by applying program classification. Since then, there have been intensive efforts to establish a high-quality system of budget planning per programmes. The programmes (projects and activities) defined in the Budget are required to be monitored on the accounting level. It is also necessary to ensure feedback on the success of the implementation, as well as to evaluate the impact of implementation activities on the attainment of goals identified. After of establishing program budgeting, performance indicators are introduced, this should contribute to the establishment of a system of responsibility for the goals attained.

There are many reasons why performance indicators should be implemented, the most important one being that they improve management, increase accountability and meet legal requirements.

Performance indicators are a useful management tool that enables measuring, monitoring and improvement of a program's success. They have a key role in performance management on all organizational levels (strategic and operative ones) and they also assist in evaluating to which extent the set goal was reached. They also enable the monitoring of efficiency in providing services in the context of their contribution to the attainment of the goal. Performance indicators assist the public management in identifying pressing matters and raising the quality of the rendering of public services.

Another major contribution of performance indicators is the increase in transparency and accountability of the management for the results achieved. Performance indicators may assist in informing the Government, the Croatian Parliament and the wider public on what an individual state administration body does and how successfully.

In order to evaluate the performance of the public sector it is necessary to carry out an evaluation of services provided, i.e. it is necessary to provide answers to the following questions:

1. Are public services client-oriented?
2. Are public sector units formed in a way that they would provide better services in the future?
3. Is management provided by central state administration bodies successful?
4. Are all inputs used in a way that they offer maximum value for money?

Budget users should, within their limitations, be able to develop key performance indicators (KPIs) that provide a comprehensive, complete and the best overview of a program's success. It is crucial to identify program goals oriented on the desired results and the target group on which the project is focused. It is not possible to monitor the

attainment of individual goals on the basis of general information. Therefore, the following steps should be taken when defining KPIs:

- identify base values, i.e. the last known (historic) indicator values;
- establish a system of gathering indicators (establishing a way of gathering relevant information, appointing the person responsible for the collection and the deadlines for making the information available);
- define the timeframe within which target values are planned to be attained.

Improving the quality of procedures and tools for budget planning will create the conditions needed to measure the usage of public funds. In order to enable the measuring of activities carried out, KPIs should be:

*specific* – that they truly measure what need to be measured,

*measurable* – in terms of quality and/or quantity,

*available* – in terms of acceptable costs,

*relevant* – in relation to the goal identified

*time-bound* – that the goals identified are to be attained within a given deadline.

The main characteristic of KPIs is measurability, and it is, therefore, necessary to quantify them, i.e. express them clearly and univocally if they are presented qualitatively.

Also, the use of KPIs enables cost-efficiency and a more efficient public finances management. Programs that achieve good results are presented with a possibility of increasing the resources, whereas those that do not achieve defined goals face a threat of a part of their resources being cut or them being excluded from the budget.

When drafting strategic plans and financial plan justifications, two types of performance indicators are used.

### **Outputs**

Refer to public services provided and public goods ensured that are a *result* of different activities or methods of attaining the goals identified. The results can be standardized when equal services are rendered (e.g. obtaining a driver's license or a passport) or can be heterogeneous when the services are different due to different needs of different end users (e.g. medical treatment differs according to different diseases and patients). Also, qualitative results do not guarantee the attainment of results planned (e.g. education or retraining for an unemployed individual does not mean that they will get a job). These indicators focus on operative aspects of the budget users' programs and are most frequently used by persons responsible for the implementation of programs. In practice, they are used more often, as they are easy to be established and measured. They answer the question as to how many public goods/services were provided by this program?

### **Outcomes**

Refer to economic and social changes achieved by defining general goals (e.g. reducing the rate of under-age crime). The effects are sometimes visible only after a few years, which make them less measurable and therefore used more rarely. They are most frequently used to make policy-making decisions on the strategic level. They answer the question as to what the long-term effect of this program is?

KPIs will assist the ministries or other state administration bodies in drafting a report on the progress and the attainment of set goals and on the establishment of a system of monitoring the implementation of strategic plans.

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## 6 BUDGET USER RESPONSIBILITIES

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### Introduction

Budget Users (including their senior executives and staff who have responsibilities for the planning and budgeting processes) are responsible for determining the financial needs of the organization, for requesting those funds from the MOF (through the annual budget requests) and for properly managing the funds that are provided for the organization's use in accordance with relevant laws.

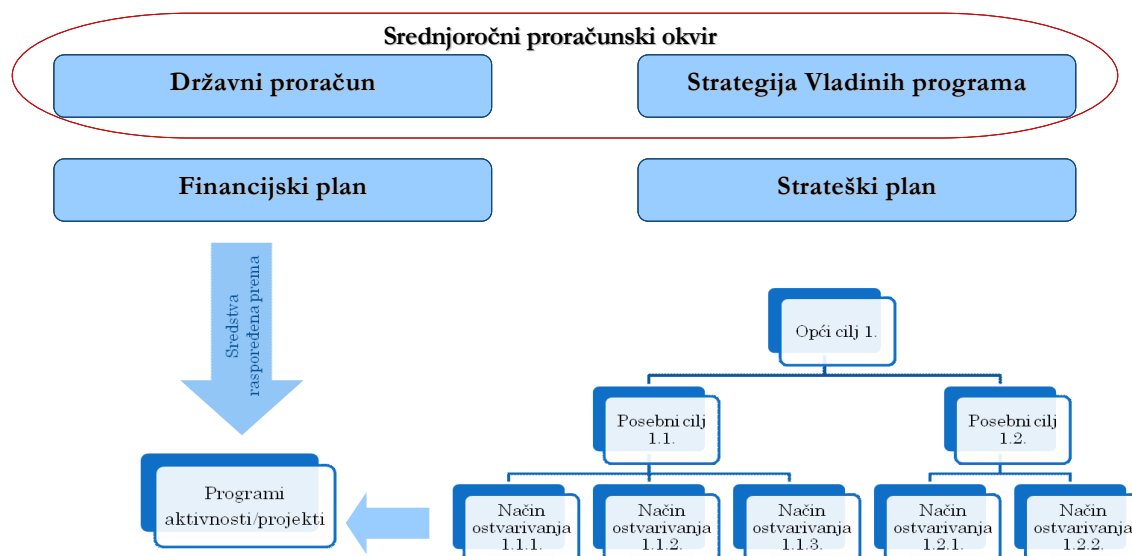
This Chapter of the Guidebook describes those responsibilities from the perspectives of the Budget User itself and of the individuals who have responsibilities under the planning and budgeting processes. In this Chapter, the Budget User's responsibilities are presented first, followed by Chapters regarding the roles and responsibilities of other participants in the budget process.

### **Connections between the Strategy of Government Programmes, MTBF and the annual budget/ financial plans of budget users**

The MTBF is driven by the Strategy of Government Programmes. The MTBF, through Economic and Fiscal Guidelines for a three-year period, takes the specific and general goals and their methods of attainment developed in the Strategy and combines that information with revenue forecasts over a three-year period. The MTBF is the first link between overall Goals and the budget process. Since all Goals cannot be attained immediately and since resources are limited, the MTBF helps the MOF as well as Budget Users set priorities by estimating the resources available over the shorter planning horizon.

Just as the Strategy of Government Programs drives the MTBF, the MTBF drives the annual submissions of the Budget Users. Namely, on the basis of Economic and Fiscal policy Guidelines that define the MTBF, the MOF drafts Instructions for the Preparation of the State Budget Proposal for the next three-year period that are the basis for the drafting of budget users' financial plans. Therefore, the first responsibility of Budget Users under the overall planning and budget process is to participate actively in the Strategy of Government Programmes and MTBF processes in order to provide necessary information for the construction of those processes and the resulting documents. Next, the Budget Users must ensure that their annual budget requests are consistent with the priorities and goals of both.

Figure 6: Connection between strategic planning and the State Budget



Introducing strategic planning and drafting a three-year Strategy of Government Programmes was essential in order for the strategic priorities and goals of the government policies to directly affect the allocation of resources within the budget. Strategy of Government Programmes for a three-year period should clearly define the priorities, goals and policies. This strategic choice should be reflected in the budget for each year covered by the stated three-year period. This means that the Strategy of Government Programmes for a three-year period explains budget allocation to a great extent, and, as such, serves as a support to the budgets, as they are presented to the public or to the Parliament representatives.

In the budget preparation stage, in which financial plans proposals of individual ministries and other state bodies are discussed, a clear connection to the adopted Strategy of Government Programmes for a three-year period must be established.

This is where the need to position strategic planning within the MTBF really stands out, as the MTBF is necessary to ensure the sustainability of budget policies and to enable any changes therein.

Before any medium-term planning can be undertaken, it is essential to have an estimate of the resources available during the years within which the MTBF is to be implemented. In Croatia, the Bureau for Macroeconomic Analysis and Planning, through Economic and Fiscal Policy Guidelines, takes the lead responsibility in developing such estimates for the MTBF.

The macro-economic forecast is prepared on the basis of the best available information, and producing these forecasts is an iterative exercise during the time in which the MTBF is prepared.

Croatia has established a rolling budgeting process to integrate annual budgeting and multi-year budgeting. This process includes multi-year estimates prepared in the previous year as the starting point of the budget preparation process. The MOF updates the costs of the multi-year estimates prepared the previous year, taking into account expected developments of economic parameters, budget execution and expenditure reviews. Based on this the first year of the MTBF is rolled forward to become the budget year, and another year is added at the end of the MTBF, consistent with the baseline budget, which now reflects the policy decisions agreed for the forthcoming budget.

Croatia's MTBF process does reflect that approach, and, subject to revisions in the MOF's annual instructions, consists of several actions:

- Each year the MOF, in consultation with Budget Users, will update the multi-year estimates prepared the previous year as the starting point of the current budget preparation process. The MOF will update the costs of the multi-year estimates prepared the previous year, taking into account expected developments of economic and demographic parameters, and budget execution and expenditure reviews, to bring them in line with the price basis for the forthcoming annual budget;
- The MOF will then prepare ceilings for individual Budget Users for each year of the multi-year budget, on the basis of existing government policies and already approved policy changes. The annual budget and the multi-year estimates are prepared under these hard budget constraints;
- Budget Users are required to submit detailed justifications for all programs, including proposed new policies and policy changes and
- All policies and policy changes are the subject of negotiation.

Budget for the period of three years (budget for the next year and the projections for the following two years) provides decision makers with a better understanding of the resource implications involved than are available from estimates for a single year.

### **Budget User Budget Submissions**

The concepts underlying the MOF's annual and periodic budget instructions have been presented and discussed previously in this Guidebook. Therefore, this section of the Guidebook gives Budget Users additional information in how to fulfill their responsibilities for constructing and submitting their annual budget requests.

Budget Users in Croatia and virtually all other governments feel they do not have sufficient resources. In most cases it is probably true that the Budget User could probably carry out its Mission and Goals, and otherwise fulfill its roles in the GPS and the MTBF, more fully if it had more resources. However, resources are not unlimited in any government. That is why governments prepare strategic plans, so that limited resources are applied in a manner consistent with the government's priorities.

For a Budget User in Croatia as well as in most nations to obtain continued (or perhaps more) funding to carry out its Mission, two fundamental concepts must be followed:

- The Budget User must align its budget submission with Government Goals as defined in the GPS and/or MTBF (the forms for doing so are annexed to the Budget Instructions);
- The Budget User must choose the proper performance measurements and show that



the strategies it has selected to attain the Government Goals are indeed providing results.

To the extent that the Budget User can show that it is taking this approach, its chances of obtaining continued funding for existing programmes and/or securing funding for new programmes is better.

This is part of the process of **justifying** a Budget User's request. While all Budget Users have different Missions and are different in measuring their programs' performance, the overarching item each has in common is that it must **justify** its budget request.

To fully justify a request for funding (especially additional funding) from the national budget, a Budget User must answer the following questions:

- What is the Goal of the funding?
- How does this proposal further the Budget User's Mission?
- How does this proposal align with the GPS and the MTBF?
- What strategy (or mix of strategies) will be used to attain the Goal?
- How will the effectiveness of that strategy or mix of strategies be measured? and
- What alternatives were considered to address the Goal for which the funding is requested and why was each alternative rejected?

These questions generally can be answered in conjunction with the steps contained in the MOF's Budget Instructions. Budget Users should be advised at the outset that if they do not address these issues in their Budget Submissions, MOF Budget Analysts should be expected ask these questions as part of their review. Budget Users that cannot answer these specific questions, as well as other questions the MOF Budget Analyst may ask, are unlikely to receive funding for their initiatives. This is because it will appear that the Budget User lacks the understanding of its own needs and/or the capacity to communicate about and then implement and manage the activities for which it requests funds.

At the end of the day, Budget Users must realize that the national budget is limited. Budget Users compete for portions of that finite amount, and although the Budget Users' needs are important to the individual Budget Users (and their beneficiaries). Government decision makers, aided by their staffs, make the decisions which they believe are in the overall best interests of Croatia, based upon the information they have. Therefore, the more useful information budget analysts and decision makers have that supports the Budget User's request, the greater the chances that the Budget User will receive additional funding for its request. In the most effective budget processes, information about the anticipated results of the requested spending is as important, and often is more important, than simple information about the amount of spending that is requested.

Most Budget Users have Budget Analysts who prepare the organization's budget on behalf of the organization's Chief Executive (the Minister, Director, for example). It is that Analyst's responsibility to ensure that the budget is properly justified. However, program managers within the organization also bear responsibility to help the Budget Analysts justify the organization's Budget Submission. That is, it is not enough for a program manager to simply tell a Budget Analyst that an additional HRK1 million, for example, is required. The program manager should know more about his/her program

than anyone in the organisation and must describe in the budget request how the additional funds will help the programme and the organisation to carry out its Mission, how the additional funds will be used for activities that align with the organisation's Strategic Plan, MTBF and the GPS, and the performance measures that will be used to determine whether the expenditure of additional funds has been a success. This is essential if the Budget Analyst is to prepare and defend the strongest possible budget request.

Characteristics of effective budget submissions are shown in the following table:

**Table 11: Characteristics of Effective Budget Submissions**

<b>POSITIVE CHARACTERISTICS</b>	<b>NEGATIVE CHARACTERISTICS</b>
Timely	Submitted after the due date
Complete data and text	Incomplete data or text
Accurate data and text	Mistakes in calculations or text
Fills out forms properly	Fills out forms incompletely or overrides imbedded formulas
Introductory section clearly ties the request to the Budget User's priority programmes	No clear relationship (or poorly explained relationship) between budget requests and Budget User priorities
Introductory section clearly ties the request and the Budget User to the MTBF	No clear relationship (or poorly explained relationship) between budget request and MTBF
Provides logical and complete discussion of programme goals, performance measures, etc.	Provides only partial or irrelevant information about programme goals, performance measures, etc.
Within the Budget Ceiling, or contains a plan for reductions or trade-offs for attaining ceiling	Exceeds the Ceiling and does not propose reductions or trade-offs
Contains no proposed increases, or proposes increases which are related to existing policies and programmes	Proposes increases which lack a basis in approved policies and programmes
Proposes increases which are sustainable in view of future years' budget constraints or programme performance requirements	Proposes increases which are unsustainable regarding budget needs or programme expectations
Presents and discusses any new laws that may be necessary	Does not discuss legal requirements (at all, or adequately)
Presents and discusses any legal aspects or impacts of increases	Does not discuss legal aspects of increases (at all, or adequately)
Cooperates with MOF staff regarding questions on the submissions	Does not cooperate, or does not provide necessary information

## The Recurrent Budget

The Recurrent Budget, as its name implies, consists of funds that are appropriated to cover the recurrent, or ongoing expenditure of a Budget User. It covers the following categories:

- Wages and Salaries;
- Goods and Services;
- Utilities; and
- Subsidies and Transfers.

These types of expenditure are made every day, and are often what the public thinks of, when they discuss “the budget”.

A Budget User should never seek to develop its Recurrent Budget for the coming years without first examining both its spending from recent years and its current needs. This is because most organisations’ expenditure requirements are somewhat consistent from year to year, and so – once an organisation has conducted a thorough and accurate review of its recent expenditure and current ongoing needs, consistent with guidance from the MOF – the organisation can be able to predict its expenditure requirements for the near-term.

There are many factors that may require the Budget User to recalculate its near-term needs (based on a review of recent and current spending), including things such as:

- New programmes that are added, previous programmes that are terminated, or current programmes that are changed;
- Changes in the number or compensation of employees;
- Changes in the costs (increases or decreases) of the inputs that the organisation purchases in order to conduct its activities and to support its facilities. This includes: office supplies; utilities required for operating its buildings; fuel for its vehicles; as well as any services for which issues contracts;
- Changes in laws or regulations that influence what the organisation does, or how it operates; and
- Changes in the numbers of people or groups to which the Budget User must provide services.

As a result of the need to fulfill its responsibilities for proper financial management and stewardship over public funds, all organizations must gather, manage, analyse, and act upon information about its expenditure, in order to ensure integrity and transparent use of those funds.

The FMIS provides detailed information on past budget executions as well as the current year budget of the Budget User, the year for which the request is made, and a projection two year into the future.

The FMIS provides this information at a much more detailed level than the 4 expenditure categories listed above. This allows a Budget Analyst to focus on the major items of expenditure in a Budget User’s request.

As part of the annual budget development process, Budget Users should anticipate questions from the MOF on the major budget items contained in the details that are

included in FMIS. As mentioned earlier, it is the Budget User's responsibility to justify its budget request. Hence it behooves a Budget User to anticipate the questions that will be asked and provide a written justification of its Budget Request when it submits its budget. This is preferable to simply submitting a Budget Request and then waiting for the MOF Budget Analyst to ask questions. A Budget User stands a better chance of receiving funds for its initiatives if they are justified along with its original request.

## Capital Budgeting

Capital Budgeting is described in the Glossary of this Guidebook, but generally, it involves those items which are large, expensive, and durable – that is, they are significant items which will usually remain in service for a number of years (such as bridges, roads, buildings, and major computer systems). Many capital items are especially useful, because they generate lasting benefits for Croatia and add to its economic development.

Although budgeting for capital items is conducted in Croatia and other nations, Croatia is not among the nations which have a separate Capital Budget process/cycle. This has been found to be necessary because there are additional complexities which are associated with budgeting for capital items and so many nations issue special instructions regarding it. Pursuant to Article 45, item 3 of the Budget Law, the Government of the Republic of Croatia prescribes the investment project evaluation methodology by means of an ordinance. The Ordinance is at the last stage of its development and adoption. It will prescribe the investment project evaluation procedure that will ensure the assessment of all costs and benefits of the projects, as well as their efficient and effective implementation and economic use of budget resources.

Most of the items that are contained in the Capital Budget are not purchased very often, and in addition, they may require more than 1 year to purchase or to put into service. Budget Users should ensure that the ongoing costs of operating its Capital items are contained in the Budget. Without such assurance, and without the necessary operating funds, it is not possible for the Capital items to function as planned.

However, capital projects are expensive, and therefore, funds used for these purposes must be devoted to the highest priorities of the Government. To ensure that these funds are devoted to the highest priorities, Budget Users must provide the best information available as to the costs and benefits of these projects so that the decision-makers in the Government and the Parliament can review them carefully and decide about them appropriately.

As stated elsewhere, the **Public Investment Programme** (PIP) process in many countries is the part of the budget system that focuses on Capital investments and that is intended to ensure that, for such types of expenditure, Budget Users accomplish a conscious investment strategy. In many nations, the PIP process has an information system which supports it and which is also fully integrated with the larger budget IT system. The following types of projects are usually required to be entered into the PIP System:

- Proposed new capital projects over the equivalent of €5,000 (smaller items belong in the Recurrent Budget);
- Large operational expenditures that either vary significantly on a year-by-year basis or are one-time expenditure (e.g. a population census);

- All projects proposed for donor funding; and
- Ongoing projects taken over from donors.

Even without a PIP process, **all** Budget Users should be required to prepare detailed analyses of their proposed capital projects. The Budget Users should prepare the estimated cost of the project for three years: the year of initiation, and for the two subsequent years. The estimated cost of **each** project is expected to be updated for the current year and for the two subsequent years as additional information becomes available.

In addition to estimating costs, Budget Users are required to:

- Identify the need for the project;
- Specify why the Government should be undertaking the project;
- Explain how the project is compatible with overall Government policies and sector policies;
- Submit complete projects (that is, projects that cover all stages from the conceptual to the operational stage) on a “stand-alone” basis (rather than partial projects that require additional components before they become operational);
- Identify options for both large and small scale projects;
- Conduct an analysis of the benefits and costs of each option, along with a recommendation of the preferred option;
- Ensure that project risks have been identified and mitigated;
- Ensure that necessary processes related to any relevant regulatory measures have been undertaken; and
- Ensure that management processes are in place to implement the project.

Budget Users are also expected to prioritise projects so that MOF Analysts can take that into account in making their recommendations on the allocation of funds for capital projects. A second “tier” of Projects that cannot be funded by the national budget can be submitted for donor funding.

After the Budget Users determine their capital investment needs for the budget process, they enter relevant data into the government-wide PIP data base. Budget Analysts in the MOF use the projects included in the system to make Capital Budget recommendations. However, for the MOF Budget Analysts to make recommendations that support Government Goals, Budget Users need to put more emphasis on how the GPS, Sector Strategies, and MTBF are supported by the specific projects submitted and why the projects are given the priorities they are. This requires much greater involvement of strategic planning activities or units in the Budget Users in the whole process of project selection, preparation, and prioritisation.

The procedures for using PIP are contained in each nation’s relevant PIP manuals and relevant websites. Therefore much of the detail about national PIP processes need not be repeated here. However, there are some important things for Budget Users to remember:

- Capital projects “compete” against one another for funding from the national budget. All other things being equal, **those projects that are well-justified in the PIP System will be more likely to receive funding**; those that are not so well justified will not;
- Budget Users should at least ensure that the **description of the project is complete**.

Otherwise the MOF Budget Analyst does not have a clear idea of the purpose for which the funds are being requested;

- Budget Users should be as **precise as possible when estimating costs for projects** over the three year period. Clearly it is difficult to estimate with exactness two to three years into the future, but Budget Users must do their best with the information available. Costs will change as time passes and more information is gathered, but those costs should not change radically;
- Budget Users should **continually update their costs** as more information becomes available. The PIP System is not to be completed only at the time of budget submission; it is a year-round process; and
- Virtually all capital projects cause recurrent costs. These **recurrent expenses should also be presented** so that Budget Analysts have a complete picture of the costs of a project.

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## 7 THE BUDGET ANALYST'S RESPONSIBILITIES

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### The Importance of a Budget Analyst

The importance of the Budget Analyst's role in a modern government, as well as the importance of their performing at a professional and thoroughgoing way, cannot be overstated. This is true in both a nation's Ministry of Finance as well as the organizations that comprise the rest of the government. Quite simply, if Budget Analysts are not trained well and are not functioning effectively, it is highly likely that Budget Users will not be fully effective in attaining their goals.

