

Mapping city dynamics

Public sector performance



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Foreword

Changes are a part of the daily agenda. Over the next few years, the public sector will need to be 'match fit' to deal with major structural challenges and changes.

In today's complex environment, it takes a team with knowledge in many areas to get the job done. And individuals with strong principles and values, to get it done the right way.

Deloitte has undertaken the study with the aim to understand better how municipalities see themselves and what is their rating in the five areas: Finance, Human Capital, Infrastructure, Public Works and Taxation. The results may serve as a reference point for any future challenges and opportunities facing the region in its development and as guidance for what may be done to assist constituents.

I would like to extend my thanks to the mayors of the municipalities we interviewed in support of this report. Without the insight and perspectives they provided, this work would not have been possible.

John Winkler

Partner in Charge

Methodology

The Deloitte PannonAdria Public sector survey was developed to in order to provide municipalities in the geography with an indicative of view of how they perform in the areas of strategy, finance processes, human capital management, municipal infrastructure (IT and processes), public works and taxation and to see what challenges and opportunities other municipalities in the geography are encountering.

The survey is not designed to provide statistically robust information. It is a subjective survey that provides indicative information and should be read within that context. The conclusions stated in the survey report are developed from a combination of responses to the survey questions and Deloitte's experiences with clients in the geography. The responses of the participants have not been audited or validated for correctness.

The survey questionnaire was sent to mayors in the municipalities of Zagreb, Karlovac, Šibenik, Zadar, Split, Osijek, Pula, Rijeka, Velika Gorica, Varaždin, Dubrovnik, Sisak, Koprivnica (Croatia), Ljubljana, Maribor, Koper, Novo Mesto, Kranj (Slovenia), Centar Sarajevo, Stari Grad Sarajevo, Novo Sarajevo, Novi Grad (Bosnia and Herzegovina), Banja Luka (Republic of Srpska), Belgrade, Novi Sad, Nis, Kragujevac (Serbia), Óbuda, Józsefváros, Újpest, II. District, Várkerület, Kispest, Soroksár, XV. District, XVI. District, Pestszentlőrinc-Pestszentimre, Újbuda, Rákosmente, Belváros-Lipótváros, Budafok-Tétény, Angyalföld, Csepel, Kőbánya, Terézváros, Zugló (Budapest), Győr (Hungary).

From these 47 municipalities, 10 municipalities provided either full or partial responses to the whole questionnaire.

The survey was performed between the period of December 2008 and January 2009 and hence the responses are relevant based on information and knowledge available to the municipalities at that point in time.



Executive Summary

Deloitte has undertaken a first of its kind comprehensive municipality survey in PannonAdria. The survey focused attention on the areas of strategy, finance processes, human capital management, municipal infrastructure (IT and processes), public works and taxation. With this survey, Deloitte wanted to provide to municipalities in the region the opportunity to compare themselves against other municipalities and against global best practice. Of 47 municipalities that received the survey, 10 responded in some form to the survey.

Strategy

The survey results tend to indicate that many Municipalities in the region do have strategies of some sort. The high level of existence of strategies indicates that municipal leaders understand the importance of having a vision, a direction for their municipality. But as one great leader stated: A bad strategy well implemented is much better than a good strategy poorly implemented! So in line with that thought, the survey looked further into the operations of the municipalities.

Financial processes

Based on the responses in the survey, it appears that municipalities in the region do not generally utilize best practices. It appears that the custodial function of the finance area is dominant and that the new approach whereby finance is a value adding partner in the organization has not been fully adopted in municipalities in the region. Greater adoption of best practices can enhance the quality of finance processes and better support decision making.

Human Capital Management

The responses to the survey indicate that the importance of human capital management is understood by municipalities in the region. Some of the elements of a complete human capital management system appear to be in place at several municipalities but it does not appear that municipalities have fully embraced the role of the Human Capital management as a strategic role within the organizations, viewing it more from an administrative and compliance perspective.

IT and Processes (Infrastructure)

Based on responses to the survey questions, it appears that municipalities understand the need for continuous improvement in these areas. In many cases the municipalities indicated their level of dissatisfaction in these key areas, or they responded that they are aware that performance and the level of development in these areas is insufficient.

Public Works

The survey responses show that municipalities in the region will be undertaking major public works projects in the next 5 years and that the financing of these undertakings is not always resolved or planned in a structured manner. Although different sources for funding will be utilized, it appears that there is room for greater creativity and utilization of new sources of financing. One surprising finding of the survey is that the EU is one of the most frequently used sources for funding for infrastructural projects.

Taxation

A majority of responding municipalities are tax payers, yet only a minority undertake tax planning. The management of Value Added Taxes appears to be more robust than corporate tax management as a majority of municipalities regularly review their VAT contributions. Improving overall tax planning can lead to more efficient use of constituent funds and enablement of more constituent facing services and projects.



Preface

Municipalities and cities (we will use the word municipality to refer to towns, municipalities and cities) are the places with which people associate themselves, where they call home and where they are strongly influenced by their environment and surroundings. Because they are so important to the people living in them, Deloitte has undertaken a study that to our knowledge has never been undertaken: a survey of municipalities in the PannonAdria area focusing on the primary areas of municipal strategy, finance processes, human capital management, municipal infrastructure (IT and processes), public works and taxation.

The study was undertaken with the aim to understand better how municipalities in this geographic area see themselves and how they rate in the six subject areas. How municipalities perform in the six areas has a direct impact on how well constituents are served. And because the survey included a broad range of municipalities in this area, the results are interesting because it is the first time that such a comparison has been undertaken. The results can serve as an initial bellwether of what challenges and opportunities lie ahead as this region develops into the future and what can be done to better serve constituents.



Strategies

Seventeen questions were put forward in this part of the survey. The questions focused on the areas of strategy, planning/budgeting, financial management/accounting, treasury/risk management, management reporting and capital budgeting.

Do Municipalities have strategies?

Of the 10 municipalities that responded 8 have responded that they do have a strategy and 2 do not. Although the survey does not assess the quality of what the municipalities refer to as a strategy, it is encouraging that initial indications tend to indicate that municipalities have a long term view.

Deloitte would consider the existence of a strategy as a best practice in the public sector. A strategy is important because it provides direction, it is a flag pole in the sand somewhere off in the distance towards which the organization aspires to. A municipality can be many things to many people, but it cannot be all things to all people, so it must choose its future and this is done through the formulation of a strategy. There are several approaches to strategy development for municipalities.

The framework put forward by Deloitte in its Government Performance Map® focuses on 4 key areas:

| | |
|-----------------------------|---|
| Policy Objectives | <p>Effective legislative and executive policies guide the development of program guidelines</p> <ul style="list-style-type: none"> • Outcome-focused approaches help translate these policies into tactical program plans that deliver measurable results. |
| Program Delivery | <p>Successful programs comprise activities that deliver real results and essential services.</p> <ul style="list-style-type: none"> • Programs should be designed to meet or exceed the agency's strategic goals around effectiveness, efficiency, and increased constituent satisfaction. |
| Operating Efficiency | <p>Refers to delivering maximum value for money in terms of service levels, product quality or operational support.</p> <ul style="list-style-type: none"> • Performance excellence is driven by the ability to deliver expected outcomes while optimizing resource utilization. |
| Asset Efficiency | <p>Management of organization assets to maximize utility with minimal cost.</p> <ul style="list-style-type: none"> • Performance excellence is driven by the ability to effectively and efficiently manage human capital, physical assets, and financial assets. |

Another framework that has been put forward refers to 3 key areas that should be touched on in a strategy: Good Urban Governance, Effective Local Economic Performance and Systematic Poverty Reduction¹. The following table shows the sub topics under the 3 general main headings:

| Urban Governance | Local Economic Growth | Poverty Reduction |
|---|--|--|
| Improved participation | Economic and growth strategy | Improved service delivery |
| Access to information | Improved access and terms for municipal credit | Equitable pricing policies |
| Reduced social conflict | Improved revenue streams | Extension of secure tenure |
| Reduced discrimination | Improved service delivery | Upgrading of informal settlements |
| Enhanced participation by women | Private sector engagement | Active women participation |
| Systemic capacity building | Informal sector engagement | Improved revenue collection |
| Public institutions adopt pro-poor approach | Municipal debt reduction | Reduced wastage |
| Clear institutional framework | Women economically active | Reduced systems losses |
| | Improved access and terms of credit within informal sector | Improved terms and access for household credit |

Other frameworks are possible, however from the point of view of the author of the study, the strategy of a municipality should attend to: a vision for what the municipality wants to be for its constituents, the most appropriate ways to provide services to constituents, the most appropriate ways to utilize municipality assets, inclusiveness and transparency in the governance of the municipality and social well being for constituents.

