

CHALLENGES RELATED TO PUBLIC FINANCIAL MANAGEMENT AT THE MUNICIPAL LEVEL IN GEORGIA



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IMPORTANCE OF PUBLIC FINANCIAL MANAGEMENT AT THE MUNICIPAL LEVEL

Providing full-fledged public services that would ensure the general well-being of society and the unimpeded development of each citizen or group would be impossible without central governance. However, for the governance system to adequately respond to the needs of the population and to ensure citizen participation in the decision-making process, it needs to redistribute governance powers and resources between the central and local governments.

Government decentralization at the local level is connected to the fundamental rights of citizens through the development of one of the most important democratic institutions: local government. Fiscal decentralization is a key component of that reform.

Fiscal decentralization implies the transfer of fiscal responsibilities to regional and local authorities and delegating certain responsibilities for expenditures and revenues to the lower branches of government.¹ Fiscal decentralization can improve the efficiency of public service delivery by prioritizing and rationally allocating resources.² Local government has a better understanding of local needs and priorities, and therefore this branch of government, compared to the central government, is equipped with an informational advantage in determining which goods and services would best meet citizens' needs. Legally determining who controls specific geographical areas helps ensure that the costs and benefits of public services are efficiently utilized, thus improving the efficiency of resource allocation.

Fiscal decentralization can also increase efficiency through a stronger accountability mechanism. The geographical proximity of public institutions to the local population and eventual beneficiaries increases the degree of accountability and, to some extent, improves the end results of public services. This is especially true in such

¹ "Intergovernmental Fiscal Relations," World Bank website, .

² Moussé Sow and Ivohasina Razafimahefa, "Fiscal Decentralization and the Efficiency of Public Service Delivery," IMF working paper, International Monetary Fund website, last modified March 2015, <https://www.imf.org/external/pubs/ft/wp/2015/wp1559.pdf>



social sectors as education and health care. It is expected that local populations, as part of this accountability, would force local governments, even those with limited resources, to find ways and ensure the production and delivery of better public services. Accountability is an incentive to spend more resources on public investment and sectors that support economic growth. In addition, populations directly electing their local governments enhances accountability.

Decentralization gives the electorate more leverage to control government. It promotes competition between local governments and thus facilitates the improvement of public services. Voters are given the opportunity to use the achievements of other local governments and draw their own conclusions about the competence or attitudes of their own elected politicians. The potential benefits of fiscal decentralization may include weakening lobbying by interest groups, changing flawed policies, and reducing inefficient and cost-ineffective management of state resources.

These are just some of the reasons that fiscal decentralization can become a policy tool that increases the efficiency of public service delivery. Ensuring cost-effectiveness requires a capable political and institutional environment.

Fiscal decentralization and the provision of adequate financial resources to self-governing units requires special focus on economically justified, productive, and efficient spending of financial resources, an improved Public Finance Management (PFM) system, and applying good-governance principles.

Principles of good governance such as productivity, efficiency, and rational financial management should be established in local governments.

Effective management of public finances – that is, the rational management of resources and provision of quality services – plays an essential role in the process of strengthening, developing, and improving local governments. Effective, transparent, and law-abiding PFM systems are important tools for the government to put fiscal decentralization into practice.³

3 Anwar Shaw, *Local Public Financial Management: Public Sector Governance and Accountability* (Washington DC: World Bank, 2007) <https://openknowledge.worldbank.org/handle/10986/6655>.



In the process of fiscal decentralization, local governments are given more power to decide for themselves where and how to spend the resources at their disposal to better meet their citizens' needs. Therefore, a well-structured PFM system is beneficial for both the central and local governments. This, in turn, leads to the rational and accountable use of public resources.

Assessing the efficiency of municipal finances provides a clear picture of municipalities' financial conditions and facilitates dialogue with stakeholders including the central government, financial backers, and citizens. In addition, it provides the ability to compare and evaluate how rationally and efficiently taxpayers' funds are used.⁴

To analyze established practices and challenges of public financial management in municipalities, international instruments that rigorously evaluate and help improve public financial management systems should be used.

