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MFM Project

FOLLOW-UP SESSION WITH THE ECONOMIC PLANNING DEPARTMENT CITY OF VLADIVOSTOK

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MUNICIPAL FINANCE AND MANAGEMENT PROJECT

An important aspect of the transition from a centralized political and economic system to a pluralistic, democratic form of governance is the devolution of power to the local level, where citizens have a greater prospect of participating in government. Countries of the Newly Independent States (NIS) are at a very early stage in this transition:

- local authorities are still unpracticed in democratic processes;
- local authorities have not been fully empowered to govern; and
- local authorities lack many of the requisites of an effective democratic structure.

The Municipal Finance and Management (MFM) project is helping redress these deficiencies by strengthening those basic institutions of local government that promote openness, participation, and accountability.

The MFM project has three overall objectives.

- (1) Introduce municipalities in the NIS to the best available techniques and systems for municipal management, budgeting, and finance in the context of democratic local governance and a free market economic system.
- (2) Introduce automated management information systems to support this kind of local municipal management and governance.
- (3) Establish and conduct training programs locally and in the United States to orient our counterparts to the techniques and skills needed to make the systems work.

MFM is helping counterpart cities in Russia, Ukraine, Kazakhstan, and Kyrgyzstan in the following ways:

Building Expertise in Financial Management. Open and responsive systems of governance require accurate and credible financial data as a basis for citizen participation in decision making. MFM helps local professionals to develop expertise in sound financial management in the following ways:

- *Improving financial practices.* We are helping City Managers to identify and quantify municipal income, expenditures, and assets in order to produce realistic budgets and objective, auditable financial statements.
- *Access to the facts.* Once a budget reflects full information on revenues and expenditures, city managers can provide the public and all decision-makers with the necessary facts to allocate resources responsibly.
- *Public participation.* MFM encourages public hearings, focus groups, and task forces on municipal issues to widen the base of stakeholders in improving community life.
- *Introducing capital finance.* MFM experts are familiarizing city finance experts with the legal frameworks for issuing and selling municipal bonds and for enforcing covenants, all of which require open financial reporting.

Stronger Local Government and Citizen Empowerment. The MFM project is revolutionizing the approach to municipal-level decision-making, as we help cities make strategic decisions for the first time about their own finances and management. Because budget decisions on the delivery of basic public services profoundly impact the living conditions of city residents, MFM is fostering increased citizen attention to and influence on city spending priorities.

And MFM is not limited to finance and budget. It tackles municipal management in other important ways geared to making the city more responsive to the needs of people. Transportation improvement, capital improvements, local economic stimulation, strategic planning, personnel management, handling citizen complaints, conflict resolution, public relations and performance monitoring--all are areas where MFM is making an impact.

Demonstrating Democracy -- Seeing and Doing. Cities selected for MFM participation are interested in making the transition to democracy and a free market. MFM brings officials from each project city on study tours of US cities, where the practice as well as the theory of participatory government can be demonstrated. Participants observe American democracy and its market economy in action. On return home, these officials continue to advance those precepts through practical applications. MFM provides most project cities with their first experience in competitive purchasing, a practice so novel that in some places it has received television and newspaper coverage. Public hearings on budget, accountability in spending and openness in information sharing are intrinsic to MFM's finance and management.

Information is Power. Under the Soviet system, information was tightly held and controlled by the power elite. MFM cities are changing the old habit of hoarding information with the introduction of computers and computer networks, linking units of government to common databases and transforming the way information is handled.

The Economics of Democracy. For democracy to succeed, local government needs the support of its constituents. This support will not come if economic conditions do not improve; therefore, the MFM program in many cities has an economic development component.

