



PERFORMANCE AUDIT REPORT





State Audit Office of Georgia

**The Progress with the Implementation of
IPSAS for the year 2020**

Performance Audit Report

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Table of Content

Abbreviations	4
Executive Summary.....	5
Conclusions and recommendations.....	9
1. Introduction.....	11
1.1. Audit Motivation	11
1.2. Audit Objective and Questions.....	11
1.3. Audit Scope and Methodology.....	12
1.4. Audit Criteria.....	12
1.5. Entities to be covered by the audit.....	13
2. General Information	14
2.1. Overview of the existing accounting framework.....	14
2.2. Global State of Accrual Accounting.....	14
3. Audit Findings on the Progress achieved	17
3.1. Lack of a detailed and comprehensive strategic plan	17
3.2. Lack of an approved Action Plan.....	18
3.3. Poor consideration of resource requirements.....	18
3.4. Lack of supervisory functions over the implementation process	19
3.5. No consideration of challenges associated with the full implementation	20
3.6. No consideration of the indirect reference approach	21
3.7. No consideration of the expected benefits of IPSAS implementation.....	22
3.8. Deficiencies in accountability.....	23
4. Audit Findings on the level of Readiness for IPSAS implementation	24
4.1. The Government's consolidated financial statement do not consider inaccuracies identified in the audits	24
4.2. Performance on IPSAS readiness indicators	25
Appendix 1: List of IPSASs implemented at central government level as at 2019	28
Appendix 2: Stages of Adoption of IPSAS across the European Union	29

ABBREVIATIONS

CBA	Cost-Benefit Analysis
CIPFA	Chartered Institute of Public and Accountancy
EPSAS	European Public Sector Accounting Standards
EU	European Union
GoG	Government of Georgia
GPSASB	Georgian Public Sector Accounting Standards Board
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IPSAS	International Public Sector Accounting Standards
IPSASB	International Public Sector Accounting Standards Board
KPIs	Key Performance Indicators
LEPL	Legal Entity of Public Law
MoF	Ministry of Finance of Georgia
MoU	Memorandum of Understanding
NPLEs	Not for Profit Legal Entities
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
PwC	Price Waterhouse Coopers
SAO	State Audit Office of Georgia
SOE	State Owned Enterprise



EXECUTIVE SUMMARY

In 2009, as part of its agreements with the International Monetary Fund (IMF) and the European Union (EU)¹, the Government of Georgia (GoG) committed to the implementation of International Public Sector Accounting Standards (IPSAS). The implementation strategy was included in the Ministry of Finance Order 701 of 3 November 2009. The strategy envisaged a phased implementation with full transition to IPSASs by 2020. This meant that in that year a consolidated financial statements of public agencies would be prepared in accordance with the standards.

By the implementation of IPSAS, the GoG aimed to align its accounting and reporting standards to an international recognized one. This would improve the quality of the financial information on which basis the GoG and the Parliament makes its resource allocation decisions.

With the support of a EU-funded project², the State Audit Office (SAO) conducted this performance audit which examines the **progress** in the implementation of the standards and concludes on the **readiness** of the GoG to implement the standards in accordance with the agreed timelines. Specifically, the audit examined the quality of the decisions and measures to implement IPSAS and the degree of implementation of these measures. The audit has resulted in recommendations on the necessary future steps and resources to support the implementation process.

KEY FINDINGS

PROGRESS IN THE IMPLEMENTATION OF THE STANDARDS

The planning and associated arrangements for the implementation were generally weak and not well documented. The implementation process was not properly documented. In 2009, with the support of international consultants, a detailed 'IPSAS implementation plan' was prepared. The document was accepted by the MoF, but not formally approved. Also, the action plan has not been updated since 2009 and it has become outdated and its timeline has not been followed. The only approved document for planning purposes was the Order 701 of the Ministry of Finance (MoF) which laid down the phases of the implementation process. However, the Order did not provide sufficient details.

Resource requirements for the implementation were not fully identified and adequately planned for. Effective management of the IPSAS implementation process requires detailed analysis of the necessary resources and the funding at the planning stage. Timely provision of the resources contributes to the uninterrupted implementation. During the reform, resource needs were assessed on an annual basis depending on the activities proposed for each year. However, there was no comprehensive consideration or estimate of the likely expenses required to achieve full implementation.

