

PERFORMANCE BUDGETING IN LOCAL SELF-GOVERNMENT SYSTEM



ARMENIA

- *new quality and level of management*
- *justified and impartial decisions*
- *effective mechanism of control*
- *high effectiveness and quality of service delivery*
- *integral linkage between inputs and outputs*



PERFORMANCE BUDGETING IN LOCAL SELF-GOVERNMENT SYSTEM

The "Performance Budgeting in Local Self-Government System" Manual is developed in the frameworks of the UNDP-supported Performance Budgeting Initiative.

*Program Officer
Project Coordinator*

*Narine Sahakyan, UNDP Portfolio Manager
Susan Bagratuni, UNDP*

AUTHORS

*David Tumanyan,
Vahan Movsisyan,*

Translation

K. Adumyan

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PREFACE

The "Performance Budgeting in Local Self-Government System" Training Manual is owed to comprehensive and in-depth work in the frameworks of the UNDP-supported Performance Budgeting Initiative.

Since its inception in 2005, the Performance Budgeting Project has generated much interest among local government bodies (LGBs) in Armenia. The goals of the Project are to support further decentralization in Armenia, to strengthen LGB capacity, and to facilitate accountable and measurable public expenditure management. It assists the implementation of a performance budgeting format in the community planning, monitoring, and evaluation process. Structure use of this method is new to not only Armenia, but also the region.

The Performance Budgeting Project promotes community-level active citizen involvement in the local development process, ensures the technical awareness of local authorities, accountability and measurability in efficient infrastructure use and service delivery, and encourages closer linkages between communities and the treasury.

During the pilot phase of this project, joint research and creativity of local and international experts gave birth to the idea of developing such a training manual. The manual is intended for not only the pilot LGBs involved in the project, which are already practicing this method, but also anyone that may wish to learn about result based budgeting and use it in their communities.

The Introduction covers the urgency and relevance of performance budgeting in great detail. The

importance and timeliness of the Manual itself is explored below.

There is an abundance of books, training manuals, and guides on local government systems, bodies, and community budgeting, while there is no comprehensive literature, either locally or internationally, on the methods, phases, practices, and peculiarities of performance budgeting. The experts devising this Manual had to have profound knowledge, research skills, and commitment. Developing the Manual required the project team to perform an in-depth overview of the scarce literature on performance budgeting and the international experience in this field.

The "Performance Budgeting in Local Government" Training Manual is rather unique and timely, because local government development and reform trends raise the need for adopting performance budgeting.

The Manual encompasses the experience gained during training courses, advisory meetings, and joint seminars conducted in the pilot cities, as well as the knowledge and expertise of local experts. The Training Manual provides a detailed description of the local performance budgeting principles, framework, budgeting process phases, and budget planning, execution, and oversight. It contains examples from the budgets of the pilot communities and citations of relevant laws and other legal texts.

The Communities Finance Officers Association has been the main implementing partner for the Performance Budgeting Project. The experts of this organization have made an enormous contribution to the implementation of this Project and the cre-

ation of the Manual. Their experience in communities and their profound knowledge on budgeting have served to increase confidence in the Project in the target communities.

Our government partners the Ministry of Territorial Administration and the Ministry of Finance and

Economy are positive about UNDP's activities in this sphere, and their support is key to the successful implementation of the Performance Budgeting Project both centrally and locally.

Susan Bagratuni

"Performance Budgeting" project coordinator

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INTRODUCTION:

Budgeting Reform in Local Government

For many years, both central government and local government budgeting was considered a standalone sphere of administration everywhere in the world. It was a consequence of budgeting requirements. During this period, line-item budgeting models were practiced, which were based on a clear classification of budget revenues and expenditures and reporting on the basis of such classification. It was this set of confined activities requiring very specific knowledge and skills, rather than a comprehensive exercise, which underlay the emergence of budgeting as a separate sphere.

Initiation of Budget Reform Efforts

Starting from the 1970s, developed democratic countries started to look upon finance management, including budgeting, as an integral element and implementation tool of policy based on performance and expected outcome. It meant a transition from a centralized system of budgeting to a decentralized one at the same level of administration, and broadening of the powers of central government and administrative-territorial units governmental bodies in the area of budgeting. The first attempts in this direction were taken in the USA in 1949 and 1965. Such an approach was implemented in both central and local government systems of various developed countries. This new model of budgeting is known as performance budgeting or output based budgeting. It is currently widely practiced in the US, Great Britain, Australia, and New Zealand in both central and local government.

Local Government Budgeting

Local government bodies (LGBs) generally deal with demand for infrastructure and public services. The inadequacy of the latter increases the expectations of LGBs. Access to infrastructure and services is presently deemed important in terms of its impact on both economic development and an improved standard of living. In this context, the requirements of LGBs are three-fold:

- Optimization of all sources of funding, which will enable LGBs to ensure infrastructure operation integrity and efficient service delivery;

- Using all possible means of infrastructure operation and service delivery; and
- Achieving economy, efficiency, and effectiveness assessment of infrastructure operation and service delivery.

In developing countries, greater powers are gradually devolved to local authorities in the areas of service delivery and infrastructure operation. The exercise of powers is ensured by prescribing some responsibility. Performance of such growing responsibility is often hindered by insufficient institutional conditions, i.e. responsibility for service delivery exists, but resources have not been designated for the exercise of decentralized functions. As a result, the debate on public expenditure management policies, infrastructure development, and service delivery mainly focus on central government, which can negatively affect local governments. At the same time, in the elaboration of development policy at the local level, enough attention is not paid to the importance of using planning and budgeting tools.

To facilitate infrastructure development and service delivery, developed countries use a planning and measurement process, which is widely used in the budgeting practice of transition economies and developing countries, as well. This process is known as performance budgeting.

Performance Budgeting in the Post-Soviet Countries

Post-Soviet countries still retain most of the conventional approaches to budgeting. Conventional line-item budgeting practices can be found in Armenia's local government, as well. Though the legislation requires program budgeting, this requirement has not become reality yet. Some training and consultancy projects have been implemented in this area, including, in particular, USAID-funded projects carried out by ICMA and the Urban Institute during 1998-2005. Due to the lack of government support and a conducive environment, they have mainly not become sustainable.

The experience of advanced countries shows that the implementation of performance budgeting consider-

ably improves the efficiency of local government and the quality of their services. *The need for its implementation and its importance for Armenia is due mainly to the following reasons:*

- Under line-item budgeting, there is a limited number of budget understanding, and the budget does not reflect justified calculations, whereas performance budgeting is more simple, understandable for many, and fully justified.
- Line-item budgeting is mainly performed by the municipality financial unit, which, on the one hand, excessively burdens the unit, but on the other, reduces the burden and responsibility of other units. Under performance budgeting, responsibilities and accountability are distributed almost equally between all the units of the municipality.
- Under performance budgeting, the possibilities of public engagement in the budgeting process grow.
- Under performance budgeting, the publicity and transparency of the budget grows, because the expenditures for performing all the various tasks are clearly spelled out.
- Under performance budgeting, the community is better informed about the quality of services provided in the municipality.
- Performance budgeting allows a better evaluation of program outputs.

Budget Reform at Two Levels – National and Subnational

Budgeting reform in local government need to be prepared at two levels national and municipality. National-level reform implies legislative and regulatory changes, whereas municipality-level reform can be carried out under the extant laws, as well.

Budgeting reform should be seen primarily in the context of the budgetary system. The budgetary system includes a wide range of subsystems, from macroeconomic forecasting to auditing and performance/policy evaluation. There are strong linkages between these subsystems. Failure of any one of them can have negative effects on the other subsystems and may undermine the effectiveness of the whole budget system. To undertake successful reform, it is necessary to meet the following three conditions:

- a) To defining the reform objectives;
- b) To undertake a comprehensive review of the budget system in order to determine the main weakness-

es and the changes necessary to deal with these problems; and

- c) To set reform criteria that will allow assessing the three main objectives of budgeting in balanced manner, i.e. fiscal discipline, effective resource allocation, and operational efficiency.

When reforming a budget system, linkages with other systems, particularly with political and governmental systems, must be taken into account. For example, to reinforce expenditure control at the spending agency level, improvements in public procurement and human resource management systems are as important as reforms of the budgetary procedures themselves. Nevertheless, it must be kept in mind that policy choice is essentially political, and strengthening decision-making requires recognition of the multitude of factors that bear on these decisions. It is, therefore, also important to address issues such as those related to the municipal governmental bodies coordination mechanisms and the relationships between the executive and the representative bodies.

Municipality-level transition to performance budgeting may be initiated by local government bodies. To implement it, an action plan needs to be prepared. This plan should include the following elements:

- The overall goal of the reform and the specific objectives of each of its component parts.
- A list of the components.
- A list of activities for preparing and implementing the reforms (e.g. pilot studies, user surveys, training courses); the deadlines for completing these activities; and milestones for accomplishing key tasks.
- Indicators to monitor and evaluate progress achieved.
- The organizational arrangements to prepare the reform and supervise its implementation.
- The resources that will be devoted to the reform in order to purchase the required inputs of technical assistance, equipment and computer software, training of staff, etc.

Existence of the will and commitment of the municipality council and mayor is one of the important conditions for the reforms success.

A steering group must be created to manage the reform, which will be chaired by the mayor or his deputy, and will have municipality council members, representatives of municipality units and institutions, advisors, and experts as its members. The steering

Box 1.

Performance Budgeting in Sunnyvale, California

The budgetary system of Sunnyvale is based on the city's General Plan, which is comprised of seven elements (Transportation, Community Development, Environmental Management, Public Safety, Socio-Economics, Cultural, and Planning and Management) and various sub-elements, covering each of the 24 fundamental areas of city services. This document is a 20-year strategic plan, providing a long-term vision of what the city hopes to achieve in a particular area of municipal responsibility. Each plan is both a problem statement and an integrated set of goals, policies, and actions.

The city's General Plan is reviewed and updated approximately every five years, with considerable involvement from the public.

Each year the city adopts a 10-year financial plan, projecting the city's revenues and costs to support the goals of the 24 elements. The two-year performance budget is derived from the financial plan. While the city budget is adopted annually, the second year of the budget cycle generally addresses minor modifications and budget supplements. Sunnydale's budget is a service-oriented document, placing its primary focus on the level of service to be provided to the community and how much that service will cost.

The performance budget is organized around the same seven elements as the General Plan. Within these elements are a total of 82 budget programs. For example, within the Transportation element are four programs (such as Traffic Engineering and Street Lighting), while within the Cultural element there are 17 programs (such as Tennis Activities and Cultural Arts Services). Under these budget programs are listed over 300 different service level objectives, stated as measurable performance goals. Arrayed under these objectives are about 1,500 separate tasks, covering every type of activity in which city employees engage.

The promise of this arrangement is that if all the tasks are completed, all of the service objectives should be accomplished and if all the objectives for that year are accomplished, the city should be on track to achieve the strategic goals of the General Plan.

Source: <http://www.governmentperformance.info/library/pbmbms-sunnyvale.pdf>

group must elaborate the main areas of reform with the engagement of non-governmental organizations and other public groups. It must then supervise the implementation of the reform.

Day-to-day management of the reform must be performed by a core unit or group with competent and responsible specialists. It should have a very clear understanding the present situation of budgeting, the idea of performance budgeting and its implementation nuances, and have a close linkage with the financial unit. If necessary, the group can engage outside experts. The group should be directly responsible to the mayor and the steering group.

Working groups can be created for implementing specific reforms in particular areas, e.g. a financial management information system working group.

It is very important for the municipality staff to be fully informed of all reform-related issues and for everyone to be aware of it. To this end, seminars, discussions, and training events must be emphasized

engaging the municipality staff, non-governmental organizations, and other public groups.

International Experience

The city of Sunnyvale (California, USA) has abundant experience in local government performance budgeting. Sunnyvale has gained the reputation of a success story and is rather popular worldwide (see Box 1). The city government system is based on long-term policy planning, long-term financial planning, performance budgeting and governance, and payment against performance. This system has been improved and developed for several decades already, without radical or comprehensive change, which testifies to its viability and efficiency.

Sunnyvale's government and budgeting system was planned and its implementation started in the 1970s. However, its first major revision was performed only in 1994, when the city manager appointed an interde-

partmental task force to study where the municipality is and what it should achieve in the 21st century¹. The task force was instructed not to change the government system, but rather, to simplify and modernize it and to make it a powerful tool for service delivery administration policy-makers (the city council) and the city staff.

Sunnyvale's budgeting system is focused around qualitative outputs, ensures clear and accessible information, is understandable, usable for many, flexible, consumer-oriented, conducive of interdepartmental collaboration; it makes achievements measurable and encourages greater efficiency and reform sustainability.

Sunnyvale's Outcome Management: Taking Performance Budgeting One Step Further. Government Finance Review Journal, December 1996, p.13.

1

BUDGET TYPES

This Chapter is intended to clarify and present the line-item and program budgets most frequently found in practice, to convert Armenia's line-item budget to a program budget and performance budget, and to evaluate the situation in the field of local government budgeting in Armenia. Exploring the peculiarities of different budget types makes it possible to identify their strengths and weaknesses, and to implement more effective budgeting models.

An important aspect of the financial activity of local government is the choice of the budget type by which the budgeting process will be implemented. The choice of budget types used in local government is mainly dependent upon the possibilities and capacity present in a municipality. Each budget type has its advantages and disadvantages. Before choosing one budget type over another, it is necessary not only to compare their advantages and disadvantages, but also to evaluate the existing possibilities and resources. The fact that compiling an line-item budget is easier and can be done without having thorough information and highly-qualified experts is a temporary advantage, and such a budget is often used because it has to be used, and not because it is the preferred budget.

1.1 Line-Item Budget

Line-item budget is a financial document classified by expenditure types, which defines the amounts that will be or have been spent for each expenditure item. This type of budget mainly focuses on what was purchased or how much was spent on what. Expenditures are classified into groups, such as salaries, allocations, and purchased goods and services. Line-item budget is the simplest form of a budget. Such a budget provides some possibilities for controlling the funds, which is reflected only in control over the planned and actual amounts spent to procure goods and services.

Despite the simplicity of its compilation, line-item budget does not contain any information on any program, output, municipality service, or spending unit. The information on expenditures incurred in salaries, supplies, renovation, and improvement works does not tell much about the exact details of the work, the number of program beneficiaries, the total length of streets being cleaned, the number of children served by a kindergarten, the criteria by which such expenditures were prioritized, the beneficiaries of such expenditures, and so on. To answer these questions, it is

necessary to classify expenditures by programs and activities, or better, classify them by performance outputs.

In table 1 is an example that is a section from a municipality's line-item budget.

The compilation of an line-item budget is not as work-consuming. It mainly consists of the following stages:

- Development of budget priorities by the staff;
- Revision and refinement of priorities by municipality head;
- Open (rare) discussion of draft budget by municipality council; and
- Adoption of the budget.

Line-item budget does not provide an adequate linkage between the budgeting and the management of the LGBs' activities. Often, the amount specified in the budget for a given activity is fully spent, but the necessary results are not achieved, and the reasons for such failure are not addressed within the budgeting process.

Not exceeding the prescribed limits of expenditures is an expenditure management (or accounting) function, whereas complete or incomplete performance of required activities is a matter of LGB management.

1.2 Program Budget

Program budget provides a different approach to budgeting and submission. The focus is not on "purchases" made by the municipality, but rather, on the provided services. Under a program budget, funds are allocated by activity types and programs, with a description of the work volume or expected outputs in line with the goals adopted by the respective governmental body. For instance, a certain amount of money may be allocated for road renovation work. The street renovation program compiled to support the perform-

Table 1.

An Example – a Section – from a Municipality Line-item Budget

Group 04 EDUCATION AND SCIENCE
Sub-group 02 Pre-school education
Organization Kindergarten No. 2

Overheads

Code	Item	Amount (AMD thousand)
0010	Salaries and salary-like payments	1200
1600	Mandatory social insurance contributions	405
2100	Office supplies	35
3550	Electricity costs	90
3600	Rent for water and sewerage company services	51.4
3500	Heating costs	126
3000	Communication costs	18
5600	Costs of acquiring other services	38
2500	Food	2170
	Total	4133.4

ance of this work will specify the goals and the planned activities; parallel to this, the funding required to achieve the goal will be estimated and submitted. As justification, this budget contains details of the expenditure items, prioritizing the goals, rather than the means of achieving them.

A program budget combines financial and program information, the policy carried out by the LGB, and the expected outputs. This budget focuses the performance of municipality tasks, whereby revenues and expenditures are related to programs that match the established tasks, goals, and strategy.

Thus, a program budget confirms the linkage between activity and funds, where expenditure is attributed to what and how will be done, by whom, what will be purchased and how. Compiling such a budget requires more time and work than line-item budget. Clearly, without a comprehensive municipality data-

base, a complete understanding of municipality issues, strengths, weaknesses, opportunities, and threats, any LGB cannot compile a program budget. Consequently, program budgeting requires competent municipality staff that must have information on the whole municipality.

An important advantage of a program budget is the possibility and need to engage the municipality residents. When developing a municipality development strategy, public involvement makes the municipality budget more targeted and topical by focusing at resolving the issues faced by the community and improving service quality. Budget execution oversight by the municipality residents adds publicity and transparency to the budgeting process and increases budget expenditure effectiveness.

In table 2 is an example that is a section from a municipality program budget.

Table 2.

An Example – a Section – from a Municipality Program Budget.

Group 04	EDUCATION AND SCIENCE
----------	-----------------------

Description

- ❖ Organizes the work of pre-school facilities (kindergartens) and extra-school institutions (station of young technicians, children's creativity center, and the like) in the community.
- ❖ Develops and implements educational programs.
- ❖ Participates in the determination of the amount of funding allocated to education and establishes control over their purposeful and efficient use.
- ❖ Coordinates the activities aimed at developing national crafts and artistic creativity.
- ❖

Goals:

- ❖ To develop a behavior of social adaptability and co-existence among the children.
- ❖ To strengthen the link between theoretic knowledge and practical studies.

Objectives:

- ❖ To coordinate the work of ----- facilities operating in this sphere in the community, which have enrolled about ----- children.

Sub-group 02	Pre-school education
--------------	----------------------

Organization	Kindergarten No. 2
--------------	--------------------

Description

- ❖ Kindergarten design capacity - 100 children/places
- ❖ Actual engagement of kindergarten - 75 children
- ❖ Actual number of employees - 26 persons
- ❖ The kindergarten building has:
 - Local heating
 - Telephony
 -
- ❖

Objectives:

- ❖ To ensure 8-hour service for 75 children (3 groups) during 2005-2006
- ❖

Overheads

Code	Item	Amount (AMD thousand)
0010	Salaries and salary-like payments	1200
1600	Mandatory social insurance contributions	405
2100	Office supplies	35
3550	Electricity costs	90
3600	Rent for water and sewerage company services	51.4
3500	Heating costs	126
3000	Communication costs	18
5600	Costs of acquiring other services	38
2500	Food	2170
	Total	4133.4

1.3 Line-Item Budget Transition to Program and Performance Budget

Budgeting reform imply the performance of many activities, of which the most important is the application of modern optimized methods of budgeting. Program and Performance budgeting are such methods, which are being used by central government and local governments of many countries.

A program budget is an interim level between a line-item budget and a performance budget. To shift to performance budgeting, it is necessary to implement and establish program budgeting. The budget program is a crucial element of both program and performance budgets. A program budget focuses primarily on implementing the budget program as a whole, whereas a performance budget emphasizes each activity contemplated under the program, as well as the impact of the program on the community. Thus, successful implementation of performance budgeting largely depends on testing the program budget and learning lessons.

Program budget implementation lessons can be learnt from the experience of the City of Szolnok in Hungary and used in implementing a performance budget, as well. Szolnok has been using a program budget since 1995. Based on five years of experience, the city officials recommended some principles (see Box 2) to municipalities interested in implementing a program budget.

