



Ministry of Finance of Georgia

Public Finance Management

Reform Policy Vision

2009-2013

Acronyms

GoG	Government of Georgia
MoF	Ministry of Finance of Georgia
CoC	Chamber of Control of Georgia
SWF	Sovereign Wealth Fund
SDF	Stable Development Fund
LEPL	Legal Entity of the Public Law
PFM	Public Finance Management
PFMRPV	Public Finance Management Reform Policy Vision
BDD	Basic Data and Directions
MTEF	Medium-Term Expenditures Framework
GFS	Government Financial Statistics
IPSAS	International Public Sector Accounting Standards
STA	Single Treasury Account
PEFA	Public Expenditure Framework Assessment
VAT	Value-Added Tax

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Section I: Background

1. Introduction

Strengthening the public finance and budget operations has been and remains an important priority of the Government of Georgia. Significant progress has been made since 2004 on improving financial systems and bringing them into conformance with international standards. These reforms, along with an improving economy, have combined to noteworthy improvement of the financial health of the Government and its ability to provide services to its citizens. Governmental revenues increased from GEL 1,367 million in 2004 to GEL 4,973 in 2007. Spending on key public programs has substantially grown during this period as well as investments in capital infrastructure.

Simultaneous to this improved economic health, management systems have been improved. Tax collection responsibilities have been merged into the new Revenues Service within the Ministry of Finance. Since 2005 the Single Treasury Account has been in operations. Beginning in 2008 both budget and accounting classifications were brought into compliance with international standards, Government Financial Statistics 2001. Since 2006, the Basic Data and Directions document has been used to not only formulate the annual budget but to guide the management of government operations and programs. Since adoption of the new Law on Budget System in 2003 the budget process and format have been changed to meet international standards. Finally, changes have been made to the intergovernmental finance system to make it more transparent and objective.

In 2007 an independent assessment of the public finance system was conducted by the World Bank and European Commission through the Public Expenditure Framework Assessment. It is designed to benchmark the performance of the organization's financial systems against the performance of other governments. The assessment report provided guidance for the completion of this Public Finance Management Reform vision document, the purpose of which is to provide a framework for the coordination of reforms and an integrated approach to improving the public finance system.

2. Public Finance Framework

The Law on the Budget System, adopted on 24 April 2003, defines the principles of the budgetary system and regulates the preparation of the Budget and the Budget's approval, execution, reporting and monitoring. The budget law establishes the Budget, which consolidates (i) the State Budget, (ii) the budgets for the autonomous republics and (iii) all other budgets for local governments. It also defines the budgetary relations and responsibilities of the central Government, the autonomous republics and all local governments

The State Budget authorises expenditures that have a national scope, such as subsidies or grants awarded to state bodies/Ministries. The budgets of the autonomous republics and the local governments are independent from the State Budget and authorise expenditures of a regional or local character.