The supervisory functions over the implementation process has not been properly performed. An IPSAS Board was established. However, the Board was only functioning as an advisory body and it did not have a supervisory mandate. The Board decisions have mostly been undocumented and thus

¹ EU Budget support program and financing agreement "Support to PFM Reform in Georgia (Phase I), 2007-2009".

² EU Project "Institutional Strengthening of the State Audit Office of Georgia."



it is difficult to evaluate its effects over the implementation process. According to the MoF, the mandate of the Board will be strengthened to increase its effectiveness in the last phase of the reform.

A number of key strategic decisions that would contribute to the effectiveness of the implementation process were not made. In particular, the option to implement the standards over a three-year transitional period as permitted under IPSAS 33 was not considered.³ There was no analysis of factors hindering the implementation. Furthermore, neither uniform accounting policies nor an IPSAS ready Chart of Accounts were developed.

According to MoF, in line with the recommendations set out in the IMF report, the strategy document will be amended from 2020, and instead of full compliance (direct reference) with the IPSAS, financial reporting will be prepared based on IPSAS. Although, MoF plans to consider the application of transitional exemptions under IPSAS 33.

The expected costs and benefits of the adoption of IPSAS were not formally considered at the time that the decision was taken to adopt IPSAS. Before the implementation process is launched the expectation of the stakeholders and the expected reform benefits should be identified and compared to the required human, financial and time resources. Cost Benefit Analysis (CBA) is an important tool to make cost-effective decisions.

There is no documented consideration by the MoF of the alternative accounting standards that might be better suited to the Georgian context and would ensure fair and reliable financial reporting. It should be noted that only a few countries in the world have adopted full IPSAS accrual and the MoF has not given the arguments why it is a priority for Georgia to do so. Furthermore, in the absence of a relevant Parliamentary resolution, there is no evidence that Parliament has been engaged in the reform.

The implementation process lacked effective monitoring and evaluation. There was some reporting of progress through the annual reports on Public Financial Management Reform prepared by the MoF. However, the reporting of progress once in a year is inadequate for the oversight of a project of this level of magnitude and complexity.

The IT and human resource needs required for effective implementation have not been defined. The approach to resourcing the implementation was piecemeal. The level of competency of financial officers in IPSAS and accrual accounting remains low despite the trainings conducted. This is one of the important issues and factors hindering the effective implementation. There has been progress in the design and roll-out of additional accounting modules to enable an IPSAS-ready financial management information system at Treasury. Despite progress in the Treasury financial system and its accounting modules, a lot of effort is still needed to complete the implementation successfully.

The quality of guidance materials available to finance officers to better comprehend and apply the standards is unsatisfactory. Out of 40 IPSAS standards, 26 standards have been translated into Georgian and reflected in the MoF Order 429 which defines the accounting rules to be applied by public entities. However, to avoid misinterpretation, there should be guidance or practice notes how

³ It is noted that IPSAS 33 was adopted as an IPSAS standard only in 2015 and could not be applied in the early stage of the reform.

to apply the standards. As noted earlier, such uniform set of Accounting Policies have not yet been developed. According to the MoF, practice notes will be developed to guide the public entities.

READINESS FOR THE PREPARATION OF IPSAS COMPLIANT FINANCIAL STATEMENTS

In the period 2016-2018, the SAO performed audits of 45 financial statements of central government budget organization prepared in accordance with the Order No. 429 which contains a few provisions of the IPSAS Standards. Out of these financial statements, the SAO issued only one unqualified audit opinion. Out of the remaining 44 financial audit opinions, 32 are qualified (71%) and 12 are adverse (27%). Despite this, no steps have been taken by the MoF to address the weaknesses identified in the audit reports. As apparent from the SAO's audit practice, local governments face even more challenges to prepare financial statements that comply with current accounting regulations.

In view of the challenges of the public institutions to prepare unqualified financial statements, it is not clear how the institutions will be able to comply with the more demanding IPSAS standards. The MoF has never assessed the impact of the weaknesses in the current financial statements on the implementation of IPSAS.