The purpose of this document is to review these tools, analyze the practices and challenges of municipal governments in Georgia based on those tools, and outline and evaluate what activities are planned in policy documents to improve public financial management.

⁴ Catherine Farvacque-Vitkovic and Mihaly Kopanyi, *Municipal Finances: A Handbook for Local Governments* (Washington DC: World Bank, 2014) <https://openknowledge.worldbank.org/handle/10986/18725>.



PUBLIC FINANCIAL MANAGEMENT CHALLENGES AT THE MUNICIPAL LEVEL

CHALLENGES IDENTIFIED IN PEFA ASSESSMENTS

We first need to clarify what PEFA assessments are and explore their relationship to public financial management systems.

Public Expenditure and Financial Accountability (PEFA) assessments are international instruments for assessing public financial management systems and identifying their challenges.

PEFA assessments have been in use since 2001. They thoroughly and objectively examine the efficiency of public financial management in a given period and provide thorough, consistent, and evidence-based analyses of public financial management over a specified period of time.

By creating a unified framework for evaluating public financial management systems and monitoring their progress, **PEFA assessments are aimed** at facilitating the development of state financial management systems using indicators and objective analyses of those systems.

To this end, **PEFA's objectives** are to:

- » Periodically provide reliable information on public financial management systems, processes, and institutions
- » Assist in the implementation of government reforms and determine how well those reforms improve their systems
- » Encourage public financial management reform and facilitate dialogue
- » Support communication between governments and donors to develop common criteria in collaboration for public financial management reform, and with such facilitation, reduce governments' transaction costs

PEFA assessments promote a common government vision for public financial management reform and develop goals for both central and local governments.

Although the PEFA tool is specifically designed to assess central governments' financial systems, it covers the entire public financial management process and



most of its indicators are applicable for measuring expenditures and financial accountability systems in municipalities.

Since 2008, PEFA assessments have been used at the local government level, which is why it has become necessary to agree on relevant guidelines. **In 2017-2018, the World Bank surveyed three local governments in Georgia (Tbilisi⁵, Batumi⁶, Martvili⁷) and presented a PEFA assessment,⁹ while the German Society for International Cooperation (GIZ) studied twelve municipalities.¹⁰**

The challenges faced by public financial management systems in municipalities were assessed using PEFA indicators. The PEFA summary report of these municipalities suggests the following improvements:

- » Earmarked grants outturn that need to improve to have a positive impact on the indicator on transfers from a higher-level government.
- » Revenue outturn where improvements are required in revenue composition and producing accurate total revenue projections.
- » Performance information for service delivery has variable scores amongst municipalities but there is need to improve on performance evaluation.
- » Fiscal risk management related to monitoring public corporations owned

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- 5** Tbilisi evaluation report: "Georgia, Tbilisi, Public Expenditure and Financial Accountability (PEFA) Performance Assessment Report," PEFA Program website, October 2018, <https://openknowledge.worldbank.org/handle/10986/30999>
 - 6** Batumi evaluation report (in Georgian): "საქართველო, ბათუმი, სახელმწიფო ხარჯების და ფინანსური ანგარიშვალდებულების (PEFA) ეფექტიანობის შეფასების ანგარიში," Batumi City Hall website, October 2018, <https://bit.ly/3NrZsQ2>
 - 7** Martvili evaluation report (in Georgian): "საქართველო, მარტვილის მუნიციპალიტეტი, სახელმწიფო ხარჯების და ფინანსური ანგარიშვალდებულების (PEFA) ეფექტიანობის შეფასების ანგარიში," World Bank website, October 2018, <https://bit.ly/3x8DVVK>
 - 8** Summary report of municipalities (in Georgian): "საქართველო, სახელმწიფო ხარჯების და ფინანსური ანგარიშვალდებულების (PEFA) ეფექტიანობის შეფასების ანგარიში: მუნიციპალიტეტების შემავალი ანგარიში," World Bank website, October 2018, <https://documents1.worldbank.org/curated/es/362771551370296543/pdf/132483-WP-SubNationalPEFASynthesisReportGeoOct.pdf>
 - 9** Reports: "Georgia," PEFA Program website, <https://www.pefa.org/country/georgia> ; "Georgia, Public Expenditure and Financial Accountability (PEFA) Performance Assessment: Municipality Synthesis Report," World Bank website, October 2018, https://ieg.worldbankgroup.org/sites/default/files/Data/reports/ppar_georgiapublicsector.pdf
 - 10** "Carrying Out PEFA Assessments at Subnational Levels," YouTube, October 28, 2020, online video, 1:23:44-1:40:14, <https://www.youtube.com/watch?v=GjrwIGH7jUk>. For a summary of PEFA evaluations at the local level, see "საჯარო ფინანსების მართვის რეფორმის სტრატეგია 2018-2021" (Ministry of Finance of Georgia, Tbilisi) Appendix 3, <https://www.mof.ge/images/File/strategia/2018/PFMRS-2018-2021-2606-final.pdf>

