

EEUROSAI



State Audit Office of Georgia

2014



STATE AUDIT OFFICE
OF GEORGIA

REFORMS OF THE STATE AUDIT OFFICE OF GEORGIA

- Institutional transformation of The State Audit Office of Georgia (SAO) dates back to 2008;
- On July 1st 2012, according to the changes in the constitution, the Chamber of Control of Georgia was renamed to the State Audit Office of Georgia;



With the support of the Swedish National Audit Office (SNAO) SAO developed and introduced Financial and Compliance Audit methodologies, in accordance with International Standards of Supreme Audit Institutions (ISSAIs) – 2010 year;



STATE AUDIT OFFICE
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REFORMS OF THE STATE AUDIT OFFICE OF GEORGIA

SAO with the support of **Swedish National Audit Office (SNAO) and GIZ**, developed and approved **Performance Audit Manual** in accordance with the international standards of Supreme Audit Institutions (ISSAIs 3000 - 3100) – *2011*

First **performance audit reports** were published in *2012*



Legal amendments in the “Law of Georgia on the State Audit Office” harmonized the independence of our work with international standards – *2011*

SAO adopted the **Code of Ethics of the Auditors** – *2010*

SAO with the support of **SNAO** developed the **Policy and Manual of Quality Control** – *2011*

Every principle of independence under **the 2007 Declaration of Mexico of INTOSAI**, was legally recognized by SAO, including: independence of SAO in planning audit activities, setting audit timeframe etc. – *2011*



STATE AUDIT OFFICE
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REFORMS OF THE STATE AUDIT OFFICE OF GEORGIA

- ✓ The SAO attracted and recruited auditors possessing extensive working experience in such international audit organizations as PricewaterhouseCoopers, Ernst & Young and Deloitte & Touche;
- ✓ Implementation of **IT audit** is currently in progress;
- ✓ The SAO continues active cooperation supreme audit institutions and international partner organizations such as **INTOSAI, World Bank, The Swedish National Audit Office, GIZ, etc.**;



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REFORMS OF THE STATE AUDIT OFFICE OF GEORGIA

According to the evaluation of the European Commission in the field of **Public Expenditure and Financial Accountability** (PEFA) SAO audit activities assessment from 2008 to 2012 increased significantly

FROM D₊ TO B₊



STATE AUDIT OFFICE
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THE ROLE OF THE STATE AUDIT OFFICE IN THE PUBLIC FINANCE MANAGEMENT (PFM) SYSTEM

The mission of State Audit Office is to support continuous improvement in delivering public services and enhance legality, effectiveness and accountability in the use of public resources.

Our aim is to support the parliament in overseeing the activities of the government, as well as to strengthen accountability and transparency of the public sector and to ensure efficient and effective management of public finances





STATE AUDIT OFFICE
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THE ROLE OF THE STATE AUDIT OFFICE IN THE PFM SYSTEM

The current strategic development plan for 2014-2017 sets out 4 main strategic goals:

Support the parliamentary oversight over the government through our audit work

Support government reforms aimed at improving government accountability

Promote transparency and accountability in political party financing

Enhance the institutional capacity of the SAO to foster the quality of our work



THE ROLE OF THE STATE AUDIT OFFICE IN THE PUBLIC FINANCE MANAGEMENT SYSTEM

The PFM system reform in Georgia including the reforms within the SAO, consisted of the following components:

- ✓ Policy based budgeting;
- ✓ Treasury reforms;
- ✓ Budget comprehensiveness, transparency and accountability;
- ✓ Other aspects of PFM reform.

A key direction of the budget reform was the move **from traditional/organizational to the program (performance budgeting) budgeting system** as a way to link the funds allocated to measurable results.

Traditional/organizational
budget system

The year of 2012

Program (performance)
budgeting



STATE AUDIT OFFICE
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THE ROLE OF THE STATE AUDIT OFFICE IN THE PFM SYSTEM

- ✓ State Audit Office of Georgia prepares reports and opinions at the budget planning as well as at the execution stage thus increasing its role in the PFM system reform.