Budget Analysts are located in all organizations which receive public funds as well as in the MOF, and overall, their role can be stated thus: To properly formulate and analyse a Budget User's request, in order to make the best possible recommendations and justifications regarding that request, so that the Budget User is able to fulfill its Mission, within the confines of available resources and overall Government priorities.

Program managers and organizational executives must understand and appreciate the role of Budget Analysts. In most nations, Budget Analysts at the MOF- or Budget User-level may be called upon to explain the basis/importance of specific aspects of program operations or of budget requests in the absence of program managers and organizational executives, and if program managers and organizational executives fail to provide Budget Analysts with the necessary training, briefings, and/or information, the Budget Analysts cannot be expected to defend the Budget User's funding requests as effectively as they otherwise could. Program managers and organizational executives that do not recognize Budget Analysts as key allies in the efforts to support program goals (by securing and justifying funding for them) are not fulfilling their own responsibilities to the best of their abilities (and in the best interests of the organization).

### The Historical Context of Budget Analysis in Croatia

The public financial management reforms in the Republic of Croatia that have been implemented during recent years included the topic of strengthening the process budget analysis in accordance with European Union standards. This strengthening of abilities, as one of the measures that needs to be achieved in the process of accession of the Republic of Croatia to the European Union, began in 2004, when MOF employees received education at the Center of Excellence in Finance in the Republic of Slovenia. This included seminars and long-distance learning organized by experts from the US Treasury Department, and continued as a grant by the World Bank for the project "Improving Budget Management".



Prior to that period, budget analysis techniques involved only a comparison of the requested budgetary funds for individual activities and projects for the coming period, against the execution of the previous year/years funds. There was little or no analysis of the benefits of the implemented activities and projects or a justification of the requests for additional funds in the coming budget years. Projections were primarily based on the experience with previous spending than on actual calculations. In 2003, the first activities regarding the introduction of program planning began in an effort to change from those practices.

When the Regulation regarding the internal organization of the Ministry of Finance changed in 2005, a Department for Budget Analysis and Evaluation of Capital Projects was established within the Budget Preparation Directorate. In accordance with the Regulation, the Department became responsible for different duties: revenue and receipts analysis, expenditure and expenses analysis of the budget users according to public spending areas; monitoring and evaluating programs by using performance indicators, and evaluating the consequences of the program implementation (or the lack of implementation) in relation to the relevant established government policies; and the analysis and evaluation of expenditures of proposed capital projects, including the evaluation of their future benefits.

Techniques for data analysis only began developing in the years following the establishment of the new organizational structure and the 2004 training. The need to strengthen the Ministry of Finance's capacities in the budgeting process was considered important for several reasons, including the need for an analysis of the fiscal effect of proposed laws or regulations on the budget. By defining expenditures and the benefits of implementing individual regulations through programs, activities and projects, responsibilities are transferred to the ministries and other budget users as the carriers of the program implementation. Parallel to that, the awareness and the responsibility of the government and the Croatian parliament is raised regarding the financial consequences of adopting a new or changed law or regulation.

As part of the May 2005 Decision of the Government of the Republic of Croatia, a specific form has been designed regarding the assessment of fiscal effects of proposed laws and regulations. The organization which proposes the change or the new law or regulation has to answer the questions: how is the law or regulation proposal connected with the budget and its structure; how it affects the budget's revenues and receipts, and expenditures and expenses; how it affects other (local units, extra-budgetary users) budgets; how it affects employment; and how the success of the law or regulation's implementation is to be measured.

Development of the reporting system also contributed significantly to the development of the process of budget analysis. Various reports that were defined are used for the analysis of data regarding the spent or required funds in the future periods. By introducing budget classifications in the budget preparation process (by the 2003 Budget Law and the 2007 Rulebook regarding budget classifications) the budget is prepared and it is reported in accordance with the program and economic classification, organizational classification, location classification and sources of financing, and for the needs of international reporting, functional classification.

## The Role of a Budget Analyst

Deciding how to distribute limited financial resources efficiently is an important challenge in all governments. This is especially true in Croatia today. This task would be impossible without Budget Analysts. These individuals play the primary role in the development of budget ceilings and analysis of submissions by Budget Users, and in the execution of budgets once approved. In short, Budget Analysts make recommendations regarding the allocation of current resources and estimates of future financial requirements, and then they oversee the execution of those resources. These processes can sometimes become adversarial, because of the multiple roles that Budget Analysts play and because of the multiple and occasionally conflicting sets of organizational hierarchies and priorities that they must follow.

Budget Analysts are also involved in long and intermediate-term planning activities such as the SGP (Strategic Planning) and the MTBF. And, as noted below in more detail, to do this effectively, the Budget Analyst must be familiar with the Budget User's operations and stakeholders.

When the Budget User sends its budget request to the MOF, the MOF Budget Analyst carefully reviews the requests of the Budget User and its programmes.

The Budget Analyst performs this role by evaluating the prospective programmes of the Budget Users, including proposed funding increases and new initiatives, estimated costs and expenses, and capital expenditures needed to finance these programmes. Budget Analysts examine the budget submissions for:

- Completeness;
- Accuracy;
- Conformance with established procedures;
- Conformance with existing laws and regulations; and
- Conformance with the SGP, MTBF, and the Budget User's Strategic Plan.

They also examine past and current budgets and research economic and financial developments that affect the Budget User's spending. This process enables the Analyst to evaluate proposals in the context of government priorities and financial resources.

After the initial review process, Budget Analysts make their recommendations on individual Budget Users. These recommendations take the form of summary analyses that support or argue against funding requests that are submitted to the MOF for review.

The amount of data that Budget Analysts must be able to analyse is greatly dependent on IT systems, but in order to make use of the analytical power of computers, data has to be collected at the Budget User level. Budget Analysts are charged not only with collecting data, but also analysing it and putting it in forms that enhance decision making. As a result, Budget Analysts will require focused, specific data of Budget Users to accomplish this. If a Budget User is unable to supply this data, this lack will jeopardize the Budget User's chances of receiving additional funds for a project or initiative.

As limited funding has increasingly become a fact of life in government, Budget Analysts have seen their role broadened. Not only do they contribute to the development of guidelines governing the formulation and maintenance of the budget, but they also measure organisational performance, assess the effects of various programmes and

policies on the budget, and help draft budget-related legislation. In addition, Budget Analysts often conduct training sessions for Budget User managers and staff regarding existing or new budget practices and procedures.

### **Work Skills of a Budget Analyst**

While a Budget Analyst's actual job description and competencies will vary, depending upon the Budget User to which the Analyst is assigned, there are certain work skills that all Budget Analysts must have in common. They include:

- **Analytical thinking:** budget analysis requires the skills of analytical and critical thinking regarding policy and programme matters. This is essential for an effective budget discussion between the Analyst and the Budget User;
- **Attention to details:** a Budget Analyst must know the financial and operational details of the programmes for which he/she is responsible. This requires reading the Laws that authorise the programme and knowing the Regulations and different enactments that have impacts on the programme. A systematic understanding of the way the programme operates is also essential. This attention to details also carries over into the actual analysis of funding requests. A Budget Analyst must make recommendations based on a sound analysis of facts and detailed information is required to make a sound recommendation;
- **Imagination:** imagination and capability to apply new solutions for long-standing problems are very important, and if necessary, "out of the box" solutions must be considered for recommendation;
- **Reasoning:** a skilled Budget Analyst must always ask questions - they need to know why a certain decision is taken, how a certain priority was set, what an action has been based upon, etc. It is the Budget Analyst's job to ensure that the best logic and the most reliable information has been applied to a problem which is being addressed through the budget process and that the proposed activities are properly costed and will have a reasonably positive impact on the problem;
- **Communication Skills:** better analysis and solutions that are highly creative are not useful if they cannot be communicated effectively. Communication skills such as good writing, speaking, and overall presentation skills are essential for the budget analyst;
- **IT skills:** Budget Analysts constantly receive a huge amount of complex quantitative and narrative information in varied formats, and it is not possible for a successful Analyst to receive, comprehend, and utilize all of it effectively without having a full range of contemporary IT skills. This includes knowledge of hardware utilization, skills in using current software such as Excel, Word, PowerPoint, etc., as well as internet research and other specialized IT applications (such as SAP or other budget formulation or accounting software programs). As is true in other aspects of the Budget Analysts' varied roles, the Analyst sometimes must teach staff in relevant Budget Users about the use of these IT functions, in order for the Budget User to be able to develop, receive, and use budget information properly and on a timely basis.
- **Loyalty:** loyalty is a continual responsibility of the Analyst. Often this takes the form of supporting the decisions of the policymaker even though the Analyst has come to different conclusions. The Analyst must make his/her best recommendation based upon the facts, but must also respect the right of the policy maker to make a decision that does not exactly align with the Budget Analyst's recommendation.
- **Flexibility:** All of the above competencies that an Analyst must possess add up to flexibility. Policies often change with changes in decision-makers and programmes are impacted by these changes. A Budget Analyst must accept and support these

changes even if they result in new policies or changed programmes in the ministry of his/her responsibility.

A generic budget analyst's competency model is provided in Annex 8 to show how competencies evolve over time as experience is gained.

### **The Budget Analyst's Activities**

At the MOF level and the Budget User level, the Budget Analyst's job involves the following:

- **Staying Abreast of Budget User Activities:**
  - In order to do a proper analysis of a budget, a Budget Analyst must be familiar with the Budget User itself. This involves being familiar with the Budget User's statutory authority, its mission, its Strategic Plan, and general operations;
  - While it is impossible for a Budget Analyst to know as much about the Budget User as all of those who work in the Budget User itself, a broad and thorough understanding is necessary so that the Budget Analyst can make the proper recommendations and ensure that the Budget User has the resources it needs to do its job, within the existing resource constraints;
  - Routinely, the Budget Analyst should make visits to the Budget User's headquarters and its branch offices during the "off-budget season." That is, the Analyst should visit and better learn operations in the January to March period, when there are no budgets to analyse for the forthcoming Budget Year, as well as at other times of the year in order to get the broadest view and deepest understanding;
  - The Analyst should also attend seminars and other events which are conducted by the Budget User (especially its key program units) so that it is possible to learn about the major policy issues (especially regarding the future) and to develop networks of contacts throughout the organisation. As stated, it is in the Budget User's interest (at both the executive and the staff levels) to cooperate with the Budget Analyst because the better the Budget Analyst's understanding of operations, the more likely it is that the Budget Analyst will understand the reasoning behind the request and, if the data support it, be in a position to support it; and
  - This "knowledge-gathering" practice should be followed by Budget Analysts regardless of the Budget User they work for – the MOF or other Budget Users. MOF analysts need this knowledge so that they can make informed judgments about the Budget Users that they analyse, and the Analysts within Budget Users must have the same relationship toward the operating units within that organisation, so that they can perform their internal analytical and oversight responsibilities on behalf of the Organisation.

- **Advising the Budget User on Budget Process Implementation Requirements:**
  - In managing the annual budget process, the MOF routinely will publish instructions (including the Budget Instructions) that provide guidance to Budget Users about the requirements to be fulfilled by those organizations. The Budget Analysts in the MOF as well as in the Budget Users must be familiar with the content and rationale of those Instructions so that they can answer questions about them or clarify how they are to be followed. (As stated, a Budget User's analysts have a responsibility to develop and implement an internal management and budget process which will allow it to both fulfill its own internal management responsibilities and to fulfill its statutory responsibilities to the MOF under the Budget law.) MOF Analysts have that responsibility toward Budget Users, and Analysts within the organizations have that responsibility to the operating units of the organisation. (In Budget Users, it is usually the further responsibility of Budget Analysts to comply with the provisions of the Instructions) ;
  - Each Budget User must organise itself in order to manage its budget process effectively throughout the year, and so it is useful for Budget Analysts to play a key role in his/her organisation's "budget working group", to ensure that the Organisation is complying effectively with the MOF's requirements; and
  - In either case, however - MOF analysts or Budget User analysts - because of the importance of correct budget information being produced by each organisation, it is appropriate for Analysts to work quite closely with organizational executives and operating staff in gathering the information which is used in responding to the requirements contained in the Instructions.
  
- **Formation and/or Analysis of Budget Submissions:** This is the Budget Analyst's primary job, within either the MOF or the Budget Users:
  - An effective Budget Analyst is aware of the importance of both budget formulation and execution, and of the need to integrate them together in the successful performance of the Analyst's job. Such Analysts know that the current year's budget cannot be executed effectively without sufficient knowledge of how it was formulated, and the analyst also knows that next year's budget cannot be formulated effectively without sufficient knowledge of the execution of the budgets for the current and recent years.
  - As stated previously, the MOF issues the Budget Instructions and other documents that require responses from Budget Users, especially regarding the annual budget submissions. Budget Analysts in the MOF may have the opportunity to review and comment on these documents in draft form in order to become familiar with them and to ensure that they are consistent with the budget process from the perspective of the users of Budget Users' information. In their role as principal day-to-day liaison officials between the MOF and Budget Users, the MOF Analysts must speak for the MOF as the Budget Users are developing their annual budgets;
  - For their part, the Budget Users' Analysts have the responsibility of leading the Organisation's technical processes of developing the budget and of supporting the integration of policy-setting activities with the "calculation" phases of the budget process;
  - As a result of the close relationship between the functions of MOF Analysts and Analysts from Budget Users, the following discussion applies to both groups of Analysts;

- When Budget Users make their budget submissions, the knowledge of the organisation and the Analyst's evaluative skills all come into play. The Budget Analyst will seek to ensure that the budget submission aligns with (supports) the Budget User's Strategic Plan. Then, the Analyst will seek to determine whether the specific programmatic or monetary request will produce the expected outcomes;
- In this latter case, there is usually no "magic formula" that will give the "correct" answer. Here the Budget Analyst uses all of the data and analytical skills at his or her disposal to come to a conclusion and make a recommendation on whether the funds requested are warranted;
- Often, the Budget Analyst agrees that additional funds are warranted, but is not able to recommend them due to a scarcity of projected resources for the upcoming budget year. In such an instance, the Budget User should keep that project on its "list" of High Priority Projects for the next budget cycle when funds might be available. (Budget Users should note, however, that the data will require updating prior to resubmitting the project in the next budget year);

### **Budget Monitoring, Control, and Programme Evaluation**

A Budget Analyst's job does not end once the final budget is approved.

Throughout the year, Analysts must periodically **monitor the budget** by reviewing expenditure reports and other accounting records as necessary, to ensure that appropriated funds have been spent and programme planning goals have been met as specified. This requires the development of strong working relationships between the Analysts and their counterparts in the MOF or organisation-level Treasury unit.

If **significant deviations** appear between the approved budget and actual performance, Budget Analysts must take steps to conduct a deeper analysis and to initiate appropriate corrective action. To avoid or alleviate possible overspending, Budget Analysts may **recommend programme cuts or reallocation** of excess funds. Analysts also inform programme managers at times of the status and availability of funds in different accounts. Before changes are made to an existing programme or before a new one is recommended, a Budget Analyst must **assess the programme's efficiency and effectiveness**.

However, even the focusing upon budget expenditures does not complete a Budget Analyst's job, because – under the Results-Oriented approach being developed within Croatia's budget process - Budget Analysts in the MOF and in Budget Users must:

- monitor the results of the Organisations' programme activities on an ongoing basis;
- ensure that they are (and remain) consistent with the relevant Goals, Objectives, and Targets; and
- verify that the performance measures that are produced are valid and are demonstrating the appropriate progress.

### **Estimating the Costs of Legislation**

The State forms the society and the economy through laws and other legal acts, by defining the rights and obligations of natural and legal entities. With the intent of ensuring the protection of human rights, national defense, protection of environment, road safety, conditions of economy, availability of education and health services, the

State prescribes regulations which regulate the activities of its citizens, public administration bodies and local self-administration units, NGOs and all stakeholders on the market.

In order to achieve optimal results at minimal costs for all stakeholders, including the State Budget, it is necessary to analyse the area that needs to be arranged, when drafting regulations. As a tool for the implementation of the said analysis in developed countries a Regulatory Impact Analysis has been introduced. The Regulatory Impact Assessment is used for identifying goals that are to be achieved through the adoption of a certain regulation as well as for the evaluation of advantages and disadvantages, including costs and different models for the actualisation of these goals.

This analysis is used to determine the impact of the implementation of the regulation on the level of poverty and social exclusion of certain social groups (Social Impact Assessment), on the environment (Ecological Impact Assessment), on the national economy (Economic Impact Analysis). It is also used to establish whether the implementation costs of certain regulations would justify the purpose of their implementation (Fiscal Impact Assessment), all for the purpose of improving the quality and the efficiency of providing public services and goods. This allows the decision makers (the Parliament, the Government) to have at their disposal beforehand the information of potential consequences of the implementation of a certain regulation on all above stated aspects of the society.

It is important to highlight that impact assessment is an auxiliary tool used for policy decision making, and is not a substitute for decision making. The final decision on the implementation is to be made by the Government/the Parliament.

The core of the Impact Assessment is the Fiscal Impact Assessment Analysis, since the country is constantly under pressure to manage the tax payers' money as efficiently as possible. Fiscal Impact Analysis of regulation implementation is proven to be a very successful and useful tool in the budget planning process, along with its function in area of raising the quality of legal solutions.

In 2005, in Croatia, an emphasized need to improve the efficiency of budget preparation, as well as the need to reinforce the functions of the Ministry of finance in the budget process, resulted in introducing the Fiscal Impact Analysis of the implementation of laws and other regulations on the budget. Fiscal Impact Analysis of regulations is one of the key tools of sound fiscal management. It enables us to anticipate and control future spending and increases the transparency of the decision making process.

The basic role of the MOF has to be focused on introducing and maintaining fiscal discipline. By making an assessment of the fiscal impact of the application of the law and other regulations, future spending is anticipated, thus retaining (or reducing) the level of public expenditures in the foreseen macroeconomic framework. In this context, it is necessary to ensure to re-direct public expenditure management to the mid-term perspective, i.e. to ensure a better control of future obligations and fiscal risk management, which is also one of the main tasks of the fiscal impact assessment of the application of the law and other regulations.

Fiscal Impact Assessment has been introduced in order for the Proposer to consider the sustainability of the law (this is done simultaneously with the drafting of a new law,



decree, strategy, program or other by-law). What also needs to be considered is whether the implementation of the new law would enable a successful attainment of identified goals, taking into account the Government's priorities and the limited resources. This is especially important since legislation upgrading and the drafting of long-term strategic documents for certain areas, always aims at improving the quality of the efficiency of the services provided by the State to its citizens.

Legal pre-requisites for the introduction of the Fiscal Impact Assessment were already established by the 2003 Budget Law and the Standing Orders of the Government of the Republic of Croatia. The 2005 Amendments to the Standing Orders of the Government prescribe that, when proposing decrees or other by-laws to the Government or submitting proposals of laws and other acts that Government proposes to the Parliament, the central state administration bodies and the Government's administrative services must submit a Statement on the Impact of the Proposed Legislation on the State Budget, local and regional self-administration units and the number of civil servants and employees. The introduction of the Statement is one of the most significant steps in the process of getting closer to the EU standards regarding quality assurance and fiscal acceptability of a law or a by-law.

Pursuant to the Amendments to the Standing Orders, the Croatian Government adopted the Decision on the Standard Methodology Form for Financial Impact Assessment in a session held on 20 May 2005. The Decision entered into force on 8 June 2005.

Financial Impact Assessment of the implementation of the proposal of a new law or by-law proved to be very useful, together with the filling out of the Form. This enabled the Proposer to be aware of the financial consequences of the application of the regulation proposed for the State Budget, as well as the budgets of local and regional self-administration units. This has resulted in costs of the future budgets to be anticipated, which made the process of their preparation rather easier.

However, in the course of the two years of using the Form, there came a need to modify it slightly. National programs, strategies, plans, projects, policies and similar documents provide guidelines and the framework for the future work of the Government. They also significantly affect the way in which certain areas of Croatian legislation are modified and amended through laws and by-laws that are expected to be passed. Since the Decision stipulated that the Financial Impact Assessment is drafted solely for the proposals of laws, decrees and other by-laws, the impacts of the proposals of the stated documents were not identified precisely and/or were not considered into detail.

Therefore, it was necessary to expand the scope of the impact assessment of the implementation of regulations to those documents, as well. This was achieved by means of the Amendments to the Standing Orders of the Government of June 2007. The newly included documents became collectively known as planning acts. Also, it was proposed that the name of the existing Statement on the Financial Impact Assessment be changed into the Statement on the Fiscal Impact Assessment, since the term fiscal defines the purpose of this assessment more precisely, i.e. it determines the scope of the impact assessment of the proposed regulation on the budget (lat. *fiscus*). The Standing Orders of the Croatian Government prescribes that central state administration bodies that draft the proposals of new laws and planning acts, must deliver the Statement on Fiscal Impact Assessment that is in compliance with the official opinion provided by the MOF, in case the opinion is considered acceptable. It is also prescribed that the Government, i.e. its

permanent working bodies, would not consider proposals of regulations and planning acts that are not accompanied by the Statement.

Pursuant to the Amendments to the Standing Orders of the Government, the Croatian Government adopted the Decision on the Standard Methodology Form for Fiscal Impact Assessment, in a session held on 20 June 2008. The Decision entered into force on 26 June 2008. The new Decision comprises the Standard Methodology Form for Fiscal Impact Assessment, as well as the Instructions on how to fill out the Form. The Decision, the new Form and the Instructions are available at the official MOF website: [www.mfin.hr/hr/priprema-proracuna](http://www.mfin.hr/hr/priprema-proracuna).