by a municipality needs improvement.

- » Public investment management needs improvement.
- » Debt management needs improvement especially with regard to strengthening the recording and reporting of debt and guarantees and developing a debt management strategy.
- » Fiscal strategy needs improvement especially with regard to fiscal impact of policy proposals.
- » Medium-term perspectives in expenditure budgeting needs improvement especially with regard to improving medium-term expenditure ceilings and consistency of budgets with previous year estimates.
- » Budget preparation process needs improvement mainly because its effectiveness is hindered by the timing of information on grants which limits the time available to prepare the budget. There is also the need to improve on budget submission to the legislature.
- » Annual financial reporting needs improvement in the submission of financial reports for external audit, compliance with accounting standards based on international good practices, and coverage of the financial reports.
- » External audit of financial reports for municipalities is not annually done.
- » Legislative scrutiny of audit reports needs to be improved by ensuring that the Sakrebulo [local councils] are involved in the scrutiny of audit reports.¹¹

The PEFA methodology includes 31 indicators which are used to assess budget credibility, transparency of public finances, asset and liability management, policy-based strategy and budgeting, forecasting and controlling budget execution, accounting, reporting, external analysis, and audit systems.¹² The evaluation

11 “Georgia, Public Expenditure and Financial Accountability (PEFA) Performance Assessment: Municipality Synthesis Report,” 4.

12 “The Revised Guidance for Subnational Government PEFA Assessments is Available for Piloting,” PEFA Program website, 15 October 2020, <https://www.pefa.org/news/revised-guidance-subnational-government-pefa-assessments-available-piloting>. Guidance for Subnational Government (SNG) PEFA assessments include components directly assessed by subnational governments and the relevant indicators.



report provides insights into the strengths and weaknesses of public financial management to all stakeholders. Each answer category is graded with scores of A, B, C, or D, with D being the lowest score and A being the highest. This is why the C and D rating indicators are especially interesting.

In the document evaluating the three municipalities, C and D-rated indicators are found in several “blocks” or thematic categories of different indicators:¹³

THE FIRST BLOCK, “Budget Credibility,” evaluates how realistic central and municipal budgets are and whether they are used purposefully. The indicator is estimated by comparing actual expenditures and revenues (PFM direct data) with initially approved budget parameters. Assessments of the first block are the result of the performance of indicators in the other blocks.

From three indicators combined in the first block, two are rated C + and C (PI-2 Expenditure Composition Outturn and PI-3 Revenue Outturn). The HLG-1 transfer rate by a high level of government is given a D+.

According to the 2018-2022 Public Financial Management Reform Strategy, some measures should be taken to improve first block assessments. There are two possible measures that would affect the evaluation of sub-indicators (PI-7.1 Systems for allocating transfers and PI-21.4 Significance of in-year budget adjustments), which in turn would have a positive impact on the assessment rate of PI-1 and PI-2 indicators.¹⁴

One of these measures would be the timely submission of information on grants (conditional and capital) by the central government so that the upper limit data of the budget (the so-called “ceilings”) are reflected in the budget calendar at an early stage. The central government should also ensure a higher degree of budget credibility so that the need for additional budgets would be reduced. Municipalities should be more active in preparing

13 Three municipalities (Tbilisi, Batumi, and Martvili) were evaluated using the 2016 PEFA methodology. All 31 indicators (and their 94 sub-indicators) were used. The involvement of Martvili Municipality in the PEFA assessment is important since it is a small municipality with a population of about 4,000, which, when compared to Tbilisi and Batumi, is more representative of most municipalities in Georgia.

