



STATE AUDIT OFFICE OF GEORGIA

REPORT

**ON THE GOVERNMENT'S REPORT
ON THE ANNUAL EXECUTION
OF 2017 STATE BUDGET**

SHORT VERSION

STATE AUDIT OFFICE OF GEORGIA

REPORT ON THE GOVERNMENT'S REPORT ON THE ANNUAL EXECUTION OF 2017 STATE BUDGET



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CONTENTS



THE MAIN ECONOMIC INDICATORS

4



1 EXECUTION OF THE STATE BUDGET

5



2 FISCAL DISCIPLINE

6



3 STATE BUDGET REVENUES

8



4 STATE BUDGET EXPENDITURES

10

4.1. Deficiencies in budget planning and execution processes in budgetary organizations

11

4.2. Legal Entities of Public Law / Non-Profit (Non-Commercial) Legal Entities

16

4.3. Reserve Funds of the Government and the President of Georgia

19



5 STATE FINANCIAL ASSETS MANAGEMENT

20

5.1. Shares and other equity

20

5.2. Loans

21



6 PUBLIC DEBT MANAGEMENT

23

6.1. Stock of Public Debt

23

6.2. Credits from External Sources

24



7 PROGRAM BUDGETING

25



8 CONDITION OF RECOMMENDATIONS FULFILLMENT ISSUED BY THE STATE AUDIT OFFICE

26

THE MAIN ECONOMIC INDICATORS



	2014	2015	2016	2017
Nominal GDP (Million GEL)	29,151	31,756	34,029	38,042
GDP Per Capita (GEL)	6,492	8,551	9,146	10,231
Economic growth	4.6%	2.9%	2.8%	5.0%
Receipts (million GEL)	9,157	9,891	10,374	11,619
Expenditures (million GEL)	9,010	9,703	10,292	11,765
Tax revenues (million GEL)	6,847	7,550	7,987	8,991
Budget deficit to GDP (GFSM 2001)	-2.1%	-1.1%	-1.4%	0.9%
Budget deficit to GDP (GFSM 2001 modified)	2.5%	2.7%	3.0%	2.9%
Public debt stock (million GEL)	10,375	13,161	15,123	16,956
Public debt to GDP	35.6%	41.5%	45.5%	44.6%
Inflation-Consumer Price Index	3.1%	4.0%	2.1%	6.0%
Exports (million USD)	2,861	2,205	2,113	2,728
Imports (million USD)	8,602	7,292	7,295	7,983
Foreign trade balance (million USD)	-5,741	-5,088	-5,182	-5,255
Remittances (million USD)	1,441	1,080	1,151	1,379
Current account deficit to GDP	-10.6%	-11.7%	-13.3%	8.6%



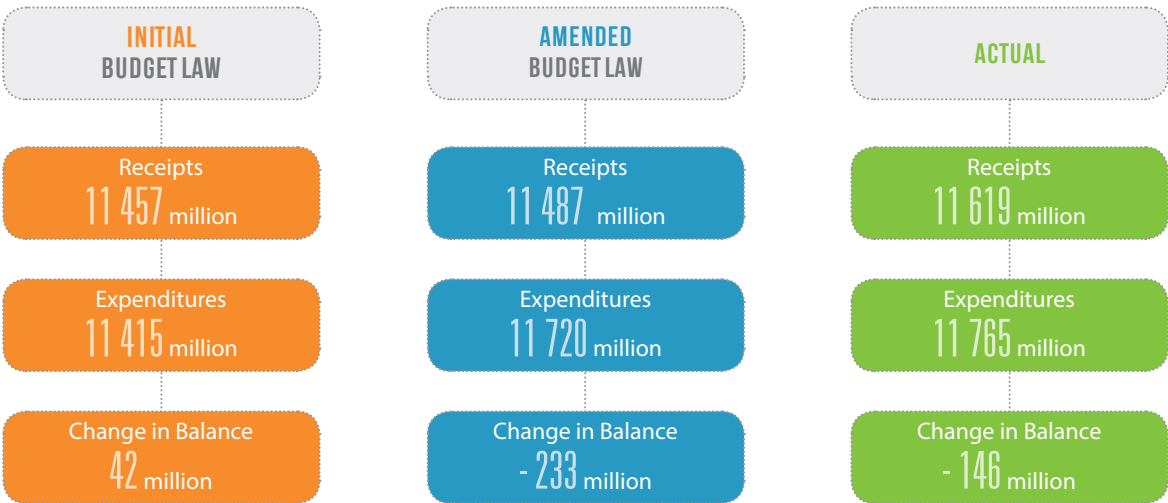
1. EXECUTION OF THE STATE BUDGET

State budget receipts and expenditures for the fiscal year 2017 was planned at the amount of 11,457 and 11,415 million GEL, respectively. But, at the end of the fiscal year, as a result of amendment in the State Budget Law plan of the receipts have increased by 30 million GEL and the expenditures - by 305 million GEL.

According to the initial budget law of 2017 Budget Balance was planned to increase by 42 million GEL. But as a result of amendment, Budget Balance was defined to decrease by 233 million GEL. As for the actual performance, in 2017 Budget balance decreased by 146 million GEL.

It is noteworthy, that the amount of balance on the treasury accounts presented in budget execution report – 2,810 million GEL, does not match with the data received from the treasury, due to the technical error. Namely, the budget execution report duplicates the balances of the state budget, autonomous and municipal budgets and budgets of legal entities of public law/ non-profit (non-commercial) legal entities deposited at commercial banks with the amount of 555 million, 180 million and 181 million GEL respectively. The real amount of the balance on treasury accounts comprised 1,894 million GEL in the end of the fiscal year.

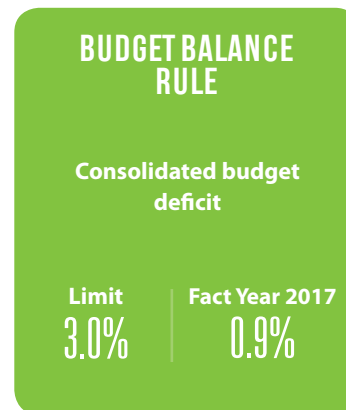
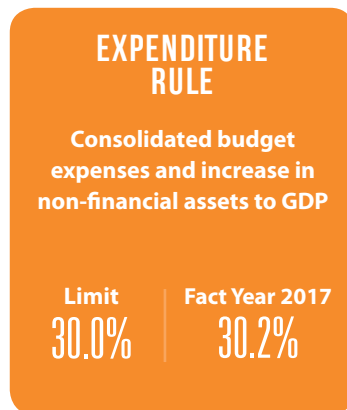
Figure 1. Aggregate Indicators of the State Budget of 2017 (Million GEL).