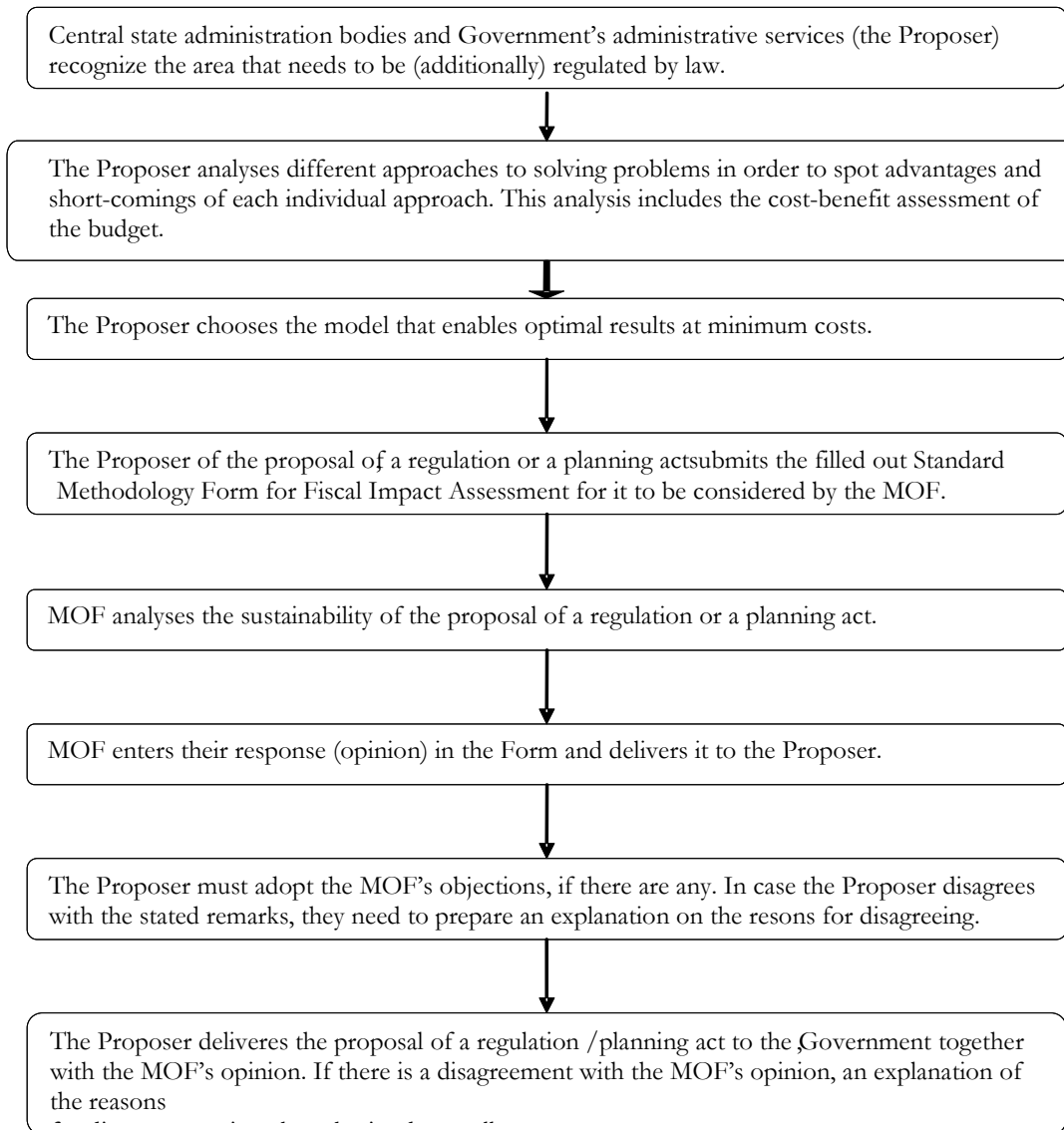
A new proposal made certain parts of the Form somewhat simpler, whereas the Instructions are far more detailed in elaborating on how the form should be filled out.

The Statement on Fiscal Impact Assessment is provided on the Standard Methodology Form for Fiscal Impact Assessment, and it comprises the following:

1. projected revenues and expenditures, as well as receipts and expenses of the budget for the budget year and the next two years,
2. proposals to cover the increased expenditures and expenses of the budget,
3. proposals for the substitution of the reduced revenues and receipts.

Prior to submitting it for governmental approval, central state administration bodies and the Government's administrative services submit the proposals of regulations or planning acts to the Legislation Office, the MOF, the Ministry of Foreign Affairs and European Integrations and other bodies who have jurisdiction in the matter covered by the proposal. The MOF must receive not only the text of the proposal, but also the Standard Methodology Form for Fiscal Impact Assessment. The MOF then evaluates the proposal's sustainability from the perspective of the assessed fiscal impact. It is necessary to determine the availability of resources that are estimated as necessary for the implementation of the regulation or the planning act, in case it is adopted by the Government/ the Parliament. After an analysis is carried out, the MOF sends their response (opinion) to the Proposer. The Proposer must submit the final proposal (compliant with the MOF's opinion) to the Government, together with the Standard Methodology Form for Fiscal Impact Assessment. In case the Proposer disagrees with the MOF's official opinion, the Proposer should attach a statement containing the reasons for disagreeing, as well as the areas that are not agreed upon. The final decision lies in the hands of the Government.

**Figure 7: Steps in the process of drafting a Statement on Fiscal Impact Assessment**



The Standard Methodology Form for Fiscal Impact Assessment is in MS Excel format and is submitted, as such, via e-mail and in hard copy. An insufficiently effective means of communication between the Proposer and the MOF, as well as the Form being filled out without a proper control system established and with no connection to the adopted state budget, has encouraged the MOF to develop a web application for Fiscal Impact Assessment.

The web application is a technical upgrading of the Form, whereas the methodology and the very appearance of the Form remained the same. The application can be accessed online by means of a user name and password. As the Proposers and the MOF have simultaneous access to the Forms filled out and those still being completed, the communication between the stated bodies was made faster and easier.

The application's features enable the comparison between the fiscal impact assessed and the state budget and the projections for next years, which will result in improving the

decision making process from the perspective of determining fiscal policies.

### **Ethics in Budgeting**

All public servants must abide by the Laws and Regulations that bind them. They must also abide by any Codes of Ethics that apply to them.

However, it might be reasonably argued that Budget Analysts should be held to a **higher standard**. They have much to say about the disposition of public funds. Therefore, their recommendations carry a special significance. They must give their best analysis, untainted by personal opinion, to their superiors and then respect the right of their superiors to accept, reject, or accept with modifications, those recommendations. It is a responsibility that others in government do not carry.

Equally importantly, Budget Analysts must make their recommendations free of influence. Outside organizations, Budget Users, and special interests will almost always attempt to influence a Budget Analyst's recommendation. It is the Budget Analyst's duty to make his/her recommendations based upon an unbiased analysis of the facts. As noted above, decision-makers may disagree with the analysis and decide on a different course of action, but the Budget Analyst must present the best analysis possible despite that.

## **8 THE KEY STAKEHOLDERS IN THE BUDGETARY PROCESS**

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### **Introduction**

In every nation, there are key organizations inside and outside of the government that have a special interest in the ways that the budget process works as well as in the budget levels that it contains. Some of the organizations influence the process, some of them manage it, while others must only follow its requirements. Understanding the roles that these organizations play and the relationships that exist between them, is important to the overall understanding of how the budget process works. Most especially, the existence and activity of these organizations illustrates the complex and far-reaching nature of the budget process.

This section of the Budget Guidebook starts from that generalised statement, and then identifies and describes the large and diverse array of stakeholders in Croatia's budget process. As will be seen in this section, some of these stakeholders have roles because they are created in legislation, some have stakeholder roles based on their official positions within the hierarchy of government or within the procedures which drive the governmental activities, while others are stakeholders because of their roles in a democratic society.

### **The Ministry of Finance**

The primary stakeholder in the budgetary process is the Ministry of Finance (MOF). On behalf of the Government, the MOF has both policy-setting and operational functions and responsibilities, and thus it is responsible for managing the overall financial affairs of Croatia. The MOF does this through Departments responsible for: Macroeconomic and Fiscal Policy; Budget; Tax Administration; Treasury; Audit.

Although they are not formally considered as stakeholders, the staff of the MOF is actively engaged in all aspects of financial activities in the MOF and in the results of the use of budget funds. The staff have oversight responsibilities regarding the funds themselves.

The MOF's Vision Statement:

Stable economic growth and development in a stable macroeconomic environment.

The MOF's Mission Statement:

The MOF is developing and implementing the Government's fiscal and economic policies, efficiently collects and allocates budget funds, which contributes to the socio-

economic development of the country and the creation of a society in which each citizen has the pre-requisites for a better quality of life.

### **Bureau of Macroeconomic Analysis and Planning**

Bureau of Macroeconomic Analysis and Planning is an administrative organization within the MOF that drafts annual and multiannual projections and forecasts on budget aggregates; it monitors and analyses macroeconomic developments in Croatia and the rest of the world, it especially analyses and plans fiscal policy at the level of the State Budget, extra-budgetary funds and local and regional self-government units; performs the analysis of the monetary policy and the exchange rate policy; takes part in the activities of state cooperation with international institutions and in activities related to Croatia's performance on the international financial market and before the agencies for the evaluation of Croatia's credit-worthiness, according to international and European standards, it drafts reports (GFS and ESA95 reports) for the central State Budget, reports for extra-budgetary funds and agencies, as well as reports for the general state; they update the fiscal statistics- a long series of data and the preparation of the Monthly and Annual Statistical Overview of the MOF; it performs coordination activities and the management of own resources of the EU, collaborates with domestic and foreign schools of economy and relevant institutions, with the Croatian National bank (HNB); it carries out other tasks determined by the Minister.

The Bureau of Macroeconomic Analysis and Planning comprises the following departments:

1. Department for Fiscal Statistics
2. Department for Macroeconomic Research and Forecasts
3. Department for Fiscal Analyses and Projections
4. Department for the Coordination and Management of Own Resources of the EU

#### Department for Fiscal Statistics

The Department for Fiscal Statistics drafts fiscal reports according to international and European standards for fiscal statistics (GFS and ESA95 reports) for the central State Budget, fiscal reports for extra-budgetary funds and agencies and fiscal reports for the general state; they update budget-related statistics- a long series of data, and perform all other tasks regarding the improvement of fiscal statistics according to international standards.

#### Department for Macroeconomic Research and Forecasts

Department for Macroeconomic Research and Forecasts follows and analyses Croatian and international developments; drafts annual and multiannual forecasts and projections of economic growth, inflation and other macroeconomic aggregates, especially of the basic fiscal categories; with the Department for Fiscal Analyses and projections and in collaboration with administrative organizations and departmental units of the MOF, it drafts the Monthly Statistical Representation in Croatian and English, as well as the MOF's Annual Report; it collaborates with domestic and foreign scientific institutions, banks, the HNB and international organizations.

## Department for Fiscal Analyses and Projections

The Department for Fiscal Analyses and Projections performs activities of monitoring the fluctuations in the budget; drafts parallel analyses with previous years; it drafts daily information, projections of revenues and expenditures until the end of the quarter and the year; in collaboration with the Sector for Public Debt Management, it drafts a financing plan on a yearly or quarterly basis; drafts three-year budget projections and fiscal policy principles in compliance with the Budget Act; it makes international budget comparisons and analyses.

## 4. Department for the Coordination and Management of Own Resources of the EU

Department for the Coordination and Management of Own Resources of the EU performs tasks related to technical and technological preparation for the activities of coordination and management of the own resources of the EU in line with the obligations related to EU full membership; they perform activities related to establishing administrative capacities and procedures, defining and creating the necessary databases; calculations, collection and control of own resources of the EU, coordinate the collaboration with and reporting to the EU (regarding the own resources of the EU).

## The State Treasury

### The State Treasury performs the following tasks:

- preparation and the execution of the budget;
- state accounting;
- cash and public debt management.

## Directorate for Budget Preparation and Financing of Local Governments

Directorate for Budget Preparation and Financing of Local Governments performs tasks related to the planning, drafting and adopting the State Budget and the consolidated State Budget, as well as the budget of local and regional self-government units; works on improving the public finances management; follows and analyses revenues and receipts according to areas of public spending that is financed from the State Budget; performs preparation, drafting and monitoring of the budget according to programs and takes part in the drafting of legal and sub-legal acts that prescribe the rights and stipulate the obligations for the State Budget; it performs other tasks determined by the Minister or the Chief State Treasurer.

1. Sector for the budget preparation and budgeting and for the preparation of financial plans for extra-budgetary users
  - 1.1. Department for the preparation and drafting of the State Budget
  - 1.2. Department for the preparation of financial plans of extra-budgetary users and budget consolidation
  - 1.3. Department for budget analyses and capital project evaluation
    - 1.3.1. Division for fiscal impact assessment and budget analysis
    - 1.3.2. Division for capital project evaluation
2. Sector for the financing of local and regional self-government units
  - 2.1. Department for the records system and fiscal equalization



2.2. Department for the analysis of fiscal capacities local and regional self-government units

### **Instructions for the Execution of the State Budget**

The Directorate for Budget Execution performs payments in the domestic and foreign currencies on the basis of payment requests submitted by budget users, in line with the State Budget; it drafts the projection of the size and the dynamics of cash flows on the account of the State Budget and all State Budget users and determines the amount of monthly available resources for each individual State Budget; it issues instructions in line with the jurisdiction of the Directorate within the Central State Treasury and the instructions for regional state treasuries; it takes part in the formulation of the draft proposal of the Budget Execution Act and other acts, as well as in the formulation of proposals of sub-legal acts in line with the Budget Act; provide opinions and suggestions regarding advance payments; performs normative regulation and development of the accounting; develops and monitors accounting and auxiliary records of the State Treasury's Ledger; consolidates and analyses financial reports; prepares reports for internal and external users, drafts plans and reports on the work performed within the Directorate's scope of activities; carries out budgetary supervision of central state administration bodies, extra-budgetary users, local and regional self-administration units and recipients of funds from the State Budget; takes measures related to the elimination of irregularities and illegal actions and orders measures for the improvement of the situation; undertakes activities aimed at protecting the financial interests of the EU; carries out other activities, as determines by the Minister and the Chief State Treasurer.

1. Sector for financial flows management, payments and financial analysis of budget execution
  - 1.1. Department for financial flows management
    - 1.1.1. Division for the planning of liquidity of the State Budget
    - 1.1.2. Division for the management of liquidity of the State Budget
  - 1.2. Department for payments in domestic currency and financial analysis of State Budget execution
    - 1.2.1. Division for payments in domestic currency
    - 1.2.2. Division for financial analysis of State Budget execution
  - 1.3. Department for foreign payments
2. Sector for state accounting and financial reporting
  - 2.1. Department for the regulation of the accounting system
  - 2.2. Department for bookkeeping
  - 2.3. Department for the analysis of financial reports
3. Sector for budgetary supervision
  - 3.1. Department for budgetary supervision of central state administration bodies
  - 3.2. Department for budgetary supervision of extra-budgetary users, local and regional self-administration units and recipients of funds from the state budget
    - 3.2.1. Division for the budgetary supervision of extra-budgetary users and recipients of funds from the state budget
    - 3.2.2. Division for budgetary supervision of local and regional self-administration units
  - 3.3. Department for the suppression of irregularities and fraud (AFCOS)

### **Directorate for public debt management**

1. Sector for public debt management

- 1.1. Department for borrowing
- 1.2. Department for public debt and risk management
- 1.3. Department for public debt records
  - 1.3.1. Department for accounting monitoring of financial liabilities
  - 1.3.2. Division for record-keeping and reporting on public debt management
2. Sector for public guarantees
  - 2.1. Department for the issuing and record-keeping of state guarantees
  - 2.2. Department for the collection of state guarantees

### **Sector for development and support of the State Treasury system**

1. Department for the development and implementation of State Treasury system projects
2. Department for IT and operative support to the State Treasury
  - 2.1. Division for training and assistance for users of the State Treasury system
  - 2.2. Division for the production and management of the authorization system

### **Sector for National Fund affairs**

1. Department for financial management
2. Department for financial control
3. Department for accounting affairs

### **Sector for normative and legal affairs of the State Treasury**

1. Department for normative affairs
2. Department for legal affairs

### **Croatian Tax Administration**

The Tax Administration carries out professional activities related to:

- the collection of tax declarations, registration of tax payers in the tax accounting, the collection of taxes and issuing of tax returns
- determining the timeliness, legitimacy and regularity of tax declarations submitted
- determining the tax basis and the tax
- carrying out of inspection supervision
- enforcement of foreclosures for tax collection
- submitting requests for the initiation of criminal, offense and preliminary proceedings
- conducting the offense proceedings of first instance due to a violation of tax regulations
- providing opinions on the application of regulations in individual tax cases
- international legal aid in tax-related matters
- examining the tax systems and cooperation with tax authorities of other countries
- monitoring the application of international contracts dealing with tax-related matters
- issuing credentials and certificates on facts used as a part of official records kept by the Tax Administration
- creation and usage of a tax information system
- issuing approvals and the supervision over lottery and prize games
- issuing tags for the marking and registration of slot machines and game tables

- enforcing foreclosures for the purposes of collecting other public charges according to state administration bodies and courts, in compliance with relevant laws
- enforcing foreclosures for the purposes of collecting budgetary revenues determined by the Financial Police in the course of financial inspection.

The Tax Administration also performs tasks related to accrual supervision, collection and foreclosure for the purposes of collecting contributions for mandatory insurance. It also raises minor offense charges and conducts offense proceedings due to a violation of regulations on the payment of mandatory contributions.

The Tax Administration gathers and processes data on the determined and paid taxes and contributions for mandatory insurance and proposes changes in tax policy and tax regulations, as well as in other regulations. This is carried out for the purposes of improving the tax system and ensuring a more efficient collection of taxes and mandatory contributions.

The Tax Administration may perform tasks related to recording, determining, supervision, collection and foreclosure for the purposes of collecting the taxes that in their entirety belong to the local and regional self-administration units, as well as of other public or other charges and fees prescribed by law.

The Tax Administration conducts and issues decisions on offense proceedings of first instance due to a violation of tax regulations and regulations on the payment of mandatory contributions, according to a request submitted by the Financial Police.

The Tax Administration performs all activities under its jurisdiction in their Central Office, regional offices and local offices (branch offices of regional offices).

### **Customs Administration**

Customs Administration is an administrative organization within the MOF that prepares a professional basis for the establishment of economic and development policies in the area of the customs and excise system, as well as of the system of customs and extra-customs protection; it drafts measures for their implementation; organizes and supervises the work of the Customs Service; monitors and processes data on import, export and transport; performs customs supervision in the movement of goods and people to and from other countries; applies international agreements on trade and bilateral agreements and contracts related to international road traffic; performs the checking of legal and natural entities in line with the customs, excise and other regulations on the entire territory of the Republic of Croatia; approves and implements treatment and usage of goods, as prescribed by customs regulations; monitors the settlements of state budget revenues at the level of custom duties, excise, special taxes and other fees that are calculated in compliance with special regulations, at the moment of imposing tax duties on goods on the domestic territory or at the moment of releasing them into domestic circulation; it undertakes measures for the assurance of the settlement of above-mentioned charges; performs the supervision and control over the calculation and the settlement of customs duties, excise, special taxes and other fees, at the moment of imposing tax duties on goods on the domestic territory or at the moment of releasing them into domestic circulation; it performs forceful settlement of customs duties, excise, special taxes and other fees; carries out the control over foreign currencies circulating in

international passenger transport; prevents and establishes customs and foreign currency offenses in international passenger transport, as well as other offenses related to excise and special taxes and criminal activities in matters regarding customs duties, excise and special taxes; conducts administrative and offense proceedings due to a violation of regulations regarding customs duties, excise and special taxes and submits requests and carries out other actions for the purposes of initiating offense or criminal proceedings; prepares a professional basis for the requests related to ensuring budget resources for the financing of the work and the activities of the Customs Administration, takes care of the construction, maintenance and modernization of customs facilities; carries out tasks related to employment, positions, rights, obligations and accountability of the employees; conducts disciplinary proceedings of first and second instance; organizes professional training and development of customs officials and employees and takes part in the preparation of state license exams; supervises the work of international shippers, issues approvals for performing international shipment tasks; collaborates with foreign customs services and international organizations; performs tasks that are placed under its jurisdiction by the relevant regulations, as well as other tasks ordered by the Minister.

For the purposes of conducting the tasks within the jurisdiction of the Customs Administration a Central Office and customs houses have been set up.

### **The Government and the Office of the Prime Minister**

The Government (that is, the Prime Minister and Cabinet) have a dual responsibility regarding the budget process. First, and most importantly, they must establish the national direction for Croatia and set the policies and priorities that are to be executed through the budget process. They must set the government-wide strategic planning process in motion (through the development and promulgation of Strategy of Government Programms and they must be the initial audience of the GPS's content and recommendations. Regarding the budget process, they must review and approve the budget ceilings each year, and then must review and approve the overall budget that is forwarded by the MOF.

The second role of the Cabinet is a difficult one because of the dual roles that are played by all Cabinet members: they are members of the Government and so they must make government-wide decisions, but they also represent specific Budget Users that must compete for portions of the government's limited budget. These differences and the conflicts that can be generated by them are not easily balanced.

As the head of the Cabinet, and in exercising their statutory responsibilities, the Prime Minister and staff are very significant stakeholders in the budget process. Among other things, they must develop and sustain such things as a well-integrated government-wide planning and budgeting process, and a resultant well-balanced and rationalised resource allocation process (including the setting of budget ceilings). They must operate with a full degree of control regarding the Government's fiscal responsibilities.

A nation's Office of the Prime Minister should contain staff members who are sector experts and who provide advice to the Prime Minister regarding decisions that must be made. In effective Governments, the Prime Minister's staff is fully aware of the Prime Minister's priorities and concerns, and, thus, is able to facilitate the overall governing process by working with Budget Users on a day-to-day basis and helping to guide technical matters in ways that are consistent with those priorities and concerns.

For detailed information please follow this link: [www.vlada.hr](http://www.vlada.hr)

### **The Parliament**

The Parliament has a narrow but important stakeholder role in the budget process. The Budget Law describes the Parliament's role, but that role is not as active a role as it is in many other nations, and under the Budget Law, the Parliament has little opportunity to shape the size, content, and direction of the budget. Further, the Parliament becomes involved in the budget process only in its later stages – the first statutory date is October 31, by which time the Government must have delivered the budget request to the Parliament – so the budget request is under the Parliament's review for a limited time prior to its being voted on and enacted into law each year. The Parliament may hold budget hearings after receiving the Government's annual budget request, and the Parliament also reviews requests from the Minister of Finance or the Government, regarding transfers between appropriations, if they exceed a certain portion of those appropriations.

The role of the Parliament of Croatia regarding the Government's proposed budget is also cited in Chapter x of the Constitution of the Republic of Croatia as well as the Budget Law.

For detailed information please follow this link: [www.Parliament.hr](http://www.Parliament.hr)

### **International Organisations and Donors**

There are a large number of international organizations and donors that are currently operating (or have previously operated) in Croatia. The list includes:

- large lending and assistance and lending organizations such as the World Bank (WB) and the International Monetary Fund (IMF);
- a significant number of large and small bilateral organizations that provide broad assistance such as the Danish government, Dutch government, British Council, and others; and
- a large number of smaller bi-lateral assistance organizations that focus on one topic or project.

Although Croatia's budget is based on its own revenues (and thus it does not contain donor grants), the level of revenues is not sufficient for a number of purposes (most specifically, to provide for some infrastructure improvements, all the required services desired, or those necessary for economic growth). In addition, World Bank provides a variety of forms of technical assistance and policy guidance to Croatia, and for all of these reasons, it has a significant stakeholder interest in Croatia.

