FINANCIAL MANAGEMENT MODEL FOR LOCAL GOVERNMENTS
I. INTRODUCTION

The brochure is meant for local governments: mayors, city secretaries, financial department heads and heads of other departments as well as City Council members, who approve and adopt local government policies. It explains the benefits of improved financial management and its role in modern management of local governments. It also introduces and briefly describes a financial management model that has been developed by the Local Government Reform Project and is being implemented in various stages in demonstration cities in Croatia: Rijeka, Varazdin, Crikvenica, Osijek and Bjelovar.

Improving financial management in local government is an important first step to increasing the efficiency and effectiveness of local service delivery and allocation of limited resources. The financial management model is a tool to begin the process of addressing many of the major finance issues facing local governments, such as the need to improve the budget structure and reporting of financial information for council, management and citizens, increase the participation of citizens in the budget planning and decision making processes, improve the organization of budget preparation and implementation and strengthen capital investment planning.

The financial management model has a variety of tools included in it, from rather simple ones to more sophisticated, which can be applied to most financial management issues. It can serve also small rural municipalities as well as sophisticated larger cities.

This brochure will identify some practical solutions on how to improve financial management in your local local government and help you create a fiscally sound, well-managed local government. The brochure will also outline the steps you need to take to participate in the program.
II. GENERAL INFORMATION

One of the most important goals of financial management in Croatia is to continually improve the efficiency and effectiveness of administrative and public services. As components of public administration system, local and regional self-governments require introduction of new management systems to improve the quality and efficiency of public services.

Finance management is the area that attracts significant attention of local self-government officials and citizens because the quality of life of residents depends on a commitment to, good long range planning and sound financial management by the local government and the continued cooperation and support of the local business community.

The present system of local financial management provides little fiscal accountability or useful information to public officials, managers or citizens. Most local governments in Croatia have yet to fully understand and embrace budget development as a policy setting process with the adoption of more informative budget documents and responsive to public participation. Moreover, local governments lack an integrated system of budgeting, accounting and financial reporting based upon a rational chart of accounts (with international standard economic and functional classifications). As Croatia moves toward devolution of public service functions to local governments, there will be a greater need to ensure local governments have the capacity to absorb decentralization measures. Additionally, local governments are aware of the need for intensive investment in infrastructure as a foundation for economic development.

What are the goals of introducing modern financial management practices in local governments?

By introducing new models, adopting improved processes and applying the experience of modern finance management, we expect to:

- Increase efficiency in local government finance management
- Improve local government resource management (capital investment projects, credit worthiness, financial capacity and debt management)
- Forecast the impact of present decisions of local governments on future budgets
- Enhance the quality, timeliness and transparency of information of local government financial conditions and program operations.

The financial management model addresses the following major finance issues that local governments in Croatia confront daily: and provides workable solutions within a modern financial management framework:

Budget structure and reporting:
- Improves budget documents to reflect the information, policy and management needs of the local government
- Provides additional options to organizing budgets according to functional, programmatic or organizational classifications
• Creates a distinction and separation between an operating budget and a capital budget
• Adds transparency to reporting total outstanding indebtedness, creditworthiness, and financial (credit) capacity.
• Improves the transparency of consolidated budget / financial statements

- Organization of budget preparation and implementation:
  • Supports and promotes transparency or accountability of the data
  • Streamlines the organization structure of local government finance departments.
  • Modernizes budget preparation based on citywide goals that are translated into department program goals, priorities and objectives where the finance department provides guidance to administrative departments and then consolidates the budgets and prepares a draft budget for consideration by the executive board.
  • Provides financial software to analyze the budget by operating / capital structure and to report by function, programmatic and organization classifications as well as economic classification
  • Uses the budget process and financial information to make local government decision-making and policy formulation transparent.

- Capital improvement planning
  • Promotes a formal evaluation process to review, prioritize and select capital projects based on clear, transparent criteria and using a rational approach that also includes the involvement of citizens
  • Analyzes capital projects for their impact on local government budgets, including financing costs.
III. FINANCIAL MANAGEMENT MODEL

The financial management model is established to enable planning, collecting, managing and controlling the quality of financial data in an environment that considers budget constraints as a central part of financial activities.

The model, processes and education are based on:

1. Existing legislation of Republic of Croatia, especially parts that relate to local and regional government and financial aspects;
2. Budget and budgetary values (annual budget, 3-year and multi-year budget);
3. 10-year development projections
4. Experiences achieved in transitional countries similar to Croatia

The model deals with several important areas of financial management. Those areas were chosen as the most critical ones to increase the efficiency and effectiveness of Croatian local governments.

The following procedures and practices create the model and contribute to achieving the improvements:

   a. More effective internal procedures to perform budgeting and other financial functions;
   b. Improved use of financial information to inform the mayor, other senior officials, and the citizens about the financial condition of a local government;
c. Improved procedures to involve citizens in budgetary policy decisions and to inform them of local financial conditions;

d. Improved documents for communicating with banks, international donors, and other external lending sources to fund capital investments;

e. Where possible, facilitating access to finance by linking finance institutions with local government projects;

f. Improved capital investment planning (CIP) including mechanisms to involve citizens in the decision making process to prioritize investments; and

g. Improved mechanisms to enhance the operating budget of a local government through the introduction of program budgeting.

What tools support the process of modern financial management for local governments?

In the process of implementing financial management models, there are various tools utilized, such as:

- Transparent budget preparation process,
- Budget mayor’s message,
- Budget public hearing,
- Budget-in-brief,
- Procedures to prepare a Capital Improvement Plan (CIP),
- Procedures to prepare a program budget.