2. FISCAL DISCIPLINE



“Organic law of Georgia on Economic Freedom” defines fiscal rules in Georgia to ensure sustainability and stability of the fiscal policy in the long term period.



EXPENDITURE RULE

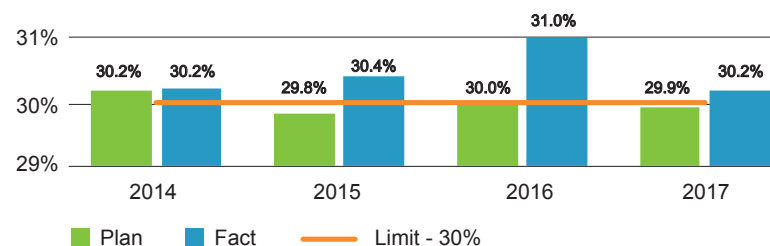
In 2017, similarly to the past years, the expenditure rule was violated and slightly exceeded the 30% limit set by the organic law. The target was set at 29.9% by the budget law but actual amount totalled 30.2%. The potential risks of breaching the target set by budget law was mentioned in the report of State Audit Office.¹

The necessity of complying with the expenditure rule is determined by its significance in budgetary processes. Namely, according to IMF, the rule limits expenditures to prevent country from excess debt pressure and to support better prioritization of expenses. In addition, the rule supports the balancing of decreased budget revenues, attributed to the negative economic shocks and significantly improves fiscal sustainability.²



It should be highlighted, that the budget execution report of 2017 does not disclose information about the above mentioned indicator, consequently not about the reasons of the indicator limit breach and the necessary actions to be taken to put the indicator back under the limit. It is also noteworthy that the legislature does not define the necessary actions that should be taken by the government in case of breaching the limit at the end of the year. This issue was highlighted by the IMF in its report - “Georgia: Fiscal Transparency Evaluation”.³

Figure 2. Data of expenditure (sum of expenses and increase in non-financial assets of the consolidated budget) to GDP Ratio over the period 2014-2017.



RECOMMENDATIONS

TO THE MINISTRY OF FINANCE:

- Budget execution report should disclose information about the complying with all fiscal rules defined by “Organic law of Georgia on Economic Freedom” and in case of breaking the rules, the reasons should be stated.

1 The report of State Audit Office of Georgia on the project of “the state budget law of 2018” (First submission).

2 Expenditure Rules: Effective Tools for Sound Fiscal Policy, IMF, 2015

3 Fiscal Transparency Evaluation, IMF, 2017.



3. STATE BUDGET REVENUES



According to the initial law of the state budget, revenue projection was set to 9,489 million GEL and increased by 934.5 million GEL (10.9%) with respect to fiscal year 2016. By the end of the fiscal year the projection increased to 9,696 million GEL (by 2.2%) within the amendments of the state budget law. Actual mobilization of revenues amounted 9,750 million GEL and exceeded the initial projection by 260.9 million GEL (2.7%).

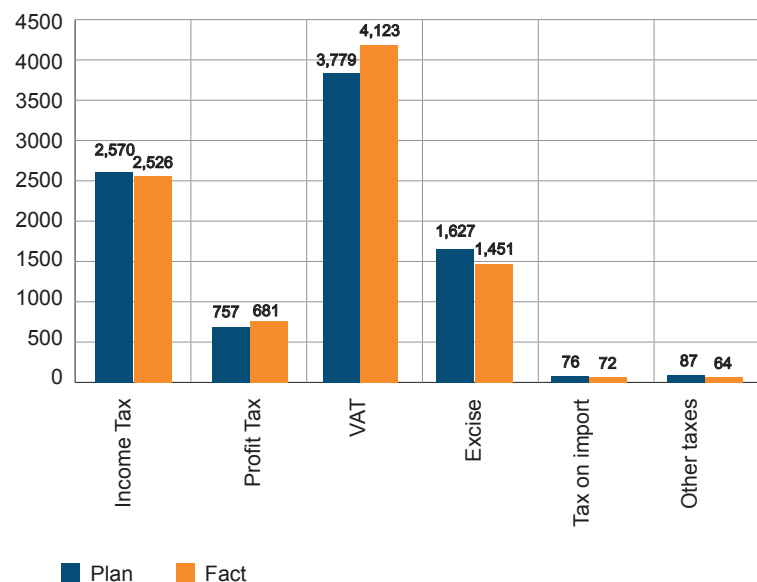
Table 1. Execution indicators of Components of State Budget Revenues (Thousand GEL).

	2017 actual mobilization of revenues	Execution to the initial projection (%)	Execution to the amended projection (%)
Tax revenues	8,991,308	101.9%	100.1%
Grants	350,602	123.3%	105.9%
Other revenues	408,417	106.1%	106.1%
Revenues	9,750,327	102.7%	100.6%

The main determinant of mobilizing revenues above the projected amount was a result of excess mobilization of tax

revenues, which itself was caused by higher economic growth compared to the targeted one. Profit and value added taxes exceeded their projections by 419 million in total (by 9.4%). In case of the Value added tax, which exceeded the initial projected amount by 343.6 million GEL (by 9.1%) points to the pessimistic planning approach.

Figure 3. Execution of tax revenues with respect to initial budget projection – fiscal year 2017 (million GEL).



As for the other revenues, which was projected to 385 million GEL, it exceeded the plan and actual mobilization amounted 408 million GEL. This was caused by excess inflow of revenues in "interest" and "realization of goods and service" budget items.

INTEREST revenues in the budget exceeded initial projection by 11.8 million GEL (25.7%). The difference is caused because ministry of finance did not consider the interests, accrued on the budget balance on commercial bank accounts, into the initial budget plan. 12.6 million GEL was mobilized from this source during the fiscal year 2017.