Diffusion and Monitoring of Results. MFM's contributions to democratic and free market transition do not stop at the boundaries of the cities in which it works. In Ukraine, MFM is the key support to the nascent Mayor's Association, which recently sent 25 members to see how U.S. cities organize and lobby for their interests. Moscow, which has a powerful influence on general trends in Russia, sent its entire City Council to the U.S. to see democracy in action. Also in Russia, MFM stimulated the convening of a national conference of cities, and is providing direct support to conference discussions of democratic transition and "reinventing government."

MFM has set up a system of performance monitoring for all of its cities which clearly defines results in terms of democratization and progress toward

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FOLLOW-UP SESSION WITH THE ECONOMIC PLANNING DEPARTMENT CITY OF VLADIVOSTOK

I BACKGROUND

In December, 1994, James McCann and Mike Daun reviewed the operations of the City of Vladivostok Economic Planning Department. The scope of this review included the mission, organization and functions of the Department, City capital planning practices, the impact of regulations and those information systems supporting Department functions. A Report presenting findings, conclusions and recommendations was prepared and released in January, 1995.

In late October, at the request of the Director of Economic Planning and RTI, Mike Daun again visited the City's Economic Planning Department to discuss the following:

- A. Comments on the current City organization structure as it affects City economic development efforts
- B. The creation of a Vladivostok Economic Development Corporation and related Department initiatives to support small business
- C. Entity to assist in joint venture development in the City.
- D. The work remaining to promote a successful conversion to the new systems environment and effective use of the installed software/databases in support of economic development activities.
- E. A review of the auditing activity and functions recently implemented at the initiative of the Economic Planning Department.

The following is a summary of the findings resulting from this follow-up visit along with a description of the operation of the Milwaukee Economic Development Corporation practices as requested by Ms. Sevastyanova.

II EXECUTIVE SUMMARY

As in the January, 1995 Report, this follow-up report again addresses the issue of consolidating the City organization to promote a cohesive, well coordinated economic development approach. Currently there are simply too many independent units working on items such as international investment, tourism, privatization and land sales, etc. to be effective. Major economic development activities should be consolidated under the current Economic Planning Department which would be renamed "The Committee for Economic Development & Marketing".

This Report also suggests that a joint City - private bank lending program for small business be established. This program could be developed by the City or take the form of a non-commercial Vladivostok Economic Development Corporation under City and bank direction. The basis of this program would be shared risk by the small business borrower, the bank lender and the City. The City would not fund the entire financial need of any business borrowing funds under the program.

The Report also suggests that the City refrain from participating in a proposed Regional Organization to Support Small and Medium Sized Business until it has conducted an inventory of current services provided to such businesses and evaluated their effectiveness. It is possible that existing programs could meet the need if properly coordinated and marketed. Also, if certain assistance programs are not functioning properly, such programs could be eliminated with the funds saved allocated to the Regional organization. The EPD should also survey small businesses to determine perceptions regarding current assistance programs and unmet needs. Such survey efforts should be completed and analyzed within the next 90-120 days after which a decision regarding the proposed organization could be made.

The Report concurs with the EPD Director's suggestion to establish a City Joint Venture Support Enterprise. This entity would provide an initial contact with local government to review project proposals. The Enterprise could be a valuable source of information about government services and assistance programs, available labor supply, etc. The entity could also serve as a "one stop shopping" point for the necessary government permits and approvals. Equally important, the Venture Support Enterprise would constitute a strong statement by Vladivostok City government of its desire to attract foreign investment for both commercial growth and infrastructure expansion/modernization.

The Report points out that significant systems work with the EPD staff will be needed if the technical capabilities of the new data processing hardware and software are to be fully exploited. With this in mind the Report suggests that an Information Sharing Work Group be established including representatives from the Economic Planning, Finance, City Statistical Department, Information Services, the Krai Statistical Department and an RTI analyst (until departure). This Work Group would meet regularly following hardware/software installation to address on-going training needs, present ideas for systems enhancements, address user problems/questions and establish a schedule of priority projects for the Information Services Department.