International organisations' funds are used for providing the technical assistance services of international and Croatian advisors that have trained Croatian staff and officials in the skills that are essential for building and maintaining effective central and local governments.

On the basis of this, it is clear that international organizations and donors have very significant stakeholder interests in the budget process, for the following:

- Some of the funds used in building the government's capacity (directly, or through

third parties such as advisors or outside institutions) are from international organizations and donors, and so they have a natural interest in observing what has been done with their funds, that is, in determining what their funds have accomplished;

- Further, international organizations and donors that have a long-term commitment to continue their assistance to Croatia will want assurance that Croatia's government will continue to strengthen and will build on the assistance that has already been provided; and
- In addition, the organizations that provided funding have an understandable interest in fiscal accountability over their own funds, that is, in determining that the uses that were made of their funds were proper.

Many governments make the decision to borrow money from international organizations and donors, and to use those funds for a variety of purposes. Some of those funds are provided as grants (that is, money that is not to be repaid), some are provided as conditional loans (to be used for a specific purpose) and some are provided as "budget support" (funds given to the budget for general uses).

### **Non-Governmental Organisations (NGOs), the Press, and Civil Society Organisations**

Non-Governmental Organisations (NGOs) have a role in democratic nations that complements the roles of public sector organizations, and they focus their attention on specific problems and/or on specific segments of the population. Some of them are advocates for specific programmes or policies, and some may provide specific services (that the government may or may not already be providing). In Croatia, NGOs have an overall goal of seeking to support greater self-sufficiency within the population. When NGOs provide a service that the government is already providing, it is often done because the government's providing of that service is not sufficient to meet the need.

Some of NGO's may have a contractual relationship with Budget Users and thus they will receive budget funds in return for providing specific goods and services. Thus, NGOs may be considered as stakeholders from 2 perspectives: 1), they are interested in the budget process so that they can be aware of the planned activities and expenditures in their subject area of interest; and 2) NGOs that have contractual relationships with Budget Users are interested in the budget because those Organisations are a source of revenue for them.

Although NGOs can be important providers of services to members of the population – either in their own right or as supplements to the government's providing of those services -- there is a potential danger to the budget at such time as an NGO ceases its operations. This is because the government may be required to assume responsibility for continuing that service and thus for the paying for its costs, which may be an unplanned expense for the government's budget.

The press has a critical role in democratic countries, by helping the public to learn about and to understand what their governments are planning and doing. Since governmental decisions about budgets and programmes are so central to the day-to-day lives and the long-term well-being of all citizens, the press is in an excellent location to facilitate and accelerate the communication and learning processes. In addition, the press' role can support a democracy's commitment to transparency and accountability. As a result, the

press becomes an important stakeholder in the budget process. Further, it is in the best interests of the MOF and of Budget Users to provide and explain information to the press, so that their reporting can be conducted on an informed basis and can be as accurate and correct as possible.

Other outside organizations, such as research organizations, independent educational institutions, professional associations, private companies, representatives of the civil society, and even private citizens, are stakeholders too. Like NGOs, they have some of the same relationships regarding the government, that is, in some instances they may have contractual relationships with the government for providing some goods or services (such as providing training courses, office supplies, computers, etc.). In other instances, they may represent specific points of view for the government to consider.



## 9 BUDGET EXECUTION

### Introduction

Budget execution in Croatia is prescribed by means of the Budget Act and the Budget Execution Act that is adopted on a yearly basis, together with the State Budget.

One of the basic functions of the Treasury is budget execution, which includes the full range of activities which are necessary for managing and monitoring the expenditure of public funds. The purpose of budget execution is to provide for an effective and transparent process for the government to use, in controlling how it spends its money.

To be effective, budget execution must link directly with budget “formulation” – funds are requested through the established budget process for specific things, to be spent by specific organizations, and to be spent in specific ways and in specific levels of detail, according to a specific coding structure. Therefore, in order to operate effectively, the budget execution process ideally will take all of this into consideration and will use a common coding structure and level of detailed information, in order to provide for accountability, monitoring of program results (and linking them to the budget) and effective record-keeping.

However, establishing and maintaining a direct and fully effective link between budget formulation and budget execution is both important and difficult to accomplish, for several reasons. First, the levels of detail may be different, that is, budget formulation may be done at a higher (or more general) level, while budget execution is concerned with the actual salaries that are paid to staff and the actual bills that are paid for supplies, equipment, travel costs, etc. Further, budget formulation and budget execution sometimes use different coding schemes (not case in Croatia), so that it is difficult to compare “apples to apples”, because there may not always be a direct correlation. Finally, budget formulation must be conducted well in advance of the actual activities and spending, and so it can only estimate what the specific activities and costs may be (and both may change according to the needs of the organization), while budget execution is conducted after the actual bills have been paid and thus it may result in very different figures from the ones developed in the budget formulation process.

The cycle of budget execution starts each year with the passage of the budget from the Croatian Parliament. It continues throughout the budget year, and it ends on the last day of the year (31.12). During the course of the year, regular reports about expenditures must be produced and analyzed, to ensure that activities and expenditures are being conducted according to plan. Any significant deviations should be identified and acted upon promptly, in order to make any changes that are necessary. At the end of the year, annual budget execution reports should be prepared and analyzed as a standard practice

regarding the year that has just ended as well as a way to help predict the coming year's expenditures.

In addition, the process of budget execution in many nations, including Croatia, is coming to also include a greater focus on program results along with the traditional analysis of financial expenditures. This growing trend is important for several reasons:

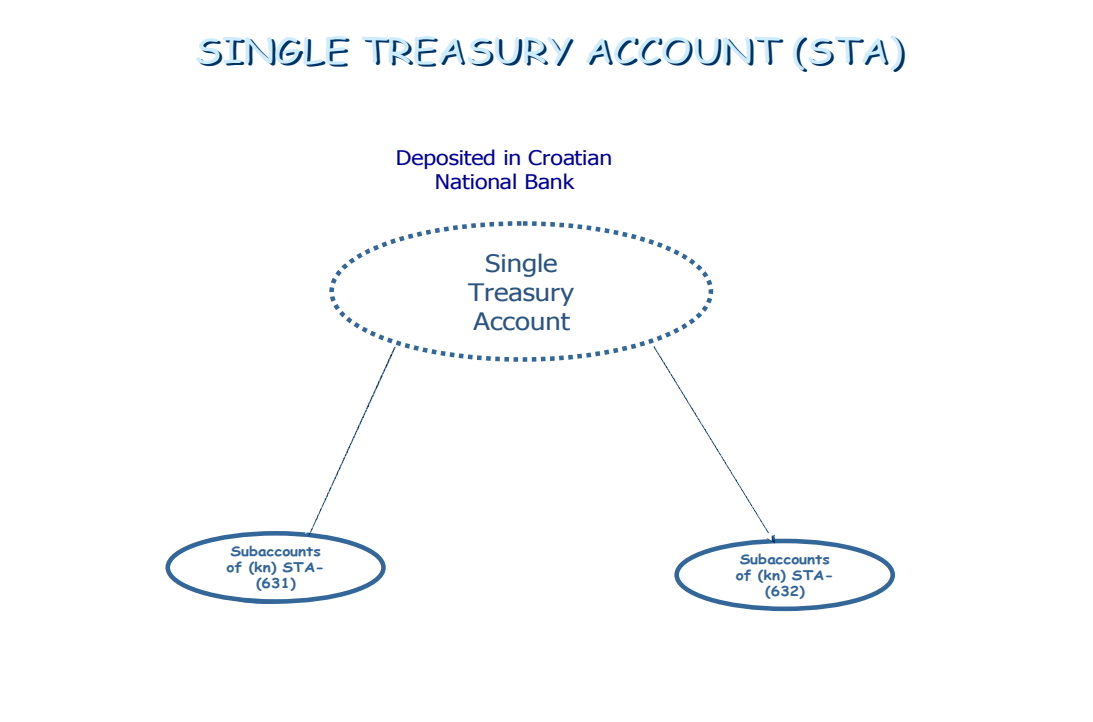
- it reflects the fact that governmental agencies need to be concerned with what they are accomplishing as well as what they are spending
- it reflects reality, that is, government is conducting activities and is spending money for them, so it is logical to collect, connect, and report this information together
- it emphasizes the important analytical function of public financial management as opposed to the simple collection of bills and the matching them against the authorization to spend money
- it acknowledges that the purpose of government is not to spend money, but to deliver effective programs and services to the citizens

For the implementation of budget execution functions, modern nations (including Croatia) have developed automated systems (in Croatia SAP IT System), whereby the budget users enter their payment requests for purchases and activities which are consistent with the year's approved budget, which are then paid out, following a review of whether they match the previously planned amounts. This method is intended to prevent inappropriate payments, that is, spending of public funds on unplanned expenses and costs.

### **Single Treasury Account**

The model of public expenditures management through the State Treasury is based on the principle of the existence of a single account through which all budget financial transactions are carried out. All revenues, receipts and expenditures of the State Budget are executed through the Single Treasury Account. Such an account ensures an efficient and transparent daily management of financial flows of the State Budget and provides the basis for efficient financial planning.

The Single Treasury Account (Republic of Croatia's State Budget Account) is deposited in the Croatian National Bank. It contains special purpose accounts for the payment of budget users' salaries and the accounts for the payment of current expenses, pursuant to the Order on opening and maintaining an accounting in the Croatian National Bank (OG 23/2002).

**Figure 8: State Treasury Account:**

## Steps in the execution of the State Budget

### Financial plans

At the beginning of a financial year, budget users draft financial plans according to months, for the whole year (this is done on the basis of the amounts planned by the budget). Financial plans are entered into the State Treasury's IT system up to the level of planned annual amounts.

### Reservations

In order to efficiently manage the liquidity of the State Budget for expenditures and expenses determined by means of the State Budget and projections for the next two years, a reservation of funds needs to be made. The reservation of funds serves as a notification that a liability is being created and is at its initial stage. The entry of a reservation is based on the following documents: Announcement of Liability, Contract and Order Form.

The Announcement of Liability document reserves the spending of budget funds at the earliest stage, pursuant to the Decision on the initiation of the public procurement process, i.e. on conducting central public procurement procedures. In other cases, the reservation of State Budget funds may be based on a public tender, a decision made by a competent authority or person (administrative board, the minister, ...) etc.

The Contract ensures the reservation of State Budget funds at the second stage of the creation of a liability. The Contract represents a real assumed liability that is related to the previous step (Announcement of Liability).

State Budget funds may be reserved also on the basis of a document called the Order Form. The above mentioned documents serve as the grounds for the State Budget funds to be reserved according to each budget address (source, activity, item), whereby the Announcement of Liability does not include data on the supplier whose liability is to be settled. The crucial role of the reservation system, as well as of the entire liability control system, is to ensure that budget users enter only in those procurement procedures that can be covered by the budget. The reservation thus becomes a tool for liability management.

### **Invoices/Requests for Payment**

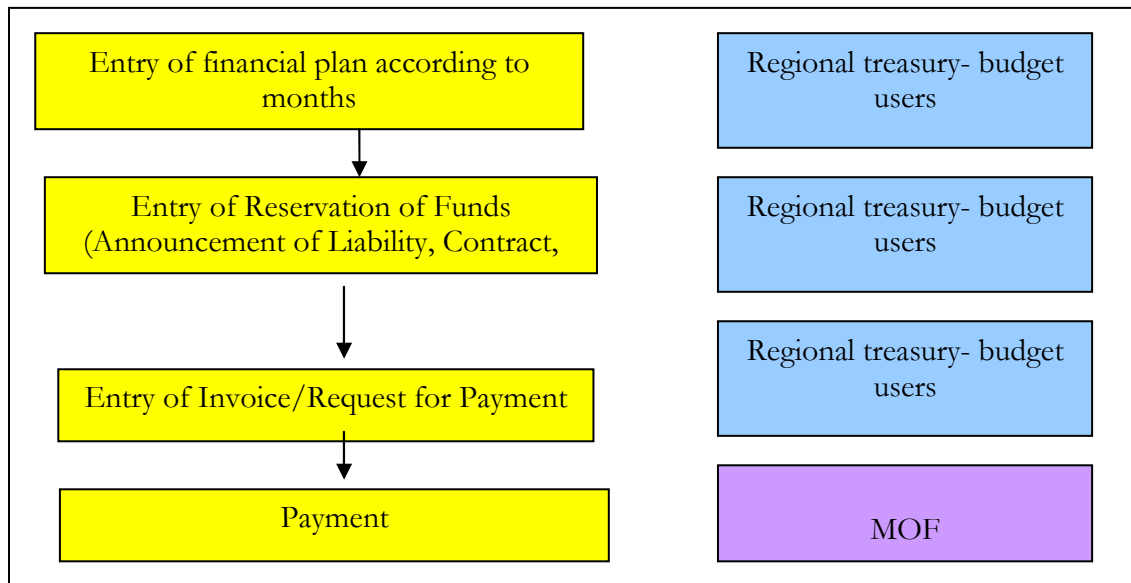
In the process of budget execution, the term “invoice” stands for an incoming invoice, calculation of salaries and other expenditures for the employed, calculation of interest rates and other accruals. The invoice is entered into the information system of the budget user (if the IT system is connected to the State Treasury’s IT system) or into the State Treasury’s information system, after it has been liquidated and authorized according to mandatory accounting controls, by debiting the budget address (source, activity, item).

With certain types of expenditures, the entering of an Invoice must be preceded by the previous stages of fund reservation- the Announcement of Liability and/or the Order Form. However, the Invoice may be directly entered into the State Treasury’s system without prior stages of reservation.

The Request for Payment and the Invoice are one document that changes the status of a specifically defined area. The change in the status of the invoice means that the head of the budget user or an authorized official has approved the payment. The Invoices whose status has been changed are transferred into Requests for Payment. It is only when they reach this status that they can be paid.

### **Payments**

Requests for Payment are approved in the MOF’s Budget Execution Directorate. The execution of the Request for Payment is carried out as a transaction by means of the National Clearing System or the Croatian System of Large Payments.

**Figure 9: Steps in the new process of budget execution**

### Foreign Currency Account

The functioning of the foreign currency account is a key part of the process of maintaining a complete STA process and thus it is vital for effective management of finances.

### Payments to foreign countries

The process of foreign payments follows the steps in the process of State Budget execution in the national currency, whereas the only difference is that it is not an automated process. Payment operations carried out with foreign countries and for the purposes of the State Budget, are conducted in several commercial banks and the Croatian National Bank.

However, an important business decision was made; payment operations with foreign countries were to be successively transferred from commercial banks to the Croatian National Bank (HNB).

Improving business operations in this segment meant that an establishment of a foreign currency account in the HNB was needed, i.e. that it was necessary to integrate all foreign currency payments in one place and to make the entire process automatic. The basic idea is to link the MOF/State Treasury's information with the HNB's application for the execution of foreign currency payments. The integration of the MOF and the HNB will ensure automatic payments and recording the liabilities fulfilled at the moment of payment. This would also eliminate the crucial short-coming of the existing process in which the payment procedure is separated from the recording (accounting entries) procedure in the reporting system of the State Treasury. The integration of the system has been designed according to the integration model of information system of regional treasuries with the State Treasury's information system.

The Single Treasury Account in the HNB will integrate the MOF's account and the accounts (sub-accounts) of budget users according to the model for the formation of a single kuna (HRK) account.

### **Payments from abroad**

In the current process of record-keeping of foreign currency inflows, the bank delivers the documentation (Bank Account Statement, Order 10) to the MOF that then makes records of the documentation manually.

The automatization of foreign currency payments is carried out at the same time as the upgrading of the system. This is achieved through the formulation of automatic record-keeping of inflows into the single treasury account.

The proposed model was the same one as for the record making of the part in HRK according to the model of combined encoding (deposit payment code-onto GK-source of financing-budget user). The stated encoding will enable the differentiation between different kinds of receipts and revenues, automatic record-keeping according to the appropriate item of the ledger and the corresponding source of financing and according to the budget user if the revenue is specially gained by individual users.

### **Managing the State Budget's financial flow**

Efficient planning of liquidity of the State Budget is achieved through efficient management of State Budget financial flows. This is one of the key roles of the State Treasury, as it ensures timely execution of the State Budget, reducing the costs of borrowing and the increase in the revenues from state deposits.

Projection of the structure, size and the dynamics of the State Budget financial flows are drafted on an annual, quarterly, monthly, weekly or daily level. The projections include:

- budgetary revenues and receipts
- budgetary expenditures and expenses
- available financial means on the account (s)

### **Projection of revenues**

The projection of revenues (structure, size, dynamics) is made in the cooperation with the Bureau for Macroeconomic Analyses on an annual, quarterly, monthly, weekly or daily level, based on analyses of time series in line with the projection of budgetary revenues on the annual level.

### **Projection of expenditures**

The projection of revenues (structure, size, dynamics) is determined on the basis of the data contained in the budget users' financial plans, reservation of funds based on the Announcement of Liability, the Contract, the Order Form, and the Invoice (Request for Payment) recorded (entered/transferred) into the State Treasury information system. The stated documents enable insight into the value, structure and maturity date of the State Budget's expenditures and expenses. .

## Projection of expenses

The projection of expenditures, i.e. the assessment of liabilities according to public debt is drafted in the Directorate for Public Debt Management on an annual, quarterly, monthly, weekly and daily level. Information on re-payments of public debt liabilities are structured according to the types of expenses, the level of expense, currency and maturity date of the said re-payments.

## Projections of receipts

The projection of receipts (structure, size dynamics) is determined following an assessment of expected revenues, expenditures and assessment of liabilities according to public debt, including the financial position – resources on the accounts. By facing the stated assessments of budget categories, a surplus/deficit of resources is established at the level of a period. A proposal of financing the potential deficit/surplus or the investment of potential surplus of budget funds is drafted, as well.

The stated budget categories used in the process of drafting liquidity projections of the State Budget are harmonized with the real fluctuations of the economic activity or the macroeconomic environment.

## Monitoring and reporting on state budget execution

The basic purpose of reporting on budget execution is to provide information on annual and semi-annual revenues and expenditures planned and realized, as well as on receipts and expenses expressed according to budget classifications, changes in plans in the course of the reporting period, on the realization of set plans and the performance in the process of attaining the goals.

The semi-annual and annual report on budget execution is published in the “official Gazette”, which is important in order to respect the principles of transparency, i.e. to enable the public and all interested parties to see how budget resources are spent.

The annual and semi-annual report on budget execution comprises and encompasses:

1. an overview of total revenues, receipts, expenditures and expenses at the level of economic classification division,
2. a special part of the budget according to the organizational and program classification and the level of the division within the economic classification
3. a report on the borrowing on the domestic and foreign money and capital markets
5. a report on the state guarantees provided and expenses according to state guarantees,
6. explanation as to how the revenues, receipts, expenditures and expenses were gained/executed,
7. explanation of macroeconomic indicators,
8. execution of financial plans and extra-budgetary users at the level of economic classification divisions,
9. explanation as to how the extra-budgetary users’ revenues, receipts, expenditures and expenses were gained/executed
10. general budget deficit

Annual report on budget execution should, much like the budget, consist of a general



and a specific part.

Budget Act defines the deadlines for the submitting and adopting of budget execution reports, whereas the very process has been simplified and established in a way that it is possible for it to be implemented in practice.

The semi-annual report on budget execution are to be submitted to the MOF by budget users until 10.7, whereas the MOF drafts a semi-annual report on budget execution for the first 6-month period of the current budget year and must submit it to the Government on 5 September of the current budget year. The government submits the stated report to the Croatian Parliament that needs to adopt it on 15 September of the current budget year.

The annual report on budget execution must be submitted to the MOF by budget users until 18.4. The MOF, in turn, drafts an annual report on budget execution and must deliver it to the Government until 1 May of the current year for the previous year. The Government has to submit the stated report to the Parliament on the 1 June of the current year for the previous year.

In the course of budget execution, the MOF may perform financial control over the legal and purpose usage of budget funds on the premises of the budget user or the end user. The said controls are performed by authorized MOF officials. In case any irregularities are established, the authorized persons are obliged to notify the MOF unit that carries out budgetary supervision in line with the provisions of the Budget Act. This is how financial controls are conducted beforehand, as opposed to the common system of controls that is based primarily on controls conducted afterwards (and these often have no preventive effect and come down to merely concluding the current state of affairs).

# Chapter 10

## 10 MONITORING, EVALUATING, AND REPORTING RESULTS

### Introduction

This Chapter of the Guidebook presents important information about the portions of the annual budget cycle which are most useful to the processes (and to the individuals) which are responsible for policy-setting and decision-making. That is because the monitoring and evaluating of programme activities, and reporting on their results, are part of the ongoing management cycle and they also produce information that must be used in preparing the programmes to continue (or to be changed or ended) in the coming year. The acts of monitoring, evaluation, and reporting are essential to any successful organization in the public or the private sector, and no organization in the public or private sector can be considered as complete or successful without them.

As such, information and understanding that is gained through monitoring, evaluating, and reporting is useful throughout the year and it is especially important to the coming year's budget formulation and MTBF processes. The year-round aspect of monitoring and evaluation is illustrated below at the Government level, although ministries can follow the same model by taking on the role of the MOF:

### Differences Between Monitoring and Evaluation

In this Chapter, the topics of monitoring, reporting, and evaluation will be presented and explained, and their important interrelationships will be discussed.

Although they are different processes, monitoring and evaluation are closely related aspects of programme management, and it is helpful to introduce and define them at the same time, so that they can be understood together.

**Monitoring** (or performance monitoring) at the ministry level is the process of gathering information regarding a programme's current use of its resources and about what is currently being accomplished through the use of those resources. Monitoring is performed on the basis of budget execution information and on the basis of activity information that comes from the organization units that are directly implementing the programme (e.g. implementation of the Strategic Plan based on KPI information or of the Action Plan based on implementation reports, if produced). Monitoring is part of the control function and responsibility of management. At the ministry level, supervision should also be performed over the subordinate units of the ministry, such as agencies and companies.

**Evaluation** is the process of organized budget and programme information that is

gathered through monitoring (as well as information from other sources that may be relevant), and about making some judgments about the performance of an institution or a program based on that information. Evaluation considers the institution's or programme's purposes and goals and compares the results of activities to the attainment of those goals. An evaluation could be based on a report that a government institution must produce to account for its performance. As such, evaluation relies on the monitoring information but goes deeper than monitoring. It does not just stop by asking only "If things got done?", but also "What was the result after things got done?" It is also a more complex process than monitoring, because it also identifies and explains the intricate relations between causes and their probable effects, and it frequently relies on data which focus on a longer time period for the analysis purposes and to draw conclusions.