¹Cities Alliance Perspective

Budgeting

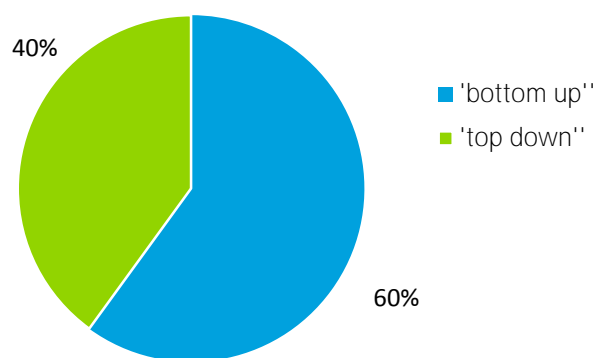
Questions 2 to 4 address the area of budgeting. In summary, best practice in the public sector includes the preparation of detailed annual plans on a monthly basis (including an income statement, balance sheet, cash flow statement and key performance indicators), and longer term plans on an annual basis, using an integrated accounting and planning software package. The planning approach should be a combination of bottom up, zero based budgeting and top down strategic planning based on accrual accounting principles. Actual results should be regularly reviewed against plan and management action taken on negative variances.

The survey results show that 9 out of the 10 respondents do prepare some kind of annual financial and operating plans although through the survey it is not possible to determine the quality of the plans prepared.

4 of the respondents noted that they prepare plans on a top down basis, and 6 prepare them on a bottom up basis². None of the respondents indicated that they use both methods as the basis for budgeting. From the survey responses it appears that there is no dominant method when it comes to using top down or bottom up planning. As noted earlier the best practice is to use a combination of methods in order to ensure sufficient understanding of the detail in a plan as well as to ensure alignment to strategic goals.

6 of 10 respondents prepare annual plans on a monthly basis and 4 of 10 prepare them on an annual basis. Again, there appears to be no single consistent approach in this area. If the plans are not done on a more frequent basis than annually, then the municipality loses the ability to monitor ongoing performance on a regular basis and take appropriate actions to actual developments. Although the development of monthly plans requires more effort and work during the planning process, the pay off comes in greater transparency of performance and in the ability to use the plan as a real time performance management tool.

What is the basis for the preparation of the annual plans?



Source: Deloitte Research, Public Survey

8 of 10 respondents indicated that financial plans are prepared for years beyond the current fiscal year. 2 of 10 respondents did not respond to this question. The fact that a high proportion of the respondents indicated the existence of financial plans into future years indicates that the municipal leadership is aware of the importance of the longer term view.

² Respondent that noted that they do not prepare annual financial and operating plans however does do some kind of planning

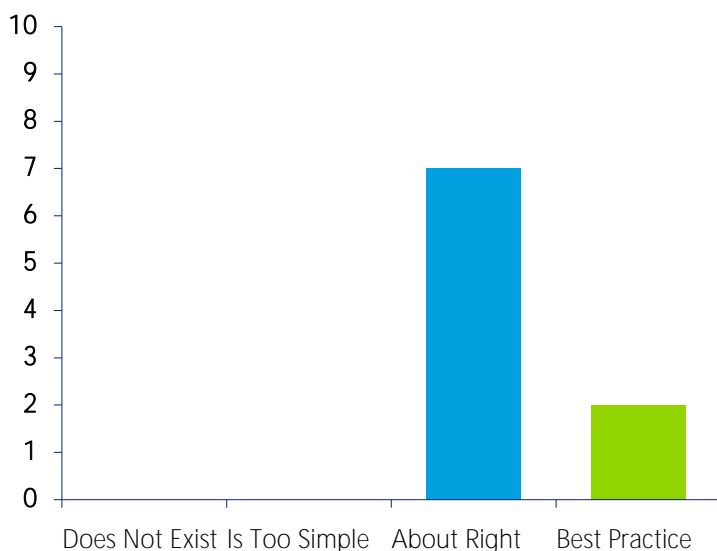
Preparing plans for future years allows the municipality leadership to keep in mind the municipalities' strategy and future requirements so that current decisions can be made within the context of future needs. This approach also reduces the risk of a municipality running into fiscal difficulties in future years because of exorbitant commitments in the current year.

It is surprising to note that 2 of 10 respondents said that their plans are still prepared manually. 8 of 10 respondents use some kind of electronic software to perform the planning process. Using financial software is a basic requirement in this day of computerization and one would not expect to find the preparation of plans to be done manually.

The best practice is to use integrated planning software that is connected to the financial accounting of the municipality. In recent years, there has also been an increase in the use of add on business intelligence (BI) software that is used alongside the main enterprise resource planning (accounting) system. The BI systems are popular because they are increasingly providing to leadership and management more sophisticated tools with which to monitor the organizations performance.

4 of 10 respondents answered that the planning is done in an integrated financial software tool. 6 of 10 respondents reported that the planning is done independently of the integrated financial software package. The questionnaire did not ask whether the BI types of packages noted above are used or if the planning is done using, for example, a spreadsheet tool such as excel. Deloitte's experience in working with clients shows that Excel is probably the most used tool when it pertains to planning. Excel has the advantage that it is a very flexible, cheap tool however, the downside is that it is... a very flexible tool. The excel tool is prone to human error and when it becomes complicated then it is difficult to detect errors in the spreadsheets. This is one of the reasons why it is becoming increasingly common for organizations to use business intelligence software for business planning purposes.

Do you feel that the budgeting and planning process is:



Source: Deloitte Research, Public Survey

9 of 10 respondents noted that they use cash based accounting. The predominance of cash based accounting is somewhat surprising as Deloitte's experience is that municipalities are increasingly using accrual based accounting. Cash based accounting has many shortcomings and increasingly municipalities, especially those that use debt financing through various financial instruments, are using accrual based accounting as their financial partners require this in order to properly assess the municipality's financial standing.

When asked the question of how often actual performance is assessed against plan, the municipalities that responded to the survey had a range of answers. 3 respondents review actual performance against plan on a monthly basis. 2 municipalities review performance on a quarterly basis, 2 municipalities review performance half yearly, 1 municipality does not review actual to plan performance and 2 respondents did not answer the question. As stated in the outset, best practice is monthly performance review against plan. The regular assessment of performance allows the municipal leaders and managers to take real time corrective actions so that the delivery of services and fulfillment of obligations to constituents is not jeopardized through poor performance or lack of action to constantly changing environments.

When asked if plans are linked to purchase decisions, then 8 of 10 respondents answered yes.

1 respondent answered no and 1 did not answer. Linking of purchasing decisions to plans is an important control feature. The fact that so many of the respondents link the 2 indicates that this control feature is well used across the surveyed geography. Obviously, further study would have to be undertaken to understand in more detail how the two are linked and what degree of sophistication is involved.

The municipalities were finally asked to subjectively assess the level of their planning processes. 2 of 10 responded that they feel it is best practice, 7 of 10 responded that they felt it is about right, and 1 did not respond. As noted, the question is a subjective one and the responses emanate from the experience and needs of the municipalities.