The transition from the line-item budget to a program budget and performance budget cannot be accomplished without major preparatory work. Such work includes the following:

- Readiness of [central and local] government bodies to shift to the new method of budgeting and to take decisions;
- Preparation of training materials and methodologies;
- Conducting training courses and seminars; and
- Practical support to staff involved with budgeting, etc.

During the transition from line-item to program budgeting and performance budgeting, several budgeting functions remain as elements of the new budgeting method, complemented by activities typical of and necessary under the program and performance budget. Such additional activities are performed during the stages of budget planning and approval, as well as budget execution and oversight.

1.4 An Overview of Budgeting in Local Government System of Armenia

After the adoption of the Republic of Armenia Constitution (on July 5, 1995) and the Law on Local Self-Government (in July, 1996), local elections took place in Armenia in November 1996, which resulted in the formation of local self- government bodies and a new system - local self-government - in the public administration system.

Among many other powers, the law vested in LGBs the right to have their own sources of funding and to manage such funds autonomously. With a view to effective, transparent, and public use of funds, management of municipality revenues and expenditures, alignment of cash flows, and other needs, LGBs have been given the possibility to form and execute municipality budgets in accordance with the procedure defined by law (i.e. the Republic of Armenia Law on the Budget System).

When compiling their first budgets, newly-created municipalities mainly lacked serious professional skills and awareness of municipality issues, which caused the Ministry of Finance and Economy of Armenia to issue budgeting instructions and expenditure standards for municipalities in 1997. The standards were consultative, i.e. they did not have to be used in municipality budgets; currently, they are rarely used in local budgeting. Parallel to this, the Ministry of Finance and Economy annually develops and publishes budgetary manuals to support consistent local government budgeting throughout the country.

Due to the lack of competence and sufficient budgeting experience, many LGBs mainly compile their annual budgets by expenditure items. Technically speaking, these are line-item budgets, which do not contain substantive information on works to be performed and services to be delivered. Though budget should be based on a three-year municipality development plan approved by the municipality council, the plan is often not compiled (especially in rural municipalities), or a superficial plan is drawn, and the budgeting of many municipalities has no specific linkage with the medium-term plans of the municipality and the expected outputs.

In order to strengthen the capacity of LGB financial officers and modernize the budgeting process, donors (ICMA, the Urban Institute, GTZ, and others) and local organizations have recently carried out a number of training courses and practical sessions aimed primarily at urban and district communities.

Box 2.

Lessons learned from the implementation of the program budgeting in the Szolnok city, Hungary

- *Program budgeting may be a difficult concept for people to grasp. To explain program budgeting, use examples that elected officials and professionals can understand.*
- *Budget reform can be a threat. It can demonstrate that specific activities are inefficient or ineffective posing a threat to program managers and others who have an interest in maintaining the status quo.*
- *Develop the municipal vision of what the reformed budget should look like. The budget document and data collection and reporting systems must respond to the municipality's informational "need to know". While the Szolnok budget, its forms and support systems work well for Szolnok, they may not be appropriate for another jurisdiction.*
- *The finance staff of the office of finance needs to devote time and energy to learning about the various budget reform methods and processes for bringing about reform. Staff skills must reflect the informational demands of program budgeting.*
- *The finance staff of the office of finance and municipal departments must work in partnership. Where implementation problems arise, the partners should resolve them jointly.*
- *Implementing reform takes significantly more time than imagined at the outset of the process. Develop a multiyear work plan that incorporates realistic expectations of what will be accomplished, and by when.*
- *Keep it simple. When initiating program budgeting, limit initial implementation efforts to departments that exhibit a strong management ethic and have expressed willingness to reform their budgetary practices.*
- *Generate reports that reflect departmental accomplishments under a program budget approach. Reports should identify both expenditures and accomplishments against predetermined performance measures.*
- *Involve the leadership-administrative and political-in the process from the very outset.*
- *Keep citizens informed on reform efforts through the media, public forums and neighborhood gatherings. Summarize the budget and budgetary issues in a clear, concise and transparent manner. Be available to respond to questions and concerns, and, importantly, actively seek citizen input on budget investment decisions and results.*

Source. Budget Reform in Szolnok, Hungary, a case study. Prepared by Philip Rosenberg. East European Regional Housing Sector Assistance Project 180 0034. May 1999.

Numerous rural communities compile their budgets in the form of an expenditure and revenue estimate, without major forecasts and programs. Often they are not doing tax revenue projections, however in the revenue side of the budget they often indicate the sum of accrued annual revenue from taxes (land tax and property tax), plus arrears and fines carried forward from previous years. The execution of revenue budgets compiled in this manner becomes practically impossible and, as a result, budgets are under-executed. If we take into account that municipality budgets are balanced, then the expenditure side of an inflated budget will contain items that either cannot be executed or cannot be fully executed. Municipality budgets that contain inflated expenditure items and are approved

by the municipal council create room for the municipality head to exercise discretion in the determination of expenditure priorities, which undermines municipal council involvement in the determination of municipality expenditure priorities.

The professionalism of the municipality's staff can be seriously harmed by a change of the municipality head as a result of elections, which will be followed by a change of municipality staff (the so-called "staff massacres"), which often lead to the firing of competent and experienced specialists. This occurrence is rather frequent in respect of financial unit staff, which has implications for the budgeting process, as it prevents the transfer of good traditions, know-how, and experience from one generation to the next. The law on

"Municipal Service" of RA (adopted on 14 December 2004) will have great importance and role in this issue but it will be required a long time for fully to carry a law into effect.

In the Republic of Armenia, there are numerous municipalities that do not have sufficient budgetary resources to perform serious work or provide services, and are spent predominantly on municipality staff maintenance. Such municipalities do not have positions designated for financial officers, and the budgeting process is steered by accountants, with budgets mainly being compiled either with the involvement (command) of or by the governor's office ("marzpetaran").

Parallel to this, in the sphere of budgeting some positive work has been done in the majority of urban and Yerevan's district municipalities. Though their budgets remain line-item budgets, they perform revenue projections, municipality situation assessment, some programming, public hearing of draft budgets, and other activities. Many of these municipalities have to some degree addressed the issues of recruiting qualified human resources, collecting and processing municipality information, ensuring transparency of the budgeting process, learning about best practices, automation, and the like.

Municipality budget-related fiscal functions are performed through the Treasury System of the Republic of Armenia. The Treasury is a structural component of the Ministry of Finance and Economy, which has units in the regions of Armenia and in Yerevan. The Treasury System operates as a Single Account through which reports are received and summarized, consistent financial policies carried out, and municipality cash flows and accounts served. This system

plays an important role in local budgeting; further improving it will considerably improve the timeliness and autonomy of municipality financial management, preventing improper interference with such management.

Thus, an overview of local government budgeting in Armenia leads to the conclusion that there is an acute need for reform and capacity strengthening in this sphere, for which implementation the larger municipalities have the required potential and preconditions.

Practical application of performance budgeting in communities depends to a great degree on the adoption of relevant legislation, the development of training manuals, and the introduction of continuous learning as ways of facilitating community capacity building. Performance budgeting cannot be implemented without skills to apply it. There is no doubt, however, that the future development of Armenia's local government system will depend on the implementation of this method of budgeting, among other conditions.

Conclusions

The choice of a local government budgeting model mainly depends on the requirements of legislation and the existence of municipality capacity. Armenia's local government system is currently using the simplest of budgeting models – line-item budgeting, which is a consequence of the aforementioned conditions not being met. Transition from line-item budgeting to program and performance budgeting is a challenge to the development of local government in Armenia.

2

ESSENCE OF PERFORMANCE BUDGET, BUDGETING PRINCIPLES, SCOPE AND CYCLE

This Chapter is devoted to defining and explaining performance budgeting, its advantages and limitations, the budgeting principles and successive steps, and the components and contents of the budget document.

2.1 Essence of Performance Budget

In the context of public administration, a budget is a financial plan of revenue generation and expenditure execution at any given tier of government for a certain period of time (normally, one year), which is aimed at accomplishing the objectives and performing the functions of government bodies at the given level. Both revenues and expenditures can be determined by different methods and formats. The choice of methods for determining budget revenues is important in terms of planning a realistic budget, but it does not play a significant role in the actual collection of revenues. The choice of a budget expenditure execution format, on the other hand, is extremely important in terms of effectiveness and outcomes. A performance budget has a unique format of expenditure planning and execution.

A performance budget is aimed towards the performance results of any given public entity (central government or municipality). It shows the results that will be achieved by carrying out the specified work or budget program, and the resources that are necessary to achieve the required strategic program outputs.

Definition: *A performance budget is a financial plan providing a statement of the municipality mission, goals, and objectives and a regular assessment of their performance as a part of the budgeting process, which creates linkage between the necessary inputs for the implementation of the municipality strategic development plan and anticipated outcomes.*

A performance budget provides the answers to the following questions:

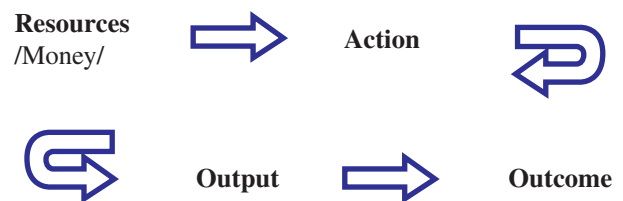
- What output will be achieved?
- What will be the impact on society?
- What will be the impact on consumers?
- How much money will be spent to deliver a service for a given purpose?

A performance budget includes the annual [budgetary] plan of implementing the municipality's strategic

plan and an annual budget, which reflect the relationship between program funding and expected outputs. It emphasizes the goal or the group of goals that must be achieved with a given amount of expenditures, and creates a link between the money spent and the outputs. It also indicates the way in which the relationship emerges. It is a key precondition for the effective implementation of the strategic plan.

A performance budget envisages all the activities required to accomplish the budget project, including both direct and indirect inputs, and underlines the expenditures necessary to accomplish each activity. It can be illustrated in the following manner:

To manage their resources effectively, project managers must have timely and accurate information on



expenditures and performance. To meet this condition, it will be important to clearly specify who is responsible for performing what action and to set performance indicators.

A performance budget is an effective tool for ensuring accountability. It is a simple and clear indication of the resources spent to achieve any given output (or to provide any given service). This type of budget is comprehensible for municipality council members and the public at large.

Performance budgeting takes place as a simultaneous top-down and bottom-up process. At the local level, the municipality head and council must define the municipality strategic development goals and objectives and the resources necessary to achieve them, and define the indicators and criteria that will allow determining whether the goals were achieved and the resources spent efficiently. All of this must be done with the direct involvement of all the layers of munic-

ipality staff and the leadership (responsible people) of municipality organizations, as well as the municipality residents and active groups. These leaders have a better understanding of the situation in their respective sectors and can prepare a rather realistic annual plan of performance. As a result of such close cooperation between the local government bodies and the municipality staff and organizations, leaders at all levels will not only understand the direct connection between the annual plan and the performance budget, but also condition their successful implementation.

Advantages of Performance Budgeting

Performance budgeting has several advantages over line-item budgeting, which allow considerably improving the performance of municipality subdivisions and organizations and increasing the effectiveness of budgeting and its impact on community life.

Performance budgeting means a new quality and level of management. It is a permanent process that engages all levels of leadership of the municipality staff and organizations subordinate to the municipality. Such management becomes a feedback circle, which allows the leadership (responsible officials) of all levels to possess up-to-date information needed for the entire work process. A performance budget requires more efficient use of resources by municipality units and subordinate organizations. The municipality leadership must make more rational use of resources in order to achieve the outputs envisaged in the budget.

Performance budgeting is a valuable tool for building an integral linkage between inputs and outputs. Heads of units and programs gain direct access to the complicated interface between inputs and outputs and to develop their own "rules of the game" to regulate this interface. In general, it improves project management and implementation effectiveness, provides possibilities for better evaluating project action outputs, and generates more information on the quality of services rendered to the public.

Performance budgeting ensures great transparency of budget project actions and execution. By applying standards of well-defined actions and comprehensively estimated expenditures as the basis for the implementation of the project output and goals, a performance budget is a valuable tool for estimating how changes in expenditure influence outputs. This is a key condition for budget justification and provision of transparency.

Because standard procedures and methods of calculating expenditures are well understood and accepted, the projected budget has greater acceptance. Additionally, because outputs are clearly defined and reported, citizens can better understand what has been accomplished with the money spent. Not only is this a key condition for justifying the budget, but also increases the transparency of budget execution so that all interested parties can follow input of funds and outputs and outcomes from the expenditures.

Performance budgeting builds an effective mechanism of oversight. The municipality head and council can easily monitor the accomplishment of predefined goals, objectives, and actions, as well as the expenditures designated for them. Setting and estimating expenditures for the performance of each activity and its issue focus make the oversight easier and more effective.

A performance budget contains useful benchmarking data. It is based on the unit cost (for instance, the cost per student) of the delivered service. When some municipalities manage to lower the unit cost, it can become a best practice and "infect" the other municipalities, as well. Besides, project managers can use benchmarking data in order to improve the effectiveness and quality of their actions.

A performance budget implies the elaboration of a multi-year budget. A multi-year (mainly medium-term) budget clarifies the framework that is needed to effectively manage community revenues and expenditures, and facilitates the achievement of strategic goals of community development.

Performance budgeting allows taking more justified and impartial decisions on service delivery. Under performance budgeting, the heads of municipality staff units must know about the necessary expenditures for each activity, as well as the current situation.

Table 3 provides a comparison of the main characteristics of line-item, program, and performance budgets. There are many similarities between a performance budget and a program budget. The main difference between them is that program budgeting emphasizes the program-expenditure linkage, while program and financial reports are not tightly linked, whereas performance budgeting focuses on the program-actions-expenditure linkage with an emphasis on performance efficiency and effectiveness, and program and financial reports are closely linked. Municipalities often use a mixed type of budgeting, where they combine program and performance budgeting elements.

Table 3.

Characteristics of Line-item, Program, and Performance Budgets

	Line-item Budget	Program Budget	Performance Budget
Budget Format:			
<i>Question:</i> What can we do? What should we do during the next fiscal year?	<i>Answer:</i> The funds will be spent on staff, purchasing some goods, subsidies, and the like.	<i>Answer:</i> The money will be spent to implement certain programs.	<i>Answer:</i> The money will be spent to provide services in accordance with certain results and efficiency.
Budget Planning			
<i>Question:</i> How is the budget planned?	<i>Answer:</i> Mainly by the incremental method ² .	<i>Answer:</i> Mainly by the zero-based method ³ .	<i>Answer:</i> Mainly by the zero-based method.
Accounting			
<i>Question:</i> How is the budget executed?	<i>Answer:</i> The money is spent by expenditure items.	<i>Answer:</i> The expenditures are made by programs.	<i>Answer:</i> The expenditures are made by programs and performance results.
Audit			
<i>Question:</i> What have we done? How did we do it in the past?	<i>Answer:</i> The money was spent in accordance to the legislation.	<i>Answer:</i> The money was spent in accordance to the legislation, by programs.	<i>Answer:</i> The money was spent in accordance to the legislation, with some economy, as well as efficiency and effectiveness.
Accountability			
<i>Question:</i> What reports are being prepared?	<i>Answer:</i> Financial report.	<i>Answer:</i> Financial and program implementation reports are prepared separately.	<i>Answer:</i> Financial and program (performance) reports are prepared in combination.

Limitations of Performance Budgeting

When reporting the advantages of performance budgeting, it would be appropriate to mention some of its limitations, as well. These limitations, however, are mainly typical of all types of budgets.

Performance budgeting does not solve the problem of scarcity of funds. Performance budgeting concerns the expenditure side of the budget. It is not aimed at increasing revenues or, moreover, introducing new types of revenues. Though the increased efficiency of

2 Previous year's performance with some increases (decreases) is the bases for the budget planning by the incremental method.

3 Zero level of expenditures are the bases for the budget planning by the zero-based method. Each project is examined in order to justify its existence, and is compared to alternative projects.

budget expenditures can generate some economy of funds, it cannot be sustainable.

Performance budgeting cannot rid the budgeting process of politics. The budget is a political document. The types of services delivered by municipalities are mainly defined by law, but to a certain degree and scale, their financing decisions are taken by local elected officials. To one degree or another, such decisions reflect the needs of municipality residents and are adopted as a result of a political process.

Performance budgeting cannot reduce the impact of interest groups. Interest groups have different levels of strength and impact on the political process, but they all have one goal, which is to derive benefits for their members. If strong interest groups are present in a municipality, then the elected officials of the municipality cannot but reconcile with their demands.

Performance budgeting requires the existence of comprehensive information. Performance budgeting requires extensive information on the municipality, including data collection and analysis, planning, setting criteria and indicators, database creation and updating, and the like. They are rather labor-intensive and difficult activities, and difficulties may arise during their performance.

Performance budgeting does not solve the issue regarding the absence of a direct link between the performance and the outputs. For many of the municipality works and services, the expected outputs are rather obvious (for instance, improvement of streets, cleaning sanitation, garbage removal, current repairs, capital construction, and the like). However, there is some work (for instance, legal, economic, managerial, and the like) the direct results of which are difficult to define, because they are not measurable.

2.2 Principles of Performance Budgeting

The principles of performance budgeting are basic theoretical principles underlying the budgeting mechanisms. They reflect budgeting patterns and the links between budget elements. To this end, the way in which principles are reflected in legal acts is very important. The principles prescribed in legal acts provide specificity and stability to the budget relationship and guarantee their implementation and sustainability.

It is necessary to bear in mind that in real life, principles are only possibilities. To turn them into reality, active, targeted, and structured activities are necessary, alongside with the creation of effective mechanisms.

The following are the main principles of performance budgeting:⁴

1. **Strategic planning:** performance budgeting must be based on a strategy that describes the reallocation of resources.
2. **Accountability:** preparing an annual report is a necessary precondition of performance budgeting; the annual report must contain information on results achieved (i.e. impact on society) and inputs made (clear and direct achievements in terms of organization).
3. **Continuity:** strategic planning lays the groundwork for the continuity of budgeting. Resource allocation is aimed at the realization of future intentions (plans), determined by past and present activities.
4. **Clear definition of objectives` performance priorities:** performance budgeting requires all priorities to be aligned by priority, which will allow avoiding difficult choices.
5. **Consistency and correspondence:** projects are the main units of performance budget analysis. Projects must be compiled in accordance with the organization structure.
6. **Clear redistribution of powers:** budgeting powers must be clearly redistributed between the organization head, financial unit head, and heads of other units in such a way as to place the main burden on unit (project) heads.
7. **Measurability:** performance budgeting must make it possible to measure the economy, effectiveness, and efficiency of infrastructure development and service delivery.

There are some similarities between the aforementioned principles and the community budgeting principles enshrined in the legislation of Armenia (see Box 3). For instance, the Armenian law defines the principles of budgeting on the basis of the triennial municipality development plan, economy, efficiency, and transparency, which are all principles of performance budgeting. However, these principles have not become a part of practical arrangements, and Armenia is in effect using a model of expenditure budgeting.

4 See also McGill, R. (2001). Performance Budgeting. International Journal of Public Sector Management, p. 387-388.

Box 3.