The Report repeats an earlier recommendation for a controls audit of the local tax collection system including the work of the City, Krai and local banks collecting these taxes. Sample taxpayer audits should also be conducted to test tax return accuracy and completeness. Because of the broad scope of this audit, the affected organizations should each contribute auditors to the audit team for this project. Properly staffed, such an audit will require 4-6 months to complete.

Finally the Report suggests building on the initiative of the EPD in the area of professional auditing. The Report suggests the following:

- 1.) Establishing a program of continuing education as a requirement for maintaining certification as a licensed auditor.
- 2.) Developing Financial Accounting & Reporting Standards as Requirements for Organization Financial Statements.

III DISCUSSION & SUGGESTED FOLLOW-UP

A. Economic Planning Department (EPD) Organization & Mission

In the January, 1995 Report, the authors recommended that the City consolidate all major economic development functions in the EPD and rename the Department to reflect this broadened responsibility. The current administration has not yet indicated its support for such a change. In the current environment where responsibilities and authority are often not clearly documented, the EPD director has been aggressive in pursuing actions consistent with a broad economic development role. Her initiatives, some of which are discussed below, have received a measure of acceptance. This is probably due as much to the high degree of respect afforded her by City leadership and to her aggressive management style as to her official position in the City. However, continued, indeed, accelerated progress toward a cohesive, practical City economic development strategy will be difficult without bringing together key economic development activities under the EPD umbrella.

FOLLOW-UP 1 - CONSOLIDATE ECONOMIC DEVELOPMENT ACTIVITIES IN THE CURRENT ECONOMIC PLANNING DEPARTMENT

Responsibilities the Mayor should consider adding to the EPD include: marketing the City and its related major enterprises such as the Port and the airport. A targeted effort at attracting tourism could also be located within this Department if no separate Tourism and Convention agency assumes this role. While the number of quality hotel rooms trade show/convention venues may be limited at the present time, the future of Vladivostok would be well served by focusing efforts in tourism and convention development.

The EPD should also be the focal point for attracting international investment for City infrastructure as well as general commercial purposes. As mentioned in the January, 1995 Report, without large scale foreign investment, City government will find it impossible to close the massive deferred maintenance and modernization requirements of its transportation, sewer/water, telecommunications, electrical generation, port and airport facilities. This very investment holds the key to the future of Vladivostok. If consolidation

is not appropriate or possible, a clear distinction between the roles of the EPD and the Vladivostok International Department should be made, with the EPD assuming the role of encouraging and assisting investment in Vladivostok.

Policies and decisions with regard to privatization may also be unnecessarily divided in the City's current structure. Under the current organization structure, the privatization efforts of the existing Vladivostok privatization agency could work at cross purposes with the targeted business assistance efforts of the EPD. Those efforts should likewise be consolidated within the current EPD.

In Vladivostok municipal government, there are simply too many diverse and generally independent organization units involved in economic development activity. As in any organization, this promotes inefficiency, disputes regarding proper authority/accountability and a structure which is very confusing to the businesses seeking government approval and/or assistance.

At a minimum, the Economic Planning Department should be the clearinghouse for all major economic development policies and decisions including business loans, land use planning and land sale and major privatization efforts. The EPD should also be given the specific responsibility for coordinating the City's economic development efforts with those of the Krai and rions.

A Mayoral Decree or other formal policy document should be prepared to announce the change, specifying what functions will be shifted to the EPD. To re-enforce this shift of responsibility, the EPD name should be changed to the "Committee for Economic Development & Marketing".

B. Small Business Assistance Efforts

During the follow-up visit, two organization initiatives for small businesses were discussed extensively with the EPD Director - creation of a Vladivostok Economic Development corporation and establishing a Regional Agency for Small & Medium Business Support. A third organization in support of joint ventures was also considered and is discussed later in this report.