From this description of monitoring and evaluation, it is clear that evaluation is usually an ex post instrument, that is, it is used after a programme has been established and run for a while. It is also possible that there is a need for a situational analysis before a programme is established (ex ante evaluation). This sort of evaluation can reveal what kind of policy instruments would be likely to best suit a problem at hand, or what the likely consequences of different sets of actions are.

There are a few important differences between monitoring and evaluation:

- Monitoring is generally a passive process, based on observation and information-gathering;
  - The main goal of monitoring is to gather information and to help managers, staff, and decision-makers to learn about the programme;
  - Monitoring is usually followed by some types of reporting, but it does not necessarily also include making analyses on the basis of the information that is gathered or the activities that are observed. For example, one can report on performance without providing a judgment whether the results were good or bad;
- Evaluation is generally a more active process, which begins with gathering information and then it automatically progresses to more complex steps, such as analyzing the trends, drawing technical conclusions on the basis of the information that is gathered, and using the information for making policy decisions about the programme; and
- Evaluation has several goals, the most important of which is to support decisions on current and future directions of the programme. Evaluation study therefore usually ends with a report where these positions are articulated and justified.

Care should be taken in both the monitoring and evaluation processes, however, in order to ensure that the information is understood clearly and is used properly, and in order to avoid confusion and misinterpretation of the information. This is especially true in a controversial programme or a highly organized environment.

Evaluation is a very important part of the overall responsibilities that the management process of any successful organization must be able to fulfill:

- One of the common characteristics that is found in all successful organizations is the existence of an ongoing cycle of examining their activities and using the knowledge gained in this process to examine the organization's policies and procedures and results, in order to improve what the organization does;
- This is especially true in a competitive environment, which can be found in either the private sector (where several companies make similar consumer goods and each one

wants a larger share of the total customers' spending) or in the public sector (where various agencies must compete for a desired portion of the government's limited budget resources)'

- In a competitive environment, especially in the current constrained resource situations that are facing both the public and private sectors, organizations that do not conduct some evaluation activities, and that do not take actions on the basis of evaluation results, are not likely to meet their goals and or to be as successful as organizations which do conduct such activities; and
- Like internal auditing, programme evaluation is not easy or routine or automatic, but it is a necessary step in the strengthening of that organization.

Monitoring and evaluation both are important parts of the strategic planning cycle. As stated, strategic planning is a constant and ongoing cycle that includes the steps of:

- Establishing goals and objectives,
- Specifically focusing the organization's activities and resources on the pursuit of those goals and objectives, and on attaining specific results, as the ultimate purpose of all of the organization's activities,
- Implementing programmes which are intended to address those goals and objectives,
- Determining ways of measuring the progress of these programmes in meeting the goals and objectives, through the establishment of specific performance measures,
- Using performance measures to evaluate the results of the programmes in relation to goals and objectives, and
- Using the results of programme evaluation in order to refine the goals, objectives, performance measures, and programme activities, and to renew the focus on goals and objectives.

### **Roles of Monitoring and Evaluation**

Evaluation plays a role in decision-making, priority-setting, and resource allocation activities, as well as in planning future programmes or future changes in current programmes. There should be a direct linkage between the evaluation process and the budget process. This means that evaluation results should be taken into account when drafting a budget submission. This is especially true, because both are part of the strategic management process.

Evaluations and their results are essential for helping to make decisions, in setting priorities, and in allocating resources, especially in governments where the need for resources exceeds the availability of resources. However, such governments face problems which make monitoring and evaluation difficult, including: a lack of monitoring and evaluation information and information systems, a lack of sufficient staff with the necessary training, and the lack of a management culture which values and uses monitoring and evaluation information. These problems must be remedied in order for monitoring and evaluation to be fully implemented and used effectively.

It should not be expected that evaluation results will be used in all decisions. For a variety of reasons, some public functions will still have to be done by governments, even if evaluation results are negative or even if there is no end of the problem.

In fact, evaluation can sometimes be counter-productive, that is, when evaluations are performed, they generally raise expectations within the organization, the programme, or

the target population, that results will be analysed and changes will be made. If nothing is done with the evaluation results, then cynicism will result and performance may decrease.

Generally, there should not be a direct linkage between evaluation results (or indeed, programme results) and programme funding. It is always important to analyze the evaluation results and then compare them to the current funding levels in order to analyze what has been happening. For example, a programme with increasing results may not actually be fully successful, because it is possible that greater results could have been achieved if certain changes were made. Conversely, a programme with decreasing results may actually be “successful”, because without the existence of this programme and its activities, there may have been even greater deterioration in the situation that the programme was designed to address.

Programme evaluations which are conducted properly and which are part of an effective management process can cause debate/focus on core goals, intent, and results of the programme, ministry, or government. Programme evaluation both allows for and precipitates a focus on the core purposes of programmes, and can help determine if the programme is serving those core purposes. Programme evaluation also can determine if the programme is focused on peripheral issues (and thus is not being as effective or efficient as it could be).

Situational analysis can create an awareness of the costs and risks of not having certain programmes or of not taking some course of action. For example, if no action is taken to combat the initial occurrence and spread of HIV/AIDS, later on it may become much more expensive and expensive to the state (cure) and society (withdrawal from the labour force of the seriously ill) to deal with the consequences. A policy study can thus determine the consequences of not taking action regarding a certain problem, that is, it can show that solving the problem may become so difficult in the future, that spending money on it now may be a good investment into the future.

Programme evaluation can be a basis for new or changed legislation. In an evolving government, it is possible that there are not enough specific laws to cover all programme needs, or it is possible that the existing laws cover only some of the programme topics which are important. Evaluation results can help to determine what laws may need to be introduced, or which ones could be changed.

Programme evaluation can be a basis for developing new programmes, or for changing or terminating existing programmes. In an evolving government, evaluation results can be used to identify gaps in the group of programmes that are intended, cumulatively, to solve certain problems. This can lead to the introduction of new programmes. Evaluation results can also be used to revise existing programme in order to make them more effective. Evaluation results can show that some programmes have accomplished their goals, or that further efforts to accomplish a goal will not be cost effective.

There are several long-term benefits of programme evaluation:

- Executives of Budget Users, programme managers, and staff become more well-informed and knowledgeable about their programmes’ accomplishments and weaknesses, and can help steer it to more productive levels;
- Wiser decisions are made by staff, officials, and legislators, regarding spending levels, program activities, timing, and priorities;

- Programme evaluation information that is accurate, timely, and relevant, can lead to increases in productivity, efficiency, and effectiveness;
- The press, the public, and others outside of the public sector become more aware of programmes and programme results, and thus they are better able to make use of the benefits resulting from the programme; and
- When programme evaluation fully becomes an accepted and valued part of the management cycle, there is a greater understanding across the government about the government's overall strategies and activities.

### **Monitoring and Evaluation in a Government**

Historically, monitoring and evaluation have been more commonly used in the private sector, where competition requires constant change and improvement in order for companies to remain in operation. Although it might not be called “programme evaluation”, all successful companies and all customers practice it.

Companies use it to evaluate the volume of sales, the level of competition, customer satisfaction, and many other factors regarding their products or clients, and to make necessary changes in their products and sales/manufacturing methods, in order to stay successful.

Customers use it to evaluate the durability, quality, and value of one product in comparison to other similar products, and to make the best purchasing choices that they can, on the basis of their evaluation.

Governments and governmental organizations should use programme evaluation, because of their responsibilities to the citizens of the nation and because of their responsibilities for executing specific laws and regulations:

- Taxpayers have certain expectations regarding governmental programmes and they seek to get the best value for their money; and
- The laws which establish each programme may have specific requirements to be met

Although it is not new *per se*, the use of programme evaluation is a new concept or practice for governments which traditionally have been centrally controlled and/or which have been only execution-oriented.

Historically, auditing was the closest activity to programme evaluation that was conducted widely in those governments. Auditing often functioned as a punitive process, not as a routine and useful tool that could help to strengthen the management of the programme and its service delivery activities.

Where governments have had no control over the decision-making process, or where there was no concern for service effectiveness or quality, programme evaluation was rarely practiced. Some governments practiced only monitoring, that is, the simple gathering of information that compared anticipated results with actual performance information.

International experience shows that it takes time to develop a governmental environment that values and is conducive of programme evaluation. It takes time to change the conceptualization of programme evaluation in some organizations, and for programme evaluation to be accepted as a useful activity, and not an unnecessary one.

As a result of being a relatively new concept for some governments, it will take some time for these governments and their staffs to learn and apply skills in the development of:

- A framework for programme evaluation;
- Trained professionals and specialized institutions who can conduct it, and sufficient information systems; and
- A political appreciation for the benefits of conducting and implementing programme evaluation, and then using its results for decision-making

It takes time to establish and implement the policies, procedures, and information systems which are necessary for gathering, maintaining, and organizing data. It also takes time for governments to develop the capacity to integrate two types of decision-making:

- decision-making on the basis of programme evaluations, and
- decision-making on the basis of political considerations.

Once there is some understanding about the benefits of implementing systematic monitoring and conducting evaluation, the most important task is to determine the best ways of conducting them. This can be difficult because of several reasons, including:

- Systems and procedures may not be in place which can produce, gather, manage, monitor, and evaluate the necessary information
- There may be insufficient staff and/or the staff may not have sufficient training and capacity to gather and evaluate the information or to set up the Terms of Reference for an outside party to do so;
- There may not be sufficient funds to support the information-gathering and evaluation process
- There may be organizational resistance to or low awareness of the need for gathering, evaluating, and reporting information
- There may not be agreement regarding what information should be gathered, how to evaluate it and/or how to use the results of evaluation.

This situation may be made more complicated because decisions about what to monitor, how to monitor it, what to evaluate, and how to evaluate it, are supported by few rules. This is because:

- There is no single way to analyse all programmes;
- Different types of monitoring and evaluation may be appropriate under different circumstances;
- Different aspects of a programme may be monitored and evaluated differently at different stages in a programme's existence; and
- Some programmes are easier to measure and evaluate than others are, and that means that they must be monitored and evaluated in different ways

### **Reporting**

As showed in the previous section, monitoring and evaluation are not really complete without reporting. In fact, monitoring and reporting are the key elements to make managers publicly accountable. The two should become a standard procedure at every level of government, including the level of an agency, ministry, government as a whole, as well as local government. As such, there are two focuses of reporting: internal and external. Internal reporting takes place within an organization based on the monitoring



information, and its primary purpose is to make sure that the organization stays “on course” for attaining the stated objectives and targets, and that the work which was planned at the beginning of the year gets done. Also, information is needed which shows that the budget is being spent according to the financial plan, and information on deviations from these plans should be readily available, so that by the end of the budget year, the budget limits would not be exceeded.

External reporting is foremost a communication and accountability tool to satisfy both the relevant public sector supervisory bodies, as well as the public, who have a legitimate right to know which progress the government institutions have made in goal attainment with the public money. It is a matter of openness and transparency to make this information available in a user-friendly and easily absorbable manner.

### **Timing of Reports**

There is also the timing issue involved. It is quite common in most countries that some sort of annual reports are prepared by agencies, ministries and/or the Government to report back on the use of budget money, and increasingly also on the non-financial performance, that is, on the performance of programs. Sometimes there are also semi-annual reports, or even more frequent ones, on certain aspects (such as budget execution) of use of money, which may or may not contain the results of performance monitoring. However, it is quite likely that internally, in order to be able to monitor progress and pace of activities, a system of reporting is also installed.

### **Types of Reports and the Linkages Between Them**

There are at least three common reports that the government agencies (or the Government as a whole) may be required to produce: budget execution reports, financial reports, and performance reports.

**Budget execution reports** are the most common reports that are produced to make the government accountable for the execution of the budget according to the appropriations legislated by the Parliament. A budget execution report is the most common form of control at the parliamentary level. However, exercising budget control in this form does not assure that the budget would have been spent effectively or efficiently. In these reports, typically there is no reference as to whether the results that were intended when the government agencies had to justify their spending requests to the MOF (or later, when their justifications accompanied the draft Annual Budget Act) were achieved, or whether the money was spent on what was planned for (especially so regarding any flexibility rule that may be exercised by the public organizations).

The Budget Act prescribes that the State Budget is to draft an annual and semi-annual budget execution report that must contain the following:

1. the overview of total revenues, receipts, expenditures and expenses at the level of economic classification division;
2. a special part of the budget according to the organizational and program classification and the level of the division within the economic classification;
3. a report on the borrowing on the domestic and foreign money and capital markets;
5. a report on expenses and state guarantees provided according to state guarantees;
6. explanation as to how the revenues, receipts, expenditures and expenses were realized;
7. explanation of macroeconomic indicators,
8. execution of financial plans and extra-budgetary users at the level of economic

- classification divisions,
9. explanation as to how the extra-budgetary users' revenues, receipts, expenditures and expenses were realized;
  10. general budget deficit.

The above-mentioned (apart from the explanation of macroeconomic indicators and general budget deficit) also applies to local and regional self-administration units.

The MOF submits the semi-annual budget execution report for the first half-year period of the current year to the Government until the 5th of September of the current budget year. The annual report is to be submitted until the 1st of May of the current budget year for the previous year. The Government sends the semi-annual report for adoption to the Parliament until the 15th of September of the current budget year, whereas the annual report is delivered until the 1st of June of the current budget year for the previous year.

The MOF makes a draft proposal of the annual and semi-annual report on State Budget execution and submits it to the Government. The Report is prepared by the Sector for State Accounting and Financial Reporting, in collaboration with: the Directorate for Public Debt Management, Sector for the Preparation and Drafting of State Budget and the Preparation of Financial Plans of Extra-budgetary Users, Sector for Development and Support to the State Treasury System, Sector for Management of Financial Flows, Payments and Financial Analyses of Budget Execution, as well as the Bureau for Macroeconomic Analyses and Planning.

After the Parliament has adopted the Report on budget execution, the material to be published in the Official Gazette is prepared.

**Financial Reporting** is usually associated with the introduction of accrual accounting. That brings accounting in the public sector closer to accounting in the private sector. This has been a general trend in countries which have implemented public financial management reforms.

It has become quite common that "balance sheet" and some other associated reports are also produced by public sector entities, especially those agencies which provide services for fee to its customers.

If government agencies are obligated and ready to produce accurate balance sheets, as well as other reports usually associated with them (such as statements of revenues and expenditures, statements of changes in net assets, and cash-flow statement<sup>7</sup>), these reports may be consolidated to give an overview of the entire public sector's financial position (such as Whole-of-Government Accounts, such as in the UK). However, a word of caution is necessary here, since in many countries with advanced financial reporting systems it has been noted that reporting this information back to the Parliament may not attract enough interest, because these reports may be seen as being merely technical in nature and not directly seen as relevant to the needs and backgrounds of most Members of the Parliament.

The Budget Act prescribes that reports that are to be drafted by budget users: reports on the state and the structure and the changes in the value and volume of assets, own

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<sup>7</sup> Of course, the exact content and titles of these reports vary from country to country.

resources, revenues, expenditures, receipts and expenses and of financial flows. The purpose of these reports is to provide information on the financial position, performance in the process of attaining the set goals, plan execution and financial flows of the budget and budget users.

The Ordinance on Financial Reporting prescribes the form and content of financial reports, periods covered by the reports, as well as the liabilities and deadlines for their submitting.

Financial reports are drafted on the following forms:

- Balance on Form: BIL,
- Report on revenues, expenditures, receipts and expenses on Form: PR-RAS,
- Report on revenues and expenditures of budget users on Form: S-PR-RAS,
- Report on expenditures according to functional classification on Form: RAS-funkcijski,
- Report on financial flows on Form: NT,
- Report on changes in the value and volume of assets and liabilities on Form: P-VRIO,
- Report on liabilities on Form: OBVEZE.

Financial reports are drafted for the periods in the course of the budget year (quarterly and annually), as well as for the current budget year. Group data (several mutually connected budgets and/or budget users) should be expressed as if all these were a unique entity, which is why consolidated financial reports should be made.

The MOF makes a consolidated financial report for the Republic of Croatia, based on the consolidated financial reports of various divisions, budgets of local and regional self-administration units and financial reports of extra-budgetary users.

Financial reports for various periods are kept until the submitting of financial reports for the same period next year, whereas annual financial reports are kept permanently and in their original form.

**Table 12: An overview of the types of financial reports and deadlines for submitting, according to users**

Deadline	Period	Tributary	Type of reports
15.2.	annual	first level Budeget Users and other State Budget Users and Local Government Budget Users	BIL, PR-RAS, P-VRIO
28.2.		Local Government	BIL, PR-RAS, P-VRIO, RAS-funkcijski, NT, OBVEZE
		Extra Budgetary Users on state level and Extra Budgetary User on local level	BIL, PR-RAS, P-VRIO, NT, OBVEZE*
31.3.		<b>CONSOLIDATED</b>	
		first level Budeget Users	BIL, PR-RAS, P-VRIO, RAS-funkcijski
		Local Government	BIL, PR-RAS, P-VRIO, RAS-funkcijski, OBVEZE
10.4.	quarterly	State Budget Users	S-PR-RAS
		Local Government Budget Users	
		Local Government	PR-RAS, NT, OBVEZE
		20.4.	Extra Budgetary Users on state level
		Extra Budgetary User on local level	S-PR-RAS
10.7.	semi-annual	first level Budeget Users and other State Budget Users and Local Government Budget Users	PR-RAS
		Local Government	PR-RAS, NT, OBVEZE
20.7.		Extra Budgetary Users on state level	PR-RAS, NT, OBVEZE
		Extra Budgetary User on local level	PR-RAS
		<b>CONSOLIDATED</b>	
20.7.		first level Budeget Users	PR-RAS
	Local Government	PR-RAS, OBVEZE	
10.10.	quarterly	State Budget Users	S-PR-RAS
		Local Government Budget Users	
		Local Government	PR-RAS, NT, OBVEZE
20.10.		Extra Budgetary Users on state level	PR-RAS, NT, OBVEZE
		Extra Budgetary User on local level	S-PR-RAS
10th of the month	monthly	State Budget Users	OBVEZE
15th of the month		first level Budeget Users and Social Security Funds	

**Performance reporting** is the latest form of reporting instituted by many governments to fill that gap.

Performance report on the agency or institution level should contain data on the following, possibly starting with first and second types and later adding the third:

- Detailed reports on operational performance and its development (in time, in relation to other similar bodies, etc.)
- Report on policy effectiveness, as is applicable to the agency
- Report on the use of resources (such as human resources, assets etc)

An important aspect of performance reporting is that actual results should be compared with the plans. If results were not achieved, explanations should be provided and not overlooked. Since reporting is also part of the political process, it may require monitoring from the Ministry of Finance or any other central body to make sure that no goals or targets are skipped by the accountable agency.

All the reports should present a true and fair picture of the agency and its finances and performance, which should be confirmed by the accounting officer (head of the agency). He or she should apply internal control systems which assure that the information provided is accurate.

A government wide picture of reports and lines of accountability can be seen in the following figure. Note that some government agencies may contribute to the attainment of objectives of other ministries, which should be taken into account while preparing the Strategic Plans and Key Performance Indicators of both organizations, and certainly while preparing the reports related to Plan and KPI attainment, but that does not change the lines of accountability.

### **Auditing of Reports**

The most effective way of assuring the quality of the reports fulfilling the external reporting requirements is to require their publicizing (assuming that the plans, such as strategic plans, would be made public in the first instance). The other (and more resource demanding way) is to audit these reports. As regards financial reports (starting with the budget execution report), in many nations this has been traditionally the task of the Supreme Audit Institution (SAI), such as State Audit Office (SAO).

With performance reports, it is rather exceptional that SAIs audit these, because a) this requires a very well developed system, where reported results and initial plans can be compared, so there needs to be fairly high amount of consistency; and b) fairly high quality must be attained in these reports before it makes sense to devote the SAI's resources to this (due to high opportunity costs). SAI-s with their performance audits may also audit efficiency and effectiveness of government activities, and related spending. This constitutes a form of evaluation of government policies, or certain institutions and their management.

It is a question about the use of resources to decide at what level and which reports should be audited by SAIs, and which could be audited by internal auditors only.

The State Audit Office is the supreme audit institution in the Republic of Croatia and it is based in Zagreb. There is a Central Office in Zagreb and 20 regional offices in County capitals across the country. It was founded in 1994, pursuant to the State Audit Act (Official Gazette, no. 49/03- amended version and no. 177/04).

The State Audit Office has the status of a legal entity and was founded as an independent institution that has the obligation of reporting to the Croatian Parliament.

Amendments to the Constitution of the Republic of Croatia, adopted by the Parliament on 16 June, 2010, additionally emphasizes the independence of the State Audit Office, whereas Article 54 of the RH Constitution prescribes that the State Audit Office is the supreme audit institution in the Republic of Croatia, and that is entirely independent and autonomous in its work. The said Article also prescribes that the State Audit Office is managed by the Chief State Auditor who is obliged to report to the Parliament about the working of the said institution. Funding, structure, jurisdiction and working methods of the State Audit Office are regulated by means of legal acts.

In compliance with the State Audit Act, the Office carries out the audit of the State Budget and budget and extra-budgetary users of the State Budget, budgets of local and regional self-administration units, legal entities that receive funding from the State Budget (are completely or partially funded from the State Budget), state-owned companies and other legal entities whose major shareholder is either the Republic of Croatia or local self-administration units.

For a certain period of time, the Office also performed the audit of the privatization and transformation, in line with the Act on Audit of Privatization and Transformation (OG, no. 44/ 01 and 143 /02) and the State Audit Act.

Since 2007, the Office has carried out the audit of financial business operations of political parties and independent representatives, in compliance with the Act on Financing of Political Parties, Independent Lists and Candidates (OG, 1/ 07).

An audit comprises the examination of documents, credentials and reports, systems of internal control, accounting and financial procedures and other financial procedures, as well as of other records, with the purpose of determining whether the financial reports are reflecting the true financial position and true results of financial activities, in compliance with the principles and standards of accounting.

An audit examines financial transactions that represent state revenues and expenditures in terms of the legal usage of funds. It also provides an evaluation of the efficacy, cost-effectiveness and efficiency of the process of attaining the goals planned.

The State Audit Office carries out audits on the basis of an annual agenda that is drafted independently by the Office, it does not act on reports and proposals, but legally may do so when it is deemed justified and purposeful to include this in the stated program- Once a year, the audit of the State Budget is performed, the budget of local and regional self-administration units, as well as of funds and institutions on the state level, where the scope thereof is determined by the annual working agenda of the Office.

Audit is performed by authorized auditors according to methods and procedures established by audit standards prescribed by the International Organization of Supreme Audit Institutions (INTOSAI). Following a completed audit, the auditor's report is delivered to the legal representative of the audited entity and the competent ministry and/or the head of the fund. The legal representative of the audited entity may file an appeal to the said report within an 8-day deadline. The appeal is to be decided upon by the Chief State Auditor within 30 days.