DIVIDENDS from the net income of the state owned corporations, amounted 66.36 million GEL which is 99.9% of the projection. But, it should be noted, that collecting state owned corporations dividends defined by dividends distributing commission still stays problematic. Particularly, the decisions made in 2015 by the state owned corporations dividends distributing commission remains unfulfilled but this issue was not discussed during the commission meeting in 2017. It turns out that, because of unfulfilled decisions, corporations have not to transferred 835 thousand GEL dividends to the budget from 2015 by the date of 31 December 2017.



RECOMMENDATIONS

TO THE MINISTRY OF FINANCE AND MINISTRY OF ECONOMY AND SUSTAINABLE DEVELOPMENT:

- Dividends distributing commission should discuss the cases of unfulfilled decisions and agreements made during previous meetings and take respective actions in this direction.



4. STATE BUDGET EXPENDITURES



Reports of State Audit Office often mention about the increasing rate of public expenditures in the last month of the fiscal year, which creates the risks of inefficient and unreasonable spending of public resources. Despite decreasing trend of this tendency in the previous years, expenditures significantly increased in December 2017. The amount of budget expenditures in the last month equalled 193% of the average spending in 11 month of the fiscal year and exceeded the analogous figure from 2016 by 41%. It is noteworthy that there is an increase in all budget items of the expenditures except the “interest” in the last month of the fiscal year.

The tendency of increased spending rate of appropriations at the end of the budget year is particularly high in the case of certain programs of spending agencies. Specifically, budget funds spent in December within the programs of the agencies (excluding “Expenditures of General State Importance”) were 2.6 times higher compared to the average amount of expenditures in the previous 11 months. In addition, in case of 49 individual programs, spending in December exceeds the average amount of expenditures in the previous 11 months two times and more.

Figure 4. Monthly dynamics of the State Budget Expenditures - 2015-2017 years (million GEL).

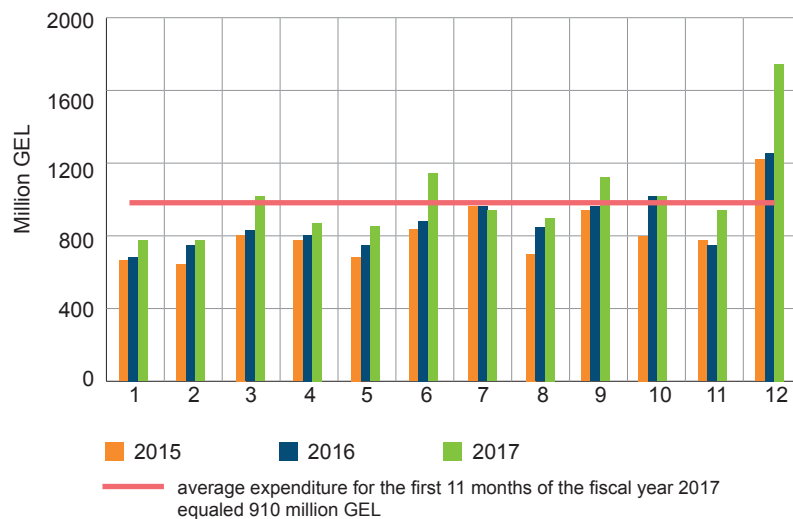
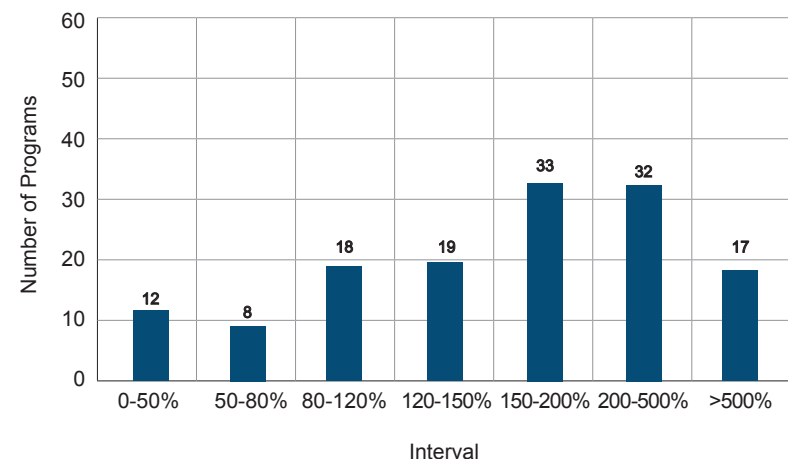


Figure 5. Distribution of the programs by the budget spending in December as a percent of average amount spent in previous 11 months.



The increase in expenditures in the last month of the fiscal year is caused by lower execution of expenditures in the previous months compared to the quarterly plans. As a result, low expenditure level in the first quarter was compensated in the fourth quarter and unused resource was fully spent in December.

Increasing the equity capital in state owned corporations by the end of the year and advanced payments that were not necessary for the public agencies at that moment, played an important role in the increase of expenditures in December, 2017. Increased spending of unused budgetary funds at the end of the fiscal year points to the deficiencies in public finance management and creates the risk of inefficient and unreasonable spending of the public resources.

To prevent significant increase in expenditures at the end of the fiscal year, it is advisable to review existing approaches and better practice examples of different countries and elaborate mechanism, which will ensure proportional spending of appropriations during the year. Several examples of the better practices of different countries are reviewed in the Publication of the State Audit Office - «Transfer of Assignments to the Next Fiscal Year Budget» (Carry-over mechanism)⁴.

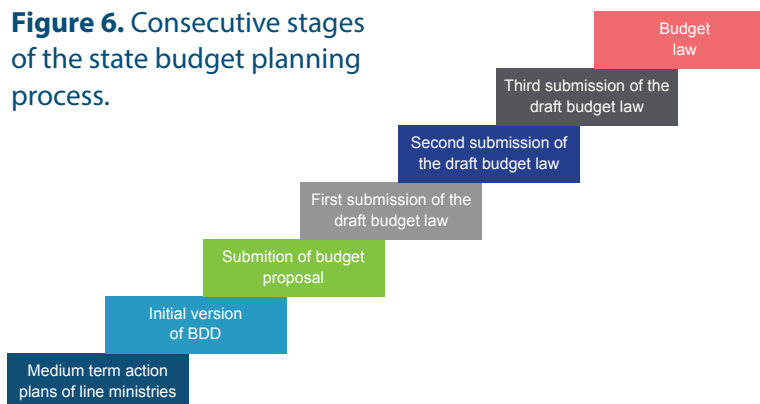
4.1 DEFICIENCIES IN BUDGET PLANNING AND EXECUTION PROCESSES IN BUDGETARY ORGANIZATIONS

Analysis conducted by the state audit office in the budgetary organizations revealed significant deficiencies in the budget planning and execution process, which is expressed in large-scale redistribution of appropriations between programs/ sub-programs during the fiscal year and in the existence of low execution rate programs and sub-programs at the end of the year.