14 “2018-2022 Public Financial Management Reform Strategy (in Georgian): “საჯარო ფინანსების მართვის რეფორმის სტრატეგია 2018-2022” (Ministry of Finance of Georgia, Tbilisi) <https://bit.ly/38WldIN>



revenue-forecast proposals that include grants. Such a calculation would be a part of the budget circular, which would allow at least four weeks for budget preparation (Score: B).

THE SECOND BLOCK, “Transparency of Public Finances,” evaluates how comprehensive, consistent, and user accessible the PFM system is. This is achieved through budget classification, transparency of government expenditures and revenues at all levels, including intergovernmental transfers, publication of information on service delivery, and unimpeded access to fiscal and budget documentation.

The six indicators combined in the second block are only given a C+ rating (PI-8 Performance Information for Service Delivery).

According to the PFM Reform Strategy, the weaknesses identified in the second block are mainly related to the PI-8 indicator dealing with information on the efficiency of service delivery. This may be caused by a number of factors such as the scale of the municipality or the budget-preparation processes mentioned in municipalities’ basic data and directions documents (PI-16 Medium-Term Perspective in Expenditure Budgeting). When developing relatively small-scale municipal budgets, the focus is only on the current budget year, while service delivery indicators (outcomes and measurable outcomes) are often neglected. This is considered a weakness for relatively large-scale municipal budgets, as standard requirements make it necessary to present target parameters or expected measurable results.

BLOCK 3, “Assets and Liability Management,” evaluates how protected the ratio of the quality of state investments is by the cost by effective management of assets and liabilities, asset accounting and management, fiscal risk identification, debt and guarantee planning, approval, and management.

From four indicators combined in the third block, we find two C+ ratings and one C rating (PI-10 Fiscal Risk Reporting, PI-11 Public Investment Management, and PI-13 Debt Management).

According to the PFM Reform Strategy, the rating of local governments’ fiscal risk reporting (PI-10.1 indicator) could be improved if all municipal enterprises were audited within the last six months of the fiscal year and a consolidated summary report published.



Improving the assessment of the PI-10.2 indicator on local government monitoring by the central government is closely related to the PI-30.1 indicator on the scale and standards of auditing. Currently, the State Audit Office is not required to conduct annual auditing of each municipality, nor does it have the resources to do so. The State Audit Office licenses private auditing companies to conduct public-sector audits of large municipalities for nine months of the year. The evaluation could be improved by the joint work of the State Audit Office and private companies if a unified summary report were published annually.

For the PI-11 Public Investment Management indicator, in the municipalities of Batumi and Martvili, the purchase of investment-project monitoring services from specialized companies accountable to the municipal service responsible for investments is assessed positively. This scheme could be replicated for all municipalities.

The central government has developed a Debt Management Strategy (DMS) (PI-13.3), which is used as a local-government model by municipalities.

BLOCK 4, “Policy-Based Fiscal Strategy and Budgeting,” assesses the extent to which the fiscal policy of the government and relevant macroeconomic and fiscal forecasts are considered in the preparation of the fiscal strategy and budget.

From five indicators combined in the fourth block, we find two C+ ratings and one D+ rating (PI-15 Fiscal Strategy, PI-16 Medium-Term Perspective in Expenditure Budgeting, PI-17 Budget Preparation Process).

In the PFM Reform Strategy, based on data from Martvili Municipality (for small municipalities), when moving from annual budgeting to a multi-year budgeting approach, capital investment and related current expenditure are indicators of required income (mostly grants received from the central government). Inclusion of survey indicators (BDD) in the documents on the fiscal impact of policy change (PI-15.1) and budget compliance with the previous year’s forecast (PI-16.4) would ensure compliance with multi-year budgeting methodology. Even after implementing these measures, it might still be possible for maximum budget targets (the so-called “ceilings”) to expand to cover the current and subsequent budgetary years.