Republic of Armenia Law on Budgetary System of the Republic of Armenia (adopted on June 24, 1997, amended on April 11, 2003) on the principles of municipality budgeting

The following are the main principles of municipality budgeting:

- a) Planning of funds necessary to address issues affecting the municipality on the basis of the three-year community development plan adopted by the municipality council upon submission of the mayor;*
- b) Creation of a reserve fund to safeguard the financing of expenditures not foreseen by the community budget for the current year and to finance loan interest and capital expenditures;*
- c) Balancing the municipality budget, i.e. the sum of expenditure accruals and debits under each item of the current year's municipality budget, as prescribed in Article 28 of this Law, shall not exceed the sum of revenue accruals and credits under the respective items of the current year's municipality budget;*
- d) Economy, i.e. the expenditure made shall correspond to the procurement of tangible and intangible assets of proportionate value;*
- e) Efficiency, i.e. an adequate relationship between expenditures made and their usefulness for the community;*
- f) Credibility and clarity, which ensure effective oversight of budget execution and the budgeting process through clear calculations underlying the various items of the budget; and*
- g) Transparency to make sure that community members are aware of the municipality budget formation and execution.*

Adopting the aforementioned principles of performance budgeting leads to four main conclusions that, taken together with political support, management responsibility, and capacity building, make up the main technical prerequisites of performance budgeting:

1. A 3-5 year strategic plan must be elaborated (based on the local experience), which should address annual sub-issues.
2. The budgeting should cover input analysis for each sub-issue.
3. Successive classification of sub-issue expenditures must be prescribed in an approved system of codes.
4. Performance must be assessed annually (outputs) and in terms of strategy (outcome), for instance, once every three years, which will result in a new strategic plan.

2.3 Performance Budgeting Cycle

Performance budgeting is a process that implies the taking of certain successive steps. They provide a comprehensive understanding of budgeting and con-

sistent implementation and oversight of the budgeting process.

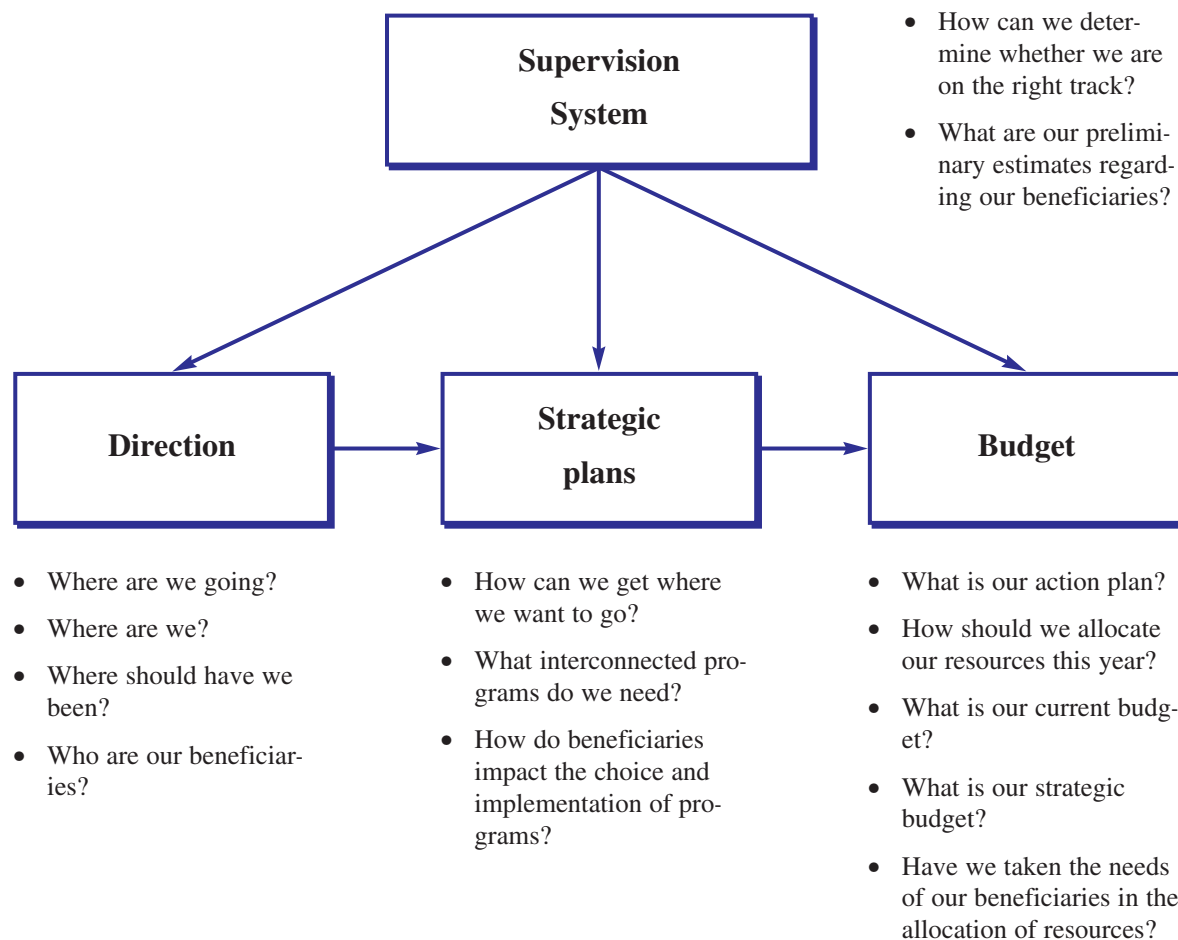
Performance budgeting is directly linked with municipality strategic planning and management and makes up a part of it.

Strategic planning is the compilation of a municipality strategic plan. *A strategic plan is a long-term vision of the municipality's future and contains the outcome that local government bodies aspire to reach.* The plan analyzes the municipality capacity and internal and external environments and reflects the impact on beneficiaries and the criteria for meeting public needs. A strategic plan is used in resource allocation decision-making and budgeting.

The municipality development plan becomes more specific in the form of future action plans during the budgeting process. At this time, priorities are determined, which are placed in the budget. Performance budgeting is a process that supports the municipality's long-term goals, which might be ignored during the course of budgeting due to the adoption of many important and secondary decisions.

Strategic planning ensures oversight of the municipality's staff and makes the staff accountable for its performance. For local government representatives that

Figure 1.
Strategic Management (Lorange)⁵



need to report their success and undertake measures to eliminate failures, strategic planning can ensure wide public support. Through strategic planning, governance establishes a linkage between the budget and higher-level strategy planning. By this, the budget becomes the main tool for achieving the strategic goals.

Strategic planning is an integral component of strategic management. Through strategic management (Figure 1), it is possible to make regular adjustments to the municipality development direction, programs, and budget, by linking them with each other more clearly.

Any model of strategic management must reflect certain issues, including the following issues that are important in terms of performance budgeting:

- What is the municipality mission or direction of activities (strategic direction)?
- What ways or strategies, i.e. goals and objectives, will help achieve this mission (strategic planning)?
- What resource allocation or budget must be developed in order to carry out the strategies (budgeting)?
- How can we be sure that strategies are carried out as designed or are monitored (monitoring)?
- What are the systems and structures that are necessary to carry out strategies (systems and structures)?

Thus, performance budgeting is an integral component of strategic management and planning. Figure 2

5 Freeman R. Edward 1984. Strategic Management. USA. Pitman Publishing Inc. p. 69.

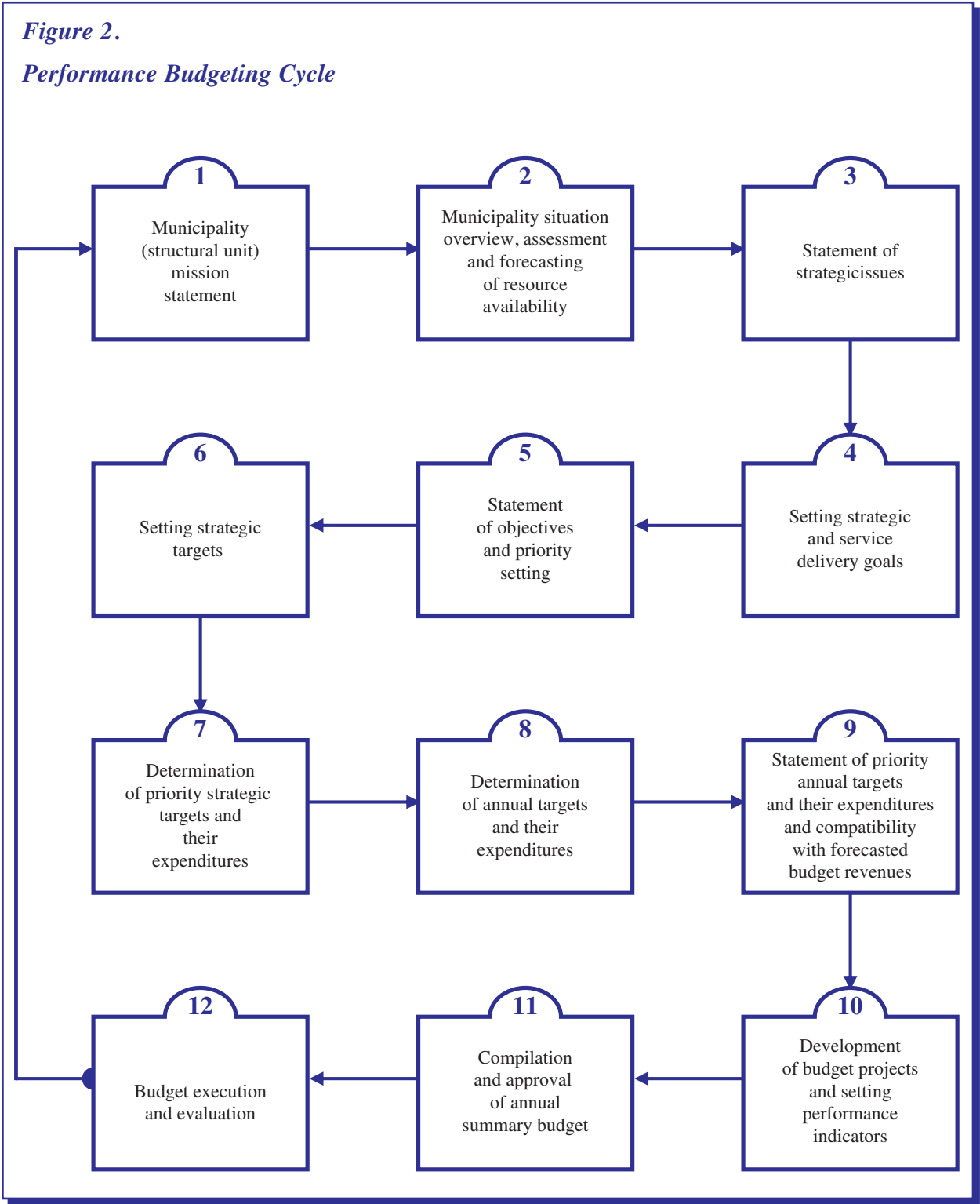
shows the sequence of budgeting steps, which will be addressed in greater detail below.

2.4 Budget Document

In general, local government activities can be summarized in policy, planning, and budgeting cycles.

Through an annual plan and a budget, policies are transformed to infrastructure operation and service delivery. LGB activities are annually reflected in a budget document, which, if compiled in the form of a performance budget, will contain the message of the municipality head, the municipality development plan, and the budget.

The budget document normally starts with the message of the municipality head. It enables the munic-



Box 4.

Republic of Armenia Law on Budgetary System (adopted on June 24, 1997, amended on April 11, 2003) regarding the municipality budgetary document (paragraphs 6, 7, and 8 of Article 31)

The municipality head shall draft the municipality budget, which shall be composed of the budgetary message of the municipality head and the draft decision of the municipality council on the municipality budget.

The municipality head's budgetary message shall include:

- 1) The municipality head's report on the main directions of development of the annual municipality budget;*
- 2) Justification of the municipality budget revenues and expenditures and of the deficit or surplus, as well as a comparative analysis of these indicators with the previous year's actual budget execution and the current budgetary year's approved and estimated targets;*
- 3) Justification of the amounts required and allocations proposed for the execution of municipality budget-financed specific programs, which shall include the following information regarding each program:*
 - The legal basis;*
 - The substance;*
 - Goals and objectives; and*
 - Execution stages and timing;*
- 4) Debt structure and comparative analysis of debt with previous year's actual budget and current year's estimated budgetary indicators;*
- 5) Justification of the allocations proposed for the reserve of the administrative components and funds of the budget;*
- 6) Information on allocations for the municipality budget, which are included in the draft stage budget (if the draft council decision on the municipality budget is submitted to the council for discussion prior to the adoption of the law on the forthcoming year's budget) or in the approved law on the state budget;*
- 7) Justification of the allocations financed from cash and financial assistance, grants, and other revenue projected during the next fiscal year;*
- 8) Information on the average annual payroll number of positions in budgetary institutions financed from the municipality budget, as well as on the salary fund of such institutions, and comparative analysis of such indicators with the estimated figures for the previous and current fiscal years, and information on the average annual payroll number of actual employees (positions occupied); and*
- 9) Other information that the community head deems necessary for justifying the draft decision of the council on the municipality budget.*

The draft council decision on the municipality budget shall include:

- 1) The community budget revenues and expenditures by budget components in accordance with the classification defined by law (with the exception of the territorial classification of budgetary expenditures);*
- 2) The community budget deficit or surplus, and the deficit financing sources or surplus use purposes in accordance with the classification defined by law; and*
- 3) Other provisions and indicators that the community head and council deem necessary to ensure community budget execution and oversight.*

pality head to present and clarify the various aspects of municipality management, where not all the directions are directly reflected in the current year's budget.

The following structure of a budget message is recommended:

- Main directions of policy reflected in the proposed budget;

- Changes in public services and their delivery, by municipality units (delivery of new services, cost economy of services, etc.);
- Budget revenue collection and expenditure execution trends and reasons for any change;
- General overview of the previous year's activities and interpretation of the budget;
- Situation in the municipality, including the financial situation compared to the previous year;
- Main directions of municipality strategic plan and how they are reflected in the proposed budget.

The budget message is normally structured in the form of narration and explanation, aimed at the municipality council and residents. It should be written in a clear and comprehensive manner.

The analytical part of the budget document is next, including municipality development planning and the performance budget. These parts should address the following questions:

- 3-year scope of strategic plan;
- Previous year's performance (budget revenues and expenditures, projects, and outputs);
- Progress during the current year;
- Action plan for the next year; and necessary resources
- Financial resources necessary for the next year according to the performance budget.

To perform the analysis and to make the draft budget comprehensible, it is necessary to use comparative tables, figures, charts, and the like.

The budget document is an element of strategic management; if its cycle works properly, then it should cover a three-year period, including the previous year, progress during the current year, and recommended activities for the next year. They are viewed together at the beginning of each annual cycle. Thus, the expected outcome of a budget document is an accountable, measurable, and community-supported planning and budgeting process aimed at improving infrastructure operation and service delivery.

Conclusions

A performance budget is an important tool for improving municipality policy implementation and service delivery economy, efficiency, and quality. This budgeting method is based on strategic management and planning, which allows carrying out the municipality mission in a structured and appropriate way, overcoming the challenges faced by the community, and solving problems.

The budget program is an important component of performance budgeting. The budget contemplates all the [direct and indirect] activities associated with budget program execution, and emphasizes the expenses necessary to carry out each activity. It creates a direct link between the program objectives, the resources necessary to achieve them, and the expected outputs.

Mission, goals, objectives, expenditures, and outputs are the successive steps that bring the current budgeting process to a logical conclusion in the context of community strategic development.

3

MUNICIPALITY STAFF STRUCTURE AND GENERAL SITUATION OVERVIEW AS BASELINE FOR PERFORMANCE BUDGETING

This Chapter covers the necessity and importance of analyzing the structure of municipality units and the overall situation in the municipality in the context of performance budgeting, as well as their impact on budgeting.

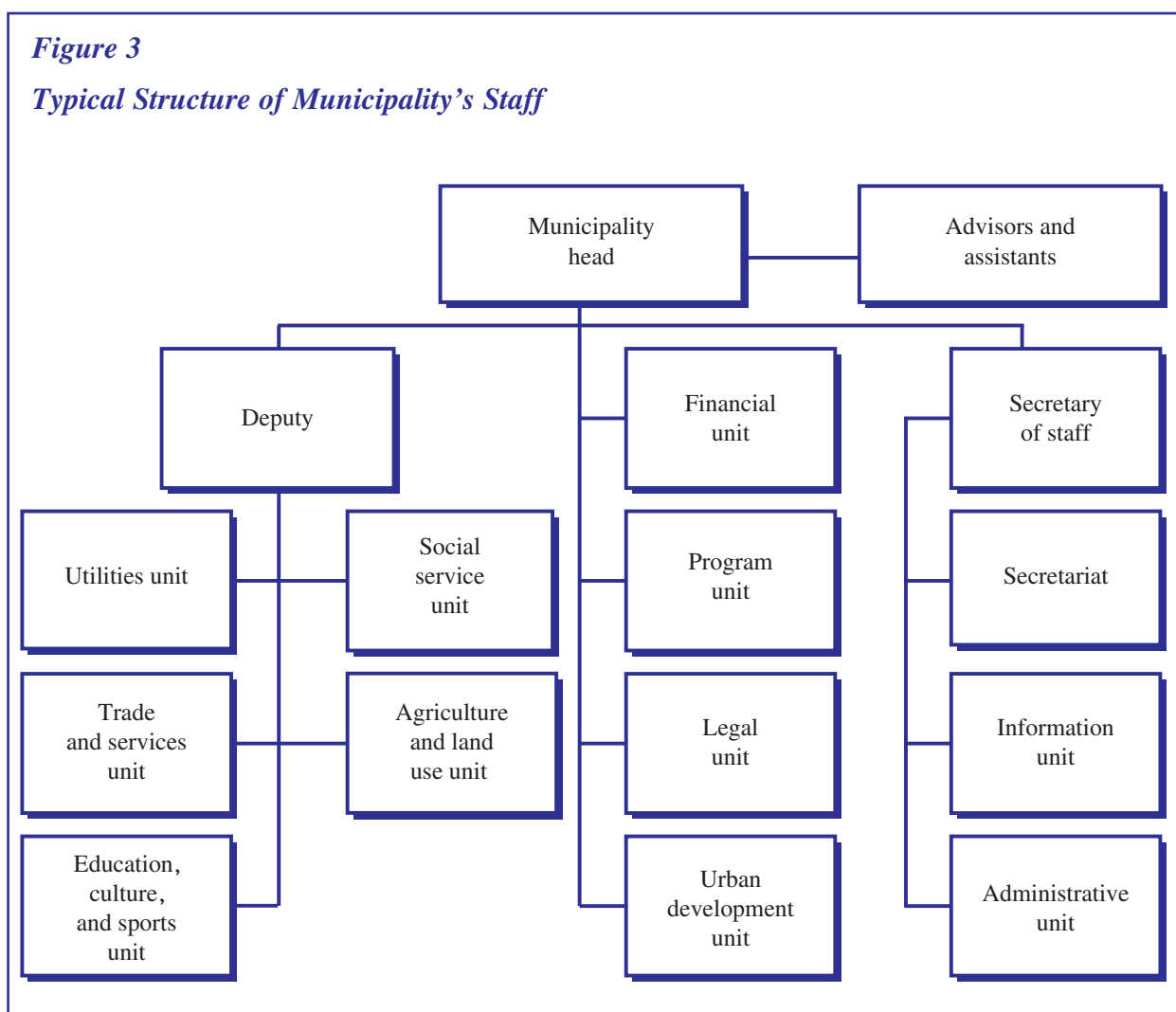
3.1 Municipality Staff Units, Their Functions, Activities, and Goals

The Municipality staff and its structure are essential to the performance of municipality functions. Each year, prior to approving the draft budget, the municipality head shall submit to the municipality council for approval the municipality staff structure, which shall become effective upon approval by the council. The municipality staff structure and number of staff positions shall be set independently by each local government, but there are some staff positions that must be

present (such as the deputy municipality head, the chief of staff, and the like), and some the existence of which is determined by the central administration body (i.e. positions necessary to ensure the performance of functions delegated to local government by the central government).