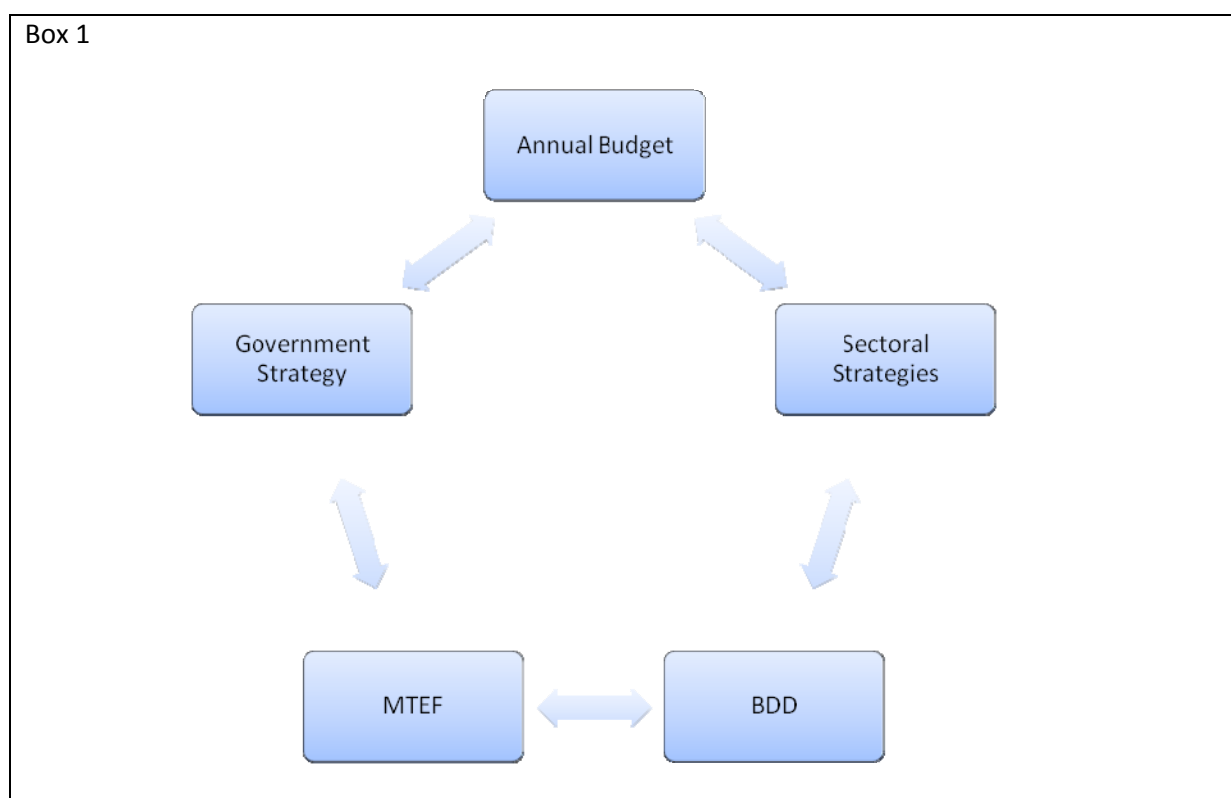
The Ministry of Finance supervises and coordinates the preparation, execution and reporting of the State Budget. The Minister of Finance is empowered to issue orders to ensure that the budget

process at all levels of government is carried out in a uniform manner in compliance with the requirements of the budget law and other applicable laws.

The Law on Rule of Revenues Distribution establishes the rules for distribution of receipts between the State Budget, the budgets of the autonomous republics, the budgets of local governments and the sovereign wealth fund. Generally, corporate taxes, customs duties and VAT receipts are allocated to the State Budget; property taxes go to the budgets of the local governments and autonomous republics' budgets; and the receipts from the privatization of the non-financial state assets go to the Stable Development Fund.

Local governments cannot borrow money directly without approval of the Ministry of Finance and are permitted to raise tax revenues only through limited property tax levies. The Government allocates funds to local governments.

The diagram in Box 1 illustrates the interconnection between the public finance connected elements.



3. Budgeting Process

Strengthening the management of public finances and budget operations is an important objective and priority of the Government. The Government has been working since 2004 to improve the management of the Budget and the budgeting process based on the best international practice and using the GFS 2001 classification. As a result, in 2007 budgeted expenditures were allocated according to functional classification spheres, which make it possible to show expenditures of significant economic importance separately, thereby making the planning process more detailed, transparent and targeted. Since 1 January 2008, the State Budget has been fully compliant with the new GFS 2001 classification, on a cash basis.

In 2006, the Government introduced and adopted the BDD, which is updated each year and distributed to the Government's ministries and agencies. The BDD provides not only data analysing the previous year's fiscal performance and the outline of the next year's financial plans, but also the Government's medium-term strategy and priorities for action for the upcoming years, along with the expected results and outcomes for that period.

The medium-term planning laid out in the BDD is based on the Medium-Term Expenditure Framework principle, which was established in 2006. The BDD and MTEF provide the Government's Ministries and agencies with a framework within which to operate and within which they can set out their priorities and a justification of those priorities, a needs assessment and the amount of funds requested, as well as expected outcomes and criteria for judging success and effectiveness. The Government believes that the MTEF will further increase efficiency and transparency and provide for more coherent and performance-oriented policies.