Preparation of an opinion is regulated by the law:

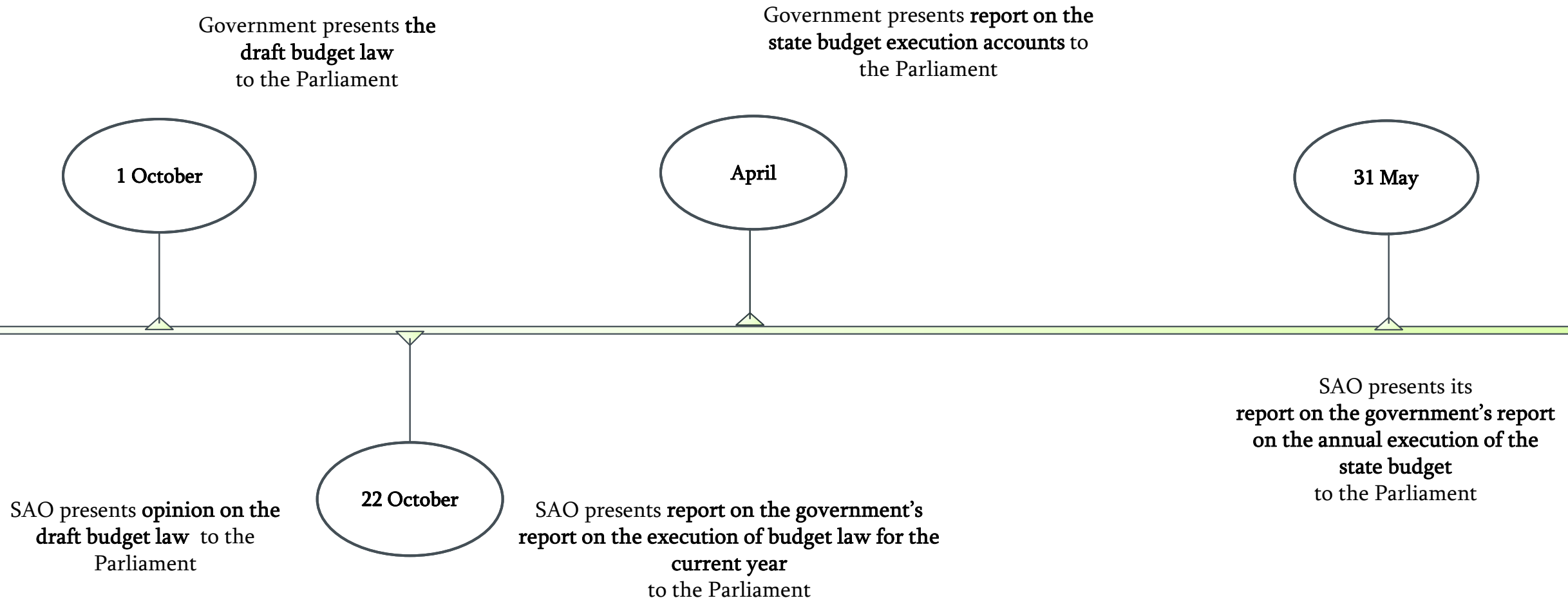
„...SAO presents to the Parliament an opinion on the reasonableness and legality of revenues and expenditures defined by the draft budget law at least 2 days prior to the summary meeting of the Finance and Budget Committee..”



STATE AUDIT OFFICE
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THE ROLE OF THE STATE AUDIT OFFICE IN THE PFM SYSTEM

Budget monitoring process:





THE ROLE OF THE STATE AUDIT OFFICE IN THE PFM SYSTEM

How could SAO meet the requirements of public finance reforms?

What kind of instruments could the SAO use to ensure fiscal transparency and sustainability of budget system during this process?