As mentioned in the first block, to improve the evaluation of the municipal budget calendar (PI-17.1) indicator, it is necessary for municipalities to have



a clear idea of potential grants from the outset or for the central government to meet their deadlines in advance. Such a change would give local councils much more time to review and approve draft budgets. However, even this gold standard might be lower than the highest (A) rating. In the case of municipalities, evaluating budget calendar indicators (PI-17.1) with a score of B and budget submission indicators (PI-17.4) with a score of C could be quite sufficient to illustrate best practices.

BLOCK 5, “Predictability and Control of Budget Execution,” evaluates how the budget is executed within the framework of effective standards, processes, and internal control systems based on the need for resources.

In the eight indicators combined in the fifth block, there were no C or D scores.

BLOCK 6, “Accounting and Reporting,” evaluates the accuracy and reliability of records and the timeliness of information being disseminated for decision making, management, and reporting.

In the three indicators combined in the sixth block, we find only one D+ rating (PI-29 Annual Financial Reports).

According to the PFM Reform Strategy, the main weakness of the sixth block is the PI-29 annual financial report indicator. The PEFA Assessment Report sets out an action plan to address gaps in the PI-29.1 and PI-29.3 indicators. The measures would also affect local governments.

BLOCK 7, “External Evaluation and Audit,” evaluates the independence of public finance review and the extent to which external control is exercised over the implementation of recommendations.

In the two indicators combined in the seventh block, we find scores of both D+ and D (PI-30 External Audit and PI-31 Legislative Scrutiny of Audit Reports, whose sub-indicators are all also given D scores).

According to the PFM Reform Strategy, the main weakness identified in the case of the local-level PI-30 external audit indicator is related to the PI-



30.1 sub-indicator. As already mentioned, increasing the number of audits in municipalities is the only way to improve evaluations. This also applies to the PI-30.3 sub-indicator.

According to established procedures, all audit reports must be submitted to parliament. **In line with best practice, municipal reports should be submitted to local councils, which would, in turn, improve the assessment of the PI-31 indicator.**

The analysis reveals that the PI-31 Legislative Scrutiny of Audit Reports indicator and its sub-indicators are a particular challenge since all of them have been given D scores. As the report states:

While external audit standards are an area of significant strength, annual audit coverage is not mandatory. The timing of audits should take place at least once every three years (Score C) and is dependent on risk analysis and the State Audit Office's work program given its resources. The audits highlighted relevant material issues and systemic and control risks... The independence of the SAO is assured by the Constitution of Georgia and the Law of Georgia on State Audit Office.¹⁵

But the frequency of audit means that there is often a significant time gap between audits given that they are not done annually. Legislative scrutiny does not meet PEFA standards as it is not carried out by the Sakrebulo [Score D] but is delegated to the State Parliament. None of the municipality audits was addressed by the respective Sakrebulo.¹⁶

Assessment data from these three municipalities, as well as from twelve other municipalities, shows that **indicators form the external evaluation and audit block are a challenge for other municipalities as well.**¹⁷

It is therefore important to review the role and findings of external audits in the management of public finances at the municipal level.

¹⁵ "Georgia, Public Expenditure and Financial Accountability (PEFA) Performance Assessment: Municipality Synthesis Report," 17.

¹⁶ "Municipality Synthesis Report," 3.

¹⁷ Apart from the three (Tbilisi, Batumi, Martvili) municipalities assessed in the PEFA report, twelve other municipalities were evaluated with the support of GlZ: Lanchkhuti, Akhalkalaki, Gurjaani, Khashuri, Dusheti, Kutaisi, Oni, Poti, Rustavi, Zestaponi, Lagodekhi, and Mtskheta. In 2017, ten municipalities were assessed using the 2016 PEFA methodology for the 2014-2016 the fiscal years, while two additional municipalities were assessed in 2018 for the 2015-2017 fiscal years. The data was used to improve the results of the PEFA assessments conducted for the municipalities of Tbilisi, Batumi and Martvili.