By September of each year, the Ministry of Finance prepares a first draft State Budget for the upcoming year. After consultation with other Government spending agencies, the Ministry of Finance then submits a draft State Budget to the Parliament before October 1. Pursuant to the Budget System Law, the State Budget is passed each year before the beginning of the budgetary year (i.e., in December of the preceding year).

The reforms contributed revenue increment and total revenues have grown over each of the past five years, from GEL 1,367 in 2003 to GEL 4,973 million in 2007. Total revenues increased year-on-year by 60.3% in 2004, 27.7% in 2005, 48.8% in 2006 and 30.4% in 2007. The continued growth of revenues since 2003 is principally a result of the Government's improved revenue collection capacity, which is a result of the Government anti-corruption actions and Government's decision to lower taxes, with the adoption of the new Tax Code in 2004.

In 2007, tax revenues into the state budget accounted for 70.1% of total revenues. Tax revenues include income tax, corporate profit tax, VAT, excise and customs taxes and have increased substantially over the past years due to improved administration and the Government's reforms of the Tax Code.

Non-tax revenues are mainly comprised of the proceeds of asset sales, as well as yearly royalties and dividend transfers and profits and revenues from public sector enterprises.

In parallel to the revenue increase total expenses have grown in each of the past five years, from GEL 1,290 in 2003 to GEL 4,343 million in 2007. Total expenses have increased year-on-year by 42.3% in 2004, 40.6% in 2005, 32.5% in 2006 and 44.6% in 2007. The principal reasons for the year-on-year increases in expenditures are increased expenditures on goods and services and on social benefits, partially offset by the decrease in expenditures on interest payments by 58.5% over the same period.

Nevertheless, a substantial agenda of public finance management reforms remains to be implemented. The purpose of this document is to provide a framework for coordination of these reforms and the basis for an integrated approach to the development of the MoF administered PFM elements.

Section II: Reforms

4. PFM Systemic Framework

The PFM system can be characterised as involving a number of distinct elements (Box 2). These comprise with:

- Strategic Budgeting – provides the policy-budget connection, a credible resource envelope and budget ceilings against which ministries and other budget users can prioritise their activities involving national and sectoral level strategies review developing process.
- Budget Preparation & Approval – process through which resources are allocated to priority activities.
- Resource Management – covers the management of: (i) financial resources (revenue mobilisation, public debt and cash); (ii) procurement; (iii) personnel; and (iv) capital assets.
- Internal Control – covers: (i) financial regulations and control procedures; (ii) effectiveness of the resource management procedures; and (iii) systems and procedures for monitoring budget performance.
- Accounting & Reporting – covers the recording, aggregation and reporting of the financial transactions.
- External Audit & Accountability – provides the independent review of government operations by both the supreme audit institution and civil society.

An effective PFM system requires strong links with a government’s policy-making and strategic planning processes. It also requires that each of the individual elements is characterised by: (i) well-elaborated and robust internal processes; and (ii) strong links with the other elements.

Box 2



5. PFM Reform

The goals of a PFM reform can be summarised as follows:

- To maintain fiscal discipline and thereby facilitate macroeconomic stability and predictability of the budget system.
- To promote a strategic approach by ensuring that resources are directed toward key policy and strategy priorities.
- To deliver value for money by ensuring that resources are used effectively and efficiently.
- To ensure accountability in the use of public resources.

Important features of the PFM reform are a need to ensure:

- Effective coordination of the reform agenda;
- Comprehensive and integrated approach to PFM reform;
- Consistency in the design of reform measures both philosophically and technically; and
- Appropriate sequencing of implementation.



Strategic Budgeting

Establishing a strategic budgeting process that ensures resource allocations are directed towards realising government policy and strategy priorities.

Current Challenges

The Government policy framework is developed and requires to be linked more effectively to the budget planning process. The resource framework for budget planning is now being determined within a medium-term macro-fiscal framework, but weaknesses in forecasting methodologies and capacities still need to be addressed. Processes for strategic planning across government are still evolving and the required skills, experience and techniques need to be developed further. Achieving closer integration between planning and policy management presents organisational and management challenges across government and within the ministries. Resource ceilings that allow ministries to prioritise their budget plans against a realistic estimate of future financing were introduced in 2004/05 and represent a key reform. However, the analytical basis and justification for these resource ceilings should be strengthened. The BDD is being developed so that it sets out with greater clarity the government's medium-term fiscal and public expenditure strategies and plans. However, the quality of the BDD analysis requires further improvement and should be extended to include realistic resource ceilings for subsequent detailed budget planning. The BDD should also be disseminated more widely.