THE ROLE OF THE STATE AUDIT OFFICE IN THE PFM SYSTEM

Fiscal transparency represents a critical element of effective fiscal policymaking and risk management since the degree of fiscal transparency represents an important predictor of a country's fiscal credibility, sustainability and performance.

Especially, in the wake of the recent economic and financial crisis, there is a need to promote fiscal transparency for several reasons:

- ✓ *Governments' understanding of their current fiscal position and related potential shocks are inadequate;*
- ✓ *Countries had substantially underestimated the risks to their fiscal prospects.*



THE ROLE OF THE STATE AUDIT OFFICE IN THE PFM SYSTEM

Budget sincerity requirements, comparisons with independent forecasts, and alternative macro-fiscal forecast scenarios can help ensure that fiscal forecasts are credible and fiscal policy settings are robust to a range of macroeconomic outcomes.

From a principle point of view, it is significant that SAIs take part in promoting fiscal transparency, contributing to the credibility and performance of a country's fiscal position.

SAIs should consider a more active role in promoting accountability for fiscal stability to increase the awareness and understanding of the parliament and society.



THE ROLE OF THE STATE AUDIT OFFICE IN THE PFM SYSTEM

Since macro assumptions represent the foundation of fiscal forecasts, unexpected risks related to these assumptions may imply unreasonable and unrealistic planning, which in turn increases the possibility of failure to execute the budget law and maintain fiscal stability in the medium term period.

SAO plays an important role in developing public finance management system, fiscal sustainability and transparency. Thus, **SAO faced a problem:**

INTOSAI doesn't provide a certain standard which will regulate reasonability and sustainability of macro assumptions and the role of SAIs in this regard

How to maintain a fiscal sustainability and assess reasonability of macro assumptions in such a way, as not to intervene in the government's fiscal policy decisions, avoid conflict of interests and regulate this process by related benchmark?



THE ROLE OF THE STATE AUDIT OFFICE IN THE PFM SYSTEM

- To resolve this problem SAO used and implemented ISAE 3400 standard on the examination of prospective financial information envisaged in the opinion on the draft budget law and limited itself by the following issues:
 - ✓ Checking reasonability and appropriateness of macro assumptions;
 - ✓ If the fiscal forecasts were properly prepared on the basis of these assumptions.



ISAE 3400

- **According to ISAE 3400, while examining fiscal forecasts defined by draft budget law, the SAO should obtain sufficient appropriate evidence as to whether:**
 - ✓ MOF's best-estimate macro assumptions on which the fiscal forecasts are based are not unreasonable and, in the case of hypothetical assumptions, such assumptions are consistent with the purpose of the information;
 - ✓ The fiscal forecasts are properly prepared on the basis of the assumptions;
 - ✓ The fiscal forecasts are properly presented and all material assumptions are adequately disclosed, including a clear indication as to whether they are best-estimate assumptions or hypothetical assumptions;
 - ✓ The fiscal forecasts are prepared on a consistent basis with historical financial statements, using appropriate accounting principles.



AN OPINION ON THE STATE BUDGET DRAFT LAW

In order to assess the reasonableness and legality of **revenues and expenditures**, in the first place, the SAO should obtain appropriate evidence if macroeconomic assumptions that are underpinning of **the fiscal forecasts** defined by the draft budget law, are realistic.

The fiscal forecasts defined by the draft budget law are based on the macroeconomic and fiscal forecasts model that MOF uses. This model contains 93 equations with 52 exogenous, 93 endogenous and 12 additional variables. According to the opinion of the independent expert, this model satisfies all necessary requirements and are compatible to its goals.



AN OPINION ON THE STATE BUDGET DRAFT LAW

MOF's macroeconomic and fiscal forecast model is used to forecast tax and non-tax revenues for the next year

If macroeconomic assumptions of the model are unrealistic, then tax and non-tax revenue forecasts will be unreasonable as well

On the other hand, if assumptions are realistic, the fiscal forecasts are not properly prepared on the basis of these assumptions.