Municipality staff units are formed on the basis of the need to render public services, regulate the activities of structures rendering such services, and serving the staff. Municipality staff units are designed to ensure the normal functioning of local government bodies. The community staff structure and activities of com-

Figure 3
Typical Structure of Municipality's Staff



munity units are defined in accordance with the local government powers enshrined in the Armenian legislation (Figure 3, Box 5). Although the legislation gives communities some freedom in forming their structure, the scope of local government functions somewhat limits this freedom. The community staff unit functions, goals, objectives, and staffing lists are defined in accordance with local government functions. It is necessary to establish a strict link between the structural unit staff number and the number and volume of functions, i.e. the workload. Otherwise, redundant jobs will be created in the staff, which will have a negative impact on performance and service delivery efficiency and quality.

In these types of municipalities (with this population, development priorities, and the like), the staff structure, without few differences, is mainly the same, which is a result of prescribing the same functions for LGBs by force of law.

The municipality staff and its units mainly have functions of management, implementation, regulation, supervision, and service. Each unit of municipality staff and each staff position within each unit shall carry out its functions in accordance with the Republic of Armenia Law on Municipal Service and the By-Laws approved by the respective LGB.

3.2 Baseline Data on Municipality and Situation Analysis

Comprehensive information on the municipality and the situation analysis based on that information is essential to the realistic planning and purposeful administration of LGB activities. This is a part of the second step of the performance budgeting cycle (see Figure 2). Municipality information can be conditionally divided into **internal and external information**.

Box 5.

Typical Structure of One Municipality Staff Unit and Example of Activities

Education Unit

- *Description of Activities and Functions*
- *Organizes the work of pre-school facilities (kindergartens) and extra-school institutions (station of young technicians, children’s creativity center, and the like) in the community.*
- *Develops and implements educational programs.*
- *Participates in the determination of the amount of funding allocated to education and establishes control over their purposeful and efficient use.*
- *Coordinates the activities aimed at developing national crafts and artistic creativity.*

Goals

- *To improve the quality and accessibility of pre-school and extra-school education services in the community.*
- *To develop a behavior of social adaptability and co-existence among the children.*
- *To strengthen the link between theoretic knowledge and practical studies.*

Staff

- *Unit head* - 1 position
- *Chief Specialist (Deputy Unit Head)* - 1 position
- *Leading Specialist* - 1 position
- *First Category Specialist* - 1 position
- *Junior Specialist* - 2 positions

Total - 6 positions

Internal information is what concerns the LGB, its capacity, ownership, assets, duties, and the like.

External information is what concerns the municipality and includes diverse information on the settlement/s, population, social, economic, education, culture, and other sectors and situations. The existence of a reliable database increases management efficiency and helps anticipate community development obstacles and devise solutions.

By its nature, municipality information can be **digital** and **descriptive**, as well as **financial** and **non-financial**.

Non-financial information on the municipality can be best characterized with the following classification:

- Historical information;
- Local government bodies;
- Health care;
- Construction and land use;
- Agriculture;
- Utility services;
- Leisure zones and parks;
- Demography;
- Culture and education;
- Physical education and sports;
- Public order;
- Environmental protection;
- Roads and transportation;
- Infrastructures and the like.

Municipality financial information is very diverse and includes, among other things, the following:

- Per capita budget revenue;
- Share of own revenues in total revenues;
- Share of official transfers in total revenues;
- Share of shared revenues in total revenues;
- Ratio of actual and planned revenues total and by types of revenues;
- Share of arrears in total revenues;
- Collected tax revenues by types of taxes;
- Share of arrears by types of taxes;
- Service payment cost-recovery;
- Collection of non-tax revenues by types of revenues;
- Total per capita expenditures;
- Ratio of actual and planned expenditures total and by types of expenditures;
- Share of capital and current expenditures in total expenditures;

- Debts and debt service;
- Profits or losses of municipality enterprises; and
- Expenditures financed by other investors, etc.

A municipality database is compiled using several years' data, which is especially important in terms of being able to dynamically study and analyze information (year to year change). The situation overview reveals the municipality strengths, weaknesses, opportunities, and threats.

To achieve the strategic (long-term) development goals of the municipality, the situation analysis and assessment reveal obstacles and define work/program performance priorities.

Under performance budgeting, a robust and reliable municipality database is essential, because it not only supports municipality budget planning, but also allows comparing the current year's budget performance with the previous year's performance.

3.3 Municipality Staff Structure and Capacity Impact on Performance Budgeting

The main unit of performance budgeting is the municipality structural unit. The budget is planned in accordance with the structure of the municipality staff, and the heads of units are responsible for the execution of the respective parts of the budget. It means that budgeting is no longer perceived as execution of a financial plan; instead, a greater emphasis is placed on the effective delivery of public services and the achievement of the goals of the "municipality" as an organization. The activities of municipality structural units are aimed at achieving the outputs specified in the budget, with a great focus on the economical and efficient use of funds. It is ensured by means of providing some budgeting autonomy to municipal structural units and prescribing responsibility for the performance of programs and activities.

The functions of municipality staff structural units are divided based on the powers of the municipality head in different sectors. In many municipalities, as a rule, the functions of one structural unit cover more than one sector. The number of sectors covered by one sector is especially large in small municipalities. In very small municipalities, it is even difficult to differentiate between structural units. The budget projects of structural units are prepared by sectors. The head of the unit is responsible for the budget projects. In large municipalities, one unit may have many projects. In

such a case, a complicated and extensive project may be led by a staff member, rather than the unit head. He should be fully responsible for the implementation of the project. Thus, the municipality staff structure determines the overall budget structure, which has relatively autonomous elements such as staff unit budgets, with their respective projects.

Performance budgeting is a complicated and labor-intensive process, and without appropriate municipality staff capacity, it cannot be accomplished. Capacities are usually divided into two categories: institutional and individual (managerial). *Institutional capacity* focuses on institutions, procedures, and management systems, which ensure the normal functioning of the municipality. It includes the formation and consolidation of labor, material, and financial resources and their conversion to goods or services. *Individual capacity* includes the skills of LGB members, municipality staff managers, and officials, which they exercise in the performance of their functions. From the standpoint of municipality budgeting, policy management, resource management, and project management are considered especially important elements of capacity.

Policy management includes municipality strategic development planning, goal and objective setting, provision of labor and financial resources for the municipality, policy implementation, and performance assessment.

Resource management includes the management of financial resources set aside for information, staff, and the strategic plan.

Project management by its nature is similar to policy management, but it takes place at the level of the municipality budgetary unit (division or municipality-subordinate organization), which is actually responsible for policy implementation.

Alongside with other management skills, municipality staff leaders must have skills of financial management and decision-making in this sphere. The existence of management skills determines the implementation of adopted policies, the achievement of designated outputs, and effectiveness and efficiency.

Performance budgeting facilitates capacity strengthening and development. In the course of budget execution, LGB members and municipality staff leaders encounter new issues, gain experience in addressing such issues, skills to respond to change, and undertake to acquire new knowledge and maximize outputs.

A performance budget can be compiled by one or several highly-qualified specialists of the municipality. However, budget compilation is only one stage of the budgeting process. The more difficult stages are execution and assessment, which cover the whole staff of the municipality and its subordinate organizations. If they do not have the necessary skills, then the budgeting process will fail completely. Thus, the existence of appropriate skills among municipality staff is the key to successful performance budgeting.

Conclusions

Building an optimal municipality staff structure, clearly defining and separating unit functions, and determining the appropriate level of staffing are important conditions of performance budgeting. The municipality staff structural unit is the main unit of performance budgeting.

The situation may be analyzed, issues revealed, and solutions sought only on the basis of complete and accurate information on the municipality. This budgeting method is sophisticated and demanding, and requires strong capacity.

4

BUDGETING PROCESS PHASES AND PARTICIPANTS

This Chapter provides a brief overview of the budgeting process phase, the budgeting process actors within and outside the municipality, and their roles in the different phases of budgeting. The relevant charts better illustrate the presentation of these matters.

4.1 Budgeting Process Phases

The budgeting process can be conditionally divided into the following three main phases:

- Budget planning;
- Budget execution and control; and
- Budget audit and evaluation.

The **budget planning** phase activities begin in the second quarter of the year preceding the planned year and end with the approval of the budget.

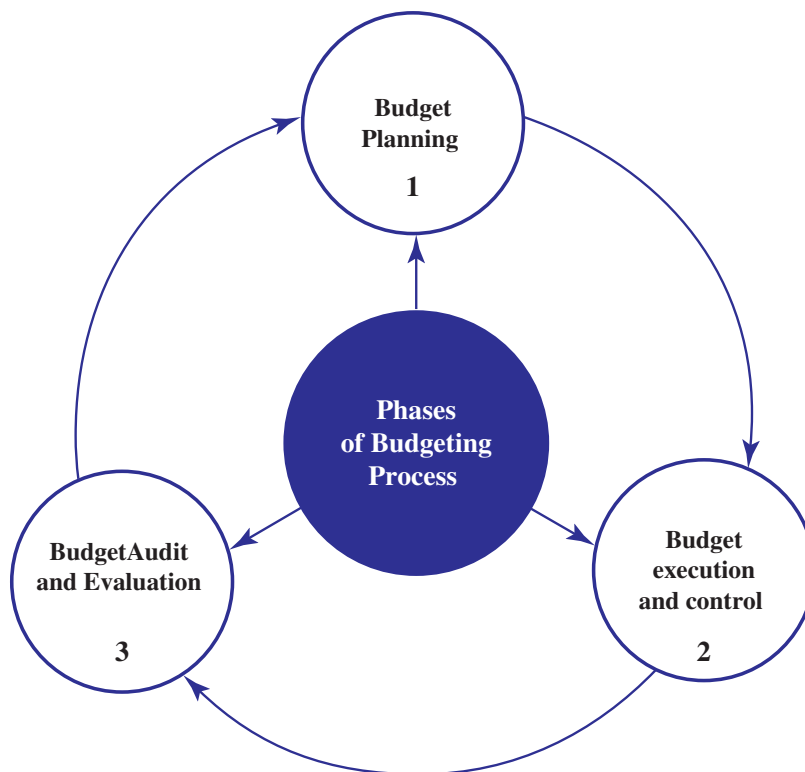
To structure and coordinate the activities of this stage, it is necessary to put together a budgetary calendar,

which is approved by a decision of the municipality head. Table 4 presents an example of a budgetary calendar, which takes into account the requirements of the Armenian legislation.

In preparing a municipality budget calendar, it is necessary to take into account the state budget drafting timetable, because the Law establishes some linkage between these two levels of budgets. The Armenian state budget planning timetable is approved by a decision of the Prime Minister. Box 6 contains a section of the local government part of the 2006 state budget drafting timetable.

The Republic of Armenia Medium-Term Expenditure Framework (which is a three-year document) contains

Figure 4.
Budgeting Cycle



information on the provision of subsidies to the municipalities by the state. The Framework creates an opportunity for medium-term budgeting at the local government level.

The budget execution and control phase timing matches with the timing of the whole budgeting process. The budget execution process lasts 12 months, the beginning and end of which fully coincides with the fiscal year (January 1 to December 31), whereas the budget control takes place during budget execution, as well as planning and audit, and evaluation.

The budget audit and evaluation phase starts on the day that immediately follows the end of the fiscal year. According to law, the annual budget execution

report must be submitted to the municipality council by the municipality head no later than prior to March 1 of the year following the fiscal year, and the council must approve it no later than before March 20 of the year following the fiscal year.

A detailed overview of each phase of the budgeting process can be found in Chapters V to VII.

4.2 Budgeting Process Participants

The municipality budgeting process participants can be conditionally divided into two groups of municipality and extra-municipality participants (Figure 5).

Box 6.

Section from 2006 Republic of Armenia State Budget Drafting Timetable

To be carried out by	Activity to be carried out	Entities receiving documents	Deadline
Republic of Armenia Ministry of Finance and Economy	Draft and make available methodological guidelines and instructions for the compilation and presentation of funding requests from the state budget and for the drafting of municipality budgets in 2006	Local government bodies, through territorial administration bodies	June 7, 2005
Republic of Armenia Ministry of Environmental Protection; Republic of Armenia Ministry of Health	Municipalities to notify about their positions on the breakdown of funding and priority activities contemplated under the programs presented to the Ministry of Environmental Protection and the Ministry of Health	Municipalities of Armenia	July 16, 2005
Republic of Armenia territorial administration bodies	Present funding requests for subsidies from the 2006 state budget to municipalities within the respective region (or the City of Yerevan)	Republic of Armenia Ministry of Finance and Economy	August 1, 2005
Republic of Armenia Ministry of Finance and Economy	Provide preliminary information on the amounts of allocations to be made to municipalities from the 2006 state budget	Local government bodies, through territorial administration bodies	October 5, 2005

Table 4.**Example of Municipality Budgetary Calendar**

Deadline	Activity	To be carried out by
June 7	Define municipality policy and fiscal policy priorities for the fiscal year	Municipality head and council
June 7-25	Distribute methodological guidelines and revenue and expenditure calculation forms to municipality units, budgetary institutions, and enterprises with the aim of drafting the municipality budget and preparing requests for funding from the state budget	Financial division, Program division
June 26-July 16	Projecting municipality budget revenues	Financial division
July 16-August 1	Presenting to the Ministry of Finance and Economy funding requests for subsidies from the Republic of Armenia state budget	Program division
July 16-August 15	Units, budgetary institutions, municipality enterprises, and organizations present expenditure requests, projects, and justifications	Divisions, budgetary institutions, municipality enterprises and organizations
August 16-30	Preliminary discussion of requests and projects presented with the involvement of the presenters	Municipality head, Financial division, Program division
September 1-27	Prepare a preliminary draft budget	Financial division
September 28-October 3	Discuss the preliminary draft budget	Municipality head
October 4-10	Make amendments proposed to the preliminary draft budget as a result of the discussions	Financial division
October 11-25	Make a change to the budgetary allocations, taking into account the approved amount of allocations from the state budget to the municipality budget	Financial division
October 26-27	Preliminary discussion of the final draft budget	Financial division
October 28-29	Final discussion of the final draft budget	Municipality head
October 30-November 4	Draft community council decision on the municipality budget	Municipality head, Financial division
November 05-10	Public discussion of the draft budget	Municipality head
November 10-15	Make final adjustments and changes in the draft budget	Financial division
November 15-16	Present draft budget to municipality council members	Municipality head
November 20-December 5	Budget discussion and approval by the municipality council	Municipality council
January 1	Beginning of fiscal year	

Municipality role-players are the main participants of the budgeting process, which take final budget decisions and ensure the implementation of the budgeting process.

These activities, including budget elaboration, approval, and execution, require the efforts of numerous officials of local government bodies, the roles of which are divided between three main "actors":

- The municipality council;
- The municipality head and staff; and
- The municipality residents (including non-governmental organizations, initiative groups, and the like).

Municipality Council

The municipality council takes an active part in the budgeting process. Council members should be utmost involved with the budget preparation and determination of expenditure priorities. By approving the budget, the council approves the policy that will be pursued by local government bodies to ensure the delivery of public services. Throughout the municipality budget execution process, the council is authorized to monitor any function of the budget, to learn about performance efficiency and effectiveness, and to demand reports on expenditures made.

Below are some general rules that can be helpful to council members in the performance of their duties:

- The municipality council must actively participate in the budget preparation prior to the municipality head presenting the final draft budget to the council for discussion. Developing the foundations of budget policy will help local government bodies focus the budgeting effort in the required direction.
- The municipality council must aspire to learn about all the materials that are needed to conduct a comprehensive and multilateral analysis of budgetary suggestions presented by the municipality head. The materials presented to the council for review must contain comprehensive information in order for the council members to develop a complete understanding of budget policy.
- The municipality council should not go into the fine details of administrative and financial considerations underlying the budget. When reviewing the draft budget, council members may be distracted from the most important program and financial considerations of the budget by dwelling upon the details. In particular, council members should

avoid concentrating all of their attention on specific expenditure items. The council should be confident that the budget details have been elaborated on the basis of justified research. Such confidence can be achieved by means of active involvement in the budgeting process.

In order for the council to be more active in the budgeting process, it can create a finance and budget commission that will collaborate with the municipality head, staff, and financial unit head throughout the budget drafting.

Municipality Head

The municipality head is a key actor of the budgeting process. His activities in this area mainly focus on the following:

- Developing, drafting, and submitting the budget to the council for review;
- Presenting a budgetary message;
- Providing commentaries on the current situation, prospects, and budget execution to the council;
- Ensuring execution of the budget approved by the council and achieving the outputs specified in the budget; and
- Ensuring the publicity and transparency of the budgeting process.

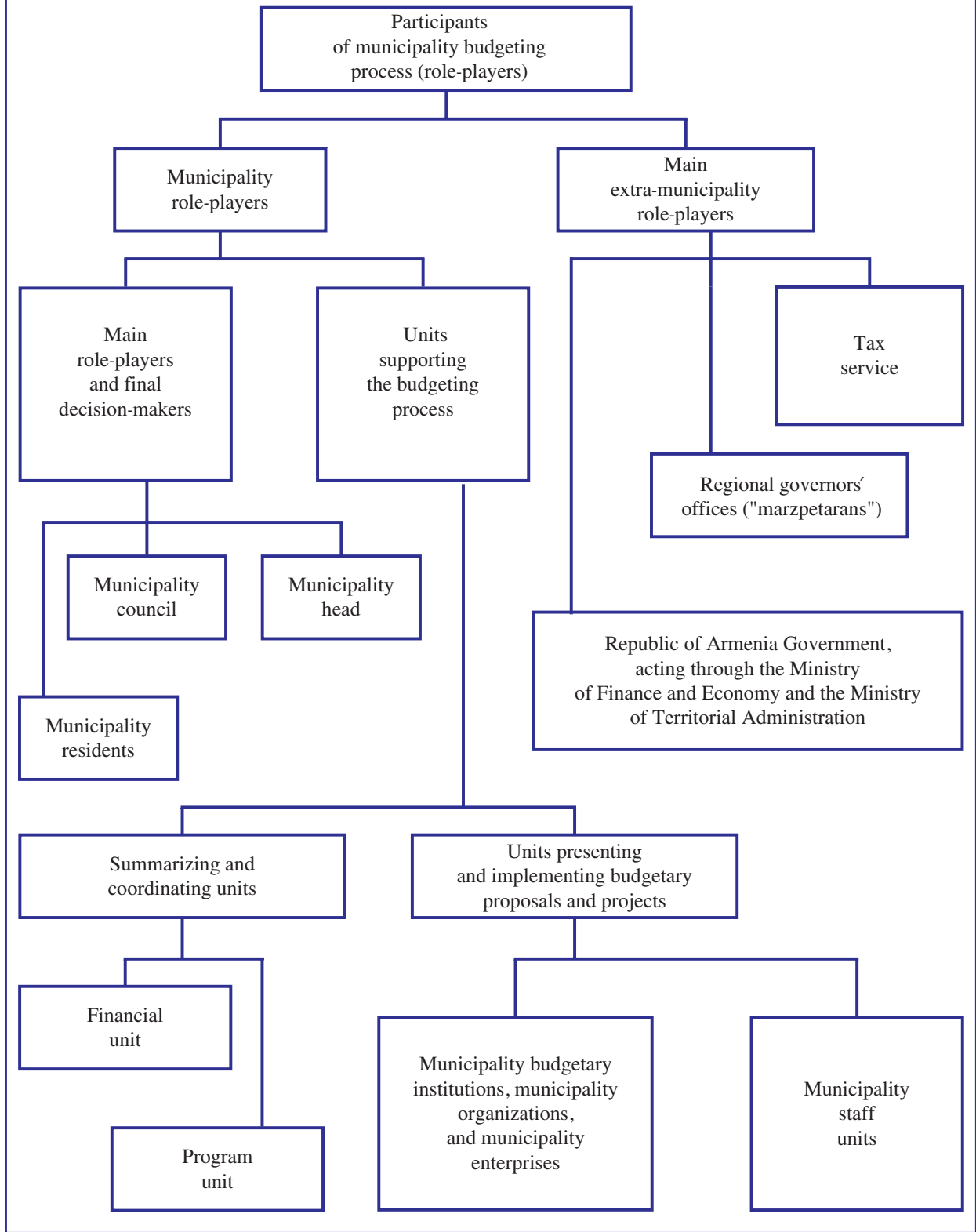
The municipality head is also responsible for the efficient use of resources designed for budget execution, coordination of efforts, and financial supervision.