4.1.1 Budget Planning

Budget planning is the most important stage of the budgetary processes. Existence of good planning framework is a crucial for the successful implementation of state programs, but by the analysis of the budgeting process several systemic deficiencies were identified at every stage of planning process.

Figure 6. Consecutive stages of the state budget planning process.



⁴ http://sao.ge/files/kanonmdebloba/pubnlication/Carry_Over.pdf



Basic Data and Directions document (BDD)

During the planning process of the expenditures for the fiscal year 2017, the appropriations of the spending agencies were changed significantly in the different versions of the Basic Data and Directions (BDD) document prepared in 2016. In spite of complexity of the budget planning process which may cause necessity of changes in BDD, the frequency and scale of changes are noteworthy.

The analysis points to the fact that there is a necessity of improvement in the quality of information related to the planning ceilings and appropriations of the spending agencies and programs presented in BDD.

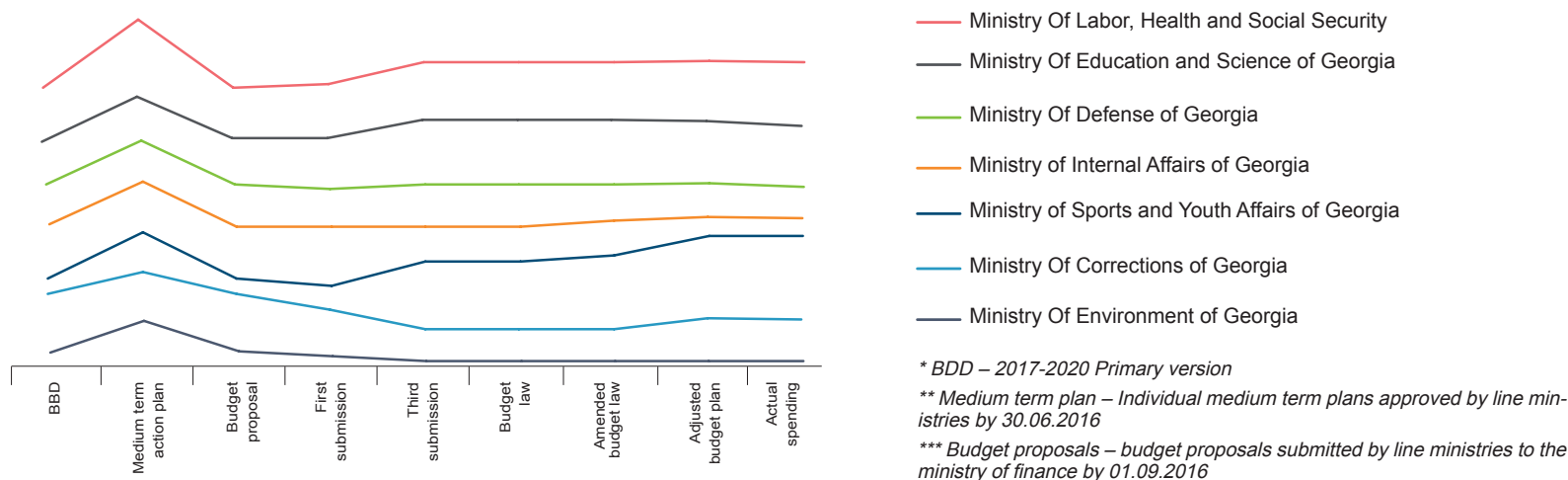
Medium Term action plans

The appropriations in the medium term action plans of line ministries significantly exceeds those from BDD as well as from budget proposals and budget law and does not reflect the figures defined on the other planning stages. Therefore, the document does not have practical use in planning process of the agency appropriations.

Figure 7. The amount of spending agencies for which appropriations for 2017 fiscal year were changed in different versions of BDD.



Figure 8. Appropriations for the fiscal year 2017 on the different stages of the budget planning process for several line ministries⁵.



In particular, the appropriations in medium term action plans exceeds those from BDD in case of 12 line ministries out of 14⁶. The difference fluctuates from 5 to 146 percent and equals 38 percent on average⁷.

Besides, line ministries have to prepare report about the execution of their medium term action plans after each fiscal year, in order to consider achieved results for planning budget for the next fiscal years. But, as the medium term action plans

does not comply with other documents such as BDD and budget law, comparing the achieved results with those defined in medium term action plans does not make much sense.

In order to be an effective planning document, line ministries should approve realistic medium term action plans which will be based on the cost estimations for the activities to be fulfilled for achieving certain program goals.

⁵ The Figure is based on conditional scale because of differences among assignments of the line ministries

⁶ Ministry of Justice did not approved its medium term plan for 2017-2020 period within the terms. Ministry of foreign affairs has not reported the assignments in its medium term plan.

⁷ The analysis is based on only budget resource (grants and credits are excluded) for suitability with BDD



Budget proposals of spending agencies and submission of draft state budget law to the parliament

In most cases, budgetary organizations do not submit formal justifications via the budget management electronic system (eBudget) for resources requested above the ceiling defined in BDD. The obligation of submitting formal justification would facilitate the realistic requirement of additional funds by the spending agencies which in turn would simplify the decision-making process for the coordinating body on the effective allocation of additional resources.

Amendment in State budget law

By the end of 2017, the amendment of the state budget law resulted in the increase of appropriations by 305 million GEL. As a result, the amount of appropriations of some spending agencies have changed significantly, as the activities and expected results of their programs/sub-programs. But, there was no change in expected results and performance indicators of the programs/sub programs, which complicates the evaluation of performance of programs/subprograms and determining the link between financial and non-financial information on the reporting stage.



RECOMMENDATIONS

TO THE MINISTRY OF FINANCE:

- In case of amendment of the State Budget law, accompanied by the amendment to the appropriations of the budgetary organizations, updated program budget annex should be prepared including the updated expected results and target indicators.