Milwaukee's Economic Development Corporation

The City of Milwaukee's experience with a development corporation was discussed as one potential model for Vladivostok. In Milwaukee, the Economic Development Corporation (MEDC) was used as a spur to small business growth by encouraging private sector lending in conjunction with municipally financed loans. The guiding principle of MEDC lending is shared risk with both the private sector lending institution and the small business borrower. In Milwaukee, the MEDC seeks small business growth among already

successful businesses by providing subordinated fixed rate loans at below market interest rates as well as credit guarantees, to supplement bank loans and borrower capital. Thus an MEDC loan is intended to close the "gap" needed to finance a business expansion project - not to provide the entire capital needed for a given project.

The City of Milwaukee decided to create a public-private partnership to provide loans rather than simply running the loan program as a government loan program for a number of reasons.

- Bank expertise in lending: The City had experience in making grants to businesses but little experience in proper lending procedures. Bank participation through a separate corporation assured the continued presence of bank expertise.
- Lower Program costs: Had the City government operated the program it would have had to acquire or contract for the professional lending staff needed. The involvement of banks insured the availability of this expertise free of charge.
- Lower Default rates: Using the bank lending expertise and linking MEDC loans to bank loans gave a clear signal to the borrower that his loan must be repaid. Also, the requirement of personal guarantees by the borrowers gave MEDC the option of attaching the borrower's personal assets to avoid default.
- Less Political Influence in lending decisions: Making this program a private-public corporation apart from the City government with clear loan underwriting guidelines sent a clear signal to all potential businesses that they would be treated fairly regardless of their political associations. This would have been more difficult in a government run program.

MEDC provides loans and loan guarantees for both fixed equipment and working capital purposes. Interest rates charged are about 25 percent below market rates. Currently, a typical loan for fixed equipment would range from \$ 250,000 to \$1,250,000 for a period of 5-7 years at an interest rate of 200 basis points (2%) below the comparable Treasury note. The amortization period for the loan normally does not extend beyond the expected useful life of the asset being financed. Working capital loans are typically of six months to one year in length, and renewable for up to three years.

MEDC is run by a ten member Board of Directors, four of whom are government executives, namely the Mayor, City Comptroller, President of the City's Common Council and a second Council member. The remaining six members are bank presidents and other business leaders. Reporting to the Board of Directors is a seven person Loan Committee

which reviews loan applications, making recommendations to the Board. The Loan Committee is comprised of commercial lending officers and a Comptroller's Office representative. Rarely will the Board overrule this Loan Committee recommendation. In effect, the Loan Committee removes loan decisions from the political arena and promotes professional decisions. Two professional staff from the City Development Department and a clerical assistant provide staff support to the Loan Committee.

Each MEDC Board, Loan Committee and staff member applicant must file a written Conflict of Interest statement disclosing that he/she will not participate in or attempt to influence any loan decision where that person, a relative or family member is in any way affected financially by the loan. Likewise, each loan applicant must disclose any business or family relationship which the applicant has with any MEDC official or staff. Equally important, each year MEDC produces an independently audited financial report of its activities over the past year. This report discloses all the loans made, fees charged, and funds retained by the MEDC. This report is essential to assure the continued credibility of the organization by the private sector.

Russian Law Enabling Municipal "Small Business Loan Fund"

In Vladivostok, a Federal law exists which enables Russian municipalities to establish a Small Business Loan Fund "...to create financial arrangements to support small business.". Such a Fund maybe financed with proceeds from privatization and/or voluntary fees. Foreign investors are also encouraged to participate. At least 50 percent of the Fund's initial capitalization is to come from the municipality's budget. This Small Business Loan Fund could form the initial basis for the ultimate creation of a Vladivostok Development Corporation.