The approach to the consolidation of financial statements of Ministries and Agencies remains unclear. In particular, the appropriate levels and stages of sub-consolidation and consolidation are yet to be planned and the level of manual versus automated consolidation is yet to be determined. The current financial reporting systems and processes do not support the netting off (elimination) of intra-group balances.

The level of IPSAS proficiency of finance and accounting officers across government is yet to be improved. Finance and accounting staff across government have been trained but were not required to take tests. No arrangements were made to monitor the effectiveness of the trainings. The quality of financial statements based on the transposed standards was generally found to be low upon audit which is indicative of the need to improve level of IPSAS proficiency among the staff preparing the statements.

The process of translation and transposition of the IPSASs is still ongoing. All of the standards published by 2012 have been translated into Georgian and this was done accurately at the time as evidenced through review and sign-off by the International Federation of Accountants (IFAC). However, the translated standards are yet to be updated for changes subsequently made by the IPSASB. Out of 40 standards of current edition only 26 standards have been transposed for implementation in the current accounting instruction.⁴ According to the MoF within the updated Memorandum of Understanding with the IFAC in 2019 it is intended to update/translate all the standards.

The MoF has not taken measures necessary to achieve IPSAS compliant opening balances for the proposed year of the full implementation. Unless the MoF considers all the necessary arrangements and measures with this respect, there is a risk that the necessary measures are not performed and IPSAS compliant opening balances for the proposed year of the full implementation is not achieved.

⁴ Made effective through inclusion in Decree #429 of the MoF.

The SAO's legal mandate to audit government's consolidated financial statements is not yet clearly defined. Future users of the consolidated financial statements should be given assurance on the reliability of the information in the document. However, the mandate of the SAO to conduct the audit of the consolidated financial statements is currently open to interpretation. There is no statute or regulation that clearly requires that the consolidated annual financial statements are to be submitted for audit to the SAO. Currently, there is also a restriction on the SAO's mandate to audit revenues which inhibits also the audit of the revenue component of the consolidated financial statements.⁵ Furthermore, no legislative reforms are currently proposed to stipulate the role of Parliament with regards to approve the consolidated annual financial statements.

⁵ Tax revenues of the Government of Georgia are currently not subject to audit as the SAO has no access to tax revenue information due to section 4 of article 20 of the Law on the State Audit Office and article 39 of the Tax Code.



CONCLUSIONS AND RECOMMENDATIONS

The MoF has made some progress with its preparations for the implementation of IPSAS across the tiers of government of Georgia. However, much more needs to be done at the level of the central government. Based on the current state, the progress achieved with the implementation of the IPSAS the individual and consolidated financial statements at the level of central government for the financial year 2020 will not be fully compliant with the IPSAS.

The progress of preparations at local government levels (autonomous republics and municipalities) is weaker and requires much more efforts. The implementation of the IPSAS in Georgia requires better planning, coordination and implementation of the process, following the recommendations below.

1. The current implementation strategy and action plan are severely limited and will require significant improvement. The MoF should take urgent steps to:

- Prepare a more detailed and costed implementation plan that includes clear timelines, milestones, deliverables, selected implementation approach, benefits, risks and their mitigation measures, and a mechanism for the regular monitoring of progress.
- Develop a new more detailed action plan with agreed more realistic timeline, which specifies responsibilities, costs, expected results and progress monitoring.
- To define the resources requirements for the IPSAS implementation including necessary financial, human and IT resources.
- Communicate clear and full information on the necessary resources of IPSAS implementation to the GoG and those responsible for implementing the standards.

2. The current GoG approach to implementation assumes only full implementation of IPSAS. In this respect the GoG should take urgent steps to:

- Identify the customers, key stakeholders affected by the implementation, and their expectations. Especially, the GoG is urged to engage with Parliament in the process.
- Revisit the need to fully implement the IPSAS (direct approach), including deliberations on alternatives such as indirect approach.
- Define the benefits expected from the implementation of IPSAS, develop realisation plan of the benefits identified and perform the CBA. The expected benefits of adoption of a new financial reporting framework needs to be documented and tracked during and after the implementation process.