CHALLENGES IDENTIFIED IN STATE AUDIT OFFICE REPORTS

When discussing the challenges identified in the reports of the State Audit Office, the role of the State Audit Office in improving public financial management at the municipal level should be discussed first.

The main goals of the State Audit Office are:

- » Promoting the efficiency and accountability of public administration
- » Protecting the legality, purposefulness, and efficiency of the use of budget funds and other public resources
- » Protecting the wealth and property of the state, autonomous republics, and municipalities
- » Improving public financial management

According to the Organic Law of Georgia on the State Audit Office, the State Audit Office monitors the expenditure and execution of municipal budgets in order to perform the tasks assigned to it by law.

Audit data is reflected in reports. The State Audit Office is also authorized to make recommendations based on their audits. Audit reports and recommendations, if any, are submitted to the audited entity and possibly that entity's parent agency or the central, autonomous republic, or municipal government that the audited entity is accountable to.

Sections or parts of these audit reports that contain evidence of crimes are immediately sent to law enforcement agencies. These agencies must then inform the State Audit Office of their decisions and the measures taken based on the submitted information.

The State Audit Office submits a report to Parliament of Georgia once every two years on the audits conducted on the expenditure and execution of municipal budgets.



Regarding the management of public finances in the municipalities, there are several interesting findings in the summary reports of the municipal audits submitted to Parliament by the State Audit Office:¹⁸

The report on audits conducted in 2012-2013 on expenditures and execution of municipal budgets records both systemic and specific violations and shortcomings.¹⁹

Systemic shortcomings are related to issues such as the budget process and revenue forecasting, procurement-process management, deficiencies in cost estimates and performance reports, the disposal of property owned by municipalities, limited liability companies (LLCs), and non-profit (non-commercial) legal entities (NE(NC)LEs) established by municipalities, as well as the registration of property, claims, and liabilities.

Specific violations and shortcomings include overpaid amounts, lost earnings, cost-ineffective spending of budget funds, low quality goods or services being supplied, inappropriate or inefficient spending, unjustified expenditures, various illegalities, improper disposal of local property, and accounting issues.

The report on audits conducted in 2014-2015 on expenditures and execution of municipal budgets reflects shortcomings in state procurement, budgetary resource management, asset management, financial accounting, and organizational and personnel management.

The **systemic shortcomings** category includes non-utilized funds during the budget year, unmet work-completion deadlines, and issues related to non-commercial legal entities established by municipalities.

¹⁸ <https://bit.ly/3moC4XE> The State Audit Office prepares reports once every two years and submits summary reports of the audits conducted on expenditure and execution of the municipal budgets to Parliament. These reports contain summary information on the activities of various municipal bodies in the following areas: compliance with applicable law, legislation and other acts influencing the use of public resources and the preparation of financial statements, rational spending, cost-efficient use of funds, and any other issues of importance for improving public financial management and financial practices in the public sector. As of January 14, 2022, the reports for 2012-2013, 2014-2015 and 2016-2017 were available on the website of the State Audit Office.

¹⁹ Recurring violations and shortcomings need to be regulated by improving the qualifications of local officials and making changes to legislative regulations.



The report on audits conducted in 2016-2017 on expenditures and execution of municipal budgets reveals shortcomings in the management of budget funds in state procurement, budgetary resource management, asset management, and financial accounting. There are significant systemic shortcomings at the municipal level in property management and the funding of representative and executive bodies' activities carried out as part of infrastructure construction, rehabilitation, and operation programs.

Both the PEFA assessments and the audit reports clearly show that there are still challenges to public financial management in municipalities. To improve the current public financial management situation, it is necessary to analyze what activities are planned in policy documents.

For this purpose, we need to explore both the decentralization and public financial management strategy documents.