FOLLOW-UP 2 - ESTABLISH A JOINT CITY/BANK LENDING PROGRAM FOR SMALL BUSINESS

Whether Vladivostok decides to establish a development corporation immediately or begin with a Loan Fund, is a decision which is best left to the EPD Director and the City administration. This decision would also impact the City's potential participation in the proposed Regional Agency for Small and Medium Sized Business Support. In any case, there seems to be a general consensus that capital to expand small business in Vladivostok is badly needed. Therefore, some City - bank lending partnership should be seriously considered. Under any business lending option it is essential that the City involve the local banking community from the outset. Communications should begin immediately with selected banks or a bank trade organization to discuss how the loan program should be established. Joint development of the loan program will promote the desired combination of private bank and government loan staff and other resources to operate the program and joint loan funds as well.

Regional Agency for Small & Medium Sized Business

During this latest visit to Vladivostok, the concept of a new organization unit to assist small and medium sized businesses was discussed. Such an agency had been proposed earlier by local officials as a regional entity including the private sector and government, Federal and local governments. If established, this entity would provide a variety of consulting and financing services to such businesses. These would include simple services such as registering the small business and establishing a bank account to making loans, preparation of business plans, auditing and other more extensive business services.

FOLLOW-UP 3 - DELAY DECISION ON ESTABLISHING REGIONAL AGENCY FOR SMALL BUSINESS SUPPORT UNTIL SURVEY OF CURRENT SERVICES & NEEDS IS COMPLETED

The desirability of the City of Vladivostok supporting and participating in such an organization was discussed. Ms. Sevastyanova pointed out that there are already numerous organizations available in Vladivostok to serve small business including the Commercial Institute, Fishing Institute, Technological Institute, Morozov's (spelling?) Business Academy, the Technical University and many others. Possibly the biggest challenge is to assure that small businesses are aware of existing services and have access to these services.

There is also a real possibility that some of these services may already duplicate each other and that still another organization would make this duplication problem worse. Consolidation or elimination of certain existing organizations/programs which are not performing at acceptable levels may be appropriate before considering another new organization.

Both Ms Sevastyanova and the author agreed that before the City of Vladivostok commit to participating in this new organization, a survey of existing services and small business needs should be completed by the City. This survey would inventory the current small business assistance services now available in Vladivostok including any service gaps or duplication. Small businesses themselves would be surveyed on a sample basis to determine their knowledge of current services and those services most in need. Based on the results of this survey, Ms. Sevastyanova felt that the City would then be able to decide whether or not to participate in the proposed Regional Agency for Small Business Support. Hopefully, such a survey could be completed and analyzed within a 90-120 day period.

C. Organization to Support Joint Ventures

The Economic Planning Department is also considering creation of an organization to assist joint ventures in Vladivostok. Such ventures hold open the primary means for the City to attract the billions of dollars in new commercial activity as well as the massive funds needed to rebuild/expand the Vladivostok airport, port, transportation, telecommunications, electrical/water treatment systems and other infrastructure. As requested by the EPD Director, what follows is a brief discussion of the operation of a typical joint venture to rebuild or expand infrastructure as it could occur in Vladivostok.

In a typical public-private joint venture, the municipality, a public enterprise operating the system (example: port facility) and domestic and/or foreign investors are the major participants. The City municipality and the investors form the joint venture. Depending on the share composition, either the municipality or the investors can be the controlling shareholders. The operating entity (Port) grants the joint venture a "concession" to arrange for management of the enterprise in exchange for the funds provided through borrowing and equity investment by the investor members of the joint venture. Joint venture equity investments and bond proceeds are used to rebuild, repair or expand the public facility.

The goal of the joint venture is to establish an operation which meets the level of service goals established by the City within acceptable tariffs/user charge limits. Financial feasibility studies are conducted to determine if such an investment can result in an operation which can repay all debt service due and return a reasonable investment return to joint venture investors. For example, with investments in modern plant and equipment, many operations can be automated, resulting in significant labor cost savings while improving level of service.

Only with a continually growing influx of external investment in Vladivostok facilities, can the City hope to begin to close its large deferred maintenance backlog and achieve modernization sufficient to compete economically with other international locations. However, potential joint ventures in Vladivostok, indeed, anywhere in Russia, face many obstacles.