It is important to highlight that the State Audit Office regularly publishes current reports on their work and audits performed on their official website, all for the purposes of reinforcing the transparency of its activities.

A reporting regimen should have two aspects: reports that are required by law or other standardized sources (such as the requirements of the budget cycle, Budget User management oversight activities, etc.), as well as reports that are relevant and appropriate to the nature of the programme and the ways in which it operates. Standardised reporting requirements are already an ongoing part of the budget process and are contained in documents such as the Budget Law and other relevant legislation, the Budget Instructions, as well as related technical processes. In addition, there are information systems which support these reporting requirements, such as the Treasury FMIS and related systems, so they will not be repeated in this section of the Guidebook.

In conclusion:

- There is a need to specify in the law and by-laws, what reports (in addition to the existing budget execution reports) will be produced and by whom, which ones need to be published and how would the hierarchy of reports appear and be presented;



and

- Budget Users should develop their own reporting regimens for internal management, planning, and decision-making purposes, which would support the fulfillment of requirements described in the previous point.

### **Strengths and Shortcomings of Monitoring and Evaluation**

Programme monitoring and evaluation can:

- Generate both basic and new/updated information and insight about programme activities;
- Reveal new ways of examining or conceptualizing the programme;
- Educate both programme staffs and observers about the programme;
- Provide a forum for discussing a programme, in a comprehensive way;
- Develop strategies and information that can be used in strengthening, revising, or eliminating a programme;
- Supplement the transparent discussion and debate among knowledgeable observers, using objective information;
- Identify areas in which legislative or regulatory changes are needed; and
- In a highly political environment, can be used to justify virtually any decision.

Programme monitoring and evaluation can not:

- Automatically make decisions about programmes;
- Answer all questions that might be asked;
- Replace the transparent discussion and debate among knowledgeable observers;
- Replace the process of political decision-making

### **Types of evaluation**

There are many different types of programme evaluation. Different types of evaluation are appropriate to use in different circumstances and at different stages of a programme's existence. In addition, there may be different names for a single type of evaluation in different references sources, but several of the main types of programme evaluation are described below.

#### **Formative Evaluation:**

- This applies to programmes which are new, or which are newly being formed. This type is intended to determine if the new programme is headed in the right direction, and if it can be expected to succeed. Evaluations of this type are intended to answer questions like: How can the likely results of a programme be determined if it hasn't started yet? On what basis can money be provided to a new and unproven programme?
- This type of evaluation is conducted by comparing the ways in which this new programme is being organised and implemented, with ways in which similar programmes – which are already operating successfully – have been organized and implemented;
- Experts from the new programme (as well as the more well-established ones) should be included in the evaluation process, in order to ensure that the new programme can be judged from a logical perspective; and
- There is a parallel between the situation faced by programs seeking to conduct this



type of evaluation, and the experience that many young people face upon trying to enter the workforce: how can they get a job without having previous experience, and how can they gain experience if they don't have a job!

**Process Evaluation:**

- This applies to programmes that exist only to provide a step-by-step process, such as the issuance of licenses;
- This type of evaluation involves the use of procedural experts (and customers, to the extent that customer service is an element of the programme) in examining the step-by-step activities that are conducted, and the judging of how efficiently and effectively the programme is being conducted; and
- Ongoing programmes such as these should be re-examined periodically, to ensure that they are continuing to attain their stated goals.

**Periodic/Cyclical Evaluation:**

- This applies to programmes that follow the same cycle during the course of a year (or some other recurring period) or that go through the same series of steps, regardless of time period;
- This type of evaluation involves both content experts and procedural experts (as in the previous type of evaluation), as well as experts in determining the impact of the recurring programme, to ensure that the cycle is an effective one. (For example, testing water for contamination at certain intervals should be done frequently enough to determine the basic quality of the water, and then it should be tested periodically to detect/prevent seasonal contamination); and
- Thus ongoing programmes should be re-examined periodically, to ensure that they are continuing to attain their stated goals.

**Long-term (or longitudinal) Evaluation:**

- In some ways, this is the most important form of evaluation, because the nature of many governmental programmes is to provide for a permanent, long-term, or constant way to provide a service to people or to prevent a problem situation.
- For example, this type of evaluation is intended to determine if educational progress is being made in teaching children to read over a period of years, if long-term or wide-spread health problems are being reduced, etc. This type of evaluation is conducted by sampling a portion of the subjects at the beginning of the study period and then at key times over a period of years.
- This type of evaluation may be difficult and expensive, because it relies on information that may not always be available or comparable over a period of time. However, the information it provides is often vitally important because it is directly related to the highest goals and core aspects of a programme's very existence.
- Over time, the circumstances of the programme may change, or the population may change, or the long-term effects or results of the programme may take time to become clear.

**Outline of Process Steps for Conducting a Programme Evaluation**

This Budget Guidebook recognizes that the budget process in Croatia has been underway for several years, and that it is somewhat artificial to include recommendations in the Guidebook which are expressed as if the programmes were all newly starting up. However, it is possible to describe the monitoring and evaluation processes from a start-

up perspective, because in most instances, Croatia's programmes have undergone little or no monitoring and evaluation review and so the following step-by-step approach is appropriate to present in this chapter. In addition, since monitoring and evaluation are ongoing activities, they can begin at any time, and thus they need not be delayed until the start of any one year's budget process.

- Determine or identify **the basic legislation** that supports the programme:
  - This step is used in order to establish the things that the programme is legally required to do or to produce, and therefore, to identify what must be monitored and evaluated on the basis of legal requirements. It is important to determine this in order to ensure that the programme will be operating within a legal framework **and** that the programme's activities can be evaluated to ensure consistency with the law;
  - This step is not difficult to perform, but whenever possible, it is useful to meet with legislators or legislative office staff who are familiar with the legislation, in order to establish a consistent understanding of exactly what the legislation's core purposes were. To ensure consistency and to facilitate the communication process regarding the legislation, it is useful to prepare a brief written report about the core purposes of the law and to distribute that report among the individuals and groups who will have some influence over the project;
  - In most cases, laws (and even implementing regulations) may be vague (or may cover only a part of the work that many programmes actually do) and so it is quite necessary and common for programmes to undertake a variety of activities and approaches in implementing the law. Each of these should be able to be measured in order to determine how well they support the pursuit of the basic purposes of the legislation; and
  - This step is conducted by the simple process of examining the laws which are in place and which have some control (directly or indirectly) over the programme, and by determining what they require the programme to do.
  
- Identify clearly the answers to at least these **key questions**:
  - a. What is the programme supposed to accomplish?
  - b. What is the best way to accomplish these things?
  - c. How will we know if they are being accomplished, in ways in which all observers can agree?
  - The answers to these questions form the core of any monitoring and evaluation process, because they will focus attention on the programme's intent. The answers should be put in writing because they will form the basis for the approach that is used in performing the monitoring and evaluation tasks;
  - The processes involved in answering these questions should be conducted in a broad and transparent manner, because a variety of groups (legislators, executives of the Budget User, programme managers and staff of the programmes, other related Budget Users, customers of the programmes, and donors and other outside groups) may all have varying perspectives on the programmes and may believe that different things are important for the programmes to undertake and accomplish;
  - Although the Budget User is not required to conduct a formal process in gathering information to help answer these questions, the organization should seek to develop some degree of consensus about them, in order to facilitate the implementation and ongoing operation of the programme;
  - This step is accomplished by engaging the executive levels of the Budget User in

- a transparent process of discussing the questions and of affirming that the ways in which the organization is operating are consistent with the attainment of programme goals; and
- The Budget User is responsible for ensuring that the methods undertaken in implementing and conducting the programme are able to accomplish its goals to the maximum extent within the resources available.
- Identify the **goal, objectives, and performance measures** which are necessary for the programme:
    - Based on the law and on the intent of the programme, each Budget User must develop some structure within which to conduct its programmes and to monitor and evaluate them;
    - This is a difficult task, and one that must be conducted on an iterative basis, because programmes continue to evolve and the conditions within which they are implemented continue to change. As time goes on, some intermediate accomplishments will be realized but other new obstacles may appear, priorities may change, the nature of the problems which the programme addresses may change, etc.;
    - As was found in the answers to the questions cited in the preceding step, different groups (even those with direct responsibility for the programme) can be expected to have different perspectives on the goals and objectives of the programme and on the things that should be measured;
    - In other parts of this Guidebook, there were discussions of different types of performance measures (especially regarding the difference between Output and Outcome measures). **Selecting the best performance measures which are appropriate to a programme is often the single most difficult step in the monitoring and evaluation process, because of the different viewpoints about programme purposes and because of shortcomings about programme data;**
    - It is important to develop a hierarchy of goals, objectives, and performance measures and to do so in a flexible way, so that they can be revised and refined as time goes on and as more insight continues to be gained regarding programme and programme information; and
    - This step is accomplished by continuing the dialogue and analyses described in the preceding step and in establishing a written set of goals, objectives, performance measures, and other aspects of the monitoring and evaluation framework.
  - Identify **how those goals, objectives, and performance measures are appropriate** to the ways in which the programme is organized, managed, budgeted, implemented, and evaluated:
    - This step is important because it is intended to ensure that the monitoring and evaluation framework is consistent with the actual ways in which the programmes and the Budget User are operating;
    - It is not uncommon to determine that there are inconsistencies between actual activities of the programmes, and the most appropriate framework for monitoring and evaluation. **Reconciling these differences presents a challenge to the management of Budget Users which must be addressed in order for the monitoring and evaluation processes to be useful;**
    - The reconciliation process can be challenging because current operational procedures may have been put in place over a series of years and for a series of

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- reasons, and changing them can be difficult for the organization to do.; and
    - This step is accomplished by a self-assessment of the Budget User, which is led by (or at least supported by) the executive level of the organization and which is intended to bring the current operational procedures into alignment with the monitoring and evaluation framework which can best support the organization's attaining of its goals.
  - Conduct a **detailed review of the ways in which the programme operates**, and compare the results with the goals and objectives of the programme:
    - It is at this step where a series of decisions must be made regarding the course of the monitoring and evaluation process. As has been stated above, in many programmes and in many nations the necessary programme information does not exist and/or it cannot be readily produced under current circumstances and resource constraints
    - The most effective response to this issue is for Budget Users to:
      - develop an interim plan for generating and gathering the necessary information (even including the use of surrogate measures until the desired information is available);
      - estimate the resources required for a fully effective monitoring and evaluation framework, and request it as a governmental priority;
      - include this estimate in the next possible budget request so that it can be undertaken; and
      - implement the more effective framework when the resources become available.
  - This step is accomplished when a clear understanding has been written regarding the relationship between the actual programme operations, the best evaluation methodologies, and the steps which must be taken to reconcile the differences; and
  - This is also the step in which final decisions are made regarding the best methods which are to be used in monitoring and evaluating the programmes. Some of the most widely used methods are described elsewhere in this chapter of the Guidebook.
  - Determine **strengths and weaknesses in the programme** or in the service-delivery process, make recommendations for changes:
    - This is the step in which the monitoring and evaluation framework is implemented and in which the monitoring and evaluation information is actually used to review programmes, and to draw conclusions about them; and
    - In many instances, especially at the early stages of a framework's implementation, it is common to find that only partial or preliminary information is available and/or only partial decisions can be made. This situation will change as the Budget Users (and the government as a whole) become more skilled in the analysis and application of monitoring and evaluation information.
  - Support **the development of new legislation, new programme processes**, budget revisions, etc. in order to make necessary alterations to the programme:
    - This step completes the process of conducting a monitoring and evaluation programme; and
    - If the programme's monitoring and evaluation framework has been implemented and conducted successfully, it will produce information and understanding which is fed back into the overall strategic planning and budget system and which is

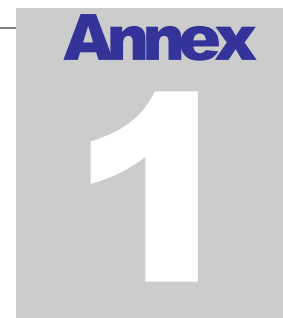
used in making decisions and resource allocations regarding the programme.

### **10.9 Cost-Benefit Analysis and Cost-Effectiveness Analysis**

Cost-Benefit Analysis is not actually a use of evaluation, but it is a technique which is used to measure programmes. Specifically, it requires that the costs of managing or delivering a programme or a service (either altogether, or to specific individuals or groups) should be compared to the monetary or economic or social benefits that the programme or service provides. Programmes which result in a greater benefit or contribution to the nation or the economy than they cost, are generally well supported.

Like cost-benefit analysis, Cost-Effectiveness Analyses is not an actual use of evaluation, but it is a technique which is used to measure programmes. Specifically, it requires that the costs of managing or delivering a programme or service should be compared to some cost-related benchmark for delivering it. Programmes which cost more to deliver than they should, or which do not produce results which off-set the costs of delivering services, should be examined in order to determine how they should be revised.

However, in both cost-benefit studies and cost-effectiveness studies, it is possible that legal requirements or political realities will play a role in continuing (or ceasing to continue) the current programmes and their delivery mechanisms. That is, programs which are not cost-beneficial or cost-effective may still be continued, because of legal or political reasons.



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## Annex 1: A GLOSSARY OF PLANNING AND BUDGETING TERMS

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The broad topic of budgeting contains a large number of technical terms and concepts which must be commonly understood and applied by all participants in the budget process, and so this Annex presents and defines the terms and concepts used throughout this Guidebook. In the Guidebook, the terms and concepts generally follow their accepted international uses and definitions, although some may have special meanings within Croatia.

### **Accountability**

A key concept in governance and management, which means that people are held responsible for carrying out a defined set of duties and for conforming with rules and standards applicable to their post. A manager may also be held accountable for the actions of subordinate staff. In relation to work carried out by government ministries and agencies, accountability may be:

- **internal**, to a higher level of management, in which staff and managers are assessed on a regular basis on the way in which they have carried out the tasks set out in their job description; and
- **external**, to the Parliament, to the public, or to central agencies for their own performance (and, in the case of senior officials, for the performance of the organisation which they manage).

### **Accounting**

The day-to-day classification and recording of financial transactions and events. Accounting records include:

- documents which evidence transactions and events (e.g. invoices, contracts, etc.),
- journals, ledgers and registers (often in the form of computer-based systems).

### **Accounting Basis**

The accrual or cash basis of accounting as defined in the Accrual Basis International Public Sector Accounting Standards and the Cash Basis International Public Sector Accounting Standard.

### **Accounting Controls**

Procedures and documentation concerned with safeguarding of assets, as well as the conduct and recording of financial transactions and the reliability of financial records.

### **Accounting System**

The set of accounting procedures, internal mechanisms of control, books of account, and plan and chart accounts that are used for administering, recording, and reporting on financial transactions.

**Accounts Payable/Receivable**

Money owed to/by suppliers/customers

**Accrual Basis of Accounting**

The effects of transactions are recognised when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the periods to which they relate.

**Accrual Based Budget (Accrual Budgeting)**

This term can be interpreted in two ways: 1) budgetary documents that include accrual accounting information in addition to cash based appropriations; or 2) budgetary appropriations based on accrual accounting information

***Acquis Communautaire***

The body of legislation that has been developed by the EU up until this time.

**Activities**

Various actions of an overall programme for a common objective, required to achieve the programme and that make up a programme and objective. See also **Programme**.

**Activity Based Costing (ABC)**

A costing approach that specifically addresses the problem of overhead cost allocation. ABC differs from traditional cost allocation by seeking to identify the cost driver for a particular category of overhead, rather than simply applying an arbitrary allocation basis.

**Administrative Controls**

Non-financial procedures and records of Budget Users which ensure compliance with rules on:

- appointment, promotion, pay, and disciplining of personnel;
- public procurement;
- equal opportunities for minority groups;
- the handling of information flows;
- travel and entertainment, etc.

**Aid-in-kind (or Assistance in Kind)**

Flows of goods and services with no payment in money or debt instrument in exchange. In some cases, so-called “commodity aid” goods (such as grain) are sold and receipts are transferred to the budget. More commonly, the receipts are transferred through a specific fund.

**Allocations and Allotments**

Authorisations or distributions of apportionments of funds which are made by the chief executive or his/her designee - for example, the line minister or the budget director - within a Budget User, which permits Budget Users to either commit or pay out funds, or both, within a specified time period and within the total amounts appropriated and authorised.

**Apportionment**

After the approval of the annual budget by the Parliament, the approved budget for each Budget User is broken down to the detailed level and apportioned over time (quarters or months).



**Appropriation**

The maximum amount legally authorised by the Parliament to be spent in a specific period. Appropriations are usually contained in the annual budget law and are usually for one fiscal year.

**Arrears**

Payments which are due, but which are not yet made, with a longer-than-normal delay.

**Assumptions**

The resource expectations that a Budget User has when it sets its performance objectives.

**Audit**

Expert examination of financial compliance or of management or programme performance, carried out to satisfy the requirements of management (internal audit), or an external audit entity, or any other independent auditor, to meet statutory obligations (external audit). Audits should function as, and be seen as, routine functions of management but **not** as punitive actions.

The scope of audits varies widely and includes:

- financial audits, covering the examination and reporting on financial statements, and the examination of the accounting systems upon which those statements are based;
- compliance or regulatory audits, which examine legal and administrative compliance, the properness of administration, financial systems and systems of management control; and
- performance audit/value for money audits, which assess the management and operational performance (economy, efficiency and effectiveness) of public programmes, and of ministries and agencies in using resources in meeting specified objectives.

**Audit Finding**

Pertinent statement of facts. Audit findings emerge by a process of comparing “what should be” with “what is”.

**Audit Risk**

The risk that procedures carried out by the auditor will not detect matters which, if known, would required auditor’s report to be altered.

**Balance Sheet**

A financial statement showing the values of the stock of assets and liabilities held by an entity at a particular point in time. Balance sheets summarizing starting balances, incomes and outflows, and ending balances are generally required for each distinct fund within a government’s accounting system. However, in practice very few governments prepare statements for their financial positions that can genuinely be described as comprehensive balance sheets covering all assets and liabilities.

**Baseline**

The basic amount of resources that are necessary to continue the current level of activity. It is often used as the basis for projecting costs into the future (when that is done, it is also necessary to adjust for inflation and other known changes in costs). This amount is sometimes referred to as the Current Services or Current Level amount.

**Baseline Budget**

The amount of funding for current programs or existing policies -- often adjusted for inflation, one-time expenditures, legally mandated requirements under changed demographic conditions- from which increases and decreases in expenditures are negotiated during budget preparation.

**Below the Line Items**

Revenue or expenditure items that are usually outside of the normal budget formulation process but which the government should consider in its decision-making about the year's budget.

**Benchmark**

A measurable starting point or level regarding a Budget User's or a programme's performance or resources, which can be standardised and used in comparing with the program's own progress over time, or with another Budget User's or programme's performance or resources.

**Budget**

The mechanism by which a government puts resources behind its policy priorities. In countries with representative governance systems, the budget is the financial mirror of society's choices.

**Budget Instructions(s)**

Instructions and guidelines conveying the MOF's policies and requirements regarding various aspects of the budget process, information that Budget Users require in order to participate in the process, procedural fiscal requirements which are to be followed by Budget Users and detailed forms and instructions for the completion thereof.

**Budgetary Control**

Methods to ensure that funds are being used for the intended purpose and to ensure that overspending does not occur.

**Budget examination (or Budget Analysis)**

The process of reviewing budget requests from Budget Users, ministries and agencies by a budget analyst or other appropriate staff member of a Budget User or the MOF, in which the budget request is analyzed, alternatives are developed, conclusions are reached and recommendations are made. Also, the process of reviewing budget requests from subordinate units within a Budget User, ministry or agency by a staff member of that organization's budget department.

**Budget Execution**

The process of controlling, accounting for, monitoring, and reporting on the expenditure of resources, which have been received for a specific purpose and time, in accordance with established policies and procedures. Budget execution should also take an interest in information regarding program results, so that resource utilization and program results can be combined to provide a full picture of the program's activities during a specific period. Budget execution information also provides one starting point for the budget formulation process for the coming period.

**Budget Formulation**

The process of forecasting, calculating, and seeking the amount and types of resources

that are required for specific activities for a specific period of time, in accordance with established policies and procedures. It should flow from the Strategic Planning and policy-setting processes and should be closely integrated with operational program planning. Budget formulation precedes budget execution, but also, budget execution information from one period becomes a starting point for the next cycle of budget formulation.

**Budget User**

An organisation which receives appropriated funds from the Croatian Budget.

**Budget Proposal (or Budget Request or Financial Plan)**

A request presented by the appropriate executive of a Budget User (or the entire government) to the higher level decision-making organization such as the MOF or the Parliament for the authority to receive and spend funds for specific purposes. The request may be subject to negotiation with the MOF and revision by the Parliament.

**Budget Year or Fiscal Year**

The year for which resources are sought and payments are planned. (In Croatia, the Budget Year and the calendar year are the same.) Usually, it is the year following the current year. Actual allocations, commitments, deliveries, and payments for a particular budget's expenditure programmes may extend past the year in which they were originally appropriated, if allowed by law.

**Budgetary documents**

The set of documents presented to the Parliament with the budget. In addition to the proposals relating to government spending, revenues and borrowing, the budget documents may include a statement of the economics and the fiscal context for the budget proposal, the governments' economic fiscal policy objectives, medium-term macroeconomic projections, major priorities as well as program objectives, and some detailed explanation of the government programs and activities to be funded under the budget.

**Budgeting**

The process whereby an organisation plans for its future programme activities, estimates the resource requirements of those future programme activities, and links its plans to the resource requirements.

**Capital Expenditure**

Expenditure for acquisition of land, intangible assets, and non-financial assets, or for permanent structures and major purchases of more than a minimum value and to be used for more than one year in the process of production. All budget expenditures which are not capital are called "current."

**Capital Grants**

Non-repayable, unreciprocated transfers received by one government from another government or international organisation, for the purpose of financing the acquisition of capital assets by the recipients.

**Capital Revenue**

Proceeds from the sale of non-financial capital assets, including land, intangible assets, stocks, and fixed capital assets of buildings, construction, and equipment of more than a

minimum value and usable for more than one year in the process of production, and receipts of unreciprocated transfers for capital purposes from nongovernmental sources.

**Capital Transfers**

Non-repayable, unreciprocated payments designed to finance the acquisition of non-financial capital assets by the recipient, compensate the recipient for damage or destruction of capital assets, or increase the financial capital or cover accumulated debts or losses of the recipient, or that are non-recurrent and distinctly irregular for donor or recipient.

**Cash Accounting**

An accounting method which records cash receipts, payments and balances. The cash basis of accounting recognises transactions and events only when cash has been received or paid.