The position of the municipality head enables him to define the directions of the budgetary policy and to organize the budgeting process. Within the frameworks of the approved budget, the municipality head determines the proportions of expenditures to be made. He examines all proposals and sets priorities, taking into account the community issues and potential financial difficulties.

When the planned expenditures exceed the expected revenues, then the municipality head has the right, to take decisions on limiting expenditures temporarily (or for a longer period of time) for the submission to the council. In a context of competition between unit heads, local budget-financed enterprises, and various programs, municipality heads need to make choices based on expenditure execution priorities and the importance of issues faced by the municipality.

To ensure the publicity and transparency of the budgeting process, the municipality head may organize public hearings of the budget (draft and/or execution),

Figure 5.
Participants of Municipality Budgeting Process



as well as budgetary discussions, and may publish information materials on the budget.

Financial Unit Head

The financial unit head plays an important role in the preparation of the budget and in terms of supporting the municipality head in the budgeting process. If instructed by the latter, he may develop a budgetary manual, methodological instructions, and work plans for budget-financed organizations and budgetary institutions, as well as study budget-related materials, perform financial analysis, and take decisions. The financial unit head:

- Monitors the execution of the budget;
- Ensures accounting for budget expenditures and timely reporting;
- Presents a budget execution report to the municipality head, council and the governor ("marzpet");
- Prepares the budget calendar and organizes the budgeting process;
- Performs financial analysis with a view to projecting the municipality financial and economic growth (decline);
- Forecasts the revenue for the upcoming fiscal year; and
- Provides methodological assistance to municipality staff units and municipal enterprises and organizations in the budgeting process.

The financial unit head plays an important role in collecting and analyzing data on the financial and economic situation in the municipality. Such data is very important and can be used by the municipality head and council in making budget decisions. Moreover, information on programs, expenditures on municipality organizations and enterprises, and outputs can be used to perform budget allocation analysis and determine the possibilities of saving. In other words, the financial unit head becomes involved in all the phases of the budgeting process on behalf of the municipality head.

The municipality council-approved budget is mandatory for execution. During budget implementation, the financial unit head must supervise programs and expenditures.

Staff of Municipality and Municipality Organizations and Enterprises

The municipality staff unit heads and key officials must be involved in the budget preparation and all execution-related details from the beginning on.

An important aspect of performance budgeting is that some efforts are shifted from the financial unit, which carries most of the budgeting process burden, to other units and public services coordinating officials, while the financial unit is left mainly with consultative, methodological, and financial functions. Under such conditions, the municipality staff and municipality

Box 7.

Public Hearings of Municipality Budgets

The Armenian legislation has not regulated the issue of public participation in the municipality budgeting process. Participatory budgeting is effectively left to the discretion of the municipality council and municipality head.

The public discussions and hearings on local budgets in nine model cities (Jermuk, Sisian, Gyumri, Vanadzor, Alaverdi, Sevan, Ijevan, Yeghegnadzor, and Kapan) organized by the Communities Finance Officers Association in 2001 with financial support of the Urban Institute are rather interesting. A large amount of preparatory work for the budget public hearings was carried out. Guidelines on Municipality Budget Public Hearings was drafted and published, and seminars were organized. The seminars mainly focused on issues such as how to organize public hearings, what in particular to focus on, what is more important, what technical means can be used, what materials need to be prepared, and who should be invited. After the seminars were conducted, public hearings of budgets started. Representatives of the municipality's staff, the council, parties, non-governmental organizations, territorial administration bodies, and the mass media, as well as municipality residents attended the hearings. During the hearings, materials and leaflets on the budget were disseminated to the participants. Public hearings of the budget were organized in later years, as well. However, the level of activity remains low, and very few residents take part in these hearings.

organization and enterprise leaders would do the following work:

- Collect, group, and analyze municipality information related to their sphere;
- Analyze information to evaluate the current situation and define strategic issues in accordance with their mission;
- Within the frameworks of strategic issues, set strategic goals and strategic (three-year) objectives for reaching these goals;
- Based on criteria selected by the municipality, define output (expenditure) measurement units for annual priorities in accordance with priority strategic goals;
- Execute or monitor the activities (projects, expenditures) prescribed under the budget for their respective sector; and
- Submit regular reports on the use of budget funds, compare, and analyze actual and planned outputs.

Municipality Residents (including Non-Governmental Organizations, Initiative Groups, and the like)

Municipality residents as the main beneficiary of activities planned under the municipality budget cannot but be involved in the budgeting process. The public services are aimed at meeting the needs of community or their groups, which means that successful delivery of services largely depends on the assessment of municipality residents' needs. To this end, it is extremely important to discover how the municipality residents feel about expenditure priorities and expected results, as it can become a key factor guiding the development of budget policies.

Clearly, assessing the opinion and needs of each community member is practically impossible and not realistic; therefore, this issue is addressed by municipality non-governmental organizations, municipality initiative groups, active citizens, and the like.

The following measures can be undertaken in order to involve the public and active groups in the budgeting process:

- Form an *initiative group* from among the active population, which will take part in the preparation of the budget;
- Prepare a manual explaining the municipality budget, which will clarify what budget is, how it is

prepared, where municipality revenues come from, and how they are used;

- Involve the initiative group in the setting of budget expenditure priorities;
- Organize public hearing and public discussions of the draft municipality budget; and
- Regularly notify the public of budget execution progress and the achievement of expected results.

Extra-Municipality Role-Players: they are participants of the municipality budgeting process, which do not influence the adoption of budget decisions, but have consultative, methodological support, monitoring, and other functions. The main extra-municipality role-players are the State Tax Service, the governors' offices, and the Government (acting through the Ministry of Finance and Economy and the Ministry of Territorial Administration).

4.3 Roles of Budgeting Process Participants by Budgeting Process Phases

Each participant of the budgeting process has an active role to play. These roles determine the smooth and complete execution of the budgeting process during which actions are taken, as set by phases of the budgeting process. Figure 6 presents the roles of budgeting process participants, requiring:

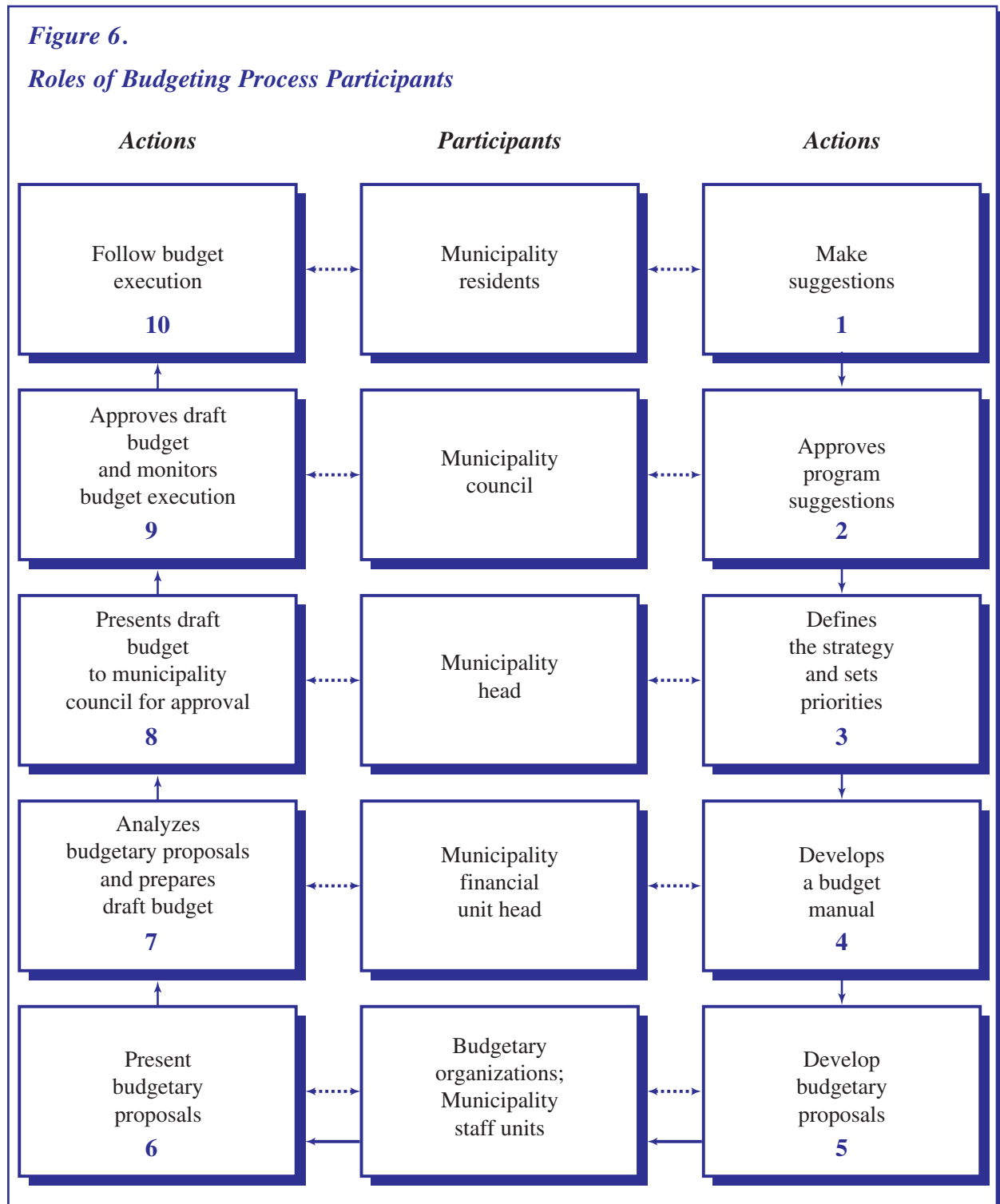
- Active involvement of all stakeholders in the budgeting process;
- Budget drafting, approval, and execution in accordance with the procedure and time periods specified by laws and other legal acts of the Republic of Armenia;
- Municipality budget preparation on the basis of principles such as the integrity of the budget system, budget classification, accounting, and reporting;
- Adherence to the main phases of the budgeting process;
- Financial resource and result-oriented budgetary expenditure planning in accordance with the three-year municipality development plan, the issues set by the municipality, and strategic and annual targets; and
- Ensuring publicity and transparency of the budgeting process.

Conclusions

To enhance the efficiency of the budgeting process, it is necessary to divide it into phases. In practice, there are three phases of the budgeting process: a) planning; b) execution and control; and c) audit and evaluation. Phases are perceived separately, each with its own activities, but, at the same time, as parts of a whole. It allows prescribing all the necessary activi-

ties and the entities responsible for performing such activities, and ensuring budget execution.

The budgeting process should have a large number of participants, which will have their own unique roles. It creates necessary conditions for revealing community problems and identifying issues, defining priorities, adopting and executing the budget, ensuring transparency and publicity, and the like.



5

PERFORMANCE BUDGET PLANNING

This Chapter covers the successive steps of the performance budgeting cycle (Figure 2) planning phase. The theoretical material is combined with numerous examples that make the material more practical.

5.1 Municipality Mission Statement

Figure 2, step 1

Performance budgeting is based on strategic planning. It starts by defining the mission of the municipality (municipality units and municipality-subordinate organizations). The mission states what the organization (structural unit) is, what it does and for whom. It is derived from the organization status, which includes the "responsibilities" of the organization and is usually linked with official documents such as legislation, by-laws, and adopted policies. When the mission of an organization is combined with its status, it becomes its *raison-d'être*. The Republic of Armenia Constitution classifies municipalities as public entities; under law, local government bodies have the power to deliver some public services, which determine the mission of municipalities (as well as their structural units). However, mission is more than the *raison-d'être* of an organization. It can serve as a consolidation tool to manage organizational energy and resources, to eliminate the possibility of an undesirable clash, to minimize uncertainty, and to describe the future of an organization.

5.2 Assessment and Forecasting of Resource Availability

Figure 2, step 2

Need for Assessment of Resource Availability

As an organization, the municipality functions in a certain external and internal environment. The internal environment of a municipality is its structure, inter-structural relations, material, financial, and human resources, technology, technical facilities, and entities under subordination of the municipality. The internal environment is directly supervised by the LGBs. The external environment is outside the control of LGBs. It includes the municipality demographic trends, population needs, economic trends, etc. (see

Chapter 3). This paragraph will cover the internal environment.

Assessment of resource availability pertains to the internal environment of a municipality. Resource availability and the possibilities for their utilization will largely determine municipality development. Resource availability is necessary for any project to be carried out. If some of the resources necessary for a project are not available, then they must be incorporated in the project. To this end, stocktaking, assessment, and analysis of resources are essential. Under performance budgeting, each municipality staff unit must have a complete understanding of the situation, resources, needs, and gaps in its respective sector/s. To do so, a database should be created and regularly updated.

The resources of the "municipality" organization can be divided into the following groups:

- Human resources;
- Technical resources;
- Infrastructures; and
- Financial resources.

Resources are interlinked and interdependent. However, human resources play a more active role than the others.

Human Resource Assessment

Any plan, no matter how good it is, will fail, if it is not backed with appropriate human resources. To this end, assessment of the human resource potential of a municipality is essential. Human resources are the capacity that can be used to carry out the LGBs' functions and to accomplish municipality plan objectives and goals. Human resource assessment is performed in order to make sure that the municipality mission, goals, and objectives are attained.

Human resource assessment indicators can be divided into two groups:

Box 8.

Examples of Missions of Municipality Structural Units

- *To organize pre-school education (what) for municipality children (for whom) to give the children access to quality education (why).*
- *To provide communal services (what) to the municipality residents (for whom) with due respect for all the rules and standards (why).*

1. Indicators that show the social-demographic attributes of the human resources, including the number of employees, age and gender breakdown, family status, level of education, etc.; and
2. Indicators that reflect the qualitative attributes of the human resources, including the level of professionalism, professional training and enhancement status, career experience, equipment skills, etc.

Qualitative indicators are particularly important attributes of the human resource potential, because they characterize the general and professional knowledge level, work skills, and abilities of staff, i.e. their professionalism. However, the existence of qualitative indicators alone is not sufficient to achieve the necessary outputs. Professionalism and the social-demographic attributes of the human resources comprise the working environment that creates possibilities for achieving the community goals and objectives.

The results of municipality staff human resource analysis and assessment help to identify the gaps and needs in this area and facilitate recruitment, promotion, and training plans.

Technical Resource Assessment

Technical resources include the devices and equipment necessary for LGBs to perform their functions and deliver the required services. Technical resources include computers, copiers, printers, telephones, communication boards, and the like. Proper use of such resources increases the effectiveness of performance and saves work time and human resources. To this end, it is very important to assess technical resource availability and to benchmark them against plans. Technical resource assessment is performed in order to compare the resources needed to achieve the municipality mission, goals, and objectives with the actual resources available, and to identify the gaps and needs in this area.

Technical resource assessment implies:

- Stocktaking;
- Understanding the technical condition and capacity;
- Determining the use load; and
- Determining service costs.

Based on the stocktaking results, a list of technical resources is compiled, which specifies all the technical resources by types, generations, and technical specifications. Then, their technical condition, usability, and capacity will be identified.

The next step is to determine the use load of technical resources. It is very important in terms of providing technical support to future projects. If the use load is very high, then new technical resources will need to be acquired for future projects.

The final step in technical resource assessment is to determine the average cost of technical resource service by types: the adjusted results of this exercise will feed into next year's plans.

Infrastructure Assessment

Municipality infrastructure-related functions make up a significant share of the LGBs' functions. Infrastructure development can be planned only after their present condition has been understood. Many budget programs are aimed at improving the present state of infrastructures and are, therefore, capital programs.

Municipality infrastructure can be divided into the following groups:

Municipality infrastructure. This includes facilities used by the public, such as, for instance, leisure places, playgrounds, streets, residential buildings, premises, and the like.

Infrastructure that supports the normal functioning of the municipality. This includes non-residential buildings and cleaning stations, water, sewerage, irrigation, gas, and heating networks and the like.

Municipality economic development infrastructure. This includes the roads, bridges, and other communications that facilitate municipality economic development.

Each infrastructure is assessed using criteria typical of that infrastructure. For instance, in the assessment of leisure places, it is necessary to take into account the condition of green areas, cleanliness, and benches, the existence of entertainment facilities, and so on. The assessment reveals the gaps and needs that can become program issues.

Community revenues, loans, and state budget subsidies are the sources of funding for infrastructure development.

Financial Resource Assessment and Forecasting

Financial resources are an important aspect of municipality projects success, because their presence ultimately determines the enhancement of human resources and the upgrading of technical resources and infrastructures. Municipality financial resource assessment is designed to support the projection of municipality budget revenues and the possibilities for expenditure execution. The list of budget revenues of the RoA municipalities determined by the Law is provided in the Table 5. In terms of municipality financial resource assessment and financial autonomy, budget revenues can be classified into the following groups:

- Own revenues;
- Official transfers; and
- Borrowings.

Assessment of own revenues is particularly important, because LGBs are primarily responsible for their collection. Own revenues can be divided into two main groups tax revenues and duties, and non-tax revenues. Tax revenues include land tax (for land that is within the administrative boundaries of the municipality) and property tax (for assets that are within the administrative boundaries of the municipality), (state-owned and municipal budgetary and non-profit organizations, and church-owned assets shall be exempt of property tax).

To assess tax revenues, it is very important to *define the taxation base and to determine the volume of tax*

revenues. Municipality tax revenues are such that their volumes can be determined with utmost precision. Once the volume of tax revenues has been determined, it is necessary to assess their collection rate, trends, and existing shortcomings. This is the way in which local duties and payments, land and property leases, and other revenue types are studied and assessed.

Based on the assessment of municipality financial resources, budget revenues are projected by different revenue types. To project municipality budget revenue means to calculate and state the amount of revenue expected during the next financial year.

There are different methods of forecasting budget revenue, including both simple methods and sophisticated computer-based ones. The method most often used in practice is called *analysis of economic trends*, which can be used to project the majority of municipality budget revenues. It is based on an analysis of the previous 3-5 years' budget revenue data, indicators, and economic conditions.

The analysis results in the identification of revenue change trends. The projection of budget revenues takes into account factors that affect the trends, such as changes expected in the revenue base, changes in the tax, duty, or payment rates, changes in the revenue collection administration, demographic changes, and changes in the living standard and demand for services.

Grants can be predicted within the frames of the current legislation, which is normally rather limited.

As a result of collecting and analyzing detailed information on the situation in the municipality and assessing and projecting the available resources, the municipality strengths and weaknesses are clarified, and the strategic issues faced by the municipality highlighted.

5.3 Formulation of Strategic Issues

Figure 2, step 3

The strategic issues faced by the municipality are directly linked with municipality policies, service delivery, and governance issues, which all have a certain impact on the municipality status, mission, and goals. The issue must be stated clearly and concisely. It is necessary to specify the factors that underline its importance, as well as the possible consequences of non-performance. The issue must be stated in such a way as to trigger a positive response on the part of the municipality.

Table 5.
Republic of Armenia Municipality Budget Revenues

Administrative budget revenues

Tax revenues and duties

- Land tax
- Property tax
- Other tax revenue (may be defined by the current year’s law on the budget)
- Stamp duties
- Local duties

Non-tax revenues

- Land rentals
- Real estate rentals
- Local fees
- Funds allocated for the performance of functions delegated to local government bodies
- Other non-tax revenue

Official transfers

Retained balance of administrative budget

Capital budget revenues

Subvention

Earmarked allocations from other sources

Funds received from reserve fund of administrative budget

Proceeds from sale of assets

Other proceeds

Retained balance of capital budget

Based on the stated issues, the goals of the municipality and its structural units are defined.