TO THE MINISTRY OF FINANCE AND SPENDING AGENCIES:

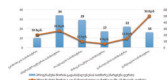
- In order to enable evaluation of achieved results with respect to the medium term action plans, line ministries should update their medium term action plans after approval of the state budget, so that action plans comply with the current budget law.
- Spending agencies should have the obligation of submitting the justification using Budget Management Electronic System (eBudget) for requiring resources above the ceiling defined in BDD. This will support the realistic requirement of additional funds by the spending agencies, which in turn would simplify the decision-making process for coordinating agency related to the effective allocation of additional resources.



4.1.2 Adjustment and execution of the state budget

During the analysis of budget execution, conducted by the State Audit Office, several systemic deficiencies were identified in spending agencies in the adjustment and execution process of budget resources:

Frequent and large-scale redistribution of appropriations



Despite the fact that the spending agencies meet the limits set by the Budget Code⁸, frequency and amount of redistribution of appropriations among programs/subprograms and among the budget classification items during the year is noteworthy, as it indicates on the deficiencies in budget formation process.

Reallocation of unspent appropriations



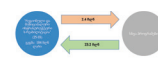
In case of some budgetary organizations, on the budget planning stage, higher amount of appropriations are planned than is required for certain programs/subprograms or budget classification item or/and unused resources are redistributed to other programs/subprograms during the year.

Funding unplanned activities



In some cases, during the fiscal year funds are allocated for the projects/ activities, or for purchasing products/services, which were not envisaged by the state budget law, or assigned program appropriations were not sufficient to complete implementation of the project.

Reverse redistribution of resources



In some cases, the budgetary organizations revert appropriations on programs/subprograms from which the resources were transferred during the year.

Programs/subprograms with low execution rate



8 programs and 27 subprograms are characterized by execution rate less than 80% of the adjusted annual budget plan. In addition, some programs/ subprograms, which have a very high execution rate with respect to adjusted budget plan, have low spending rate with respect to plan, approved by the Budget Law.

⁸ The Budget Code of Georgia, Article 31, paragraph 3: "Distribution of funds between programs of the spending institution shall not exceed 5% of the appropriations defined by annual budget for the spending institutions".



Table 2. Programs/subprograms execution rate with respect to approved and adjusted budgets, excluding target grants and direct investments – 2017.

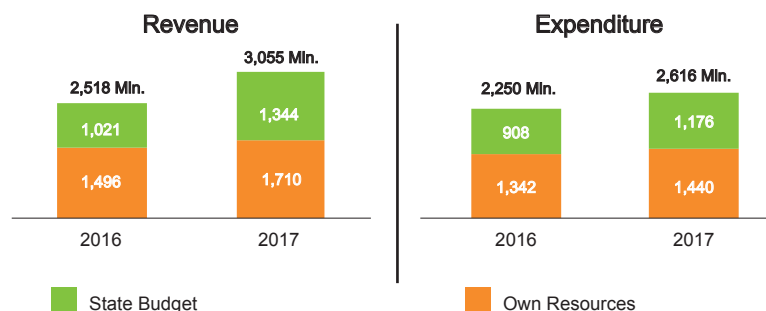
Program/subprogram execution with respect to adjusted plan				
Interval	0-50%	50-80%	80-95%	95-100%
Number of programs	5	3	15	112
Number of sub programs	15	12	56	690

Program/subprogram execution with respect to approved plan					
Interval	0-50%	50-80%	80-95%	95-100%	>100%
Number of programs	6	7	31	34	50
Number of sub programs	52	68	119	118	248

4.2 LEGAL ENTITIES OF PUBLIC LAW/NON-PROFIT (NON-COMMERCIAL) LEGAL ENTITIES

The revenues received by LEPLs/NLEs in 2017 amounted to 3,055 million GEL and the expenditures incurred to 2,616 million GEL.

Figure 9. The Structure of LEPL/NLE Income – 2016-2017 (Million Gel).



The analysis of the chapter about the LEPLs and NLEs, presented in the Annual Report on the Execution of the State Budget, revealed several deficiencies related to the completeness and accuracy of the information. Namely:



Information is not presented based on the uniform approach. In case of some LEPL/NLE there is no full coverage of the budget resources allocated for the implementation of the programs planned by the budget law. As a result, report does not provide complete financial information about all LEPLs/NLEs;

The total balance of LEPL/NLE at the end of 2016 exceeds the balance for the beginning of 2017 by 49 million GEL. Namely, in case of 75 agencies, reporting of the balance of the same period is different and does not correspond to each other, which makes the accounting principle unclear.

In case of 26 LEPLs (from 232), the amount of factual revenues exceeded the planned amount by more than 100%.

In the case of 103 LEPLs, mobilized income from its own sources exceeded the planned amount by more than 20%.

In case of 17 LEPLs, own income mobilization was planned at 0, but actually 8.9 million GEL was accumulated.

In case of 54 LEPLs more than 90% of the mobilized resource were spent.

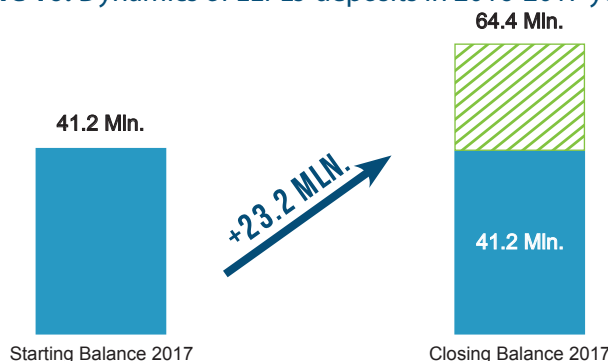
In case of 27 LEPLs there were the use of balance accumulated in the previous periods.

Budgetary organizations should pay additional attention to the budget planning stage, in order to timely and realistically define the volume of receipts and corresponding activities that would support the efficient and effective usage of public funds.

In 2017, the amount of funds allocated by the LEPLs in the state budget amounted to 60.7 million GEL and exceeded the budget plan by 50% - indicating the deficiencies in the process of determining the forecast parameter.



Figure 10. Dynamics of LEPLs' deposits in 2016-2017 years.



Although LEPL/NLE are obliged to direct particular share of their own income to the budget, there remains surplus amount of financial resources that are deposited at commercial banks to generate interest revenue. Commercial bank deposits of 8 analyzed agencies, out of 20, at the beginning of 2017 amounted to 41.2 million GEL, which was unused during the year and increased to 64.4 million GEL by the end of the year.