Objectively speaking, the collective responses to the questions regarding planning and performance management processes would not seem to indicate that the municipalities should have such a high subjective level of satisfaction. It is the view of Deloitte that the subjective responses should more appropriately tend to the end of the scale denoting a lower level of satisfaction with the processes. Further investigation would be required to understand the disjoint between the subjective level of satisfaction and the responses to the quantitative questions.

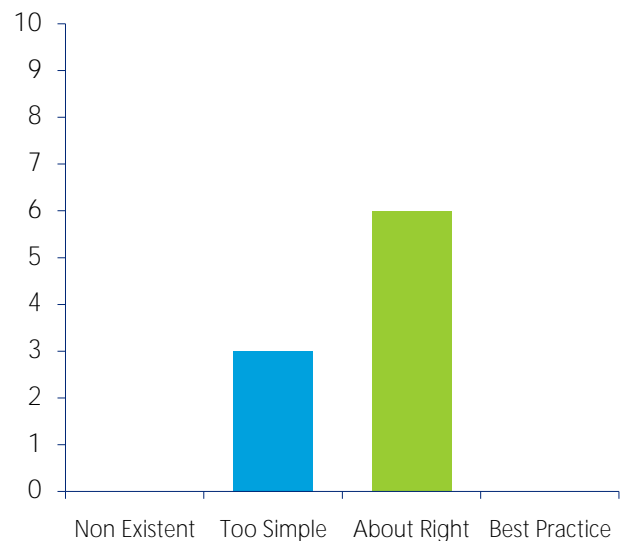
Risk management

Questions 5, 6 and 10 relate to the risk management within the municipality organization. Risk management has become a topic of ever increasing importance to all kinds of organizations over the past years. The questions in this part of the survey pertain mainly to the risk associated with cash/treasury management and controls processes

Best practice in the area of treasury management includes an existing set of principals and policies where it is clearly defined what is the organizations appetite or level of aversion to financial risk, roles and responsibilities for financial management are clearly spelled out and duties appropriately segregated and all financial dealings are clearly documented, tracked, monitored and evaluated.

In the area of process controls best practice organizations typically have an internal audit function, reporting directly to the (in the case of municipalities) mayor. The role of the internal audit is to develop and review controls on processes within the organization to ensure that risks associated with the processes are appropriately minimized, relative to of course financial and other considerations, and to report regularly to the mayor on how the controls are functioning, to recommend deviations from the norms/processes and to make recommendations for improvements in the controls.

Do you feel that the risk management processes of the municipality are:



Source: Deloitte Research, Public Survey

Appropriate risk management protects both the employees in the organization as well as the municipal organization itself. Good risk management also contributes to the strategic goal of transparency.

5 of 10 municipalities responded that they have a treasury/risk management function and 5 of 10 do not. Municipalities, even smaller ones manage relatively large amounts of cash flows and increasingly, there is more attention paid to how the cash and the financial investments of the municipalities are managed.

During the recent financial turmoil, more than one municipality saw the value of their financial investments severely deflated as the values of equities and other securities plunged ahead of the now global economic slowdown. Municipalities should have in place principals and processes to effectively manage cash and financial investments, and mitigate risks associated with these assets in order to best preserve the value of the financial assets with which the constituents have entrusted them. In the view of Deloitte all municipalities should have in place appropriate treasury management either internally or provided by external firms if the required technical expertise cannot be found within the municipality work force.

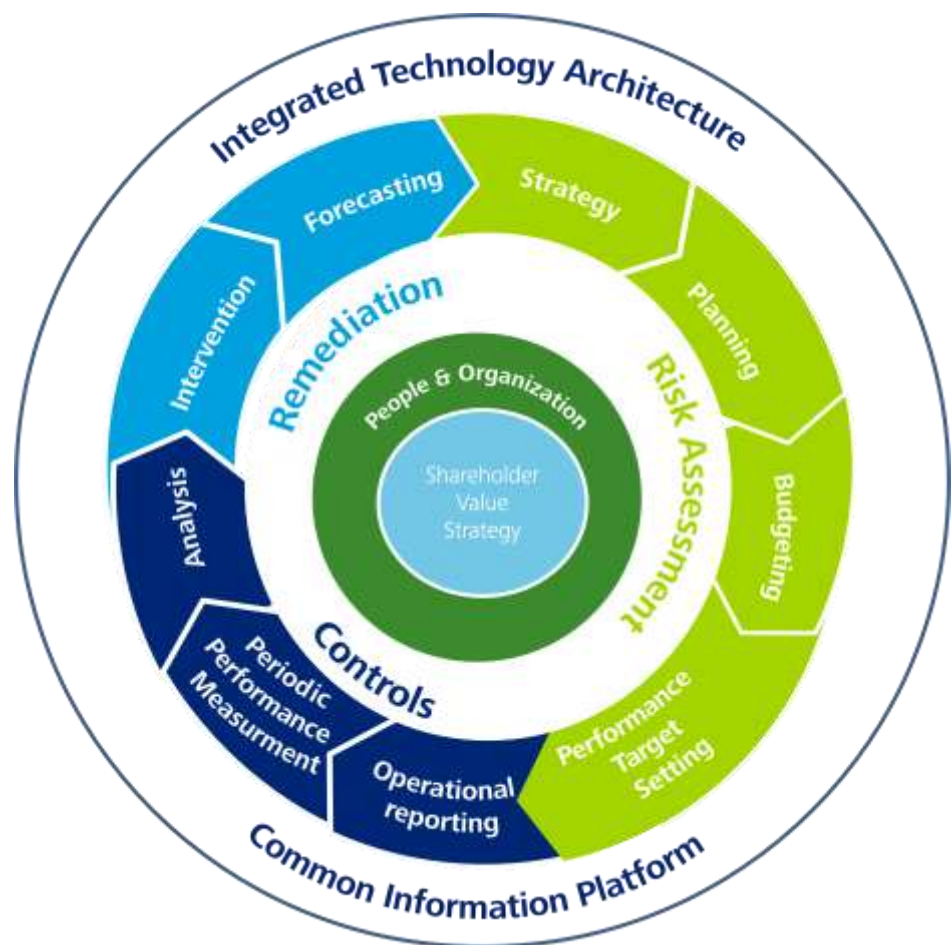
When asked if risk management processes are sufficient, 6 of 10 municipalities responded they feel that they are about right, 3 of 10 responded that the processes are too simple and 1 did not respond. This question was a subjective one and without further detailed clarification it is difficult to assess whether the confidence level in the 6 municipalities is warranted.

It is Deloitte's experience that organizations typically overrate the reliability of their risk management processes, and that a structured assessment of the risk processes reveals shortcomings that the organization had not considered or expected.

However, given that 8 of 10 municipalities responded that they have an internal audit function, and 2 do not, it can be assumed that the municipalities are focused on having effective risk processes as the internal audit department should be developing, assessing and assuring that effective controls are in place.

Reporting

Questions 7 and 8 pertain to the municipalities' level of ability in the area of management reporting. Best practice in this area can be demonstrated in the graphic below:



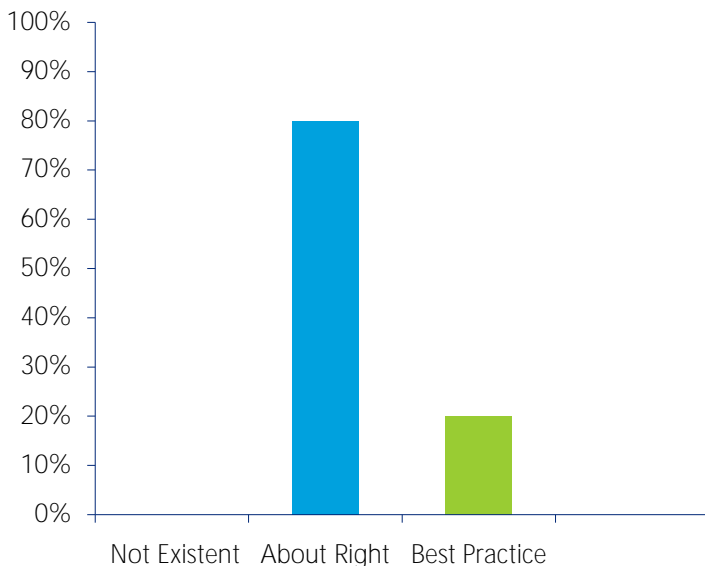
Management reporting in order to be useful has to be timely, accurate, relevant, actionable and mainly, the management has to believe the numbers and conclusions in the reporting. Too often Deloitte has seen ineffective management reporting because management argued over who has the right numbers. Therefore, it is critical that there is agreement among management regarding the source of the data for the reports so that management can focus on actions to implement to keep performance on track, and not to waste time arguing over whether the numbers are or are not correct.