**Ceilings (or Budget Ceilings or Budget Limits)**

The planning figure which identifies the types and maximum amounts of resources that may be requested by a Budget User (or parts of a Budget User) during the budget formulation process. Budget ceilings are determined by the MOF, and are intended to show a linkage between policy and spending priorities. They are also intended to ensure that the overall budget requests for the period do not exceed the estimated amount of revenue for the period, and thus they are an important component in establishing and maintaining fiscal discipline..

**Central Agencies or Ministries**

Those organisations in the executive branch that co-ordinate the activities of, and provide guidance to, and exercise specific types of control over, the operating units of the government. This includes developing and promulgating the operational procedures that are to be followed by Budget Users which receive government funds. Central Agencies or Ministries are distinct from the Central Government which is constituted of the Prime Minister and the Cabinet.

Practice varies widely from country to country, but central agencies generally include: the Ministry of Finance; the organisation(s) responsible for developing and coordinating policies in relation to standard government-wide processes such as human resource management and procurement (like the Ministry of Administration); the Cabinet Office, or the ministry assisting the Prime Minister or the Council of Ministers; the Supreme Audit Institution; and the Ministry of Foreign Affairs, in areas such as international co-operation.

**Central Bank**

The government-owned or controlled bank performing monetary policy functions in the issuance of currency, management of international reserves, and acceptance of deposit liabilities to other banks and acting as their lender of last resort, and, frequently, providing fiscal agent services for the central government.

**Central Government**

All governmental elements that are agencies or instruments of the central authority of a country whether covered in or financed through ordinary or extraordinary budgets or extra-budgetary funds. This includes funds at the central government level, decentralised agencies, departmental enterprises, social security funds operating at the national level

and relevant non-profit institutions attached to the central authority, and geographical extensions of central government authority that may operate at regional or local levels without the attributes necessary for existence as a separate government.

**Cheques Paid**

A stage in the expenditure process represented by the presentation and payment of government cheques at banks and the corresponding debit to the accounts of the treasury or the ministries. Government expenditure is reflected in the monetary accounts through cheques paid and the resulting debit to the government's accounts.

**Cheques Issued**

A stage in the expenditure process at which payment instruments are issued by the treasury or by ministries' payment officers and are sent to suppliers of goods and services as payment for goods and services received. In some countries, where the banking system may not be highly developed, separate cheques or warrants may not be issued and the payment orders certifying delivery may serve as an instrument calling for direct cash payment by the treasury. Government accounts often record expenditure on the basis of cheques or warrants issued.

**Classification Keys**

Documents identifying the classification assigned to each item or category in the government accounts or listing all items or categories in the government accounts included in each classification.

**Closed Accounts**

The principal statement on the final budgetary outcome produced by the State Treasurer or some other accounting or auditing agency after the closing of the budgetary period. Closed accounts may be cash accounts, recording annual receipts and payments (with or without a complementary period), or accrual accounts, recording also obligations for future expenditure, or obligations of future tax collections, as well as the carry-overs of revenues and expenditures from preceding budgets. Adjustments of data from the closed accounts to a chronological, cash basis is necessary.

**Commitments**

Expenditures that are contemplated by a Budget User and for which a Commitment has been submitted to Treasury, but which do not necessarily constitute a legal obligation.

**Complementary Period**

A period after the close of the regular fiscal year during which uncompleted collections and payments or commitments may be carried out and assigned to the previous budgetary period. It may be several months in duration. In some countries, the accounting period includes a "complementary period" for payments (e.g. 30 or 60 days) after the close of the fiscal year. Payments over the complementary period that are related to transactions (commitments and deliveries) incurred during the previous closed fiscal year are reported as expenditure of this previous fiscal year. Usually, this is achieved by holding the books "open" during the complementary period.

**Consolidated Accounts**

Accounts reflecting the affairs of a group of entities. For example, a ministry or holding company with many different operating agencies (subsidiary companies) may prepare consolidated accounts reflecting the affairs of the organisation as a whole, as well as

accounts for each operating agency/subsidiary.

**Consolidated Financial Statements**

Financial statements of a group presented as those of a single reporting entity.

**Consolidated Fund**

The main fund into which receipts are deposited and from which all appropriations are made, unless otherwise legislated.

**Contingency Fund (or Reserve)**

An amount of money that is sometimes included in the budget to be used for emergencies or other unforeseen requirements. It should be controlled carefully and used only under circumstances which conform to previously-agreed criteria.

**Consolidation**

The process of eliminating transactions between all units within the circle of government, which measures and combines into a common set of categories the sum of " external" transactions to and from the rest of the economy and world.

**Contingent Liability**

A possible future obligation of a Budget User.

**Contracting Out**

An arrangement whereby a Budget User enters into a commercial contract with an external supplier that provides specific goods and services. This is a commercial transaction only, and the fact that the external supplier receives government funds does not establish them as a governmental entity.

**Control**

There are two meanings relevant to management and administration; "monitor", and "regulate/ direct"

- 1 Mechanisms and means for guidance, regulation, or restraint; and
- 2 to check, verify, audit or to keep track of accounts, expenditures or events

**Cost**

The amount of resources required to provide a service.

**Cost Centre**

An organisational unit identified in the "chart of accounts" for which a manager is held accountable for financial management. Within the structure of a Budget User, this is usually the level at which costs can be associated. It is an organisational entity rather than a programmatic activity.

**Cost-Benefit and Cost-Effectiveness Analyses**

Comparative analyses of a programme's Outputs or Outcomes with the resources expended to produce them. Cost-effectiveness analysis assesses the cost of meeting a single goal, and identifies the least costly alternative to meet that goal. Cost-benefit analysis seeks to identify all relevant costs and benefits associated with a project or process, and to provide ratios between costs and benefits in order to determine whether the costs of the project or process outweigh the benefits which are realised.

**Cost-effectiveness**

The extent to which policy and program objectives are achieved at minimum economic cost: synonymous with value-for money.

**Corruption**

The misuse of a public or private position for personal gain.

**Current Account**

Receipts (including grants) and payments (including interest) which are not capital transactions. Many Governments have "recurrent" and "development" budgets: these correspond broadly with current and capital, but with many exceptions in practice. A surplus in the account means the excess of current revenue and current grants over current expenditure; a deficit is the reverse.

**Current Assets**

Cash moneys or other assets of an entity that would, in the ordinary course of operations of that entity, be consumed or converted into cash within 12 months after the period covered by its financial statements.

**Current Expenditure**

Expenditure other than for capital transfers or the acquisition of land, intangible assets, government stocks, or non-military durable goods of greater value than a minimum amount, and to be used in the process of production for more than a period of one year.

**Current Liabilities**

Liabilities of an entity that would, in the ordinary course of operations of that entity, be due and payable within 12 months after the period covered by its financial statements.

**Current Revenue**

All revenue from taxes and from non-repayable or non-repaying receipts other than from grants, from the sale of land, intangible assets, government stocks, or fixed capital assets, or from capital transfers.

**Current Services (or Current Level)**

See Baseline

**Deficit**

The overall **fiscal position** is defined as revenue plus grants, minus expenditures and minus net lending. If the result is **negative**, then a **deficit** exists; if it is **positive**, then a **surplus** exists.

**Depreciation**

The systematic allocation of the depreciable amount of an asset over its useful life. Depreciation estimated over the useful life of the assets is progressively deducted from the value of the assets each year.

**Due Professional Care**

The application of the care and skill expected of a reasonably prudent and competent auditor in similar circumstances. Due professional care is exercised when audits are carried out in accordance with standards set for the profession.



**Discretionary Expenditures**

A type of expenditure which is controllable, and which the Budget User (and the budget process) can influence each year. It is the opposite of **Mandatory** expenditures.

**Economy, Efficiency and Effectiveness in Spending**

- **Economy:** The extent to which resources of a given quality are acquired at the lowest cost.
- **Efficiency:** The relationship between output, in terms of goods, services, or other results, and the resources used to produce them. An efficient activity maximises output for a given input, or minimises the unit cost for a given output.
- **Effectiveness:** The extent to which the objectives of the organisational activity have been achieved.

**Economic Categories**

Sub-groupings of objects of expenditure used in the general economic classification.

**Economic Classification**

A classification of expenditure by the economic nature of the transaction. It is generally undertaken as a measure of the nature and economic effect of government operations and loosely corresponds to payments for the use of the different factors of production, e.g., "salaries", "interest", "transfers", etc. A well-designed object or line item classification is the basis for the economic classification.

**Elements** (of Financial Statements)

The types or classes of items that are reported in the financial statements, including notes thereto and related schedules.

***Ex-ante* control**

Prior authorisation of a specific expenditure. Payment orders and supporting documentation received are checked to verify that the transaction is properly authorised, is legal and regular, and that there are sufficient provisions in the budget.

**Entitlement Programme**

Legally-established programmes such as pensions or social assistance programmes, which provide for cash payments (or other types of transfers) to individuals who meet specific eligibility criteria. These are **Mandatory** payments and they generally involve a very large (and increasing) portion of most governments' budgets.

**Evaluation**

Retrospective analysis of a project, programme or policy to assess how successful it has been, and to identify what lessons can be learned for the future.

**Expenditure**

All payments by government for recurrent or capital purposes.

**Expenses**

Reductions in assets or increases in liabilities -- specifically, decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or occurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants. Expenses are the relevant notation in full accrual accounting.

**External auditors**

The auditors of an organisation who are not under the direct or indirect control of the organisation and may not report to the organisation. External auditors are often distinguished from internal auditors.

**External Debt.**

See **Foreign Debt**.

**Financial control**

Management control limited to financial issues and performance. In the French system, the financial control is exercised through staff of the MOF. In countries with the British system, it is normally internal. See also **Management Control**.

**Financial instrument**

Any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity.

**Financial Management**

The legal and administrative systems and procedures put in place to permit Budget Users to conduct their activities so as to ensure correct usage of public funds which meets defined standards of probity and regularity. Financial management includes the raising of revenue, the management and control of public expenditure and financial accounting and reporting, and, in some cases, asset management.

**Financial Plan**

See also **Budget Request**. (Note that in some countries, a “financial plan” is a much less significant document, it refers simply to the monthly, quarterly, and/or annual cash spending plan of a organization.)

**Financial Reporting**

The development, analysing, and communication of financial information by an entity to interested parties.

**Financial Statements**

The accounting reports and statements prepared by a reporting entity to communicate information about its financial performance and position. They include those notes and schedules that are needed to clarify or further explain items in the statements. For business-oriented enterprises, financial statements normally include a Balance Sheet, Income Statement, and Statement of Cash Flows. Governments and governmental units may have a similar set of statements or may have lists of assets and liabilities, revenue and expenses in the public sector. The statements similar to the Balance Sheet and Income Statements are commonly referred to as Statement of Financial Position and Statement of Financial Performance. Financial Statements should be prepared in accordance with International Public Sector Accounting Standards (IPSAS).

**Financing (or Borrowing)**

The means by which a government obtains financial resources to cover a budget deficit or allocates financial resources arising from a budget surplus. It includes all transactions involving government liabilities (other than for monetary policy or liquidity reasons). Financing requirements are the portion of current and capital expenditures, plus net lending that is not covered by revenue and transfers received. Financing requirements

must consequently be met through changes in assets and/or liabilities, held for liquidity purposes. Financing should be equal to the overall deficit/surplus, with the opposite sign.

**Fiscal Framework**

The financial framework of the government over which it has some degree of control. This is described in documents such as the Basic Budget Law, and Budget Instructions.

**Fixed Assets**

Durable goods except land, mineral deposits, timber tracts and similar non-reproducible tangible assets.

**Float**

Checks issued but not yet paid. The amount of float is reflected in the difference between the total of checks issued (as shown by the Treasury) and the total of checks paid (as shown in the books of the Treasury's banks). If a float can be identified, it should be shown as an adjustment to total expenditure. It is also known as items in transit. (See also **Arrears**)

**Floating Debt**

The amount of obligations, other than fixed-term contractual obligations, incurred by a government for goods and services received that have not yet been paid for, that is, an accumulated backlog of unpaid bills. (In some countries, the term refers to the unconsolidated portion of outstanding government short-term debt). Goods and services received but for which a floating debt of unpaid obligations is still outstanding should not be included with cash-based data of either expenditure or financing, but should be shown as a separate memorandum item. If consolidation of floating debt occurs through issuance of government securities to suppliers, it should at this point be included in expenditure and borrowing.

**Foreign Debt**

Debt to individuals and organisations (including banks and investors) which are non-residents.

**Forward Estimates (or Outyears)**

The years beyond the Budget Year in a Medium Term Budget Framework or Medium Term Expenditure Framework are referred to collectively as Forward Estimates (or Outyears). These represent the Budget Year plus the years immediately following the Budget Year. The Budget Year forms the basis of the annual budget law and its appropriations, while the Forward Estimates are estimates only of future expenditures and generally are not binding on the Budget Users or the government as a whole, unless there are specific circumstances or decisions warranting this.

**Fraud**

The severest form of an irregularity regarding public resources. Regarding expenditure, it includes any intentional act or omission relating to:

- the use or presentation of false, incorrect or incomplete statements or documents, which has as its effect the misappropriation or wrongful retention of funds;
- non-disclosure of information in violation of a specific obligation, with the same affect; or
- the misapplication of such funds for purposes other than those for which they were

originally granted with the same effect.

Regarding revenue, fraud includes any intentional act or omission relating to:

- the use or presentation of false, incorrect or incomplete statements or documents, which has as its effect the illegal diminution of the resources of the budget;
- non-disclosure of information in violation of a specific obligation, with the same effect; or
- misapplication of a legally obtained benefit, with the same effect.

### **Functional Classification of Expenditure**

Classification of expenditure according to the purpose for which transactions are made. It is generally used to measure the allocation of resources by government to conducting various activities in order to accomplish those activities' objectives. It corresponds to a sectoral classification, i.e. "education", "transport", "health", etc., and is therefore easily reconciled with the administrative organisation of government.

### **Goal**

A major level of performance or an accomplishment contained in an organisation's Strategic Plan that describes a desired outcome 3-5 years in the future.

### **Going Concern**

Refers to the ability of an organisation to pay its debts as they fall due. An organization which is able to do so is a "going concern". One of the key assumptions underlying the general preparation of financial statements is on the basis that the organisation is a going concern.

### **Governance**

The way in which power and authority influence public life, especially economic and social development.

### **Government Grants**

Assistance by government in the form of transfers of funds or other resources to an enterprise in return for past or future compliance with certain conditions relating to the operating activities of the enterprise.

### **Grants**

Unreciprocated, non-repayable, non-compulsory payments between governments or international institutions. The term is sometimes used also to refer to transfers of this nature made by government to all types of recipients.

### **Gross Capital Formation**

Gross fixed capital formation plus changes in government stocks or in enterprise inventories. Consumption of fixed capital (depreciation) is subtracted from gross capital formation to measure net capital formation. See also **Gross Fixed Capital Formation**.

### **Gross Fixed Capital Formation**

The value of new or existing durable non-military goods, property, plant and equipment to be used in the production process, acquired or produced for own account, less sales of such goods. It encompasses only goods with both a normal life of more than one year and more than a minimum significant value. Changes in government stocks or in enterprise inventories are included in capital formation but not in fixed capital formation.

Consumption of fixed capital (depreciation) is subtracted from gross fixed capital formation to measure net fixed capital formation.

**Historical Cost**

Assets recorded at the amount of cash, or cash equivalents, paid or the fair value of the consideration given to acquire them at the time of their acquisition.

**Impact Evaluation**

An attempt to assess the net effect of a programme by comparing programme outcomes with an estimate of what would have happened in the absence of the programme.

**Impact Indicators**

Indicators that tell whether a programme actually produced the intended effects.

**Incremental Budgeting**

A methodology that assumes the current budget as a “given” and that generally limits decision-making to any additional/incremental amounts above the current year.

**Inputs**

The resources used in order to produce Outputs. Inputs are usually expressed as amount of expenditure or of resources themselves (such as number of employee/days). An Input to an activity may also be the Output of an earlier activity.

**Intangible Assets**

Financial assets, leases, mineral concessions, patents, copyrights and similar assets not of a physical nature.

**Inventories**

Goods, other property and services which are:

- held for use in the ordinary course of operations;
- in the process of production for sale; or
- to be used up in the production of goods, other property or services including consumable stores and supplies, but not including depreciable assets.

**Key Management Personnel**

Comprise:

- all directors or members of the governing body of the organization; and
- other persons having the authority and responsibility for planning, directing and controlling the activities of the organization.

Where they meet this requirement, key management personnel include:

- a member of the governing body of a whole-of government entity who has the authority and responsibility for planning, directing and controlling the activities of the organization;
- any key advisors of that member; and
- unless already included above, the senior management group of the reporting entity, including the chief executive or permanent head of the reporting entity.

**Lending Minus Repayments (Net Lending)**

Lending minus repayments consists of gross lending and acquisition of equities minus

repayments of past government lending and government sales of equities. In determining a government's deficit or surplus, lending minus repayments, net lending is grouped with revenue and expenditure rather than with financing.

**Liabilities**

Sacrifices of service potential or future economic benefits that an entity is presently obliged to make to other entities as a result of past transactions or other past events. A liability must be recognised in the statement of assets and liabilities only when:

- it is probable that the future sacrifice or service potential or future economic benefits will be required; and
- the amount of the liability can be measured reliably.

A contingent liability is one which depends on occurrence of a specific event to materialise (e.g., default by a by a guaranteed debtor.)

**Line-item Classification.**

See **Object Classification.**

**Local Government/Local Administration**

Governmental units exercising an independent authority and responsibility in the various rural and/or urban jurisdictions of a country's territory. All governmental units at the local level which are referred to in the definition of the generic term "government" should be included. For example, local government units may include municipalities, cities, towns, school districts, water and sanitation districts, combinations of contiguous local governments organised for various purposes, etc.

**Macro-economic Framework**

The overall economic framework within which the government has to operate and over which it has limited control.

**Management Control (or Internal Control)**

The organisation, policies and procedures used to help ensure that government programmes achieve their intended results; that the resources used to deliver these programmes are consistent with the stated aims and objectives of the organisations concerned; that programmes are protected from waste, fraud and mismanagement; and that reliable and timely information is obtained, maintained, reported and used for decision making. It is the routine responsibility of an organisation's management to establish and monitor management control systems, not that of the external auditor (although an external auditor should comment on the presence/absence or adequacy/inadequacy of such systems).

**Management Information Systems (MIS)**

Those sources of data and records held within Budget Users which are designed as a common pool of information to assist managers in carrying out their responsibilities. Financial Management Information Systems (FMIS) are a sub-set of MIS and are widely regarded as essential for most governmental organisations to manage their resources better. Such systems may also assist in the evaluation of programme performance, in workload planning and in monitoring progress towards objectives. Management information systems form a key element of management controls, and must themselves be efficient and cost-effective.

**Mandatory Expenditure**

A type of expenditure which is required by law, and which the Budget User has little direct control over and little opportunity to change. In many countries, entitlement programmes (such as pensions and social welfare payments) are among the largest type of mandatory expenditure. It is the opposite of **Discretionary** expenditures.

**Market Testing**

The subjecting to competition of activities currently performed within a government agency. It can be compared to "make or buy" decisions in the private sector.

**Materiality**

Information is material if its non-disclosure could influence economic decisions of users taken on the basis of the financial statements.

**Measurement Focus**

This is the messages and information portrayed in the financial statements. A particular measurement focus is accomplished by considering not only when the effects of transactions and events involving those resources are recognised (i.e. the basis of accounting), but also what resources are measured. For example, the financial statements of business enterprises are designed to measure profit or loss and changes in shareholders funds. Government financial statements could be designed to express, for example, the flow of economic resources, the flow of total financial resources or the flow of current financial resources.

**Medium Term Budget Framework and Medium Term Expenditure Framework**

As planning tools for government, the Medium Term Budget Framework (MTBF) and the Medium Term Expenditure Framework (MTEF) are closely related, and they are both processes and documents. The MTBF consists of several elements: a macroeconomic estimate of the medium-term future, especially regarding revenue levels which may effect the budget process and which have a major influence in setting budget ceilings and thus on aggregate government spending; a discussion of major demographic trends which may influence the demand for programs and services; a discussion of major governmental policies, priorities, programs, and decisions regarding the medium-term period; and an outline of major budget trends. In this way, the MTBF bridges the gap between the longer-term Strategic Plan and the 1-year annual budget process. An MTEF is similarly a policy-level process, but it focuses more on the expenditure or resources aspect of the above list of elements. Both are called "medium-term" because they provide data on a prospective basis for the Budget Year and the following years.

**Memorandum of Understanding (MOU)**

A written and signed agreement between two or more governmental entities, to join together in ways that are specified in the MOU, under conditions that are specified in the MOU, in order to accomplish specific things during a specific period. In many cases, one organization is empowering the other organization to conduct specific activities to the betterment of a specific area of territory, a specific program, or a specific segment of the population.

**Ministerial Accountability**

The fundamental responsibilities of a minister (or ministry) regarding the fulfillment of its legally required duties. Also, to: provide answers and explain personal decisions; give an account of the activities and performance of organisations the minister heads; inquire



into and remedy faults; and repair systemic deficiencies.

**Mission Statement**

An essential high-level statement from each Budget User which is part of its Strategic Plan and which brings the organisation into focus. It should explain why the Budget User exists and describes at a high level what it does. It defines the Budget User's core business as well as its key clients. The Mission Statement articulates the direction and scope of work of the organisation.

**Multi-year Budget**

An approved budget for more than one year. It does not include published forward estimates or projections for periods beyond the budget period.

**Monetary Financial Assets and Liabilities**

Assets and liabilities to be received or paid in fixed or determinable amounts of money.

**Net Present Value (NPV)**

The present value of future net cash inflows provided by an asset from its continued use and subsequent disposal.

**New Policy Proposal**

Activities or programmes which the government did not previously undertake, and which are now being proposed for implementation and inclusion in the budget.

**Non-financial Public Sector**

General government sector plus the non-financial public enterprises. The non-financial public sector excludes financial public enterprises because consolidation with public financial institutions would eliminate statistics on the financing requirements of general government and of non-financial public enterprises met by the central bank and other government-owned and/or controlled banks.

**Non-repayable Transactions**

Transactions that involve no claim for repayment and hence do not directly affect the financial asset and liability position of the government and the other transactor, apart from the initial impact on cash or deposits.

**Object Classification**

A display of expenditures within the budget formulation and execution systems that identifies the specific types of goods or services acquired or transfer payments made; often called "line-item" classification.

**Operating Activities**

Activities which relate to the provision of goods and services by a public agency in fulfilling its legally required responsibilities.

**Operating Statement**

A financial statement that shows, for a financial period, the full cost of resources consumed by an agency in achieving its objectives, the extent of any cost recoveries (through user charges) and any other operating revenues from independent sources and revenues from the government. It is in effect an Income and Expenditure statement.