Probably the primary obstacle facing the City of Vladivostok is the apparent lack of a stable, clear and effective system of contract law and related enforcement. The complex agreements established in a typical joint venture demand assurance that in the event of default (one contracting party does not fulfill its basic contract responsibilities) or dispute between contracting parties, there is a predictable and efficient way of enforcing the terms of the contract and fairly resolving any dispute. For example, a party to a contract may establish a "security interest" or legal claim to the counterparty's property in the event of default on the contract. If the counterparty defaults, the legal system must assure that the injured party may execute his claim on the property as called for in the contract. In Russia, it may be that such laws are not well established or, to the extent prescribed, not consistently enforced.

Another obstacle faced by investors in projects located in Russia is the substantial currency risk associated with ruble denominated agreements. The persistently high inflation rates in Russia make this risk crucial and a potential "deal breaker" for many Russian projects. Although there exist various methods to limit these risks, unless all needed capital for a project originates in Russia, the currency risk can never be completely eliminated.

Given the lack of a well established legal foundation for contract agreements, it is especially important for those involved in a joint venture to thoroughly understand and fulfill the approval requirements at the municipal, Krai and Federal levels. Operating entity and joint venture approvals will need to address in detail the operational and financial requirements for the project at a sufficient level of detail to generate written support from all appropriate governmental bodies and their authorized individuals.

Financial documentation must be complete in terms of describing the source, destination and process by which all cashflow transactions will occur. This would include operations cashflows, debt service payments, taxes, reserve funds, equity repayments, etc.

Another major obstacle in these projects is the probable loss of jobs associated with modernization of the enterprise. Local governments have been understandably reluctant to see many of their citizens lose jobs as the result of "privatization" projects associated with infrastructure modernization. Response to this concern has resulted in agreements between the municipality, the enterprise and the investors to phase in or delay any layoffs to allow time for job retraining, identifying alternate employment and utilizing natural attrition (retirements) to ease the jobs loss. One example approach is to have a three year moratorium on layoffs following the completion of modernization projects. This will of course increase the start-up costs of such projects. Economic feasibility studies would factor in these added costs. However, such efforts to minimize job loss may be necessary to gain support for the project.

FOLLOW-UP 4 - ESTABLISH JOINT VENTURE SUPPORT ENTERPRISE

Given these requirements, the City would be well advised to consider an organization which would be a focal point to assist potential and established joint ventures. Such an organization could take the form of a division within the EPD or a non-commercial enterprise directed by the City and local business leaders. The Krai government could also be considered for inclusion on the enterprise Board to promote support for such ventures at higher levels of government.

This Joint Venture Support Enterprise would provide the following:

1. An initial contact with local government. Here the Joint Venture could discuss its proposal, get an initial response from the government regarding the project's desirability, discuss the potential for any government assistance, and outline the issues to be resolved.
2. A Reference Source to Local Services and Contacts. The Venture Support Enterprise could provide contacts for needed labor, banking and other financial services, government loan programs and requirements, area equipment suppliers, contractors, etc.
3. A "One Stop Shopping" point to help the Joint Venture identify and obtain all necessary government approvals and permits. Also, staff would provide guidance as to the legal and financial issues to be addressed for such ventures in Vladivostok and the required procedures and reporting.
4. An Important Symbol/Statement By the Local Governments that they are committed to encouraging private and public-private venture investments in Vladivostok.

Staffing for this Venture Support Enterprise would include attorneys, accountants, finance personnel and an Economic Planning Department staff person trained in various government procedural requirements and financial aid programs. With the exception of the EPD staff, other staff may have to be acquired on a contract, as needed basis. The organization would be self-sustaining, receiving fees for the services it provides to the joint ventures.