8 of 10 municipalities feel that they have the right level of information about their costs and expenses and 2 of 10 believe that they have best practice in this area. When correlated to question 3.7 (frequency of reporting and assessment of variances) the responses to this question appears to run counter to the responses in 3.7 which did not indicate a superlative level of review of results. It may be that the municipalities have become used to the cost/expense tracking processes and reports being used and may have not critically looked for improvements in this area, a sort of don't fix it if it does not appear to be broken approach. However, further investigation would need to be undertaken to understand the disjoint between the subjective assessment and the objective responses to 3.7.

Responses to question 8 show that 8 of 10 municipalities feel that information on revenues and expenses is prepared on a timely basis, one municipality does not, and one municipality did not respond. The responses to this question correlate to the subjective feelings expressed in question 7 above, and it can be that they do not run counter to responses in 3.7. If the municipality has chosen quarterly, or semi-annual reporting and reports are prepared according to schedules, then the information really can be assessed as being prepared on a timely basis.

However, in Deloitte's view, best practice is that the information is available either real time or at a minimum as shortly as possible after a month end. Best practice organizations have this information prepared and analyzed the same day as the month end by using soft close practices and accruals for known expenses and revenues.

Do you feel the municipality has information about its expenses and costs?

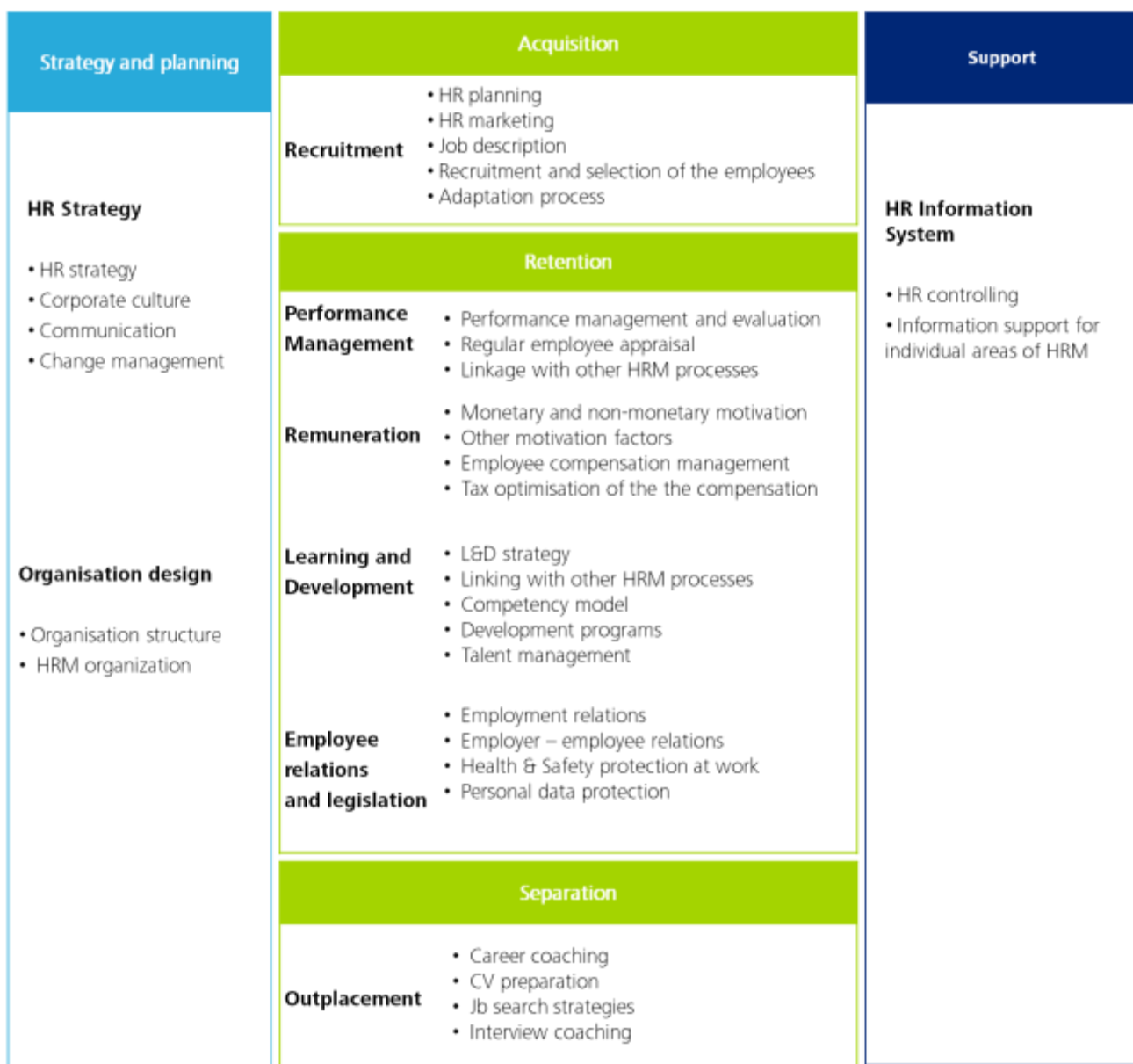


Source: Deloitte Research ,Public Survey

Human Capital Management

As organizations have in past years invested in upgrading information technology and business processes there is now a visible focus on effectively managing the most important assets that all organizations have: the people that work within the organization. Municipalities are no exception to this practice. Attracting and retaining talented, motivated employees is critical to an organizations ability to deliver on its strategy and annual performance targets.

Deloitte’s HR framework envisions the role of the HR function as follows:



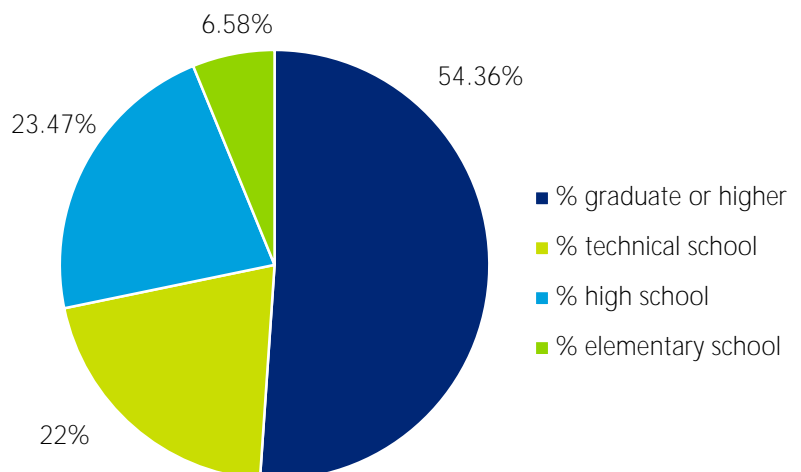
Effectively, HR plays a key role in attracting, developing, retaining and separating from the human resources of an organization.