Knowledge gained from these new modern finance management processes is supported by financial software called “Financial Analysis Model (FAM)”. The FAM represents a program tool that brings together in a synergistic fashion the complete coordination of the local government budget, communal companies, public institutions and other business entities of local government.

This tool enables the local government management to monitor in a single location financial data and financial indicators of overall environment, and therefore can focus financial management from so-called "intra-environment" to "inter-environment".

What is FAM?

FAM is finance software tool that serves as a fundamental support to local governments to implement finance management improvement processes (CIP, budget execution, and program budgeting). The financial analysis model was developed in Access software and its user interface, functions and methods of operation is completely adjusted to users who use Windows operating system on daily basis.

What are the goals of FAM?

The FAM program is developed as a computer program, which upon installation and implementation training, aims at:

- Establishing a coordinated and uniform system of financial data of local government and its environment,
- creating uniform format of data output essential for financial management, and
- applying financial analysis based on results generated from inputted data. One-time data entry needs to be emphasized, thus enabling simultaneous budget analysis according to economic, organizational and functional classification.

What approach makes achieving these goals possible?

The FAM’s approach allows input of financial data of all entities within local government environment into one program makes this model and program different from others. This approach contributes to quality financial analysis because:

1) Every single entity is in the FAM database,
2) Financial analysis is conducted on the complete local self-government sector, and;
3) Financial analysis is based on a combined financial balance sheet at local government level

GRAPHICAL PRESENTATION OF LOCATION AND ROLE OF FAM IN LOCAL GOVERNMENT MANAGEMENT PROCESS
(within data entry, data processing, reports and analysis)

Units of local and regional self-government can be observed as mini-centers in one environment and then function as a core for a series of activities in business, political, cultural and other areas. Implications of good or bad decisions in local government management process on local government environment are multiple in comparisons when decisions are brought by entities within environment of a local government. In order to minimize risk of bad assessments or decisions, it is important to acquire information that decreases risk.

The following GRAPHICAL PRESENTATION shows the different types of information that has to be available to the local government executive board to be able to make appropriate and timely decisions. It also shows the central place and supporting role of FAM in collecting, processing, analyzing data and preparing reports.
FINANCIAL MANAGEMENT MODEL

GRAPHICAL PRESENTATION OF FAM SCREENS
IV. REPLICATION OF THE MODEL

What cities have introduced the finance management model?

Financial management model is being introduced in "demonstration sites": Osijek, Varaždin, Bjelovar and Crikvenica. All four cities have achieved approximately the same level of implementation of the model, with some differences due to varying groups of activities in each city and existing situation in terms of capital investment planning, procedures, documentation, indebtedness, etc.

What results have been achieved so far?

Achieved results through the implementation of the LGRP financial management model can be separated into several levels:

a) Representatives of demonstration sites have adopted knowledge and processes on CIP, creditworthiness analysis, budget preparation, activities related to transition towards program budget, etc.

b) The City of Varaždin published a Budget-in-brief document for its citizens, first document of this type in Croatia, which allows all citizens to gain information on the planned 2002 budget and its distribution.

c) The City of Crikvenica was the first city in Croatia that organized and held a public hearing for presentation of budget to its citizens. The Mayor of Crikvenica chaired the public hearing.

d) Demonstration sites were the first cities to prepare a budget plan for 2002 and were excellent trainers of other local government officials in their respective areas that required assistance in budget preparation.

The Ministry of Finance has adopted the FAM for all local governments as an obligatory reporting tool in the FAM’s reduced format (Budget plan for 2002). It shows that FAM has been well accepted from user’s point of view in most local governments throughout Croatia. Additionally, the Ministry of Finance has posted the budget module of the FAM on its Internet Web site for easy use (downloading) by local governments to prepare reports for executed 2000 and 2001 budgets.

What local government should do to implement the Model

If your local government wants additional information about the LGRP and the models it has developed to help local governments in Croatia successfully adapt to their increased responsibilities, we suggest that you:

- visit our web page (www.urban-institute.hr) where downloadable files on the process will be available,
- sign up for our LGRP newsletter; and
- read printed materials
The LGRP is conducting regional conferences to present more details on the models. A survey distributed during the conferences will ask attendees to express their willingness and commitment to devote local resources in implementing a particular tool. Analysis of survey results will help us identify the level of interest in each model and select the most appropriate method to help local governments replicate each model.

Possibilities include:
- LGRP technicians will train Croatian consultants, who then will be offering assistance to local governments in implementing the model
- LGRP will conduct a series of seminars with homework assignments leading to a step-by-step implementation,
- LGRP will hold other conferences, workshops, or seminars.

Representatives of local governments that have indicated an interest in implementing the model will be invited to those activities should it provide to be the most suitable method to implement the model.
The Urban Institute is a nonprofit policy and research organization established in Washington, DC in 1968 to investigate social and economic problems confronting the U.S. and government policies and programs designed to alleviate them. UI is internationally known and respected as an objective, nonpartisan source of expertise and analysis for informed policy deliberation and debate. UI has expanded its role to include analysis of analogous problems and policies in developing countries and transition economies. Recent and ongoing projects have been engaged in Bosnia and Herzegovina, Latvia, Russia, Georgia, Armenia, Hungary, Poland, Macedonia, Croatia, Albania, Bulgaria, and Slovakia.

The Local Government Reform Project offers technical assistance to local governments. There are four components in the Scope of Work for this project to address local government reform in Croatia:

1. Improve Fiscal and Management Efficiencies of local governments
2. Improve Investment Opportunities for Economic Development
3. Improve Citizen Participation in Local Governance