Focus of Future Reform Actions 2009-2013

- Review the format of the BDD, with the aim to improve the linkage between the national and regional strategies and priorities and the priorities and strategies of spending agencies.
- Extend the BDD/State Budget to include all spending agencies and clear statements of strategic directions (goals), together with performance indicators, as well as detailed costing; the step-by-step approach will be developed for introducing performance measurement indicators within the BDD and the budget.
- Improve regional development planning in close cooperation with the municipalities in the respective regions, and highlight local characteristics and development priorities.
- Develop a comprehensive approach based on medium-term fiscal forecasts and budget policies for setting realistic medium-term ceilings for the spending agencies.
- Develop new macro-fiscal framework so that it can facilitate improvements in the planning and management of the budget operations.
- Improve the processes in the MoF for the development of strategic budget planning, including the preparation of planning guidelines setting out improved procedures for budget planning and the analyses and justification of resource ceilings/allocations.
- Strengthen linkages between investment decisions and sector strategies and recurrent cost implications associated with the decisions.
- Establish MTEF fully on the local budget level through formulating a BDD and strategies to guide local budget decisions.
- Enhance overall capacity of MOF/Budget Department and spending agencies (including regions) in strategic budgeting in the following areas: policy development; macro-fiscal forecasting and analysis; analysis of the public expenditure implications of government policies; strategic expenditure planning in the ministries; capital budgeting; and effective management and organisation of the strategic planning stage.



Budget Preparation

Ensuring that the budget allocations facilitate the effective use of public resources to achieve strategic policy goals.

Current Challenges

Despite recent progress, the links between government policies and strategies and budget preparation need to develop further. The medium-term action plans have still to be fully reflected in budget allocations. Automated systems to formulate, analyze, produce, and monitor the budget are either non-existent or deficient thereby decreasing the efficiency of budget staff. Basic budgeting practices across the government are still at a reform stage: (i) budget planning processes in central and especially local governments (line ministries and local bodies) are fragile and require improvement and modernisation; (ii) organisational and capacity weaknesses in the MoF and line ministries beginning to be addressed and require further facilitation. Parliamentary discussion of the Budget continues to be focused on detail rather than strategic priorities and needs modernization to increase the accountability of the line ministries and connectivity with the Government and sectoral strategies.

Focus for Future Reform Actions 2009-2013

- Develop the budget planning process reforms to revise budget classification based upon GFS 2001 at all levels of the budget, both state and local governments.
- Revise the budgeting related legislation in order to better conform to the best practices and ongoing reforms.
- Unify the Ministry of Finance, Treasury, line-ministries, and territorial units under a common budget system.
- Improve the software used in the MoF and spending agencies for budget preparation in light of the anticipated development of the Integrated Public Finance Management Information System.
- Review the current budget execution and amendment practices and regulations to both streamline the process and to make more consistent with international practices.
- Develop and introduce improved budgeting practices and procedures for the local governments including improving the budget format to reflect municipal priorities and linkages to expenditures.
- Improve public involvement in the budget decision making process and make budget documentation and information more accessible to the public consistent with international practices.
- Establish and continue to improving capital budgeting through a step by step, phased in approach, first at the state level and then at the local government level.
- Establish a program budgeting system and format through a step-by-step phased in approach first at the National level and subsequently at the local government level.
- Continue work aimed at improving the management and monitoring of government internal and external debt with particular emphasis on debt sustainability issues.
- Create Public Law Entities database and review budgeting and reporting requirements to insure consistency internally and with international practices.

- Develop a consolidated reporting format; improve the quality of information provided by local governments, LEPLs, etc for the annual report.



Resource Management

To manage public resources in a way that facilitates the efficient implementation of public services and programs.