For this survey, there was a wide range of size and demographics from the respondents. The smallest organizational unit consisted of 121 people and the largest has 11 500 employees. The average age of employees in all respondents was 40 and above, with the highest average age being reported at 47.17. There was also a broad range in terms of the levels of education with one municipality reporting that 75% of the municipal workforce had a university degree or higher and the lowest level being 35%. All of the respondents had a predominant number of employees with at least a high school education and in all cases the level of employees with only elementary education was quite low or negligible, except for one municipality where it was reported at 18% of the total workforce. It should be noted that not all respondents were able to provide full demographic statistics, so it is not possible to analyze whether there are any characteristics of the work force that are characteristic of different types and sizes of municipalities.

8 of 10 respondents felt that the level of the municipal workforce is about right. 1 felt that it was too low and 1 felt it was too high. Trying to assess the appropriate size of the workforce for a municipality is a challenging task, as it is not an easy task to benchmark the sizes of municipalities workforces to other municipalities.

The challenges include different organizational structures, different service delivery models, different definitions of “employee”, and so on. It has been Deloitte’s experience that benchmarking is typically done on the level of organizational units i.e. at the level of service delivery organizations such as waste management, when municipalities wish to assess if they have an appropriate level of employees. A better approach to assessing if organizational size is too small, too large or just about right is to assess it from a process level and determine the number of employees required to perform tasks within processes. This approach is more closely related to the selection of services that the municipality chooses to deliver to its constituents. Of course, a major contributing factor is also the revenue generating ability of the municipality as regardless of the levels of employment, the municipality must have the ability to remunerate the employees that it employs.

What are the education demographics?



Source: Deloitte Research, Public Survey

8 of 10 respondents felt that the education level of its employees was about right. 1 respondent felt it was too low. Given the data from the demographic educational component of the survey, it is most likely fair to say that the educational levels are relatively applicable. Deloitte's experience has been that the challenge in the civil service sector is the attraction and retention of highly talented individuals, as the civil sector typically is not able to compete with private firms in terms of overall remuneration. Talented workers are typically drawn early in their careers to the private sector with the promise of better earnings and career growth. This area will be one of the major challenges for municipalities into the future as they seek to expand and improve services to constituents they will need to have talented workers able to fulfill the missions. In order to attract and retain these workers the municipality will have to be able to offer a combination of interesting work with an appropriate level of remuneration. Creativity in developing these offerings will be of key importance.

9 of 10 municipalities felt the average age of the workforce was about right, with one municipality reporting that it felt the average age was too high. In all countries there are laws regulating the minimum and maximum working ages, and apart from any special conditions an employer is not allowed to discriminate on the basis of age. The assessment of average age though is interesting if viewed from a skill set and experience perspective.

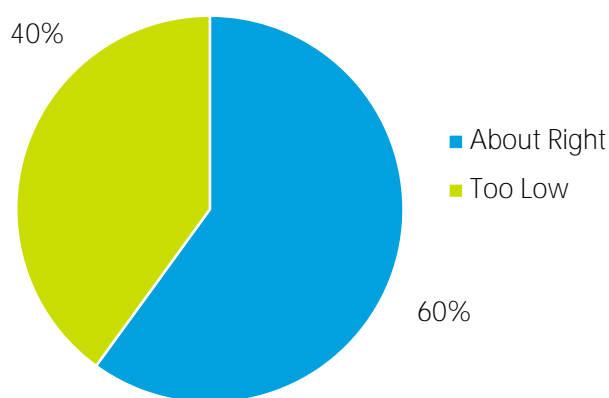
The geographies surveyed all went through political and social changes within the last twenty years and people that grew up prior to the political and social changes typically carry a different skill set than people born and/or educated after the changes. A municipality, and any organization for that matter, needs to strike the right balance between youth and experience and the skills, energy and wisdom that come with the different age groups.

6 of 10 respondents felt that wages are about right relative to productivity and 4 of 10 respondents felt that wages were too high relative to productivity. This is a very interesting result and it denotes a sense that the municipalities are aware of the importance of aligning results with compensation. This question again is subjective so without further investigation it is not possible to say whether the subjective views correlate with reality. However, it is encouraging that the municipalities are considering the productivity aspects. Measuring productivity in the service sector is not as straightforward as it is in, for example discrete manufacturing situations, but that is not to say that it is impossible. As noted in an earlier paragraph, if viewed from a process perspective, then there are relevant and robust ways to look at productivity measures in the public sector. A structured and consistent approach to productivity would provide more transparency and also allow municipalities more rationally and objectively allocate its financial resources.

7 of 10 municipalities responded that job descriptions exist for all positions, 2 reported they do not have them for all positions, and 1 did not respond. This response level indicates that municipalities are aware of the need for documented job descriptions. The existence of job descriptions is important because it serves as a foundation for other facets of human capital management such as performance assessment, compensation level assessment, training and development needs assessment. Without proper and complete job descriptions, the system would not be transparent and employees would not have a clear understanding of what is expected of them.

When asked if written Human Resource (HR) policies and procedures are in place, the result was not as positive as the question regarding job descriptions. Only 3 of 10 municipalities responded that they have these, 6 of 10 responded that they do not and 1 did not respond. Documented HR policies and procedures are an important aspect of the human resource service provision. Documented policies and procedures are important for employees as they should lay out the rules of engagement on many standard aspects of daily operations in the organization, and they provide a framework within which employees can then perform their tasks. Without documented policies and procedures there can be a higher level of confusion by employees as they will not have clarity when it comes to HR issues,

Do you feel the wages of the employees compared to the productivity are:



Source: Deloitte Research, Public Survey

or they will always have to ask someone in HR and in addition to this being ineffective, it is also difficult because verbal responses may differ depending on who is being asked the question. Documented HR policies and procedures should be easily available for all employees and they should be reviewed and updated regularly.

Municipalities were asked if their employees can earn financial bonuses for superior performance. 7 of 10 responded affirmatively, 2 of 10 responded no, and 1 did not respond. Variable pay schemes that are properly aligned to stimulate desired performance can be an effective tool for motivating employees. To be effective as a stimulator, the employees must clearly understand what performance or outcomes will result in the variable financial reward,

and there must be a clear connection between the employees performance and the outcomes, that is, the employee must have an ability to influence the outcomes. The performance goals should be challenging, but reachable, otherwise they will not be motivational. Deloitte's experience in this area has been that many organizations provide variable pay but not based on performance, but more as a 13th or 14th pay that is given to more or less everyone in the organization, so that it becomes almost another "fixed" remuneration that employees expect to get every period. This type of variable pay system is not motivational and does not have a direct link to performance and thus is merely inflating the level of base compensation in the organization.

Municipalities were asked if a career planning and performance appraisal system exists. The responses were exactly the same as to the question regarding variable pay, so that there appears to be a strong correlation between responses to the two questions. On the surface this would be a logical conclusion. In order to assess a variable financial reward properly, then performance would need to be assessed and for the assessment to be carried properly, it should be against the backdrop of agreed performance goals which are set within the context of a career and performance planning process. Deloitte's experience has shown that regardless of industry type employees do change behavior in response to provided stimulus. The setting of career and performance goals is one of the key stimulus in orienting employee behavior.

It is beyond the scope of this study to comment on the robustness of the career planning and performance appraisal systems in place at the municipalities, however, further investigation in this area would be interesting in order to gain a better understanding of the types of systems that are being used in the region and the experiences that municipal organizations have with them. The final question in the HR section of the survey asked municipalities for their subjective assessment of the level of competency/adequacy of the HR function. 6 of 9 responded that they feel it is about the right level, 3 of 9 feel that it could be better and 1 did not respond. Because the question is subjective, the response only denotes the level of satisfaction that the municipality organization has with it's HR function. It is not possible to conclude whether the HR functions are indicative of best practice, or whether they even need to attain that level. Deloitte's experience in Central Europe when advising to organizations regarding the HR function is that HR is viewed and used mainly as an administrative support function. Best practice globally puts the HR function at a higher level and HR is a partner on the board level and is viewed by the organization as strategically significant. Organizations that do not utilize the full strength of HR as a strategic partner are indelibly not optimizing the value of their human assets, and at the very least, are not able to objectively assess whether they are or are not getting maximum value from the workforce.