3. Successful implementation will require an effective and well managed governance framework. The GoG should revisit arrangements for the oversight of the implementation and ensure that:

- The Board has the appropriate levels of authority for implementation oversight and managerial decision making.
- The role, authority, objectives, responsibilities, and accountability of the Board are clearly defined.
- Minimal requirements for the functioning of the Board are defined including the frequency of meetings and documentation of the Board's deliberations and decisions.
- The Board deliberates at least twice a year to assure that the action plan and set objectives are aligned.



- The Board requests the progress reports at least quarterly. These reports should contain the results achieved and measures taken in response to the Board instructions.

4. There are several key indicators of readiness that need to be met if the process is to have a good chance of a successful outcome. The MoF and the Board should ensure that:

- Audit findings are considered, the impact of these findings on the consolidated financial statements are defined and significant weaknesses at the entity level are properly addressed.
- Guidelines are developed to address the systemic weaknesses revealed by the SAO's audit.
- The new standards and amendments in the existing provisions of the standards are translated and transposed into the legislation.
- Unified accounting policies are developed and applied to all public entities.
- Financial officers trained are required to take the test and those who pass are certified; the effectiveness of the trainings are assessed by those attending; This will allow to evaluate the proficiency of the financial officers across the country. The agencies will be able to better plan and make better decisions.
- For the staff engaged in the implementation process a new detailed guideline and practice notes are developed that will help them properly apply the standards and prevents the risks of misinterpreting the standards. The practice notes will also help in complying with unified accounting policies and will make themes clearer those that require explanations.
- Before the standards are fully implemented IPSAS based trial balances are produced. This allows for the evaluation if the standards are properly applied and for preparation of the opening balances by the date of the full implementation.
- The revised implementation plan includes deployment of appropriate financial management information systems, the phases of development and implementation of the new accounting modules of the system and the trainings necessary to implement these modules. It is important to train staff in accounting and application of new accounting modules.
- Under the Board supervision the consolidation plan is developed, which ensures proper accounting for the intra-group transactions and subsequent eliminations. Modules of the approved consolidation plan should be added to the information financial management information system and IPSAS implementation plan.
- Define the MoF's obligation to prepare consolidated financial statements and the role of the Audit Office in conducting audit of these financial statements, with the interaction of the legislature and other stakeholders. Legislative changes are needed to fully prepare and audit the financial statements.



1. INTRODUCTION

1.1. AUDIT MOTIVATION

In 2009, as part of its agreements with the International Monetary Fund (IMF) and the European Union (EU), the Government of Georgia (GoG) committed to the implementation of International Public Sector Accounting Standards (IPSAS).⁶ The implementation strategy was included in the Ministry of Finance Order 701 of 3 November 2009. The strategy envisaged a phased implementation with full transition to IPSASs by 2020.

By the implementation of IPSAS, the GoG aimed to align its accounting and reporting standards to international recognized ones.⁷ This would improve the quality of the financial information on which basis the GoG and the Parliament makes its resource allocation decisions.

The timeframe proposed for implementation is nearly exhausted, and SAO decided to examine the progress with the readiness to achieve IPSAS compliant financial statements for the fiscal year 2020.

1.2. AUDIT OBJECTIVE AND QUESTIONS

The main audit objective is to evaluate the progress made by the GoG in the process of transposition to full IPSAS compliant accrual accounting by 2020. The main audit question therefore is as follows: What is the current status of the IPSAS implementation (**'progress'**) and is possible to complete the process within the deadlines set forth in implementation plan (**'readiness'**)?

The main question on the progress with implementation are further divided into following sub-questions:

- Was there a benefits realization plan for IPSAS implementation?
- What were the drivers for IPSAS adoption and is the business case still valid?
- Was there developed strategic and action plans for IPSAS implementation and what was the quality of these documents?
- Did the planning of implementation take into account all the measures to be taken, necessary human resources, and good international practices?
- To what extent have the strategic and action plans been implemented in the process of IPSAS implementation?