Current Challenges

The processing of financial transactions is being improved with the establishment of the TSA and most revenues and expenditures flow through a single process. E-treasury systems are being introduced, but require further development in coverage and content to allow the budget organizations to exchange payment documentation with the Treasury electronically. There are still weaknesses in budget/cash management, which requires additional attention in order to improve the budget execution planning by the ministries as well as cash allocation planning by the MoF. Overall treasury execution system needs modernization in order to meet requested standards.

Mobilisation of financial resources has been considerably transformed with: (i) significant progress made in strengthening revenue administration, although further measures are required to improve the interface with taxpayers, and strengthen revenue administration capacities; (ii) substantial progress in reforming tax and customs legislation, policy and administration although these reforms require further consolidation; and the strengthening of internal and external debt management.

Personnel management processes need further attention in order to improve wage bill planning and management.

Focus for Future Reform Actions 2009-2013

- Introduction of the new PFM treasury execution system.
- Implementation of Treasury reforms involving completion of the TSA; progressing towards implementation a modern E-Treasury system; strengthening cash planning and cash management process.
- Consolidate and further develop revenue management through completing the on-going reform of revenue and customs policy and legislation, including the simplification of tax and customs codes and continuing with implementation of measures to strengthen Revenue Service including taxpayer services, tax audit, customs control, IT and institutional development.

- Develop a system for the tax arrears when such arrears can be declared uncollectible and removed from the total.
- Strengthen expenditure management through the improving oversight of budget execution by the MoF including introducing improvements toward providing a more strategic focus and improving management of budget execution by line ministries.
- Strengthen wage bill planning and management, and introduction of modern nominal and payroll information systems.



Internal Control

Establishing probity in the budgeting process and ensure that information is available to facilitate efficient budget management.

Current Challenges

Different internal control instruments are in place and have been under development over the past years. For instance budget expenses commitment control mechanism has been introduced since 2003 and has contributed to better management of public spending. However, many internal control instruments are poorly formulated with limited compliance and oversight. There is no legislative basis for internal audit. Although some financial inspection and supervision functions are operational, there is insufficient oversight of resource management procedures within ministries.

Focus for Future Reform Actions 2009-2013

- Develop a comprehensive set of financial management regulations, including internal controls that are consistent with international standards.
- Introduce internal audit and the progressive development of internal audit processes and capacities within the ministry as well as systems for monitoring actions taken in response to audit findings.
- Develop improved procedures for monitoring of, and disseminating information on strategic objectives and plans linked to the implementation of the MTEF; budget performance and management; and the progress of reform initiatives related to key policy goals such as anti-corruption.
- Modernize the commitment control mechanism linked to the implementation of Treasury reforms.



Accounting & Reporting

Ensuring the timely and useful recording and reporting of financial transactions necessary to guarantee the effective budget management of public resources.

Current Challenges 2009-2013

Treasury reforms to date have focused on improving the recording of transactions and were successful, however accounting and reporting systems and practices are not standardised. Budget classification is done with GFS 2001 is used for cash transactions, while the accounting instructions give a different type of chart of accounts for accrual accounting. Accounts, particularly with respect to local governments, LEPLs, other public entities are not consolidated and comprehensive. While central government reporting is sound improvements are required for consolidated financial reporting. Reporting between key players tends to be paper-based. This contributes to delays in reporting and makes analysis by recipients more difficult. There remain weaknesses in accounting capacities throughout Government with particular challenges to be faced in establishing accounting and reporting practices for semi-autonomous bodies, LEPLs, state owned enterprises, etc.

Focus for Future Reform Actions

- Adopt a GFS compliant budget classification system and Chart of Accounts.
- Gradually introduce IPSAS accounting standards: first cash based, then modified cash based, and finally accrual based.
- Develop a consolidated annual financial statement that complies with international standards.
- Build accounting and reporting capacities across government and in quasi-government entities involving: implementation of improved reporting procedures; development of electronic links between Treasury and ministries; and provision of relevant accounting training (Treasury, ministries, local governments, LEPLs etc.).
- Prepare annual report on aggregate financial risk associated with Public Law Entities and State Owned Enterprises.
- Improve capital asset management by establishing a register of capital assets.