Infrastructure (IT and Processes)

In order to function, organizations require to have in place processes which facilitate the performance or delivery of services and products and they need to have in place information technology (IT) that supports these processes.

Historically organizations have tended to view themselves on a functional or divisional basis. This is true also for public sector organizations such as municipalities. It is important that organizations have functional hierarchies in order to provide clarity on many issues, however, the daily business of organizations is carried out through processes that cut across functional lines. Increasingly, organizations are adopting a best practice approach which looks at processes as the main organizational value drivers. Modern IT systems also are developed on the basis of processes which are either mapped onto, or modified for, the organizations that implement the IT systems. The benefit of focusing on processes is that organizations can then optimize service delivery from start to end, whereas a functional point of view may lead to disjointed and sub optimal decision making. Deloitte's experience has been that organizations that focus on end to end process improvement tend to achieve more consistent improvements than do organizations that adhere strictly to functional views.

Deloitte has even developed Enterprise Value Maps that show in detail processes within different types of organizations and the discrete parts of those processes and how they contribute to value creation.

In addition to processes, appropriate IT systems can help smooth the flow in an organization. Typically in large organizations, as municipalities can tend to be, investments into IT systems are large and the implementation projects are time consuming and intense. Research on the benefits of these implementations is inconclusive. In some cases, organizations do realize intended benefits and other times they don't. Reasons for failure of systems to bring the intended benefits are surprisingly not typically due to poor functioning of the IT system itself, but are due to the human factor commonly through the ineffectual management of change. Best practice in the area of IT is that large organizations typically try to cover as many of their technology needs with one large integrated package and then cover off other areas with specialized softwares that integrate into the larger system. In organizations that do this well, the IT needs are defined by an effective interface between the organizations end users and the IT department, so that the IT department understands what are the needs of the users and then can translate these needs into a specific solution.

Information Technology

Questions 23-27 and 30 of the survey are focused on the area of IT.

5 of 10 municipalities responded that they do have in place an integrated IT system, 4 of 10 do not and 1 did not respond. The existence or absence of an integrated IT system is not in and of itself a good or bad thing. What is more important is that an organization has the appropriate level of IT infrastructure in order to be able to perform optimally. Optimal IT infrastructure does not necessarily mean that the system has to be fully integrated, but the system should at least be configured in a way that manual interventions are minimized, as research shows that manual interventions increase the risk of errors exponentially every time a document is recorded manually into a system. Hence, optimal IT systems not only reduce processing time, they also reduce the amount of errors which increases overall productivity and reduces cost due to correction of errors.

7 of 10 municipalities responded that they do have an IT function, 2 of 10 responded that they do not have an IT function and 1 did not respond. It is interesting to note that 2 of the municipalities do not have a formal IT function. It is most likely that the responsibility for IT falls under another name or function as the two municipalities do have IT capability.³

Best practice in this area is that the head of IT is typically a member of the senior management team due to the fact that IT has become strategic to most organizations and hence the requirement for the IT head to be at the same level as heads of other functions. Recent developments in the area of IT include the “outsourcing” of some or all of the IT function. There are various models applicable, however, in its most basic format, an organization will not purchase its own IT hardware and software but will pay an external firm to provide the required IT services and then run its affairs on this system. As with all business models, outsourcing has its benefits and challenges and no single solution fits all, however there is a growing tendency towards this model and there are examples of public sector organizations utilizing this type of business model.

5 of 10 respondents felt that there hardware and software are too simple, 4 of 10 felt it was about right, and 1 municipality did not respond. From the response to this question, it is apparent that the municipalities surveyed and responding are aware of the fact that their IT needs are insufficiently addressed by their current systems.

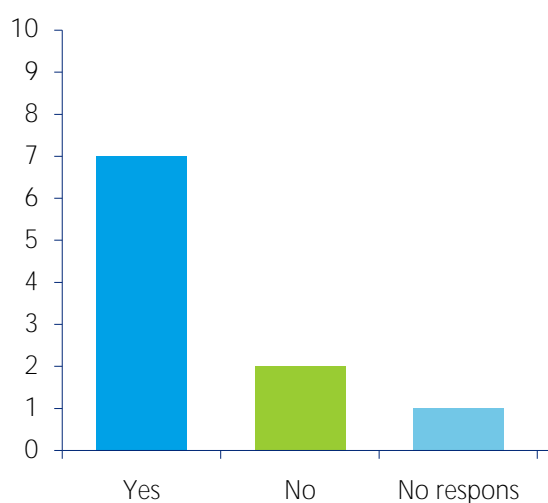
³ Note by author based on personal experience with respondent municipalities

This result is consistent with Deloitte’s experience that municipalities tend not to have robust IT infrastructures. Deloitte does not have empirical data as to why this is often the case, however the author of this report believes that limited available financing may be a contributor to this phenomenon. As stated earlier IT investments typically tend to be large and garner much attention from the public and municipal leaders may be cautious in IT spend, rather utilizing the municipalities revenues on services that are more politically acceptable. This approach may be politically expedient, but may not always lead to the desired effect, as a well designed, implemented and functioning IT system can bring about many benefits for constituents including reduced administrative burden, reduced operating costs, improved ease of data access, plus numerous other benefits.

6 of 10 municipalities reported that they do not provide citizens the option of performing transactions with the municipality over the internet, 3 of 10 do and 1 did not respond. This response is quite a surprise and would indicate that of the municipalities that responded, many of them would greatly benefit themselves and their constituents by implementing the ability to do business over the internet. Of course many factors could influence this situation, such as overall internet penetration in the municipalities.

However, it is typically expected nowadays that municipalities will have at least some minimum level of internet transaction ability for its constituents. Typically referred to as E-Government, all leading municipalities and many smaller municipalities allow constituents and businesses to interact with them via internet channels for the reasons noted in previous chapters, such as expediency, cost, reduced administrative burden, etc. Not only is this good business, it is also politically expedient as constituents will value the fact that they can save time and money in their interactions with the municipality.

Does the municipality plan to make strategic investments?



Source: Deloitte Research ,Public Survey

When asked if the municipality has sufficient hardware and software to perform its work effectively, only 3 of 10 municipalities responded yes, 6 of 10 responded no and 1 did not respond. This response level would tend to indicate that municipalities are aware of the benefits that could be had by implementing appropriate IT support, but, for reasons not probed in this survey they have not acted on this opportunity. The best practice approach would be to develop an IT strategy, which is aligned with the overall municipality strategy and then translate the IT strategy into an operational action plan which would culminate with the implementation of the desired hardware and software needed to fulfill the municipalities' strategic goals. This process is a complicated and technical one and must be done with the support of a suitable experience IT practitioner or team of practitioners.

7 of 10 municipalities noted that they plan to make strategic investments into the IT area over the next years, 2 of 10 do not and 1 did not respond. These responses are not surprising given that many of the municipalities indicated in earlier responses that there is a low level of IT ability within their organization.

There were 2 questions regarding processes on the survey, the first one asked about processes that are constituent facing and the second looked at internal processes. 2 of 10 municipalities feel their constituent facing processes are best practice, 3 of 10 feel they are about right,

4 of 10 feel they are too simple and 1 did not respond. In the view of Deloitte, the responses to this question are in alignment with the fact that 6 of 10 municipalities reported earlier that they do not have internet constituent facing service ability. So it may be that the processes referred to by the municipalities may be optimized to the point they can be given manual delivery of the service, there may be room for improvement by making the process more electronic. However, constituent demographics and abilities must be considered. For example, if a municipality has a high level of elder constituents with no or limited computer experience, the implementation of computerized services may be daunting and ultimately not be the best possible solution for the circumstance.