5.4 Identification of Strategic and Service Delivery Goals

Figure 2, step 4

The strategic issues faced by the municipality need to be solved, which means that goals must be set. A goal defines the direction of future activities of a municipality (including municipality units or municipality-subordinate organizations) and is in turn affected by the municipality status and needs. A goal is the end-

result that a municipality (including a municipality unit) aspires to reach, or the result that a program should end with.

Any goal must meet the following criteria:

- The goal must be determined by the status and mission of the organization;
- The goal must ensure a clear policy direction for the activities of the organization;
- The goal must describe the public demand;
- The goal must be inclusive and non-measurable;
- The goal must be specific and clearly defined;

Box 9.

Examples of articulated municipality issues

- *Inadequate state of municipality roads*
- *Dilapidated state of municipality parks*
- *Insufficient conditions for efficiently organizing pre-school education*
- *Low qualification of municipality staff*

- The goal must be future-oriented and non-time-bound; and
- The goal must be typical of the organization.

The following verbs are typically used when defining the goal:

To ensure	To preclude	To prevent
To improve	To guarantee	To reach
To avoid	To protect	To designate
To eliminate	To expand	To make

There are strategic and service delivery goals. *Strategic goals* are goals related to the governance of the municipality, which are aimed at improving the municipality capacity to better carry out its mission. Strategic goals are formulated through a long-term planning process. Strategic goals are rather inclusive and change, as fiscal restrictions on institutional capacity, new service delivery strategies, new capacity strengthening, and new investments change.

Service delivery goals are directly related to the fulfillment of the mission of the municipality or its structur-

al unit. Each service delivery goal has at least one measurable objective and performance indicator. As long as the mission remains the same, service delivery goals remain stable, unlike strategic goals.

5.5 Statement of Objectives and Determination of Strategic Targets and Their Costs

Objectives

Figure 2, step 5

Objectives reflect outputs expected during a certain time period. Objectives must be stated clearly and comprehensively and have numeric expression. They reflect the improvement in qualitative and quantitative indicators of current services. Objectives must always be aimed towards the end-result of a project. An objective defines what needs to be done, how much, and when.

An objective must meet the following criteria:

Box 10.

Examples of Goals

Service Delivery Goals of Municipality Structural Units

- *To ensure inclusion of all willing children in the municipality into the system of pre-school education and to preclude complaints concerning the activities of pre-school institutions;*
- *To expand the scope of utility service beneficiaries;*
- *To make all the municipality parks a decent and pleasant leisure venue for the public*

Municipality Strategic Goals

- *To make municipality X the industrial and cultural center of the region, while ensuring prosperity for the people;*
- *To ensure broad public involvement in the governance of municipality X.*

- Show measurable progress in terms of municipality services delivered to the public, which must stem from the goal;
- Clearly specify what the municipality wishes to accomplish;
- Be measurable during a specific period of time;
- Highlight the beneficiaries and show the impact on them; and
- Show the impact on the municipality residents.

The following verbs are used to define objectives:

To increase	To add
To reduce	To augment
To cut	To maintain
To reach	

When defining an objective, it is necessary to have an understanding of the current level at which an issue is viewed, which is the basis of the objective. Using percentage expression is the most convenient way.

In the objective statement, the present level of the issue is reached to the level specified in the strategic plan.

Strategic Targets

Figure 2, step 6

Strategic targets are possible ways of achieving an objective during a time period established for the objective (for instance, in three years). The share of each target in 100% achievement of the objective must be defined, and the unit costs and total costs must be estimated. As a result, a chart of strategic targets must be compiled for each objective. (Table 6)

When planning a budget, particular attention should be paid to strategic targets that need to be achieved over the course of several years. Based on the performance of a target during the previous year, the

deviation from the target is estimated, and an adjustment is made to determine the share of the target to be achieved during the next year. Performance assessment is covered in greater detail in Chapter VII.

5.6 Setting Annual Targets and Determining Their Costs

Figure 2, step 8

Annual targets are certain parts of strategic targets, which must be achieved during the current fiscal year. If, for instance, the total costs of a strategic target are known, and 1/3 or 33% of this target needs to be achieved during the current year, then the strategic target will be achieved in three years, with appropriate expenditures in each year. If a strategic target is going to be achieved in one year, then it coincides with the annual target. At this stage, (Table 7) a chart of annual targets needs to be compiled, which will specify:

- The activities necessary to achieve each annual target;
- Inputs (labor force, equipment, and the like) required for each activity and their costs;
- Budget codes of expenditures; and
- Total cost of each annual target.

5.7 Priority Setting and System of Codes

Figure 2, step 5, 7, 9

An important aspect of performance budgeting is the determination of priorities within objectives and strategic and annual targets. ***Priority setting is a process whereby the municipality defines which objectives and strategic and annual targets are more important, and which of them need to be financed during the upcoming fiscal year.*** The issue of prior-

Box 11.

Examples of Objectives of Municipality Structural Units

- *To increase the number of municipality children enrolled in the pre-school education system from 60% to 90% in three years;*
- *To increase the percentage of municipality population using irrigation water from 50% to 85% in two years;*
- *To reduce the area of unattended municipality parks from 50% to 15% in three years.*

ity setting is faced by each local government, because local governments are confronted with the need to choose one of many objectives to finance, subject to resource scarcity.

As a rule, LGBs use informal methods of priority setting, which are based on human feelings, political motivation, traditions or customs, the wish of the municipality head, and the beneficiary impact. Informal methods are highly subjective; they do not ensure transparency, consistency, or respect for rules.

Formal methods of priority setting are based on the knowledge and professionalism of practitioners. Formal methods follow approved, stable, and written adopted procedures. *Criteria are an important type of formal methods.*

Criteria are provisions on the scope of issues or direction, which are used to assess alternatives or options.

Criteria are used through a scoring system to assess objectives and long-term and annual sub-objectives.

Table 6.

Strategic Targets Measurement Units and Values

Goal To provide affordable and diverse education services to the municipality population and to continuously facilitate improved quality and increased volume of services.

Objective 01 Within three years, to increase the number of municipality educational service beneficiaries by 15% and to improve the quality and assortment of services offered by 5%.

Strategic Targets		Measurement Unit	Number	Unit cost (AMD thousand)	Total cost (AMD thousand)
1	Within three years, to improve the qualification of 10 educators of pre-school institutions.	Individuals	10	100	1000
2	Within three years, to increase the number of educational circles in 6 kindergartens (for foreign languages and dancing).	Groups	12	500	6000
3	Within three years, to renovate the buildings of kindergartens number 3 and 6.	Kindergartens	2	2500	5000
4	Within three years, to increase the per-child food ration financing by 10%.	%	10	660	6600
5	Within two years, to increase the availability of property in all of the operating kindergartens.	—————	(as per list)	—————	1200
6	Within the next three years, to increase the volume of services rendered in the field of pre-school education by 15% (from 395 to 455 children).	Children	455		216000
Total					235800

Table 7.

Annual Target Activities and Costs

Objective	01	Within three years, to increase the number of municipality educational service beneficiaries by 15% and to improve the quality and assortment of services offered by 5%.
Strategic Target	0101	Within three years, to renovate the buildings of kindergartens number 3 and 6.
Annual Target	010101	1/5 of the stage of renovating the buildings of kindergartens number 3 and 6.

Activities for accomplishing annual target	Code for each activity	Estimated cost of each activity (AMD thousand)
1 Preparing design documents and estimates	010101-01	235
2 Preparing tender documents	010101-02	50
3 Tendering	010101-03	75
4 Contracting	010101-04	0
5 Renovation of the roof of kindergartennumber 3	010101-05	1140
6 Total cost of accomplishing annual target		1500

The ones that score the highest are considered the highest priorities or long-term and annual targets. As the score declines, the priority level falls.

For criteria to be useful and effective, they need to:

- Be concerned with measurable issues;
- Provide clear guidance to the municipality units;
- Present appropriate and accurate information;
- Ensure a certain level of impartiality in the scoring;
- Be rather broad in order to be applicable to a wide circle of issues, but not be uncertain and meaningless;
- Take into account all the relevant aspects of a program or issue; and
- Be regularly revised in order to make sure that they reflect changes in LGB priorities and goals.

The number of criteria in use should be kept within certain limits: having fewer criteria is more effective than having very many, which can require much time to select and analyze the list of criteria.

There are tangible and *intangible* criteria. Intangible criteria focus on values such as public health or the provision of an "acceptable" level of service. These types of indicators are subjective, and their definition depends on certain goals and objectives of LGBs. *Tangible* criteria are more objective quantitative measurements, such as estimates of value and time. The experience of different countries has shown that LGBs often use these two types of criteria concurrently.

Methods of Priority Setting

When setting priorities, regardless of the method, a scoring scale is used. The scale is composed of scores for criteria, objectives, and strategic and annual targets evaluation. Each objective (strategic target or annual target) is evaluated under each criterion, and the total score is used to determine priorities.

The following *methods* of priority setting are common:

Table 8.

Determining Priorities among Strategic Targets

Code	Code	Strategic Targets	Total cost	Criteria (1-5 points)			
				Potential impact on beneficiaries	Sustainability prospect	Potential poverty impact	Total
01	05	Within three years, to improve the qualification of 10 educators of pre-school institutions.	1000	5	2	2	9
01	06	Within three years, to increase the number of educational circles in 6 kindergartens (for foreign languages and dancing).	6000	4	2	2	8
01	01	Within three years, to renovate the buildings of kindergartens number 3 and 6.	5000	5	5	3	13
01	04	Within three years, to increase the per-child food ration financing by 10%.	6600	4	2	4	10
01	02	Within two years, to increase the availability of property in all of the operating kindergartens.	1200	4	4	4	12
01	03	Within the next three years, to increase the volume of services rendered in the field of pre-school education by 15%.	216000	5	2	4	11
Total			235800				

- The evaluation of the objective (strategic target or annual target) is performed with the involvement of the municipality residents. Using information received from the public helps the municipality in priority setting.
- The evaluation of the objective (strategic target or annual target) is performed by the municipality council. The council itself determines priorities on the basis of information prepared by the municipality staff.

- The evaluation of the objective (strategic target or annual target) is performed through the municipality staff. The staff presents the evaluation results to the council for approval.

It should be mentioned that it would be inappropriate to seek the best method among the aforementioned ones. There is no best method of priority setting. LGBs should choose the method that best suits the peculiarities of their municipality and could be efficiently and effectively applied. However, the logic of

performance budgeting best suits priority setting with the involvement of municipality residents. These methods are used to set priorities in planning both administrative and fund budgets.

System of Budget Codes⁶

Once objectives are classified by priorities, a list of objectives is compiled, where the objective that scored the highest will be the first, and the objective that scored the lowest will be at the end of the list, i.e. the least important. The most important objective will receive the code "01". A system of double-digit codes will be opened for objectives, from 01 to 99.

For each objective, strategic targets need to be classified in the order of priority, as well. Once again, the most important target will receive the code "01". These double-digit numbers (from 01 to 99) become the second part of the performance budgeting code. Thus, the first part of the code is XX (objective), and the second part is XX or "01" (strategic target), which means that the whole code will read "0101", which will be the most important target of the most important objective.

Annual targets should be classified in the order of priority, as well. The double-digit numbers here (from 01 to 99) become the third part of the performance budgeting code. Thus, the performance budgeting code system will be as follows: "XX" (objective) XX (strategic target) XX (annual target), which means "010101" for the most important objective of the summary budget. This code system ensures vertical integration of objectives with strategic and annual targets. It means that all expenditures can be classified under annual targets, and it will be clear which strategic targets are met through any given set of annual target, and which objective the strategic and annual targets serve.

It is necessary to take into account that the code system of performance budgeting has no relationship with the code system used in the Republic of Armenia. The current code system is built in accordance with the expenditure budget items. Budget expenditures are classified into 14 main groups. Each group is broken down into sub-groups, which reflect the details of expenditures in each group.

Both code systems need to be used concurrently, if performance budgeting is introduced.

5.8 Comparison of priority annual targets expenditures with forecasted budget revenues

Figure 2, step 9

After identifying priorities within annual targets, it is necessary to choose the targets the implementation of which can be financed during the current fiscal year. To this end, it is necessary to compare the projected budget revenues with the annual target expenditures. In practice, the expenditures on annual priorities will rarely be equal to the projected revenues. In this case, it is necessary to adjust the annual breakdown of the last priority strategic targets, if the municipality has co-funded projects. As a result of these adjustments, annual target expenditures will become equal to the projected revenues.

5.9 Budgetary Projects and Performance Indicators

Figure 2, step 10

Budgetary Projects

Budgetary projects make up an important tool of performance budgeting. Budgeting programs reflect the municipality strategic plan in the current year's budget.

A budgetary project is a structured group of actions and expected results, which are aimed at the achievement of a certain project goal/s and objectives stemming from the municipality status and mission, and which are carried out by a project implementer (municipality structural unit, project group, or municipality-subordinate organization) authorized and responsible for their implementation.

A budgetary project is defined by LGBs. It can be a project of municipality units, project groups, or municipality-subordinate organizations. A project is the unit of a performance budget, according to which funds are allocated and spent. A project has the form of narration and a clearly defined procedure. It reflects the ways and methods of achieving a specific goal/s and objectives.

The project manager is responsible for coordinating project activities, executing expenditures, achieving

6 See McGill, R. (2001). Performance Budgeting. International Journal of Public Sector Management, p. 383.

Table 9.
Breakdown of Strategic Targets by Annual Priorities

Code	Strategic Targets	Total cost (AMD thousand)	Annual Targets (AMD thousand)		
			Year 1	Year 2	Year 3
0101	Within three years, to renovate the buildings of kindergartens number 3 and 6.	5000	1500	1500	2000
0102	Within two years, to increase the availability of property in all of the operating kindergartens.	1200	800	400	0
0103	Within the next three years, to increase the volume of services rendered in the field of pre-school education by 15%.	216000	72000	72000	72000
0104	Within three years, to increase the per-child food ration financing by 10%.	6600	1800	2200	2600
0105	Within three years, to improve the qualification of educators of pre-school institutions.	1000	300	300	400
0106	Within three years, to increase the number of educational circles in 6 kindergartens (for foreign languages and dancing).	6000	2000	2000	2000
	Total	235800	78400	78400	79000

the respective annual targets, preparing reports, and submitting them to LGBs.

Performance Indicators

To carry out the budgetary projects, certain performance indicators need to be used. Performance indicators enable to project future activities and to compare current performance with past performance. **Performance indicators are quantitative measurement units that show progress towards achieving the strategic and service delivery goals of the municipality.**

The following types of performance indicators exist: input indicators, output indicators, outcome indicators, efficiency indicators, effectiveness indicators, and service delivery indicators.

Input (expenditure) indicators show the inputs (material, technical, labor, and financial) made to deliver a service. Taken alone, these indicators say nothing

about the outputs received from any given amount of inputs.

Output indicators show the volume of work performed. Project outputs lead to desired outcomes, but in themselves outputs do not contain any information about outcomes. Examples of output indicators include the length of repaired streets, the number of service beneficiaries, and the green-covered surface area.

Outcome indicators do not reflect the volume of services provided, but rather, show the outcome and achievements of service delivery, as well as progress towards the achievement of project objectives. Examples of outcome indicators include the share of irrigated green areas in total green areas, the share of households with access to potable water in the total number of households, and the share of the developed part of the city in the total space of the city.

Efficiency indicators reflect the unit cost in drams or work hours. Examples of efficiency indicators include the cost of repairing one kilometer of roads,

Box 12.

Examples of Municipality Structural Unit Projects

- *Waste collection;*
- *Irrigation water supply;*
- *Looking after municipality parks;*
- *Improving the condition of urban transport; and*
- *Developing pre-school education.*

Box 13.

Criteria for Selection of Performance Indicators

- **Relevance.** *Indicators should be relevant for the program implementation goals, objectives, and activities.*
- **Importance.** *Indicators should provide important information on program outputs and be extremely important for the achievement of program goals.*
- **Accessibility.** *Information on indicators should be accurate and accessible.*
- **Ease of use.** *Indicators should be easy to use and analyze.*
- **Justification.** *Indicators should reflect the subject matter, so that any change in the indicators could be easily qualified as desirable or undesirable.*
- **Timeliness.** *Indicators should make timely receipt of information possible.*
- **Clarity.** *Indicators should be clear and understandable for both local officials and the community residents.*
- **Data collection costs.** *The cost of collecting data on indicators should be within reasonable limits.*

Source: Local Self Governance Manual, Yerevan, Urban Institute Program 06901-008, April 2003

the cost per student, and the cost to collect one ton of garbage.

Effectiveness indicators are certain achievements of social output per unit cost. For instance, the reduction of complaints from parents of kindergarten children from 10% to 3%.

Service delivery indicators show the opinion of service users about the delivery of such services (e.g. the level of consumer satisfaction) or the impact on general socio-economic situation (e.g. poverty indicators).

Each budgetary project should have its own system of performance indicators. Indicators should show whether goals and objectives are being achieved or not. When preparing indicators, it is necessary to pay

special attention to the fact that under performance budgeting, outcomes are more important than outputs. Box 13 provides a set of criteria that can be used to select indicators. Box 14 shows the linkage of project goals and objectives with performance indicators.

5.10 Elaboration of Work Plans

Work plans might be drafted to support the attainment of annual objectives specified in budgetary projects.

A work plan contains a set of specific activities for budgetary project implementation in any one year, with phases and performance indicators.

Box 14.

Garbage Removal Program Goal and Objective Linkage with Performance Indicators

<i>Goal</i>	<i>To make the environment clean and safe.</i>
<i>Objectives</i>	<i>To collect garbage twice weekly. To increase the amount of garbage collected annually by 10%. To reduce the frequency of garbage collection from thrice to twice weekly, whilst maintaining an adequate service standard.</i>
<i>Input (expenditure) indicators</i>	<i>Number of staff. Number of garbage removal trucks. Expenditures.</i>
<i>Outputs</i>	<i>Volume of garbage collected. Number of families covered by garbage collection program.</i>
<i>Outcomes</i>	<i>Share of clean streets in the total number of community streets. Public satisfaction. Share of public complaints. Number of deviations from garbage collection schedule. Volume of uncollected garbage.</i>
<i>Efficiency indicators</i>	<i>Cost of collecting one ton of garbage. Cost of garbage per family. Amount of garbage collected by one employee/truck.</i>

Through work plans, a strategic plan is divided into manageable parts and operational levels. It defines the list of works and assignments to be performed by each employee.

A work plan is the whole of activities needed to achieve project goals with the available budget allocations. They are regularly revised and updated. A work plan helps organize, audit, and adjust performance. By adhering to the a work plan activities, performance audits make timely adjustment possible, which will in turn enable the timely achievement of goals.

Work plans must specify the activities to be performed, the work time needed to perform them, the

related payment costs, performance indicators, and outputs.

Usually, work plans should specify the best options of work time use and the achievement of results. Such a possibility can be created by regular performance audits, which allow evaluating progress, identifying weaknesses, and correcting the future division of work time, the expected results, and the timing of such results.

Work plans must contain the following elements:

- Activities;
- Work time spent;
- Results;

Box 15.

Form of work plan

Work Plan

Name, surname _____ Municipality _____
 Position _____ Unit _____
 Project _____
 Time period _____ to _____

Unit mission:
 Unit goals:
 Employee's functions (main duties):

Objectives	Activities	Performance indicators	Deadlines
1.	1.	1.	1.
	2.	2.	2.
2.	1.	1.	1.
	2.	2.	2.
	3.	3.	3.
3.			
Objectives	Activities	Performance indicators	Frequency
4.	1.	1.	1-2 (daily, weekly, etc.)
	2.	2.	

Unit head _____ Employee _____
Signature *date* *Signature* *date*

- Who is responsible; and
- Performance indicators.