AN OPINION ON THE STATE BUDGET DRAFT LAW

In most cases, MOF faces the problem of unrealistic macro assumptions, which in turn leads to unreasonable tax revenue forecasts.

For example, in the growth rate of real GDP in 2013 was defined at 6% and correspondingly, tax revenues at 6,920 mln GEL. Since the actual real GDP growth rate in 2013 was 3.2%, tax revenues performance lag behind its forecast level by 634 mln GEL. **Thus, unrealistic macro assumptions led to a budget failure in Georgia in 2013.**



AN OPINION ON THE STATE BUDGET DRAFT LAW

Examination of the reasonability of macro assumptions and fiscal forecasts:

- ✓ During the preparation of the opinion on the draft budget law, SAO uses alternative sources of information, dynamic/trend of the previous and current years to assess if macro assumptions are realistic for the upcoming year;
- ✓ SAO also examines the reasonableness of tax (for each type of tax revenues) and non-tax revenues forecasts. For this we use extrapolation method based on 8 months data for the respective year, data for the previous years and according to this check reasonability of fiscal forecasts for the next year.



AN OPINION ON THE STATE BUDGET DRAFT LAW

SAO recommendations on the draft budget law:

- ✓ *For more transparency, SAO recommends that the enclosures of the draft budget law's should contain detailed information about the formation of macro assumptions, related risks and their effect on the tax and non-tax revenue forecasts;*
- ✓ *It should be more informative for the Parliament to assess reasonableness of forecasts, if the draft budget law's enclosure contained information about the dynamic/tendency for the respective year (8 month execution precisely). Since the forecasts are based on the dynamics of current and previous years, it is crucial to provide Parliament with the information about the respective year.*



AN OPINION ON THE STATE BUDGET DRAFT LAW

SAO examines and assesses the reasonability and legality of expenditures determined for each program and subprogram:

- ✓ *SAO examines every program/subprogram which has substantially increased appropriation compared to the previous year and gives its opinion about their reasonability;*
- ✓ *Examining and checking the reasonability of programs/subprograms which in the previous years didn't use most part of their appropriation but according to the draft budget law they still have the same amount or increased financing;*
- ✓ *SAO also examines whether two or more different programs concentrate on the same goals/outcomes and whether programs/subprograms, their goals/outcomes and performance indicators meet the criteria defined by the methodology of program budgeting.*



STATE AUDIT OFFICE
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SAO REPORT ON THE GOVERNMENT'S REPORT ON THE ANNUAL EXECUTION OF THE STATE BUDGET

SAO submits its report on the Government's annual state budget execution to the Parliament of Georgia. This report covers specific topics on the revenues, examines effectiveness, efficiency and economy of budget spending and is based on two main components:

Analytical procedures conducted at the MOF:

- ✓ *Risk assessment procedures and drafting the plan for the analytical procedures;*
- ✓ *Opening meetings with the senior management at MOF;*
- ✓ *Fieldwork and report drafting;*
- ✓ *Closing meetings with the senior management at MOF.*



STATE AUDIT OFFICE
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SAO'S REPORT ON THE GOVERNMENT'S REPORT ON THE ANNUAL EXECUTION OF THE STATE BUDGET

Consolidation of the significant findings of the SAO performance, financial/compliance audits and analytical procedures (budget execution analysis) at the entity

- ✓ *Consolidation of the significant findings from the SAO analytical/audit work and finalization of the SAO report.*

With this report SAO:

- ✓ *Ensured the objectivity and transparency of budget revenues and expenses;*
- ✓ *Examine how projections, defined by the budget law, were actually achieved while checking the reasonability of forecasts;*
- ✓ *Support the development of recent reform process in the PFM system by identifying problems, deficiencies and drawbacks in the every stage of budget process.*

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