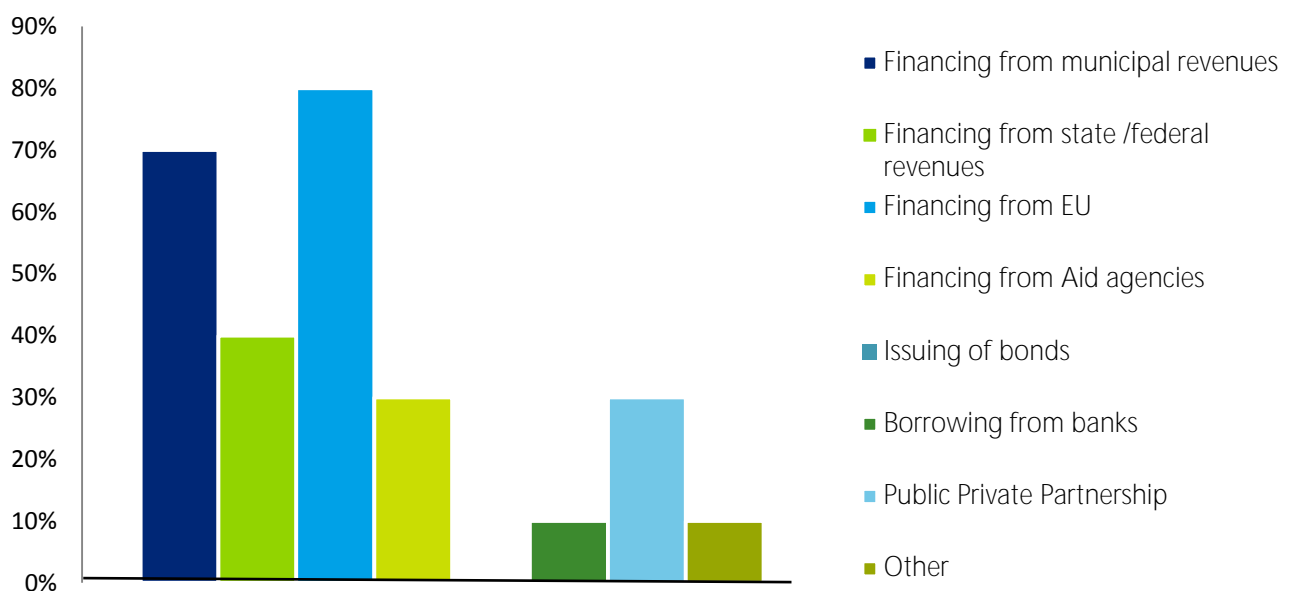
6 of 10 municipalities feel that their internal processes are about right, 3 of 10 feel they are too simple and 1 did not respond. As noted earlier in the report, optimized processes can bring many benefits to the organization that are both real and also politically expedient. Best practice in this area suggests that organizations should document their processes and periodically review them to see if they can be improved or even removed altogether. The documenting and periodic review and improvement of internal processes will ensure that the organizations assets are used and allocated effectively and resources are freed up for more value adding constituent facing activities.

Public Works

In this area municipalities were asked to respond to 4 questions regarding their future needs in the area of public works or infrastructure. This area was of interest because these outlays are typically the largest ones that municipalities make, and in this time of tightening budgets municipalities are looking to new and innovative ways of realizing these large projects. Most notably, the private sector is becoming increasingly involved in all aspects of the value chain in relation to public works and infrastructure projects. Whether it be on a Public Private Partnership basis, or through build and operate concession or through outsourcing, municipalities and private companies are increasingly working together to deliver to constituents in this complex and financially important area.

8 of 10 respondents said they will undertake large public works or infrastructure projects, 1 of 10 will not and 1 did not respond. This result underscores the fact that this is an area of particular importance for municipalities that responded to the survey and that this topic should be given appropriate attention. Municipalities in this area experienced many years of neglect of their infrastructure and it was only after the political changes of the nineties that modernization began. The high level of yes responses in this survey indicates that despite almost 20 years passing since the political changes in some cases, much work still needs to be done to improve the infrastructure networks of the municipalities.

Which forms of financing would be used to fund infrastructure projects?



Despite the high level of planned infrastructure investment, only 4 of 10 municipalities have a plan of how they will finance the upcoming projects, 4 of 10 do not have a plan how to do so, and 2 of 10 did not respond. This response hi-lites the fact that financing of these types of projects is becoming increasingly difficult as municipal budgets are squeezed by outside pressures for financial conservatism. Best practice in this area shows that municipalities prepare for these projects by developing long term infrastructure plans that take into consideration the relevant factors such as expected population growth, land use planning, regulatory developments, constituent needs assessments and other factors. When the needs are assessed and understood they are mapped against the municipalities ability to financially undertake the required projects and the different possible financing models are explored and evaluated. At the end of the process, an optimal mix of self financing, debt financing and private sector involvement is chosen in order to implement the infrastructure plans. Municipalities were asked in the survey to indicate which forms of financing they would be using to fund infrastructure projects. The choice and responses are:

- Financing from municipal revenues – 7 of 10
- Financing from state/federal revenues – 4 of 10
- Financing from EU – 8 of 10
- Financing from aid agencies – 3 of 10
- Issuing of bonds – 0 of 10
- Borrowing from banks – 1 of 10
- Public Private Partnership – 3 of 10
- Other (with explanation) – 1 of 10 (donations)

These results are very surprising. Although it is not possible to extrapolate these responses with any probability level to the region as a whole, it would appear though on first look that the EU may well be an important financial contributor to the development of infrastructure in the region. As expected most municipalities are using own funding. The survey response though would indicate that municipalities have an opportunity to perhaps become more creative in terms of financing options as very few are planning to use more recently developed financing options such as PPP models. Notable also is the relative lack of “Other” options, with only one municipality noting that donations are used for infrastructure projects.

The environment as a topic of interest to the general populace is growing in importance as the world is faced with the risks of global warming and quality of life becomes more important. In the survey, municipalities were asked to respond whether they felt that they were well equipped to fulfill regulatory requirements in regards to the environment. 7 of 10 responded yes that they felt they could, 1 of 10 responded no and 2 of 10 did not respond. These responses indicate that the municipalities that responded are generally satisfied that in the areas within their sphere of responsibility, they are able to provide to constituents appropriate levels of environmental compliance. Best practice in this area sees municipalities and organizations undertaking regular environmental audits to understand clearly how do they perform relative to the environment and then take corrective actions based on the results of the environmental audits.

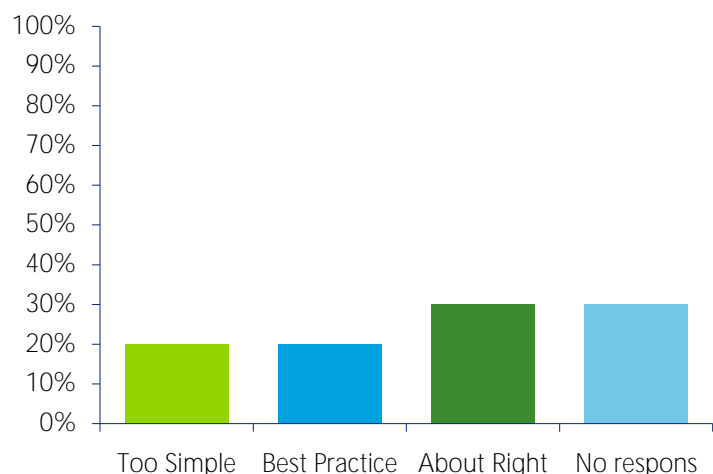
Taxation

The final portion of the survey looked at the issue of taxation, namely from the point of view of the municipality as a payer of taxes. Tax optimization is often overlooked as a potential area of revenue increase, yet a Forint, Kuna, Euro or Dinar of tax saved is a direct increase in funds available for constituent services. Therefore, increasingly municipalities are looking at ways to optimize their tax positions, being responsible tax payers but not unduly paying taxes that they do not necessarily need to expend.