MANAGING PUBLIC FINANCES AT THE MUNICIPAL LEVEL AS AN INTEGRAL PART OF POLICY DOCUMENTS

DECENTRALIZATION STRATEGY

The goals of the 2020-2025 decentralization strategy are to ensure the implementation of the principles recognized by the Constitution of Georgia and the consistent development of local government, turn decentralization into a continuous and purposeful process, increase of the role and importance of self-governing units in solving public issues, promote citizens' participation in local government, and establish transparent and accountable local governments based on the principles of good governance.²⁰

To achieve the strategic goals of establishing credible, accountable, transparent, and results-oriented municipal self-governance while introducing efficient and innovative management systems and ensuring quality service delivery, there are plans to develop modern organizational management systems, including automated human-resource management and organizational-activity monitoring systems, and **improve the public financial management system at the municipal level**. A consistent and transparent planning system will be put in place that is closely linked with the budget and financial management system.

The document states that **mechanisms will be implemented at the local level to improve the public financial management system, which, taking into account Public Finance Expenditure and Accounting (PEFA) analyses conducted in municipalities, would improve the management of public finances**.

The specific activities listed in the Decentralization Strategy Action Plan are also relevant here.²¹ In particular, the strategic goal of improving local self-government includes the task of introducing effective and innovative management systems

20 “2020-2025 decentralization strategy” (in Georgian): დეცენტრალიზაციის 2020–2025 წლების სტრატეგიისა და დეცენტრალიზაციის სტრატეგიის განხორციელების 2020–2021 წლების სამოქმედო გეგმის დამტკიცების შესახებ” (Legislative Herald of Georgia, Tbilisi, 31 December 2019) <https://matsne.gov.ge/document/view/4764626?publication=0>

21 “Decentralization Strategy Action Plan” (in Georgian): “დეცენტრალიზაციის 2020–2025 წლების სტრატეგიისა და დეცენტრალიზაციის სტრატეგიის განხორციელების 2020–2021 წლების სამოქმედო გეგმის დამტკიცების შესახებ.”



and quality service delivery at the local level. One of the activities included in that task is improving the public financial management system, which directs individual municipalities to conduct PEFA analyses, introduce mechanisms to address deficiencies identified in those analyses, conduct training sessions and workshops to strengthen result-oriented planning and software budgeting, provide budget coaching and assistance, and prepare budget documentation such priority documents, action plans, program budget annexes based on updated program-budget drafting methodologies, and budget reference guides.

When improving public finance management systems, it is also important to provide local governments with adequate financial resources. The decentralization strategy documents states that the small financial and material base of self-governing units is one of the main problems that, among other factors, hinders the effective implementation of local self-governance. Also, powers provided to self-governing units by law are often only on paper due to their lack of appropriate resources.

Thus, exercising powers imposed by law on self-governing entities inevitably requires the financial or material resources necessary to exercise that authority. Therefore, **one of the main focuses of decentralization reform is to supplement the existing and gradually increasing powers of self-governing units with resources.** To achieve this goal, the plan is to promote the consistent growth of local self-government revenues. Legislation will determine the share of total revenues given to local governments, but it will be not less than seven percent of GDP. Legislation also determines the share of municipal revenues in relation to GDP, and this will be increased gradually with the transfer of relevant functions from central and autonomous-republic governments and in proportion to the financing of those functions in these governments' budgets.²² **As financial resources increase, there should be a special focus on their effective use.**

22 “ავტონომიური რესპუბლიკების რესპუბლიკური ბიუჯეტებისა და ადგილობრივი თვითმმართველი ერთეულების ბიუჯეტების მიმოხილვა,” Parliamentary Budget Office of Georgia website, <http://pbo.parliament.ge/ge/budget/core-reports.html>. These documents contain an overview of budget implementation in Georgian municipalities



PUBLIC FINANCIAL MANAGEMENT REFORM STRATEGY

The main goal of the Public Financial Management Reform Strategy (PFMRS) for 2018-2022 is the rational use of financial resources.²³ This goal can be achieved by improving public financial management systems, which will ensure: (1) fiscal discipline, (2) work efficiency, and (3) the effective allocation of Georgia's public resources. Considering budget resources and improving the public financial management system will have a positive impact on all aspects of public services and the citizens who benefit from those services.

The Public Financial Management Reform strategy is based on previously proven successful changes in public financial management and establishes the main reforms planned for the management of the budget process in areas such as strategic planning and budget preparation, budget execution, accounting and reporting, auditing, and oversight.