RECOMMENDATIONS

TO THE MINISTRY OF FINANCE:

- The uniform reporting principle should be used in the budget execution report about the financial information of LEPL/NLE and complete data about the resources spent should be disclosed on the programs defined by the state budget law⁹;
- It is important to elaborate uniform principle of LEPL/NLE balance accounting in order to ensure the comparability of closing balances to the opening balances of next period;

TO THE MINISTRY OF FINANCE AND BUDGETARY ORGANIZATIONS:

- Unused funds, placed on deposits of commercial banks by the LEPL/NLE for generating interest income, should be allocated for provision and/or improvement of public products/ services in such a way that functioning and stability of budgetary organizations are not put under the risk.

⁹ The exception in reporting can be the expenditures on citizens pensions incurred by the LEPL Social Service Agency



4.3 RESERVE FUNDS OF THE GOVERNMENT AND THE PRESIDENT OF GEORGIA

The president's reserve fund was defined by the state budget law of 2017 at the level of 5 million GEL. Factual costs amounted to 4.9 million GEL, which was the 98% of the annual plan.

The government reserve fund was defined by the initial budget law of 2017 at the level of 40 million GEL. However, as in previous years, the volume of fund increased significantly by - 40.6 million GEL and comprised 80.6 million GEL. As for the actual spending, during 2017 year, allocated resources from the government reserve fund amounted to 76.9 million GEL and actual spending amounted to 73.7 million GEL.

Figure 11. Dynamics of government reserve fund - 2014-2017 (Million GEL).

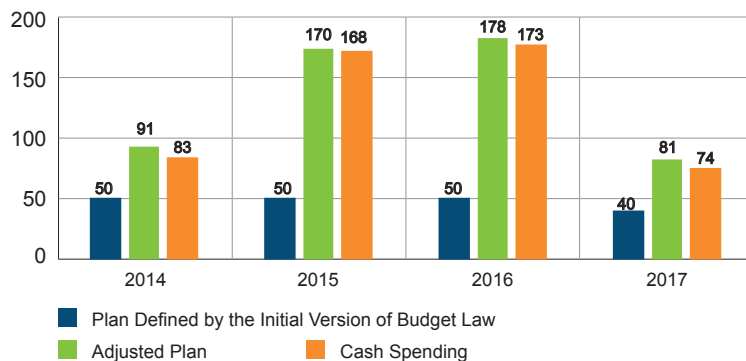
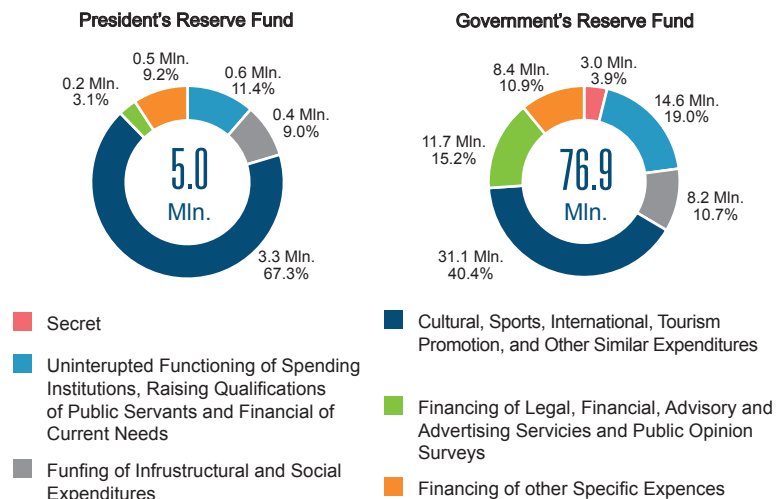


Figure 12. Distribution of the funds allocated from Government's and President's Reserve Fund, breakdown by the functional aims – 2017.



According to the Budget Code, "Reserve funds of the President of Georgia and the Government of Georgia are intended to finance unforeseen expenditures" (Article 28, paragraph 2). However, in 2017, like in previous years, there has been direction of funds for financing such activities/projects which are systematic, and because of their importance, scale, and character cannot be considered as unforeseen. In case of appropriate planning it would be possible to consider them in the budget planning stage.

It is important to fulfill the recommendations given in the previous report of the State Audit Office and to list concrete criteria based on which the activities will be chosen for financing from the reserve funds.



5. STATE FINANCIAL ASSETS MANAGEMENT



During 2017, as a result of amendments in the State Budget Law, both budget items - “Decrease in Financial Assets” (by 233 million GEL -274%) and “Increase in Financial Assets” (by 209 million GEL - 26%) have increased. The increase in financial assets was largely caused by the capital injections in state owned enterprises (SOEs) and the decline in financial assets by reducing the state budget balance.

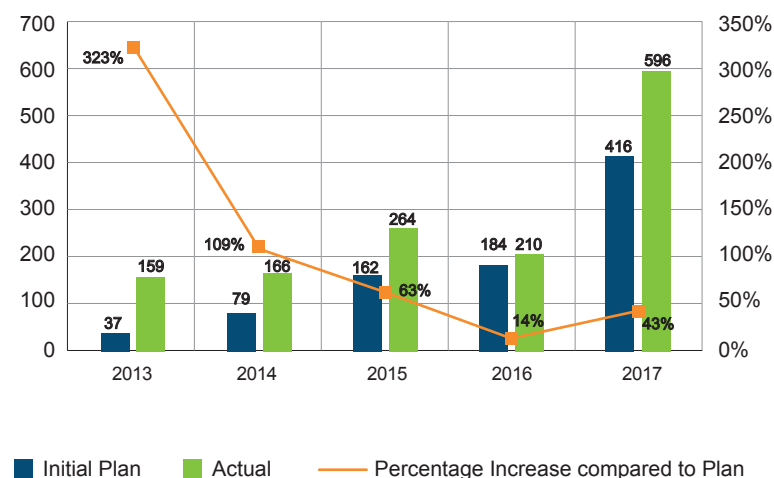
5.1 SHARES AND OTHER EQUITY

The capital injections in SOEs constitute a great proportion (65.8%) of the budget item “increase in financial assets”. It is notable that during 2017, budgetary funds directed to increase capital in SOEs exceeded the indicator of the initial budget plan by 179.7 million GEL (by 143%) and amounted to 595.9 million GEL. Unlike the last budget year, spending of budgetary funds from the budget item “Shares and other Equity” was uneven during 2017. Only in December 256.6 million GEL was directed to increase capital in SOEs, which is 43% of the total funds in this budget item.