D. Information Systems Efforts Related to the Economic Planning Department

As reported by Mr. Chetwynd in his recent Report, following the initial City network pilot installation, long equipment delays have in turn delayed the project's subsequent equipment and software installation and conversion efforts. The leadership of the EPD has shown real interest in taking advantage of the simple but powerful trend monitoring, graphics, forecast and modelling ("what if" projections) features of the software to be put in place. However, much design and system installation work remains to enable the Economic Planning Department to make full use of the data sharing, trend monitoring and other management features of the systems being introduced.

First, the hardware and software will have to be put in place. As also mentioned by Mr. Chetwynd, training in the use of the software is needed. However, the biggest task ahead may be assisting EPD personnel in uncovering how the features of the software can

be used to address both the planning, management and day to day business information needs of the Department. While RTI staff attempt to find out what the proper "data information indicators" are that should be input into the forecasting software, staff of the EPD may not see the relevance of this effort to their Department.

As others have mentioned, the EPD depends on a number of other organizations both in and out of City government for its needed information. The City Statistical Department provides economic and demographic data to assist EPD in targeted business assistance efforts and measuring the success of those efforts. EPD says that it needs more units of production as well as rubles information from this Department. A letter of intent was reportedly signed by the City Statistical Department to share data with the EPD. The Krai Tax Inspection Department provides a registry of small businesses and tax collection data which is used by EPD in its annual Economic Forecast. The City Finance Department provides City departmental revenue and expenditure data.

RTI and/or the City's Information Services Department (ISD) systems staff are needed to bridge the gap between these departments and the EPD, initially to show what data is available through modem exchange or direct network database sharing. With this knowledge established, the systems staff can then assist EPD personnel in translating these data into meaningful management tools. The City ISD has already achieved some success in this area. Mr. Naumov indicated that since some City departments demonstrated a need for accurate information about Federal and Local laws and regulations, the ISD is planning to establish a Bulletin Board of such rules for all City Departments to access. While this inventory of laws and regulations will take time to fully implement, this is an example of a creative application of the technology being put in place.

Many other information reports/screens, inquiries to assist the EPD from newly available databases need to be identified. For example, designing a "Monthly Program Monitoring Report" showing how a housing assistance or economic development effort is accomplishing its service objectives is an example of the type of assistance needed. Or possibly creating the format, programming and data sources for a quarterly "Targeted Industry Profile" Report would be needed by EPD.

In the January, 1995 Report, a format was provided to inventory current EPD reports and identify other management information needs. These analysis forms were not completed. As a result, a danger exists that while the technical capabilities of the system may be put in place, these capabilities may not be readily applied. Data provides no real benefit in and of itself. It is only in its application to relevant business needs that gives it any lasting value. The assistance of the City's and/or RTI systems analysts is essential to assure that the data sharing and processing capabilities introduced by the City - RTI effort result in real value-added for the EPD.

FOLLOW-UP 5 - ESTABLISH AN INFORMATION SHARING WORK GROUP TO PROMOTE FULL USE OF THE CAPABILITIES OF THE NEW SYSTEMS

Following hardware/software installation and initial user training, this Work Group would be established with the intent of meeting periodically to discuss how to better utilize the new information systems capabilities. The Work Group would include representatives from the Economic Planning, Finance, City Statistical Department, Information Services, the Krai Statistical Department and an RTI analyst (until departure).

Training schedules, system enhancement priorities, new ideas for data sharing, user problems, etc. - all would be points for discussion in these meetings. Meetings would initially be held weekly to assure clear communication between affected departments following new equipment and software installation. As the need dictated, these meetings could be held less frequently as time passed.

E. Auditing in City Government

The January, 1995 Report recommended that the City establish a permanent Audit Division to improve internal controls and management practices of both City departments and those external entities directly affecting the City. As Director of a major City department, Ms. Sevastyanova has seen the need for improved controls in the conduct of City financial affairs. For example, during our initial visit the EPD Director pointed out the problem of poor budgetary controls which led to chronic overspending and incomplete capital projects in the City. Issues which surround the awarding and the issuance of contracts between private vendors and the City would be another area for audit review.