In 6 of 10 municipalities there are organizational entities that are subject to tax payment, in 4 of 10 there are not. This response would tend to indicate that a sizeable portion of municipalities in the region would potentially benefit from a structured approach to tax optimization. 4 of 10 municipalities perform some sort of corporate tax planning, 3 of 10 do not, and 3 of 10 did not respond to the question. Tax planning is different from tax compliance. Tax planning implies that an organization pro actively looks at its future tax obligations and plans how to proactively comply with required legislations while at the same time not unduly paying excessive taxes. The responses in the survey would tend to indicate that more municipalities would need to adopt the proactive approach to tax management than is currently the case. 2 of 10 municipalities feel their tax planning is best practice, 3 of 10 feel it is about right, 2 of 10 feel it is too simple and 3 of 10 did not reply.

The responses to this question indicate that there is room for improvement at municipalities to improve how tax planning is performed. It is the view of Deloitte that it is incumbent of municipalities to realize the importance of proactive tax planning in order to ensure that the municipality is compliant with tax regulations and secondly to ensure that constituent money's are being appropriately utilized. Tax planning, as opposed to tax compliance, can reap benefits in terms of freeing up more money for constituent services. 8 of 10 municipalities responded that they perform regular Value Added Tax compliance reviews to ensure they have fully accounted for all claimable deductions, 2 of 10 do not. The response indicates that municipalities are aware of the need to structurally monitor VAT payments as they are substantial and regular and structured reviews can reap financial benefits in the form of reduced VAT submissions as 8 of 10 respondents are typically in VAT refund positions, and 2 of 10 are not.

In your opinion, what is the way that the tax planning is performed ?



Source: Deloitte Research ,Public Survey

Questionnaire

Finance

The questions apply in general to the municipality and the companies it owns to provide services to constituents.

1. Does the municipality have a strategy?
 Yes No
2. Are annual financial and operating plans prepared?
 Yes No
3. If yes, please answer the following questions, if no, then please continue from the next question...
 - 3.1. Are the annual plans prepared using a
 bottom up top down approach?
 - 3.2. Are the plans prepared for the current fiscal year?
 year by quarters by month
 - 3.3. Are indicative financial plans for multiple fiscal years prepared to take into account the long term nature of some investment?
 Yes No
 - 3.4. Are the financial plans prepared electronically (computer software) or manually (paper)?
 electronically manually
 - 3.5. If plans are prepared electronically, are they prepared using a financial planning software that is integrated with the accounting software or are they prepared on a stand alone basis? i.e. Excel spreadsheets.
 a financial planning software a stand alone basis
 - 3.6. Does the municipality use cash based accounting or accrual based accounting?
 cash based accrual
 - 3.7. Are variances (actual to plan) analysed on a regular basis and if yes how frequently?
 Yes No
if yes how frequently: [_____]
 - 3.8. Are the annual plans used as input for purchasing decisions i.e. is there a link between the financial plan and purchasing of actual goods and services?
 Yes No
4. Do you feel that the budgeting and planning process is:
 Does Not Exist Is Too Simple About Right Best Practice
5. Does the municipality have a risk management/Treasury function to manage it's cash and other investments?
 Yes No
6. Do you feel that the risk management processes of the municipality are:
 Non Existent Too Simple About Right Best Practice
7. Do you feel the municipality has:
 Non Existent About Right Best Practice,
information about its expenses and costs?
8. Is information about revenues and costs prepared and communicated in a timely and effective manner?
 Yes No

Human Capital

The questions apply in general to the municipality and the companies it owns to provide services to constituents.

9. How many people are directly employed by the municipality or companies it owns (at least majority share ownership)?
[_____]
10. What is average age of the employees?
[_____]
11. What are the education demographics:
[_____] % graduate or higher
[_____] % technical school
[_____] % high school
[_____] % elementary school
12. Do you feel that the number of employees is in general:
 Too high About Right Too Low
13. Do you feel the education level of the employees is in general:
 Too high About Right Too Low
14. Do you feel the average age of the employees is in general:
 Too high About Right Too Low
15. Do you feel the wages of the employees compared to productivity are (choose one):
 Too high About Right Too Low
16. Do job descriptions for all positions exist?
 Yes No
17. Are written HR policies and procedures in place?
 Yes No
18. Can employees earn bonuses for superior performance?
 Yes No
19. Is there a career planning and performance appraisal system used in the municipality?
 Yes No
20. Do you feel the human resource function in the municipality is:
 Non Existent Too Simple About Right Best Practice

Infrastructure (IT and Processes)

The questions apply in general to the municipality and the companies it owns to provide services to constituents.

21. Does the municipality have an integrated IT system?
 Yes No
22. Does the municipality have an IT function?
 Yes No
23. Do you think that the computer hardware and software the municipality uses to provide service to it's constituents are:
 Non Existent Too Simple, About Right, Best Practice
24. Does the municipality provide to constituents the ability to perform any transactions with the municipality via the internet? i.e. ordering of services or licenses, payment of bills, etc.
 Yes No
25. Do you think that the municipality has sufficient computer and software to perform it's internal work effectively?
 Yes No
26. Do you think that the processes used by the municipality to service constituents are:
 Too Simple About Right Best Practice
27. Do you think that the processes used by the municipality to perform daily internal work are:
 Too Simple About Right Best Practice
28. Does the municipality plan to make strategic investments in new computer hardware or software within the coming five years?
 Yes No

Public Works

29. In the next 5-10 year period, will your municipality need to invest in implementing or upgrading of common infrastructures i.e. sewage, roads, gas pipelines, energy distribution, schools, etc?
 Yes No
30. If yes to the above, does your municipality have a plan how these projects will be financed?
 Yes No
31. Which of the following methods are being considered to pay for the public works projects:
 Financing from municipal revenues
 Financing from state/federal revenues
 Financing from EU
 Financing from other aid agencies i.e. USAID, World Bank, EBRD, etc.
 Issuing of bonds
 Borrowing from banks
 Public Private Partnerships
 Other (Please explain)
[_____]
32. Are you confident that you are able to ensure compliance with relevant environmental legislation both current and planned?

Taxation

33. Does the city/town own any companies that are subject to corporate income tax?
 Yes No

(If answer is yes, then please answer below, otherwise skip to next question)

34. Does the city/town perform corporate tax planning?
 Yes No

(If answer is yes, then please answer below, otherwise skip to next question)

35. In your opinion is the way that the tax planning is performed Too Simple, About Right, Best Practice?

36. Does the city/town ever conduct a review to ensure that it has fully accounted for all claimable VAT deductions?
 Yes No

37. Is the city/town regularly in a VAT refund position?
 Yes No

About the author



Mr. John Winkler is a Canadian national with roots from Central Europe. Mr. Winkler has been providing management consulting services to Deloitte clients in Central Europe since 1995. In 2000 Mr. Winkler became a partner in Deloitte. Since 2003 Mr. Winkler has been leading consulting practices in the Czech and Slovak Republics and subsequently in the territory of the former Yugoslavia and Hungary (PannonAdria). Mr. Winkler has long been active in advising clients in the public sector. His public sector clients include the City of Prague, The Czech Ministry of Industry, The Czech Ministry for Regional Affairs, The Croatian Ministry of Economics, The Slovenian Ministry of Economics, The City of Zagreb Holding, The Region of Vysocina, The EU in Czech Republic, Slovak Republic, Croatia, Slovenia and Bosnia and Herzegovina among others.

Mr. Winkler has assisted his public sector clients in many areas including strategic matters, financial management, business planning, infrastructure and capacity development, performance improvement and human capital management issues. Mr. Winkler is strongly supportive of a responsive and effective public sector environment and this is one of the motivations that has driven him to proactively seek to support his public sector clients in their improvement endeavours.

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