It should be noted that the actual amount of payments incurred from the budget item - «Shares and other Equity» in the recent years exceeds the planned amount defined by the

budget law on average by 111% that should be regarded as an undesirable tendency. Therefore, it is recommended to define a list of the activities/projects to be implemented by the SOEs and the amount of financial resources necessary for their implementation on the budget planning stage.

Figure 13. Dynamics of actual spending under the budget item “Shares and other Equity” compared to the initial plan defined in state budget law - 2013-2017 years (million GEL).



The analysis of the “Shares and other equity” has revealed several deficiencies related to the time of accounting equity transactions and transfer of funds. Namely:

INCREASE OF SHARES AND OTHER EQUITY:

- 53.5 million GEL was injected in “United Water Supply Company of Georgia” Ltd, which was recorded as increase in financial assets in the budget, but this amount was not reflected in the company’s equity as of May 7, 2017;
- The equity of “State Construction Company” Ltd was increased by 10 million GEL, but this amount in the report of the state budget execution is listed as “other capital expenditures”.

DECREASE OF SHARES AND OTHER EQUITY:

The budget item – decrease in “Shares and other Equity” is presented by the reduced amount. Namely, it is reduced by 3.4 million:

- As a result of reducing equity in JSC «Akura» 1.1 million GEL was directed to the state budget, but this change was reported as “other incomes”;
- In exchange for 100% shares of “Tbilisi Balneological Resort” Ltd, budget received 2.4 million GEL and three buildings, but this transaction was classified as decrease of “non-financial assets” instead of decrease in “shares and other equity”.

According to the SAO’s assessment, it is necessary to pay attention to the classification and accounting of revenues received from the decrease in financial assets in the relevant items since the accounting of transactions under the item of “expenses” and/or “non-financial assets” affects the size of the budget deficit. As a result, the primary balance of the state budget presented in the budget execution report inaccurately reflects the actual situation in this direction.

5.2 LOANS

In 2017, 96.1 million GEL were mobilized from the on-lent credits and loans issued from state budget. Similar to previous years, the significant share of received resources - 94% (90.7 million. GEL) was directed to the repayment of loans issued from the externally borrowed funds (on-lendings).



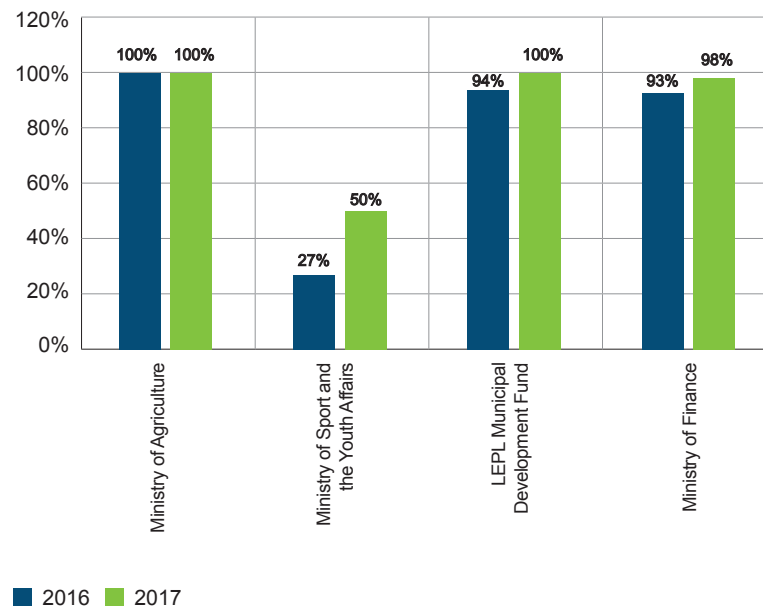
ON-LENDINGS FROM EXTERNAL FINANCIAL RESOURCES

“Enguri Hydro Power» Ltd and «EnergoTrans « Ltd were unable to repay the full amount of loan service costs defined by the subsidiary loan agreement, which amounted to 10.7 million GEL¹⁰.

LOANS FROM BUDGET RESOURCES

The analyses of the loans reveals the significant deficiencies related to the assessment of borrowers' creditworthiness and to the efficient management of the loans. At the end of the budget year, the stock of loans issued from budget resources amounted to 209.4 million GEL, from which 93% presents the overdue loans.

Figure 14. The Share of overdue loans in total active loans, breakdown by issuing organizations.



RECOMMENDATIONS

TO THE MINISTRY OF AGRICULTURE, LEPL „MUNICIPAL DEVELOPMENT FUND OF GEORGIA”, MINISTRY OF SPORT AND THE YOUTH AFFAIRS:

- The current portfolio of loans issued from the budgetary resources should be assessed and effective measures should be implemented based on the analysis to reduce the amount of overdue loans.

¹⁰ For converting the loans from EUR into GEL is used the official exchange rate of 31 of December, 2017.



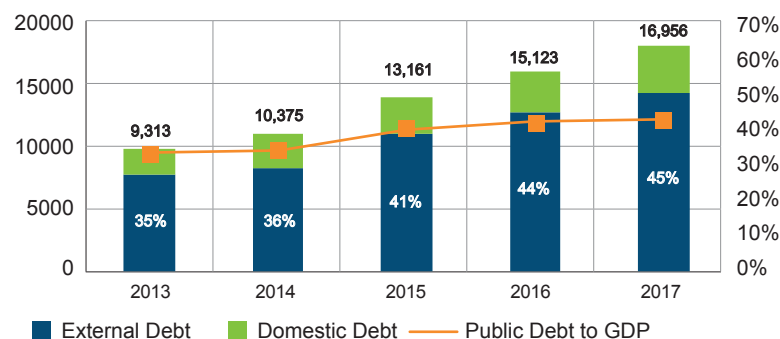
6. PUBLIC DEBT MANAGEMENT



6.1 STOCK OF PUBLIC DEBT

As of December 31, 2017, the stock of public debt amounted to 16,956 million GEL (44.6% of GDP), which exceeded the initially forecasted amount by 7% and previous year's indicator by 12%. The violation of the limit defined by the final budget law was mainly caused by the depreciation of the GEL at the end of the budget year¹¹.