Work plans are normally compiled by quarters, but they can also be prepared by time periods, for instance, by months. Work plan form is provided in the Box 15.

5.11 Elaboration and Approval of Summary Budget

Figure 2, step 11

The whole process of budget planning ends with the preparation of the annual summary budget at the level of annual targets or outputs (Table 10). This is where all the calculations are made, both the annual performance and progress under the Long-Term (e.g. three-year) Strategy can be easily evaluated.

The budget planning stage ends with its approval. The municipality budget is approved by the municipality council upon presentation by the municipality head.

Conclusions

Correct planning of a municipality budget is the key to its successful execution. Planning a performance budget is a set of successive steps that create the political, institutional, program, and financial preconditions needed for solving problems and achieving goals in the context of municipality strategic development. Budget planning is based on the mission defined on the basis of the municipality status, which is clarified for reach unit of the municipality. It defines what each structural unit should do, for whom, and why. Based on a situation analysis and resource evaluation, the goals and objectives of the municipality and its structural units are defined. Objectives in turn are divided into strategic and annual targets.

Table 10.

Section of Budget Brief

Objective 01: Within three years, to increase the number of municipality educational service beneficiaries by 15% and to improve the quality and assortment of services offered by 5%.

Code	Annual targets	Number of units	Total cost of strategic targets (AMD thousand)	Cost of annual investments (AMD thousand)		Annual total (AMD thousand)	Strategic total minus annual total, balance (AMD thousand)	Outputs
				Capital	Current			
010101	1/5 of the planned renovation of the buildings of kindergartens number 3 and 6.	Building	5000	1375	125	1500	3500	Renovated roof of kindergarten number 3.
010201	Within two years, to increase the availability of property in all of the operating kindergartens, 2/3 of planned.	As per list	1200	0	800	800	400	2/3 of the property planned as per the list for all kindergartens.
010301	Within three years, to increase the volume of services rendered in the field of pre-school education by 15%, 1/3 of planned.	455 children	216000	0	72000	72000	144000	415 children attending kindergarten.
010401	Within three years, to increase the per-child food ration financing by 10%, 1/3 of planned.	AMD 660,000 X1%	6600	0	1800	1800	4800	Increased per-child food ration financing by 361 drams per month.
010501	Within three years, to improve the qualification of educators of pre-school institutions, 1/3 of planned.	10 individuals	1000	0	300	300	700	3 educators with improved qualification.
010601	Within three years, to increase the number of educational circles in 6 kindergartens, 1/3 of planned.	12 groups	6000	0	2000	2000	4000	4 new educational circles.

Insert 16.

Performance budgeting experience in local government system of Armenia

At the initiative of UNDP, the implementation of performance budgeting in Armenia's local government system started in 2004, when two pilot seminars for representatives of four municipalities were organized. In view of the large interest shown by the municipalities and the current requirements on local government, UNDP undertook the "Performance Budgeting" initiative in 2005. One of its components was designed to support the planning of 2006 budgets of five Armenian municipalities in a performance budget format. The selected model municipalities include Abovyan, Dilijan, Ijevan, Masis, and Vedi. The budgets of these municipalities were drafted in accordance with all the budgeting cycle steps defined in this Manual. The budgeting exercise involved the heads of all the units of municipality staff, municipality council members, and municipality residents. The model municipalities received appropriate training in the form of seminars for all representatives of all the municipalities, as well as numerous visits to the municipalities in order to facilitate local budgeting directly.

The aforementioned municipalities adopted their 2006 budgets in the form of performance budgets and undertook their execution.

As a rule, there are numerous objectives, but limited financial resources in each municipality. In such situations, it is necessary to determine why money should be allocated to one objective, rather than another. It is done by means of using priority-setting methods. Throughout the budgeting process, and in the priority-setting exercise, it is very important to ensure public participation. It strengthens public confidence in local authorities and improves the level of local democracy.

Each member of the municipality staff should take part in the achievement of objectives. To this end, work plans are prepared, which specify all the activities, as well as who is responsible for the achievement of objectives.

Thus, budget planning turns municipality strategic goals and objectives into activities and mentions who is responsible for their implementation, which allows improving performance efficiency.

6

BUDGET EXECUTION AND CONTROL

This Chapter presents the performance budget execution and supervision stage, the responsible entities, internal and external accountability, and the forms of budget oversight.

Municipality budget execution is the structured activity of collecting budgeted revenues and executing budgeted expenditures. Under performance budgeting, budget execution is not aimed at the mere execution of only expenditure items (under the economic or functional classification, as it is the case under line-item budgeting), but rather, is intended to maximize the outcome achieved with the budget.

Active involvement of the public and beneficiaries is desirable throughout the planning and execution of the performance budgeting process, because it can improve the transparency and accountability of the budgeting process.

6.1 Responsibility for Budget Execution

According to the Republic of Armenia Law on the Budgetary System, the **municipality head** is responsible for executing the municipality budget. This provision of the Law, however, does not prevent the active involvement of municipality staff and officials in the budget execution process as instructed by the municipality head. Under conventional (line-item) budgeting, the bulk or, in some cases, even the whole burden of budget execution activities lies on the municipality financial unit (Finance and Revenue Collection Divisions).

Under performance budgeting, all the units of municipality staff, as well as budgetary institutions must be actively involved in the execution of the budget. The financial unit (unit head), being the main actor in budget execution, acts predominantly as an advisor, organizer, and regulator. These activities include:

- Development of budget execution manual and methodological instructions;
- Preparing work plans and information briefs;
- Accepting and serving budget project financing proposals;

- Preparing budgetary reports and documents;
- Issuing professional opinions and advice needed for the municipality head to take financial decisions;
- Performing financial functions; and
- Maintaining a linkage between municipalities and the Treasury.

In this situation, municipality budget execution is primarily seen as a structured activity aimed at achieving the outcomes planned under the budget, which is undertaken by joint efforts of all the municipality staff.

In view of his sole responsibility for budget execution, the municipality head ensures the budget execution process in accordance with the procedure defined in law, signs all financial documents, and carries personal responsibility for the correct and lawful performance of financial transactions. He defines the quarterly breakdown of municipality budget execution and, if actual revenues are lower the projected, limits (sequesters) expenditures. Sequestration is the proportionate reduction of all budgeted expenditures, with the exception of protected expenditure items in the budget, which are defined by a municipality council decision on the budget. Within a one-week period, the municipality head must submit the municipality council-approved annual budget and the quarterly breakdown to the respective Local Treasury Unit (LTU) of the Republic of Armenia Ministry of Finance and Economy, which serves the execution of the municipality budget.

The LTU is obliged to allocate the appropriate funds immediately upon request by the municipality and according to the legislation, if such funds are available in the municipality budgetary account and are budgeted for.

Treasury units submit daily information on municipality budget revenues and expenditures to the municipality head.

In the execution of the municipality budget, the municipality head may perform reallocation, which may not contradict the council decision on approving

the budget and may not exceed the total amounts set by the council.

Grants that are not budgeted in the revenue side of the approved budget may be spent by the municipality head during the same year in areas determined by the donor.

6.2 Ensuring Accountability

LGBs are accountable for their fiscal activities. Such accountability is designed to present a financial snapshot of the municipality and to make the outcome of performance visible. Reports should be presented primarily on the actual performance of budgeted revenues and expenditures. They are called to reveal the key economic and financial developments and shortcomings of the community and the deviations from the approved budget.

Under performance budgeting, reports should contain, in addition to the aforementioned, information on performance outputs (which part of outputs have been achieved, how much more remains, and the like).

Reports should also answer the following questions: what is the purpose of the report, should measures be taken, what mistakes and deviations have been identified, who is responsible, is there a need to make financial or result-oriented adjustments or take special decisions?

A budget execution report should be prepared at least once a month. A monthly report is based on the LGBs' accounting data and precisely matches the structure of the budgetary projects included in the approved budget document. For each budget project, the report will present the following information: the cost of the project included in the budget, the amount of expenditures made during the month, broken down by objectives, the amount of expenditures made from the beginning of the year to the reporting date, the amount of expenditures made from the beginning of the year as a share of the total budget (in percent), and the interim results achieved.

The following are the types of municipality budget execution financial reports:

- Current and working reports, which present current financial and accounting data on budget execution;
- Management report, which presents the level of execution of municipality management functions under the budgeted amount of funding; and
- Disbursement report, which presents the disbursement of funds to spheres of activities, with a time breakdown (who receives what and when).

The frequency of reporting can be daily, weekly, monthly, quarterly, semi-annual, annual, for a certain period, and upon request. Reports should be prepared for users such as state and local government bodies, the municipality council, and the municipality residents. As far as the users are concerned, LGB accountability can be conditionally divided into two groups – **internal accountability and external accountability**.

6.2.1 Internal Accountability

Internal accountability is accountability before the municipality council and all the layers of the municipality staff. The budgetary legislation of Armenia requires the municipality head to present quarterly budget execution reports to the council.

Considering that the municipality council members are not professionals, the report presented to them should be utmost clear and comprehensible and contain information on the volume and quality of works and services performed. It would be preferable for this information to be structured into comparative figures and charts.

The Republic of Armenia Law on the Budgetary System places an emphasis on the annual budget execution report approved by the council. Under this Law, the annual municipality budget execution report shall contain:

- Information on the justification of municipality budget revenues and expenditures during the reported year, benchmarking them against the actual revenues and expenditures of the previous year and the budgeted targets of the current year;
- Information on the purposes and amounts of expenditures made from the municipality budget reserve fund during the reported year, including the relevant justification for such expenditures;
- Information on the current year's budget arrears and debt service; and
- Other information that the municipality head may deem necessary for presenting and justifying the municipality budget execution results.

Another element of internal accountability is the presentation of the budget report to the municipality head and the municipality staff leaders. Such accountability is essential from the standpoint of budget decision-making and collective joint performance. These reports can be prepared in any format and have any frequency depending on the needs and purposes they serve.

Box 17.

Segment from the Republic of Armenia Law on the Budgetary System

The head of municipality submits the budget execution annual report to the municipality council till March 1 after the end of the fiscal year.

The budget execution annual report is discussed and approved in the session of the municipality council till March 20, in the presence of the audit body report.

During the session of the municipality council the municipality budget execution annual report discussion procedure is defined by the municipality council regulation.

After the discussion is over, the municipality council shall take a decision on approving the budget execution report.

6.2.2 External Accountability

External accountability is accountability before the **municipality residents and the central government bodies**.

Budget execution accountability before the residents is driven by the need to ensure the transparency and publicity of LGB activities.

To ensure the publicity of municipality budget execution, it is necessary to constantly inform and engage the municipality residents and all stakeholder organizations and enterprises in the execution and monitoring of the budget. Under the Republic of Armenia Law on the Budgetary System, the following must be done to ensure municipality budget publicity:

- Within a three-day period of submitting the draft decision on the municipality budget to the council, the draft decision must be published in the local media. At the same time, the main indicators of the budget, statistical and graphical bulletins, and brochures must be presented and published;
- Within a month of the end of each quarter of the fiscal year, information on quarterly execution of the municipality budget must be published;
- Within five days of approval by the municipality council, the annual report on municipality budget execution shall be published in the local media; and
- Municipality heads must create conditions for community members willing to learn about the draft municipality budget and the annual report to be easily able to obtain the respective documents.

The information presented to the public should be presented in a very simple and comprehensible form with a view to making it accessible for each member of the community. Here, the emphasis should be placed on

explaining the performance of activities prescribed in the budget and the planned and achieved results, rather than purely technical terms and numbers.

The requirements on reports submitted to the governor and other central government bodies are different, as the report forms and frequency are defined by law.

As performance budgeting is implemented in local government, reporting forms may be developed, which will focus municipality budget execution reporting onto the outcomes of expenditures.

6.3 Budget Control

Municipality performance budget controls are a set of activities and procedures used to ensure the performance of LGB programs, the use of resources for defined objectives, outputs, and goals, the protection of programs from mistakes and failures, and the receipt of timely and accurate information needed for sound decision-making. Through current oversight of financial expenditures, the budgeting process must be harmonized with the municipality policy goals, and deviations must be precluded.

Budgetary controls imply:

- Regular progress in budget preparation and execution;
- Summarizing and evaluating the performance of set objectives;
- Explaining and guiding deviations from project requirements; and
- Summarizing budget outcomes and benchmarking against project objectives and expected outputs.

There can be internal and external budget controls. *Internal (management) controls* are exercised within

Box 18.

Segment from the Republic of Armenia Law on the Budgetary System

Once a quarter, prior to the 15th date of the month following the end of the reported quarter, the municipality head shall present budget execution messages to the respective governor (in Yerevan, to the Yerevan Mayor).

The message referred to in this Article shall be submitted to the respective governor (in Yerevan, to the Yerevan Mayor) by the municipality head in the form approved by the Authorized State Body.

Within three days of the municipality council approving the municipality budget execution annual report, the municipality head shall submit the report to the respective governor (in Yerevan, to the Yerevan Mayor).

the municipality in a top-down manner. *External controls* are exercised by the central government bodies authorized by law to exercise such controls.

The main body of internal controls over the municipality budget is the municipality council. The council should form a commission from among its members to perform effective controls. It can also engage the services of an auditor. Controls within the municipality staff are exercised by staff managers. Permanent and general controls over municipality budget execution are exercised by the municipality head. He is responsible for the correct and timely performance of both financial transactions and all program objectives. The heads of municipality units control the implementation of their projects.

External control of municipality budgets is performed by the National Assembly and the Government within the scope of their powers defined by law. The Government controls the execution of the municipality budget in respect of the use of targeted state budget allocations to the municipality (including subventions, municipality budget allocations from privatization of state-owned assets in accordance with law, and state financing of functions delegated to local governments) and the use and repayment schedule of loans from the state budget and other sources permitted by law through a state body authorized for such purpose by the Government.

Types of Control

Municipality budget control types can be divided by *budgeting phases* and by *areas*. Budget control types by budgeting phases are as follows:

- *Preliminary control*, which is exercised at the budget planning phase and is intended to check the budget planning process in accordance with the procedure and time periods specified by law and LGB decisions;

- *Current control*, which is exercised at the budget execution phase in order to ensure the execution of the budget; and
- *Final control*, which is exercised at the budget audit and evaluation phase after the end of the fiscal year.

The categories of budget controls by areas are as follows:

- *Accounting and financial reporting controls*. Accounting controls include the procedures by which transactions are required to be recorded in the accounting system. Accounting controls also include the internal procedures within the accounting systems that are intended to detect and report to management any anomalies. A mechanism of account classification is created, according to which expenditures are made by areas of activities and programs of community structural units (i.e. by the performance budgeting unit). Financial reports are designed to determine whether the financial performance of the local government body was performed properly, whether the legislative requirements were met, and whether reports were prepared in accordance with them.
- *Performance and program controls*. These controls ensure the linkage between programs and budgets, as well as expenditures and outputs during program implementation, followed by their evaluation upon completion. From the standpoint of performance budgeting, it is very important for resources to be spent on programs and for the expected results to be achieved. Controls help identify program anomalies and deviations and undertake corrective action.
- *Process controls*. These are the procedures designed to ensure that actions are taken only with proper authorization required by the process.

- *Procurement controls.* These controls cover the determination of needs for which LGB procurements are made and the incorporation of such needs in programs, the establishment of procurement procedures, the tendering process, the transactions, and the documentation.
- *Separation of duties.* This is both a control measure and an indispensable element of many control systems. The central feature is that, in any transaction, at least two people should be involved to minimize the risk of improper action.
- *Internal audit.* See Chapter 7.

Effective controls of the municipality budget require the establishment of appropriate procedures. If special procedures of performance control have not been established, then the budgeting turns into an accounting procedure. Establishing a formal control procedure consolidates the budget management process.

Proper organization and implementation of municipality budget controls through checks will have positive results, including the following:

- Conducting formal checks influences the behavior of staff during the period between checks;
- The participants of the controls acquire mutual understanding and agreement on the activities performed;
- Checks promote cooperation between the representative body (the municipality council) and the executive (the municipality head); and
- Checks reveal mistakes and create a basis for corrective action.

Municipality budget controls and regular checks enable municipality unit heads and project officers to take corrective action in order to achieve the defined objectives in time. Timely checks are used to identify significant anomalies and the reasons for deviation and to develop recommendations of corrective action.

Conclusions

Planned programs become reality during the budget execution and control stage. The municipality head is generally responsible for budget execution by carrying out the functions vested in him by law. Within the limits of their authority, all the heads of municipality staff structural units, too, are responsible.

Accountability ensures the provision of appropriate information on the execution of the municipality budget. Internal accountability takes place within the municipality staff from the lower ranks of staff to the municipality head and council, while external accountability is that in respect of public administration bodies and the municipality residents. The Armenian legislation regulates accountability in rather great detail.

Municipality budget control ensures the regular planning (preliminary control), the budget execution (current control), and evaluation (final control). Control allows identifying the shortcomings and deviations within the budgetary process, and to take corrective action.

7

PERFORMANCE BUDGETING AUDIT AND EVALUATION

This Chapter is devoted to the financial and performance audit of performance budgeting, the process of their organization, and program evaluation issues, methods, and processes.

The final phase of budgeting is audit and evaluation. Its importance is underlined by the fact that the next year's budgeting process is based on an evaluation of the current year's outcome, which is taken into account in order to address mistakes and flaws and to apply more effective methods of budget planning and execution.

Under conventional budgeting, audit is mainly boiled down to an annual financial audit, which is performed to check the conformity of financial transactions with adopted rules. Under performance budgeting, the performance outcomes are treated as priority, and in this respect, the audit expands its conventional scope. It also reflects the objectives and outcomes achieved.

Audit is a type of activity and a set of actions that help define whether the financial transactions performed by LGBs were performed in accordance with the accounting principles and standards prescribed by the laws of the state, and whether service delivery programs were implemented and the expected outcomes achieved.

Audit is a means of ensuring accountability, which reports both the accuracy of financial statements (financial accountability) and the performance of service delivery programs (operational accountability). Today, auditors evaluate the performance of service delivery on the basis of economy, efficiency, and effectiveness. It should be mentioned that the municipality staff management attach great importance to the aforementioned indicators, but their approach is different from that of accountants. From the standpoint of accounting, the performance standards or principles are the same for all the communities. Managers ensure service delivery within the frameworks of financial, legal, and political conditions that are characteristic of their municipality. In other words, there is no single standard for all services and all municipalities. Municipalities differ from each other, among other things, by the various types and methods of service delivery and work performance. Because they have the goal of improving service

delivery, performance audit and evaluation should reflect these differences.

Generally, there is external and internal audit. **External auditors** are independent of the municipality or organization that they are auditing, and are contracted for their work.

Internal auditing is an independent, objective, assurance, and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve effectiveness of risk management, control, and governance processes⁷. Internal auditors are employees of the municipality or organization. Internal audit is a concept which flows logically from internal control. However, an internal auditor should not be directly involved in the process of internal supervision, but rather, should evaluate it and issue an opinion on it. An internal auditor is considered independent, if he can freely and impartially do his work.

Audit has not become institutionalized in the municipalities of Armenia yet (Box 19). While external audit is absent altogether, internal audit is just emerging. Under these circumstances, the new requirements on performance budgeting should also apply to audits.

7.1 Financial and Performance Auditing

Financial Auditing

The municipality balance sheet and financial reports are prepared by the financial unit staff, which is responsible for financial management. **Financial audit reveals the conformity of financial transactions with the generally accepted accounting and reporting requirements.**

7. This definition was approved by the Board of Directors of The Institute of Internal Auditors in June 1999 (Managing Public Expenditure. Edited by R. Allen and D. Tommasi. OECD 2001).

Box 19.