**Objectives**

The annual levels of performance or accomplishment that Budget Users establish in order to make demonstrable progress in meeting their goals under a Strategic Plan. Objectives are measurable and time bound.

**Obligation**

A legal agreement such as a contract or purchase order, entered into by a Budget User that requires the Budget User to make an expenditure in the future.

**Opportunity Cost**

The value of the most valuable of alternative uses. Often, opportunity costs are not expressed in simple or direct financial terms, but instead they are discussed as the side-effects or the necessary results of a course of action.

**Outcomes**

What is ultimately achieved by an activity or program (generally, over a longer period), as distinct from its Outputs which relate to more direct or immediate objectives. Outcomes are associated with the highest purposes of the organization, rather than on its routine operations. For example, the Outcome of a random breath testing campaign conducted by the police may be a decline in drunk driving and in automobile accident fatalities, while one of the Outputs could be an increase in the number of drivers charged with exceeding the legal alcohol limit.

**Outcome Evaluation**

This form of evaluation assesses the extent to which a program achieves its Objectives. It focuses on Outcomes (including unintended effects) to judge program effectiveness but may also assess program process.

**Outputs**

The products and services produced by an activity. Outputs are important for measuring work performance, and they are considered the day-to-day production of government programs, but generally they do not in themselves indicate the extent to which progress has occurred toward achieving the programme's purpose.

**Output Budgeting**

The process of linking budgetary appropriations to specific Outputs, more or less detailed, depending on the administrative capacity of the organisation in question. When aggregated, this detailed Output Budgeting becomes similar to Programme Budgeting.

**Payment Orders**

Certifications prepared or issued by the entity receiving goods or services indicating that delivery has been made, and that payment should be effected to the supplier.

**Pension Funds**

Separately organised schemes, in the financial sector, between employers and employees, which provide income on retirement for employees with different benefits and contributions and with an independence engaged in financial transactions in the capital market. Distinguished from social security schemes, which involve compulsory employee and/or employer contributions composed, controlled, or financed by government and are applicable to the entire community or to large sections of it. Any government employee pension fund that invests all of its funds with government is treated as part of

that government sub-sector.

**Own-Source Revenues (or Own Funds)**

Revenue collected by Budget Users as a result of services delivered, user fees collected, goods produced, etc., and retained by them for spending on approved activities.

**Performance Appraisal**

Assessment against a set of predetermined criteria of the efficiency and effectiveness with which an individual fulfils an agreed set of tasks.

**Performance Audit**

Audit covering economy, efficiency and effectiveness. Also called "value-for money" or "efficiency audit".

**Performance Budgeting (or Programme Budgeting)**

Budgeting which focuses on programmes and which is linked to measurable performance or outcomes. It is intended to focus attention on the results of the programmes, and not merely on the amount of resources used by the programme. It consists of: dividing government activities into functions, programmes, and activities; establishing performance indicators by activity; and measuring costs of activity outcomes or budgetary outputs.

**Performance Indicators (or Key Performance Indicators)**

See **Performance Measurement**.

**Performance Measurement**

Assessment of programme results against a set of predetermined criteria of the economy, efficiency, effectiveness, and the process with which an organisation carries out a particular activity or range of activities. Performance Indicators should be associated with specific programs, and should be: based on specific Benchmarks; validated through a specific Standard; focused on a specific target for the budget period.

**Predictability**

Lack of predictability of financial resources is associated with the undermining of strategic prioritisation and makes it hard for public officials to plan for provision of services. Predictability of government expenditure in the aggregate and in the various sectors is also needed as a signpost on which the private sector can rely to make its own production, marketing and investment decisions.

**Process Evaluation**

This is the form of evaluation that assesses a program activities' conformance to statutory and regulatory requirements, due process, program design, professional standards, or customer expectations, and comes to some conclusions regarding the results of the evaluation.

**Performance Standards (or Standards)**

This term can have 2 uses, within the context of the Guidebook. First, it is an important element of Performance Indicators, because a **Standard** refers to a recognized technical or other performance metric against which progress during the budget period can be measured, such as a recognized EU standard, a recognized medical standard, a recognized air quality standard, etc. Second, it indicates a specific level or quantity of

program performance that describes how well a service or activity will be delivered to customers.

**Planning**

A process of determining and deciding on short, medium and long term courses of action for programs or organizations, especially in the case of strategic plans. These plans should contain statements of government goals, strategies for achieving goals, a resource framework for the plan period (projections of revenues and expenditure), objectives to be attained in reaching those goals, measurements to determine whether the objectives are met, and a programme of activities to be implemented during the period.

**Prior Period Errors (Adjustments)**

Omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

- was available when financial statements for those periods were authorised for issue; and
- could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements. Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

**Programme**

A set of activities intended to contribute to an identifiable government objective (e.g. crop development). It is an organised endeavor of an agency that has measurable objectives and a direct relationship to the agency's mission; it has a defined budget and staffing; and has an identifiable target population.

**Programme Budgeting**

See **Performance Budgeting**

**Programme Evaluation**

Systematic studies conducted to assess how well the programme Outcomes are being achieved. They are often conducted external to the programme, either inside or outside the organisation concerned, but their results are of great importance to the organization and its plans for the future. The results of programme evaluation should be used in the budget formulation process to suggest ways in which the programme may be changed and improved.

**Program Statement**

A financial statement that shows total assets and liabilities for each program.

**Public Investment Programme**

A multi-year aspect of the budget process which focuses on identifying the need for, and then seeking funds for, capital items which can attract investment and help to build the economy or increase employment or otherwise help to accomplish the nation's major goals. **Public Investment Programmes** should always be included as a part of the larger budget formulation process, especially regarding capital expenditures and the relationship between capital items and the recurrent costs of supporting them in future years.

**Publicly Owned Enterprise**

Any legal entity which is separate from the government, but where over 50 percent is owned by the state directly or indirectly.

**Public Sector**

General government, plus all public enterprises. There should always be a positive relationship and balance between the **Public Sector** and the private sector, but in transitioning economies and/or relatively new nations, it is not uncommon for the Public Sector to be the dominant one and/or the driving force of economic development in the nation.

**Reconciliation**

The checking of one set of records with another, to ensure consistency. For example, the daily statement from the Central Bank should be reconciled (checked) against the spending unit's own records of transactions. The two documents should align, or any discrepancy should be checked and reported.

**Reporting Model**

The configuration and presentation of financial statements, in particular, what statements are included in the set of financial statements, how they interrelate, and how key measures are displayed in them.

**Reporting Date**

The end of the reporting period to which the financial report relates.

**Recurrent Expenditure**

Expenditures which are made on a regular basis to sustain the current activities of a Budget User. They include salaries, utility costs, goods and services. These items are contained in a Budget User's recurrent budget.

**Resources**

The inputs necessary to perform the activities required for the successful delivery of an output to customers. Inputs refer to people costs, equipment cost, and capital cost.

**Restructuring**

A programme that is planned and controlled by management, and materially changes either:

- the scope of an entity's activities; or
- the manner in which those activities are carried out.

**Results**

The output, outcome or impact (intended or unintended, positive and/or negative) of a Budget User's activities.

**Results-based Management (RBM) (or Results-oriented Management, ROM)**

A management strategy focusing on performance and achievement of Outputs, Outcomes and impacts, with less concern about inputs or the methodology for achieving outputs.

**Revenue**

The gross inflow of monetary resources during the budget period

**Risk Analysis/Assessment**

A systematic process for assessing and integrating judgments about probable adverse conditions and/or events, as a basis for the appropriate budgetary treatment of those conditions or events.

**Sectoral Classification.**

See **Functional classification**

**Social Security Funds**

Schemes imposed, controlled or financed by the public authorities for purposes of providing social security benefits for the community, or large sections of it, which are separately organised from the other activities of the public authorities and hold their assets and liabilities separately. Social security arrangements which do not hold their assets and liabilities separately are not called social security funds. All social security schemes are classified as a part of the level of government at which they operate. Separate statistics are needed for social security funds.

**Spending Limits**

An amount less than, or equal to, the allotment that is provided to a spending unit for a specified period of time. Spending limits may be varied during the course of the fiscal year in accordance with the results of monthly or quarterly reviews of budget performance. **Spending Limits** are related to **Ceilings** in the following way: **Ceilings** are used as a planning tool during the budget formulation process in order to ensure that organizations do not make plans for funding levels that cannot be provided, while **Spending Limits** are an implementation tool for use while the budget is being executed.

**Spending Unit**

The lowest administrative division which controls a separate budget and has the authority to spend budgetary funds

**Stakeholders**

All of those who have an interest (either direct or indirect) in an institution, its activities and its achievements. These may include clients or customers, recipients of program services, partners, employees, shareholders/owners, other government or other governmental organizations, or regulators.

**Strategy**

The method or methods chosen by a Budget User to fulfill its mission.

**Strategy Statement**

A description of the linkages between the Budget User's missions and goals and the overall government budget priorities for the budget period in question. Furthermore, it must describe how budget resources and programmes are being used to achieve its missions and goals.

**Sub-national Governments**

Governmental units that exercise authority and responsibility independently of the central government in a part of a country's territory encompassing a number of smaller localities. These include all governmental elements at the regional level and may include (depending on the organisational structure of the country) provincial, district, as well as local government. Sub-national government includes also decentralised agencies and

special-purpose funds operating at the regional level.

### **Statement of Assets and Liabilities**

A financial statement that shows, at the end of each reporting period, each class of assets and liabilities of an organisation. The public sector equivalent of the **Balance Sheet** of private companies.

### **Strategic Plan**

The large-scale and long-term process of defining the organisation's (or the nation's) overall goals and objectives, and the overall methods and strategies which may be used in seeking to attain those goals and objectives. The term refers to both the strategic planning **process** and the strategic plan **document**. To be as useful and effective as possible, the process should be conducted in a transparent and inclusive way, and should be used to provide the framework within which the MTBF or MTEF and budget process are conducted.

### **Supreme Audit Institution**

The highest public organisation, independent from Government and accountable to the Parliament, which is responsible for auditing the overall government financial operations.

### **Surplus**

The situation which occurs when revenues (or available funds which have been appropriated for a specific purpose) exceed the costs of providing goods and services during a specific time. It should be noted that the simple presence of unspent funds in an account at any one time is not automatically the same thing as having a surplus, because there may be specific plans to use those funds later in the year (or in a subsequent year, according to the programme's design). Therefore, a true surplus occurs when the purpose for which the funds have been appropriated is complete and there are still unspent funds that are remaining.

### **Sustainability**

The continuation of benefits from an intervention after the intervention has been completed and the probability of continued long-term benefits.

### **Target (MTBF Target)**

The level or amount of final products, goods, or services produced over a given period of time, by an institution, in order to achieve its objectives. Activities related to attaining these targets are typically under the control of the Budget User through relevant departments. When targets are services, they may depend on the participation of a client.

### **Taxes**

Compulsory payments to public sector entities, in accordance with laws and or regulations, established to provide revenue to the government. Taxes do not include fines or other penalties imposed for breaches of the law

### **Transfers-in**

Inflows of future economic benefits or service potential from non-exchange transactions, other than taxes.

### **Transparency**

The process of open communication and ready availability and distribution of



programmatic and financial information is essential for an informed executive, legislature, and the public at large (normally through the filter of competent management staff and capable public media). It is essential not only that information be provided, but that it be relevant and in understandable form. For example, providing large amounts of unexplained financial information to the public does nothing to improve fiscal transparency. Important areas of transparency include fiscal roles and responsibilities; public availability of information; open processes of budget preparation, execution and reporting; and independent reviews and assurance of the integrity of fiscal forecasts, information and accounts.

**User Charges**

Payments paid by the consumer or users of goods and services provided by the public sector to individuals or organisations in the private sector (whether for partial or total recovery of costs of provision) as well as other organizations in the public institutions and agencies as appropriate to the specific type of goods and services.

**Values**

Descriptions of the principles of how the organization conducts itself when carrying out its business. Generally the best statements of principles/values express the organization's attitude and likely behaviour about three things:

- People: the way employees and customers are treated;
- Processes: the way things are managed in the department; and
- Performance: the expectations of quality.

**Virement**

The authorised transfer of funds from one use to another.

**Vision Statement**

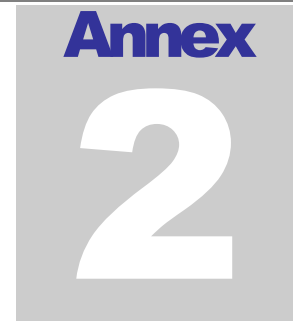
The description of where the organisation intends to be in the future. It represents a shared sense of direction and incorporates the core values of the organisation. It describes what the organisation believes in.

**Warrant**

A certificate signed by the Minister of Finance which can be used as authorisation for a Budget User to spend budgetary funds for a particular category of spending during the fiscal year; for transferring funds between accounting codes; etc. Individual Budget Users may issue sub-warrants to their subordinate spending units.

**Zero-Based Budgeting (ZBB)**

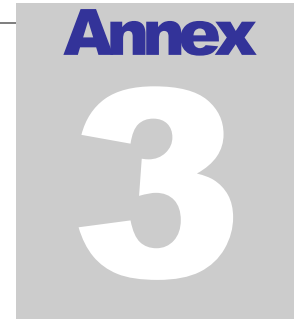
A budget methodology that requires the re-justification of a Budget User's entire budget request each year.



## **Annex 2: THE 2008 BUDGET LAW**

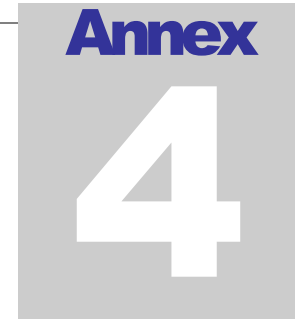
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Croatia has had a number of budget laws as an independent nation, but the most recent law, which was passed in 2008 and effective for 2009, has set in motion many of the advances and requirements which are found throughout this Guidebook. Therefore, the text of the law is included in Guidebook as a tool for reinforcing the importance of those changes.



**Annex 3: SAMPLE INSTRUCTIONS FOR PREPARING  
STRATEGIC PLANS FOR THE PERIOD FROM 2011-2013**

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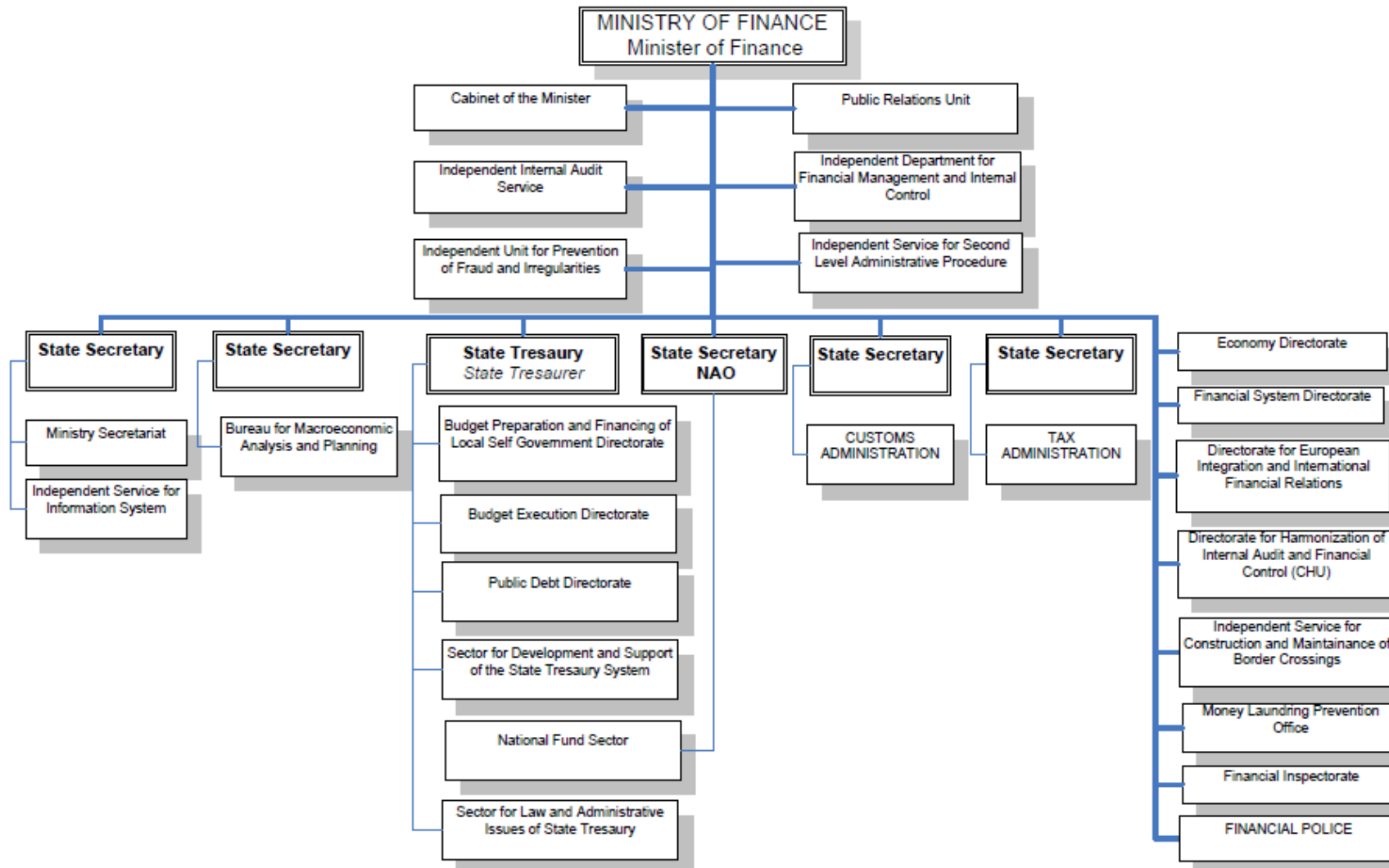
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## **Annex 4: ORGANOGRAM OF THE MOF**

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Because of its impact on the operations of Budget Users in any nation, those Users should understand the size and breadth of responsibilities of the nation's Ministry of Finance. The following Organogram illustrates Croatia's MOF so that Budget Users can understand the extent and relationships of the MOF's components.

Ministry of Finance Organization Scheme – Decree on Internal Organization of MoF (OG, 43/05, 114/05, 14/06, 138/06, 127/07, 14/08, 27/08, 29/09)





## **Annex 5. Budget Analyst's Competency Mode**

DISTINCT COMPETENCES OF BUDGET ANALYSTS		DEFINITION	LEVELS
THINKING	Strategic Conceptual Thinking	Sees interrelationships and/or patterns in situations (or between items), which are not visibly related. Able to identify root issues or causes in complex situations. Thinks creatively and in a generalising way.	<ol style="list-style-type: none"> <li>1 Has a good skill of generalization, notes interrelationships, focuses on important matters. Main focus is on short-term developments (up to 1 year).</li> <li>2 Has a good skill of theoretical generalisation. In analysing developments in the work area focuses on midterm perspective.</li> <li>3 Sees linkages between different work areas and the „big picture“, has a good skill of creative generalization and longterm development vision.</li> </ol>
INTERNALLY ORGANIZED	Achievement Orientation	Reception of challenges to improve work performance and potential. Performance means the quality of work outputs, compliance with or exceeding the standard and innovativeness. Part of improving personal performance is to set individual development goals and systematic work to achieve them.	<ol style="list-style-type: none"> <li>1 Wants to do his/her job well – result is performing the job correctly/well.</li> <li>2 Seeks better solutions.</li> <li>3 Wants to influence his/her own professional development, development of the Ministry of Finance, of the supervised sector and the whole state. The result is achievement of predetermined impact.</li> </ol>
	Self-Confidence	Internal confidence in one's own skills and ability to act effectively in uncertain environment and/or under emotional stress. Awareness of one's own capabilities to select appropriate behaviour and ability to avoid destructive behaviour, such as strong, negative emotions, stress, criticism etc.	<ol style="list-style-type: none"> <li>1 Independent and self-aware.</li> <li>2 Presents things confidently</li> <li>3 Controls his/her emotions in critical situations.</li> </ol>
	Acquiring Information	Seeking for elaborate and widespread information.	<ol style="list-style-type: none"> <li>1 Seeks for information in order to understand presented material.</li> <li>2 Seeks for additional information in order to understand the roots of a problem.</li> <li>3 Permanent and continuous search, storage and updating of information.</li> </ol>
COMMUNICATION	Establishment and Development of Interpersonal Relationships	Acts with the aim to establish and maintain friendly and warm relations and networks with colleagues both in one's own organisation, as well as outside, which may gain instant or future work-related benefits in obtaining the objectives.	<ol style="list-style-type: none"> <li>1 Communicates professionally.</li> <li>2 Takes steps to establish good relations in order to improve work efficiency and communicates constantly with partners.</li> <li>3 Establishes and develops close contacts and personal relations.</li> </ol>
	Cooperation	Cooperation with colleagues to achieve common goals. Effectiveness of cooperation embraces establishment and maintenance of conditions for working together (exchange of information, good interpersonal relations in a group, team spirit etc).	Communicates and distributes information Cooperates constructively. Initiates cooperation.



<b>BASIC COMPETENCES</b>	
Education	University education. Preferred background in economics (finances, accounting or other), public administration or law.
<b>Work Experience</b>	Minimum 3 years of work experience on positions related to economic or financial analysis in the public or private sector (for example senior specialists in a ministry planning or budget departments, or senior specialists in policy departments whose work tasks involve micro or macro analysis; analysts from banks; financial managers or senior specialists from enterprises).
<b>Language Skills</b>	Fluent in Estonian. Proficient in English to the extent which enables to read and understand work-related texts. Working knowledge of another foreign language is an asset.
<b>Computer Skills</b>	MS Excel, Word at expert level (Spreadsheet: mastering of functions, graphical design, linking to the web; word processing; file management). Computer Licence module two (or three) compliant. Internet skills. Mastering of computer applications of the MoF (Documents Management, State Treasury search engine, State Treasury databases, budget preparation application, budget analysis environment).
<b>Specific Knowledge in the Work Area</b>	Knowledge level which is necessary to perform effectively. Entails possession and acquiring of information (i.e. knowledge how to obtain information) and application of instructions and manuals.
<b>Management of Stress And Setbacks</b>	Working under stress.
Analytical Thinking	Understanding of problem/issue/situation through its components. Identification of causes and effects and deriving conclusions from that. Systematising, prioritising, planning.

<p>Oral And Written Expression</p>	<p>Expresses him/herself clearly, understandably and correctly both orally in in written form.          Explains and argues his/her position using logical arguments and data.          Formats written texts correctly according to applicable instructions and norms.          Structures written materials according to their purpose and target group.          Selects vocabulary and style keeping in mind the audience.</p>
<p>Management of Work And Time</p>	<p>Prioritization, planning for short- and long term.</p>

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