Figure 15. Public Debt to GDP - 2017.



Similar to the previous years, the stock of the public debt of 2017 exceeded the 40% limit of Georgia's socio-economic development strategy «Georgia 2020».

The difference of the forecasted public debt amount in the initial and amended versions of the budget law was mainly due to the changes in Lari's exchange rate against the original loan currency, also for non-inclusion of external debt of the National Bank of Georgia and loan from the Asian Infrastructure Investment Bank (AIIB), which was received in June, 2017.

It should be noted that the stock of external debt is 79.1% of the total public debt portfolio. Thus, the currency risk remains the main risk factor for the public debt portfolio, like the previous years. As a result, it is recommended to pay more attention to minimize the expected negative consequences of the fluctuations in the exchange rate. In this regard, one of the approaches is to reduce the share of external debt in the public debt portfolio, for which the existence of developed capital market is important.

According to the «Capital Market Development Strategy», due date for publishing the Public Debt Management Strategy was the beginning of 2016, but it is still not published as of May 7, 2017.

¹¹ In the budget law of 2017 (amended) for calculating the forecasted amount of public debt 1 USD = 2.5 GEL exchange rate was used, while on the 31st of December, 2017 national currency depreciated by 4 % (1 USD = 2.5922 GEL).



6.2 CREDITS FROM EXTERNAL SOURCES

In 2017, 1,252 million GEL worth of credit funds were mobilized from external sources, which amounted 90% of the initial and 103 % of amended plan.

As a result of amendments in the state budget law, amount of investment loans decreased by 1.7 million GEL. This decrease was partly caused by the withdrawal of 2 such investment projects («Kvemo Kartli Waste Management Project» and «Agro Credit») from the state budget, under which the assigned credit resources were not used at all during the first 10 months of the fiscal year.

According to the State Audit Office's assessment, it is recommended that funds for investments projects defined in the budget law should not be reduced because of low execution compared to the initially defined plan (or /underperformance of project) while amending the budget law. Inclusion of the original plans in the budget law will require to analyze and

explain the reasons of low execution on the reporting stage. Gained experience can be used in the budget planning process for the next years.

- It is noteworthy that another 8 investment projects are characterized by zero execution and 10 projects have less than 70% execution compared to the initial plan as of 31 of December, 2017.
- The paid commitment fees amounted to 1.7 million GEL under 12 such investment credits, which have less than 70% execution.
- In addition, in 2017, there were financed four such investment projects that were not envisaged in the original or amended budget laws. Within the unplanned projects, the utilization of credit resources amounted to 9.5 million GEL at the end of the year.



RECOMMENDATIONS

TO THE AGENCIES IMPLEMENTING THE INVESTMENT PROJECTS:

- For ensuring the efficient usage of credit resources (with minimal costs) and avoiding unreasonable spending on credits, the Project Implementing Agencies should ensure timely identification of hindering factors of the projects implementation and to take appropriate measures, to support the efficient and timely use of obtained resources.



7. PROGRAM BUDGETING



Preparing the program based budgeting has started from 2012, but still is not approved by the legislature and exists only in the form of accompanying annex of the budget law. In addition, the information presented in the program annex and the process of the budget preparing according to program format is characterized by significant shortcomings, which makes it difficult or in some cases impossible to evaluate effectiveness of the programs.

Systemic deficiencies are found on the planning and reporting stages of the program budgeting. Problems related to the planning stage were analyzed in the report of the State Audit's Office: "opinion on the draft state budget law 2017".

The analysis of the program annex of the state budget execution report 2017 also revealed systemic deficiencies in the reporting of the results achieved within the programs.

DEFICIENCIES ON THE PLANNING STAGE

- Preparation process of the ministries' medium-term action plans and the information presented in the documents are characterized with significant deficiencies, and requires further improvement;
- Expected results of programs are presented in aggregated form without expanding them by the sub-programs;
- In many cases it is impossible to compare the planned and achieved results of the program as the indicators defined on the budget planning stage does not have specific targets of what the program/sub-program should achieve at the end of the year;
- Performance indicators for programs/subprograms cannot evaluate the achieved results and measure the effectiveness of the program;
- Several programs and subprograms require additional indicator for the complete assessment of the achieved results.

DEFICIENCIES ON THE REPORTING STAGE

- In case of some programs there is no full information reported about the results achieved within the programs, and results are not evaluated with respect to performance indicators;
- In some cases achieved results are presented in the form that are non-comparable to the performance indicators, using different form that makes it difficult and complicated to compare the planned results with the achieved ones;
- In some cases the explanations are not presented about the differences between the planned and achieved results or the explanations are too general and it is impossible to determine what the cause of deviation was.
- In some cases the explanations of the deviation are not presented because it is impossible to identify the difference between the planned and achieved results, because of the absence of targets in indicators.



The budget execution report should provide the full information about all programs for which the expected results and performance indicators were determined at the

planning stage, in order to allow the interested parties to assess the results achieved within the allocations assigned to the programs.



RECOMMENDATIONS TO THE MINISTRY OF FINANCE:

- An action plan for the implementation of program budgeting should be developed, where specific activities that should be implemented within the framework of the reform will be provided by relevant timeframes and responsible departments. The existence of the targeted goals of the reform will increase the quality of responsibility of public agencies involved in the process and will also support monitoring of the reform process.

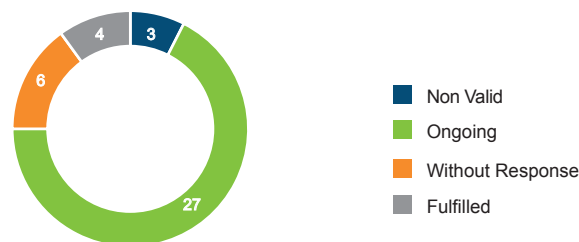
8. CONDITION OF RECOMMENDATIONS FULFILLMENT ISSUED BY THE STATE AUDIT OFFICE



In response to the systemic deficiencies and shortcomings identified in 2016 year budget execution process, the state audit office has issued 40 recommendations in total. Fulfilment status of those recommendations currently is the following:

As in the previous years, the information presented in budget execution report on the fulfilment of recommendations are too general and makes it complicated to analyze and assess the current situation of their completion.

Figure 16. Condition of Recommendations Fulfillment Issued by the State Audit Office in the report - 2016 year annual budget execution.





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