Armenian Legislation on Audit in Local Government

*The Armenian legislation requires **internal financial audit** in each municipality. Thus, Article 69 of the Republic of Armenia Law on Local Self-Government provides that the municipality staff audit body shall submit to the municipality council its findings and opinion on the annual municipality budget execution report submitted to it by the municipality head. It means that the municipality staff needs to have an audit unit.*

*Two laws are reflecting the **external audit** issue. Articles 68 and 69 of the Republic of Armenia Law on Local Self-Government provide that in order to ensure permanent and effective control of budget execution and the budget execution report, the municipality council may commission an independent auditor. Third issue of the Article 35 of the Republic of Armenia Law on Budgetary System provides that the municipality budget performance annual report is being discussed and approved during the municipality council meeting with the existence of the recommendations provided by the professional auditing organization.*

Financial audit can be conducted by both internal and external auditors. We will focus on external audit, because its importance is great in terms of obtaining accurate information regardless of the source.

Financial audit is a process comprising certain successive steps, which begins with the audit obligation undertaking by the auditor service and ends with the audit report (Box 20).

The first three steps in the financial audit process can be called the preliminary phase. During this phase, the municipality sends out a request for proposals, or an invitation to bid, for a contract to perform audit services for a period of time. This contract may be for one or more years. The successful proposal will come from a firm that is fully qualified in governmental auditing. The firm should also have some knowledge about the community it will be auditing. The audit proposal should include information confirming the qualification of the firm and the audit strategy that would include the methodology for assessing the material accuracy of financial statements.

The 4th, 5th, and 6th step of the financial audit process make up the phase during which the actual audit is conducted. During this phase, financial transactions are assessed on the basis of the methodology. It should be mentioned that an audit covers a random sample, rather than all financial transactions. However, if internal audit issues are identified, then the auditor should check more transactions.

The fiscal year should partially dictate the planning and timing of conducting the audit. Under the Armenian legislation, the fiscal year ends on December 31. The municipality and the auditor should decide the audit start date after the fiscal year end, dates for onsite visits, and when the auditor expects to issue the auditor's report. Step 6 of the

audit process is the actual audit work of sampling financial data for materiality, reviewing controls for proper procedures and documentation, and testing for compliance with laws and regulations.

The 7th and 8th steps of the financial audit process are the final phase of the audit. Auditors document their work during the audit process with work papers, which are the evidence for their findings and recommendations. The auditor's report typically contains three paragraphs. The first describes the audit scope, including the responsibility of the auditor and the responsibility of management. The second paragraph provides information on the audit standards used for conducting the audit. The third paragraph sets forth the auditor's opinion and whether the financial statements are presented in accordance with generally accepted accounting principles (GAAP).

There are four types of opinions issued by auditors: unqualified, qualified, disclaimer, and adverse. An unqualified opinion means that the financial statements are in conformity with GAAP. A qualified opinion means that the auditor has specific yet limited reservations concerning the financial statements' compliance with GAAP. A disclaimer is issued when an auditor is unable to issue an opinion on all or parts of the financial statements because he did not have enough information or documentation supporting the financial statements. Finally, an adverse opinion is issued when the financial statements are not fairly presented in conformity with GAAP. That is, the community accounting principles are poorly practiced, and serious financial mismanagement or incompetence is present.

The process for conducting financial audits and for issuing the final audit opinion are important to performance budgeting. One of the key components of

Box 20.

An Overview of Financial Auditing

Steps

1. *Accepting and establishing the terms of an audit engagement financial*
2. *Knowledge of governmental unit and environment*
3. *Audit strategy internal control and risk*
4. *Setting materiality levels*
5. *Planning, timing, and conducting the audit*
6. *Audit samples, review of controls, and tests for compliance with laws and regulations*
7. *Managing work papers*
8. *Auditor's report and management letter*

Description

- A public organization normally issues a request for proposals for the annual audit. The selected proposal is combined with the contract to establish the terms of the audit engagement.*
- The auditor should understand legal, political, and reporting requirements. The public entity should understand the auditor's administrative and operating characteristics.*
- Internal controls are a function of an entity's organizational, financial, and informational structures. Risk is a function of the environment in regard to error and fraud.*
- Audits require testing percentages, analytical procedures, sampling, and qualitative considerations. Planning and timing are a function of prior experience with the client and experience of external auditors.*
- Conducting the audit requires onsite works and scheduling considerations.*
- The core components of the audit, creating the necessary information for issuing an audit opinion.*
- Documentation of audit work, including supervisory review and checklists.*
- Issuing an unqualified opinion, a qualified opinion, a disclaimer, or an adverse opinion. An auditor may also issue a management letter, identifying financial control weaknesses that need to be addressed.*

Source: American Institute of Certified Public Accountants, Audits of State and Local Governmental Units, 17th ed. (New York: Author, 2002).

performance budgeting is financial accountability or fiscal stability. Historical financial trends of municipalities and future financial projections are critical to strategic planning, because they form the foundation for analyzing the resources required to increase, decrease, or maintain current levels of service over projected time periods. Financial statements that support historical trends and future projections must be

accompanied by unqualified audit opinions for these projections to be trustworthy.

Another connection between financial auditing and performance budgeting comes from the relationship between financial data and cost data. At present, the preferred method is the calculate the total cost of service delivery in the form of direct, indirect, and capital costs in order to track the true cost of providing com-

munity services. Cost data are superior to financial data in calculating the unit cost of service delivery. The accuracy of cost data hinges on the accuracy of financial data. Financial audits must verify that financial data are materially accurate so that cost systems can reveal the true cost of service delivery inputs, and so that performance budgeting can include consideration of service inputs and outputs/outcomes.

Performance Auditing

Financial auditing is easier than performance auditing. While financial auditing has a long experience, performance auditing is new and will take a long time to become instilled. At present, there is common belief that the purpose of performance auditing is to study and make recommendations on improving the economy and the efficiency of service delivery. Economy means that the program is structured properly to accomplish its mission, and efficiency shows how inputs are used to maximize outputs.

Performance auditing is the systematic and objective assessment of the performance of an organization, program, function, or activity by an independent auditor, who reports findings, conclusions, and recommendations to a party or group with legal responsibility to oversee and/or initiate corrective action.

Note the similarities to the financial audit, though performance auditing also has some peculiarities that will become clear when describing the process. The first two steps of the process determine how to conduct the studies and develop recommendations so that they effectively improve the studied program, performance, or process. The main elements of Step 1 are: to construct an audit work plan with input from municipality staff or project managers, to build commitment and to identify need, to select individuals with the necessary experience and background to conduct the audits, and to determine the audit objectives. It should be mentioned here that audit staff cannot determine how the audit findings and recommendations will be used. Senior municipality officials must decide how and where to use them. Together with the audit staff, they should also set the audit objectives.

Understanding management control (Step 2) is critical to conducting a performance audit and to the overall management of service delivery. It is the span of management control or authority over the policies, procedures, and practices needed by personnel to provide services to the public. Management control also encompasses management's ability to accomplish goals and objectives. As management control increas-

es, program effectiveness becomes a management responsibility. As management control decreases, the auditor must identify and control for other factors (internal and external) impacting program success that fall outside the manager's ability to enhance effectiveness.

The 3rd and 4th steps of the performance audit process are the actual audit, using specialized techniques. The audit objectives guide this process. These steps focus on the review of program processes and procedures. Sampling is performed, if the subject matter, i.e. the service delivery database is too extensive.

A general process for performance auditing is presented in Box 21.

Step 5 of the audit process is to report the audit results. This requires the offering of recommendations and implementation guidelines that will actually be used to improve municipality service delivery.

The final step in the audit process is the use of a follow-up system to ensure that the recommendations from the audit have been implemented.

Performance auditing is often considered the same as program audits. In reality, there are process and purpose similarities between program evaluation and performance auditing. The major difference, however, is that program evaluation often takes the perspective of the service recipient, relying on outcome impacts consistent with the goals of the program. Performance auditing takes the perspective of the service provider, and assesses effectiveness through the prism of economy and efficiency.

7.2 Project Evaluation

What is Project Evaluation?

Since projects are an important element of performance budgeting, project evaluation is essential in terms of the end results of municipality activities that are ultimately aimed at the delivery of municipality services. Project evaluation is aimed at determining the impact of a project outcome on the municipality residents in comparison with project objectives. Project evaluation reflects an improvement of the social conditions.

Project evaluation is the use of social research procedures to systematically investigate the effectiveness of social intervention projects that is adapted to their political and organizational environments

Box 21.

An Overview of Performance Auditing

Steps

1. *Planning the audit*

Description

The span of control over policies, procedures, and practices needed by personnel to achieve the objectives of the program

2. *Understanding management control*

Obtaining evidence based on audit objectives and documenting work with detailed and comprehensive work papers

3. *Conducting the performance audit*

Obtaining evidence through statistical sampling, through interviews and questionnaires, and through actual review of processes and procedures

4. *Specialized techniques*

Providing background information, audit scope, methodologies used, findings based on clearly articulated evidence, recommendations for change, and implementation guidelines

5. *Reporting the audit results*

Includes establishing an audit work plan, identifying who will conduct the audits, determining the audit objectives, discussing the informational needs and evidence requirements, and agreeing on how conclusions will be presented

6. *Follow-up system*

An evaluation process used to ensure that the recommendations have been implemented

Source: Leo Herbert, Auditing the Performance Management (Belmont, CA: Lifetime Learning Publications, 1979).

and designed to inform social actions in ways that improve social conditions.

Project evaluation can be performed at different stages of project implementation:

- Evaluation after the end of the project is performed once the project has ended. The project effectiveness and total cost and significance are evaluated. This evaluation is usually used for accountability purposes.
- Operational evaluation is performed during project implementation. Its purpose is to support and improve project management and implementation.

The goal of project evaluation is to improve decision-making and resource allocation by providing reliable data about the effects of policies and programs.

Evaluation provides factual information to decision-makers in order for them to take justified decisions and to prove that their decisions are optimal.

Project Evaluation Goals and Issues

Uses of project evaluation cover the following:

- **Assisting resource allocation and identifying make desirable policy changes.** Evaluation provides information on the impact of existing policies. It therefore assists policy makers in assessing the value of public programs and identifying areas where policy changes and/or shifts in the allocation of resources between different programs may be necessary.

- **Improved project management and organizational learning.** Feedback mechanisms contribute to the learning process of those managing and implementing projects and can be used to improve their operational performance.
- **Enhancing public accountability.** Evaluation can improve transparency and accountability by shedding light on the impact of local government policies.

Project evaluation should answer several key questions, which can be grouped into the following categories:⁸

- **Continued relevance.** To what extent are the objectives and mandate of the project still relevant?

Are the activities and operational inputs consistent with the project's mandate and plausibility linked to its objectives and other intended results?

- **Utility.** How does the intended impact of the project compare with the needs of the targeted population?
- **Sustainability.** To what extent can any positive changes arising from a project be expected to last after the project has been terminated?
- **Efficiency.** How economically and efficiently have the various inputs been converted into outputs?

Box 22.

Alternative Approaches to Project Evaluation

Approach

Description

Objectives-oriented

This approach focuses the evaluation on the extent to which a project is meeting its objectives.

Management-oriented

This approach is designed to provide management with critical information to enhance the utility of making decisions.

Consumer-oriented

This approach obtains feedback from the consumers or the service recipients on their perceptions of the project.

Expertise-oriented

This approach uses individuals with expertise in the field of study to analyze the worth of a project on the goals of the evaluation.

Adversary-oriented

This approach reduces the amount of bias in evaluation, introducing the views of both supporters and adversaries of the project.

Participant-oriented

This approach includes line managers in the evaluation process to obtain the necessary experience required for detailed analysis.

Source: Blain R. Worthen, James R. Sanders, and Jody L. Fitzpatrick, Program Evaluation: Alternatives, Approaches, and Practical Guidelines, 2d ed. (New York: Longman, 1997).

8 Managing Public Expenditure. Ed. by R. Allen and D. Tommasi, OECD 2001.

Box 23.

General Process to Project Evaluation

Steps

1. *Select a project to evaluate*
2. *Determine the perception of the problem*
3. *Define the nature and scope of the problem*
4. *Determine evaluation objectives*
5. *Select a study team*
6. *Prepare a detailed study plan*
7. *Establish lines of communication*
8. *Collecting, analyzing, and interpreting data*
9. *Reporting and using evaluation information*

Description

- May come from an annual work plan, a current problem or crisis, or a political request*
- Feedback from the critical decision makers on the reason to conduct the evaluation and on the goal of the evaluation*
- Helps identify the resources needed for the evaluation, responding to breadth of study and precision of results*
- Information from this step used to identify purpose in regard to objectives and to select the type of approach for the evaluation*
- Function of the size of the organization and whether internal or external evaluators are used*
- Based on the preparation work presented in steps 1-4, a clear and comprehensive evaluation plan is constructed that describes the scope, methodology, and timetable*
- Creating the ability to collect information in an efficient manner from all stakeholders involved*
- Using the selected methodology from step 6 to guide the process and preparing for unintended consequences or unforeseen results*
- Using the information by implementing the recommendations based on the implementation guidelines contained in the final report*

Source: Nicholas Henry, Public Administration and Public Affairs, 5th ed. (Englewood Cliffs, NJ: Prentice-Hall, 1992).

- **Effectiveness.** Were project objectives achieved? What client benefits and what broader outcomes, both intended and unintended, resulted from carrying out the project? Does the project complement, duplicate or overlap with other projects?
- **Cost-effectiveness.** Are there alternative solutions or projects that might have achieved the desired objectives and intended results more cost-effectively? Are there more cost-effective ways of delivering the existing project?

In addition to answering these questions, project evaluation should also assess the negative effects, shortcomings, or inefficiencies.

Project Evaluation Methods

There are multiple methods of project evaluation (Box 22). Each of them is based on a project element (objectives, management, users, and the like). Each method has advantages and disadvantages that the evaluation

Box 24.

An Example of an Evaluation Report Structure

Executive Summary

- *An overview and summary of the entire report.*
- *A discussion of the strengths and weaknesses of the chosen evaluation methods.*

Introduction

- *Description of the project in terms of needs, objectives, delivery systems, etc.*
- *The context in which the project operates.*
- *Purpose of the evaluation in terms of scope and main evaluation questions.*
- *Description of other studies that have been done.*

Research Methodology

- *Design and implementation of the research and collection of data.*
- *Analysis of data.*

Evaluation Results

- *Findings.*
- *Conclusions.*
- *Recommendations.*

Annexes

- *Terms of reference.*
- *Additional tables.*
- *References and sources.*
- *Glossary of terms.*

Source: Commission of the European Communities (1997), in the book- Managing Public Expenditure. Ed. by R. Allen and D. Tommasi, OECD 2001.

must consider. For example, the objectives-oriented approach is driven by the success of the project with respect to project objectives, and the evaluation focuses mostly on this component. The consumer-oriented method prioritizes the opinion of the service recipients. Depending on the evaluation objectives, several methods can be used in combination.

Project Evaluation Process

A different evaluation process is typical of each project evaluation method. Some methods require more work at the initial stage of the process (for example, the expertise-oriented or management-oriented methods), whereas others require a thorough methodology of data collection and analysis (for example, the con-

Box 25.

Institutional Arrangements for Evaluation

France. A National Council of Evaluation was established in 1999 and is responsible for preparing an annual evaluation program on the basis of proposals formulated by line ministries and local governments. This Council is composed of scientists, other experts and representatives of local authorities. The evaluation studies are financed by a National Fund for Evaluation, and are published. Besides the activities co-coordinated by the National Council, line ministries and sector evaluation committees also carry out evaluation studies.

United Kingdom. Organizational arrangements for evaluation are diversified and have a "polycentric" character. The National Audit Office, the Audit Commission, HM Treasury, line ministries, executive agencies and many local authorities undertake evaluation studies. There is no single organization that is responsible for supervising or coordinating this work, though the Treasury has published some guidance documents. Evaluation is well developed in some areas and findings of evaluation studies are used in setting (and adjusting) policy priorities and in budget management.

Source: Managing Public Expenditure. Ed. by R. Allen and D. Tommasi, OECD 2001, p. 381.

sumer-oriented or adversary-oriented methods). That is the reason why the program evaluation process shown in Box 23 provides only an overview, rather than the details of the process.

The process of project evaluation begins with selecting a project to evaluate, determining the perception of the problem, defining the scope of the problem, and constructing evaluation objectives. These steps are the most critical to the success of the evaluation. Without a meaningful reason to conduct an evaluation, a well-defined scope, and definable objectives, evaluation is pointless. The community council or the community mayor can be the main actors at this stage.

The 5th, 6th, and 7th steps in the process make up the evaluation preparation stage. At this stage, a detailed review plan is compiled on the basis of the evaluation objectives, and the necessary lines of communication are established.

The next step in the project evaluation process is the actual evaluation on the basis of data collection and analysis. Here, the use of accurate and credible performance data is especially important. If the data has not been audited prior to the project evaluation, then the evaluating team will need some time to verify the accuracy and credibility of the data.

The final stage in the project evaluation process is the reporting and using the findings and recommendations (see report example in Box 24). It creates the opportunity for performance budgeting. Budgetary

implications attend to every recommendation in the final report, setting the stage for performance budgeting in two ways. First, project managers can use the information as justification for budgetary requests or for reprogramming resources (changing the allocation of resources among activities) in completing their annual budget worksheets.

Second, municipality council members can use the information to move beyond horizontal decision making to vertical decision making based on project performance. Project evaluation, therefore, becomes an important precondition for a transition to performance budgeting

The Role of Evaluation in Armenia

Developing an evaluation culture needs time. Even in a large number of European countries, it is uneven and not systematically carried out.⁹ The need for project evaluation arises at a certain stage of local government development. It requires that project or performance budgeting and external audit be in place. On this general background, it would be difficult to expect that project evaluation would be introduced in Armenia any time in the near future. However, the municipalities that will shift to performance budgeting should gradually instill project evaluation, as well.

Box 25 provides examples of some countries' institutional arrangements for project evaluation.

9 Managing Public Expenditure. Ed. by R. Allen and D. Tommasi, OECD 2001, p. 380.

Conclusions

Performance budgeting places a very strong emphasis on the final stage of the budget process, i.e. the budget audit and evaluation. Under an expenditure budget, audit is mainly about checking whether the annual financial transactions were in conformity with the established rules. A performance budget is based on strategic planning and multi-year budgeting, with a primary focus on performance outputs. The traditional scope of the relevant audit grows in this way. It also reflects accomplishments and outputs.

The municipality should have internal audit designed to improve the performance of the organization and external audit conducted by an organization that is independent from the municipality and is performing the audit on the basis of a contract. External audit is performed by specialized organizations, which issue a rather objective and precise opinion on the financial transactions and programs carried by the municipality.

Financial and performance audits are carried out by a certain process, including a sequence of steps that needs to be maintained in order to reach the right conclusions.

A performance audit is carried out from the perspective of the service provider to evaluate efficiency and

effectiveness, while project evaluation is performed from the standpoint of the service beneficiary, specifying the project objectives and the impact of outputs on beneficiaries.

When evaluating a project, it is necessary to answer questions about the conformity of the project to municipality priorities, activities and outcomes being in line with the project goal, the planned project impact being compatible with the needs of the target population, the sustainability of any positive change anticipated as a result of the project after the project ends, the way in which different revenues can be sparingly and efficiently converted to outputs, the achievement of project objectives, the specific gains of service beneficiaries from project implementation or the broader public gains, and the availability of alternative solutions or projects to achieve the goals and outputs with greater cost effectiveness.

Different methods of project evaluation are known, each of which is characterized with a unique process. It ends with budget summaries that are reflected in each recommendation of the final report and become the basis for performance budgeting. In this way, the municipality council members can use the information and move from horizontal decision-making to vertical decision-making based on project execution.

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Program Officer
Narine Sahakyan, UNDP Portfolio Manager

Project Coordinator
Susan Bagratuni, UNDP

AUTHORS
David Tumanyan,
Vahan Movsisyan,

Translation
K. Adumyan

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