In the context of Georgia's decentralization, the focus is on areas related to the financial management of municipalities. Budget execution (accounting and bookkeeping) and procurement systems are generally common to central and subnational governments. In the context of municipal governance, areas such as budget development and oversight require special attention.

Public financial management evaluations have identified several areas that need to be improved. In particular, municipal financial management operations, accounting, and reporting in accordance with international standards and practices are planned as medium-term local-government tasks along with increasing accountability and transparency in municipal public finances.

The 2018-2022 PFM Strategy for Municipalities addresses key issues such as improving municipal financial management and the quality of reporting, increasing the transparency of state-owned enterprises located in municipalities, developing internal audit units, strengthening local government units with the help of the internal auditing, and increasing the coverage of municipal auditing.

23 "Public Financial Management Reform Strategy" (in Georgian): "საჯარო ფინანსების მართვის რეფორმის სტრატეგია და სამოქმედო გეგმები," Ministry of Finance of Georgia website, <https://www.mof.ge/5171>.



RECOMMENDATIONS

To increase good governance at the local level and improve the public financial management system, the following steps are recommended:

- » Municipal authorities should be guided by the principles of good governance such as productivity, efficiency, and rational financial management.
- » Local authorities should use public financial management tools effectively. These include sustainable medium-term planning and result-oriented budgeting in the form of program budgeting.
- » Policy documents should focus on the public financial management system in order to develop an efficient, transparent, and rule-based PFM system.
- » Policy documents evaluating the public financial management system should try to determine how to improve PEFA evaluation report indicators. Special attention should be paid to improving areas assessed with scores of C or D in municipalities where the PEFA assessments were conducted.
- » When managing public finances, special focus should be placed on issues identified in PEFA evaluation reports as areas for improvements and take into account PEFA recommendations. Action plans should also be developed in the municipalities where PEFA assessments were conducted.
- » PEFA evaluation methodology should be followed when managing public finances. These activities must be guided by established best practices and try to match PEFA evaluating criteria in municipalities where PEFA assessments have not yet been conducted.
- » Policy documents should include activities set out in both the public finance management improvement strategy as well as the decentralization strategy and its action plan.



- » Policy documents should reflect issues identified as municipal weaknesses in the PFM strategy document and activities planned at the municipal level in that document.
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- » Discussions of priority lists or drafts budgets in representative bodies and evaluations of budget execution, especially annual reports, should emphasize the program-budgeting component, programs and sub-program objectives, their outcomes, and the relationship between outcome indicators and the allocations assigned to them.
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- » When managing public finances, the findings and recommendations of the State Audit Office should be considered in order to promote cost-efficient spending and the productive and efficient use of public finances.
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- » The findings and recommendations presented in State Audit Office reports should be considered by representative bodies during both the planning and control stages.
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- » Representative bodies should establish the practice of reviewing State Audit Office reports and be actively involved in those reviews.
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- » Internal audit units should be involved in the budget process and provide quarterly monitoring of program implementation. Both interim and final progress data should be evaluated using a selective audit method.
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- » One of the determinants of effective public financial management is ensuring citizen involvement in decision making and implementation by local governments. To facilitate this, authorities should implement appropriate mechanisms for citizen involvement in the budget process so that civil society representatives are able to participate in both the planning and implementation stages.
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- » Executive bodies, when reviewing budget documents in representative bodies, should present additional information on the mechanisms used in those documents to ensure that citizens are involved in the budget process and desired outcomes are achieved.



- » To ensure open and transparent government and efficient public financial management, it is important to make the management process and the positive and negative aspects of that process as transparent as possible. Therefore, relevant government bodies should make every effort to ensure that reviews of all budget documents and reports of the State Audit Office in representative bodies are publicly accessible to all stakeholders.
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- » All documents related to the budget process should be posted at a visible place on municipalities' official websites. These documents should include relevant administrative and legal acts issued by the executive bodies that define the list of priorities submitted for compilation and the deadlines for submission, the drafts and the final editions of priority lists, draft budgets with their annexes, budgets with annexes as approved by representative bodies, and monthly, quarterly, and annual reports on budget execution.



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