FOLLOW-UP 6 - CONSIDER THE CONDUCT OF A TAX COLLECTION AUDIT

The EPD Director is also concerned about the level of compliance with current Russian taxes and the controls surrounding the collection of these taxes. In the January Report, the EPD Director mentioned that in her estimation only about 30 percent of the taxes properly assessed are actually collected. Since tax collection involves numerous private banks and the Krai, an evaluation of the controls applied by these external entities is an essential component of a fair and effective local tax collection system. A tax collection audit was suggested in our January, 1995 Report and should be seriously considered. Even minor improvements in control procedures and of identification of a limited number of businesses and individuals not reporting properly or making proper tax payments could increase City revenues significantly. Such an audit would ideally involve participation by local banks and the Krai since these organizations and their tax collection practices would be within the scope of the tax collection audit. A sample of individual and company tax returns would also be reviewed by the audit team for completeness and accuracy.

SUGGESTIONS 7, 8 - DEVELOP FINANCIAL ACCOUNTING & REPORTING
STANDARDS AS REQUIREMENTS FOR ORGANIZATION
FINANCIAL STATEMENTS.
ESTABLISH A PROGRAM OF CONTINUING EDUCATION
AS A REQUIREMENT FOR MAINTAINING CERTIFICATION
AS A LICENSED AUDITOR.

Toward the goal of improving internal controls and efficiency, the EPD Director has initiated an auditor development effort that is providing professional auditors to both the private sector as to Vladivostok City government. An auditing company (Company on Audit) has been formed to provide auditing services to both private and government sectors and complement the professional accounting firms' services. This organization has at least 10 professional auditors on its staff. A small corps of 3-4 auditors will also be functioning in the City government.

An Association of Auditors has recently been formed with a major goal of developing uniform accounting and financial reporting standards. Such standards provide a basic benchmark to help auditors determine the adequacy of current financial reporting and controls in the audited organization. Also, in order to keep licensed auditors up-to-date in current audit practices, a set of continuing education requirements should be established by the Association of Auditors. These requirements would include a minimum number of professional training hours to be achieved each year by each licensed auditor.

Four potential sources of auditor instruction are:

- Andy Williams, Edmonds Community College
20000 68th Avenue West
Lynnwood, Washington 98036-5999
206-640-1450

Has conducted program for Russian State Academy of Economics & Law at Khabarovsk.

- Cynthia B. Satterwhite
112 Jefferson's Hundred
Williamsburg, VA 23185
804-220-8428

Coopers & Lybrand Partner. Soon to start own consulting company. Responsible for training firm personnel in Virginia offices and State of Virginia government internal audit.

- John Davis, Partner and Government Industry Chair
Coopers & Lybrand
Columbus, Ohio
614-225-8755
- William T. Potvin, Partner
Deloitte Touche
Moscow Office
7-503-956-5000 phone
7-095-956-5000 phone
7-503-956-5001 fax

APPENDIX - LIST OF INTERVIEWEES

- 1) Ms. Alevtina, staff, Economic Planning & Forecasting
- 2) James Alloway, RTI Project Director
- 3) Alexander Belov, Systems Manager, RTI
- 4) Gennady I. Lysak, First Deputy Head of Administration
- 5) Ms. Nadezhda, staff, Economic Planning & Forecasting
- 6) Andrey V. Naumov, Chief, Information Systems Agency
- 7) Larisa S. Sevastyanova, Chief, Economic Planning & Forecasting
- 8) Natalia Sorokaletova, Deputy Chief, Economic Planning & Forecasting
- 9) Nina Timinskaya, Director, City Statistics Agency
- 10) Nikolai Vurchenko, staff, Economic Planning & Forecasting
- 11) Ivan V. Abroskin, General Director, President, Vladinport (Joint Stock Company)
- 12) Director/staff, Audit Company