The question on readiness is divided into three following sub-questions:

- Is it realistic to complete the implementation process within the agreed timeline?
- Are the existing resources commensurate to the implementation of the standards?
- How can the mandate of the SAO be strengthened to ensure a full scope external audit of the Consolidated IPSAS financial statements for Georgia?

⁶ EU Budget support program and financing agreement "Support to PFM Reform in Georgia (Phase I), 2007-2009".

⁷ IPSAS distinguishes between two sets of standards IPSAS Cash and IPSAS Accrual. In this report, when it is referred to the adoption of IPSAS by the GoG, it is referred to IPSAS accrual standards.



1.3. AUDIT SCOPE AND METHODOLOGY

Audit examined the progress with the implementation of IPSAS the scope of which covered the following:

- a) Activities of the MoF as of an entity primarily responsible for implementation of IPSAS;
- b) Activities of the Board which develops recommendations and additional instructions;
- c) Activities of Central government entities in implementing the standards at entity level;
- d) The activities of local government entities (at autonomous republic and municipal level) in implementing the standards;
- e) The activities of the MoF towards its readiness to prepare IPSAS compliant Consolidated Financial Statements for 2020 for the whole of government; and,
- f) Measures to ensure the benefits of IPSAS implementation are realised and the value added for key stakeholders through resulting financial statements is increased.

The SAO performance audit manual and methodology was applied and the selected approach was a combination of a result-oriented and a problem-oriented approaches. Data collection methods included the following:

- Interviews with stakeholders (MoF, IPSAS Board);
- Document review (MoF documents, SAO audit reports);
- Data analysis;
- Review of international research and good practices.

1.4. AUDIT CRITERIA

The audit team used the following audit criteria to assess 'progress in implementation':

- The decision to move towards full IPSAS is based on a strategy paper and a cost benefit analysis approved at appropriate government level;
- The implementation process to move towards full IPSAS is based on a detailed action plan with activities, milestones and necessary budgets that would ensure realization before the deadline of 2020;
- The progress in moving towards full IPSAS, including achievements and deviations from the original action plan, is monitored.

The audit used the following criteria to assess 'readiness for IPSAS implementation':

- An IPSAS compliant Chart of Accounts is ready for utilization;
- IPSAS standards are accurately and completely transposed into Georgian legislation;
- IPSAS competency and capability among Finance Staff is adequate;
- Preparations are underway to establish an IPSAS compliant opening balances;
- The consolidation process is facilitated by appropriate and tested financial management software
- The mandate of the Supreme Audit Institution is appropriate to audit compliance with the IPSAS standards.



1.5. ENTITIES TO BE COVERED BY THE AUDIT

The entity subject to the audit is the Ministry of Finance (MoF) which is leading the implementation process.

The head of the State Treasury is directly responsible for the adoption and transposition of IPSASs. Furthermore, the IPSAS board was established under the GoG Order 38 of February 19, 2010 as the body accountable for preparing recommendations and additional accounting instructions.

Since IPSAS implementation in Georgia is expected/planned to be adopted at all levels of government, this audit covers central, autonomous republic and municipal entities, as well as the LEPLs, NPLEs and commercial enterprises under state control.



2. GENERAL INFORMATION

2.1. OVERVIEW OF THE EXISTING ACCOUNTING FRAMEWORK

Currently the public organizations at central government level are guided by the MoF Order No. 429 of December 31, 2014 on Approval of Accounting and Financial Reporting for Public Organisations which contains the requirements of 26 adopted standards. It should be noted, that the Methodology elaborated for central government organizations is much more comprehensive than the Accounting framework created for the autonomous republic and municipal entities.⁸

According to the MoF Order No. 701 of November 3, 2009 and No. 485 of December 29, 2017 (which superseded Order No. 701), the central government institutions, also legal entities and organizations established by these institutions were obliged to prepare IPSAS compliant financial statements for the year ending 2019 and the successive periods, while the municipal and autonomous government institutions, also the legal entities and organizations established by these institutions were obliged to prepare IPSAS based financial statements for the year ending 2021 and the following periods.

2.2. GLOBAL STATE OF ACCRUAL ACCOUNTING

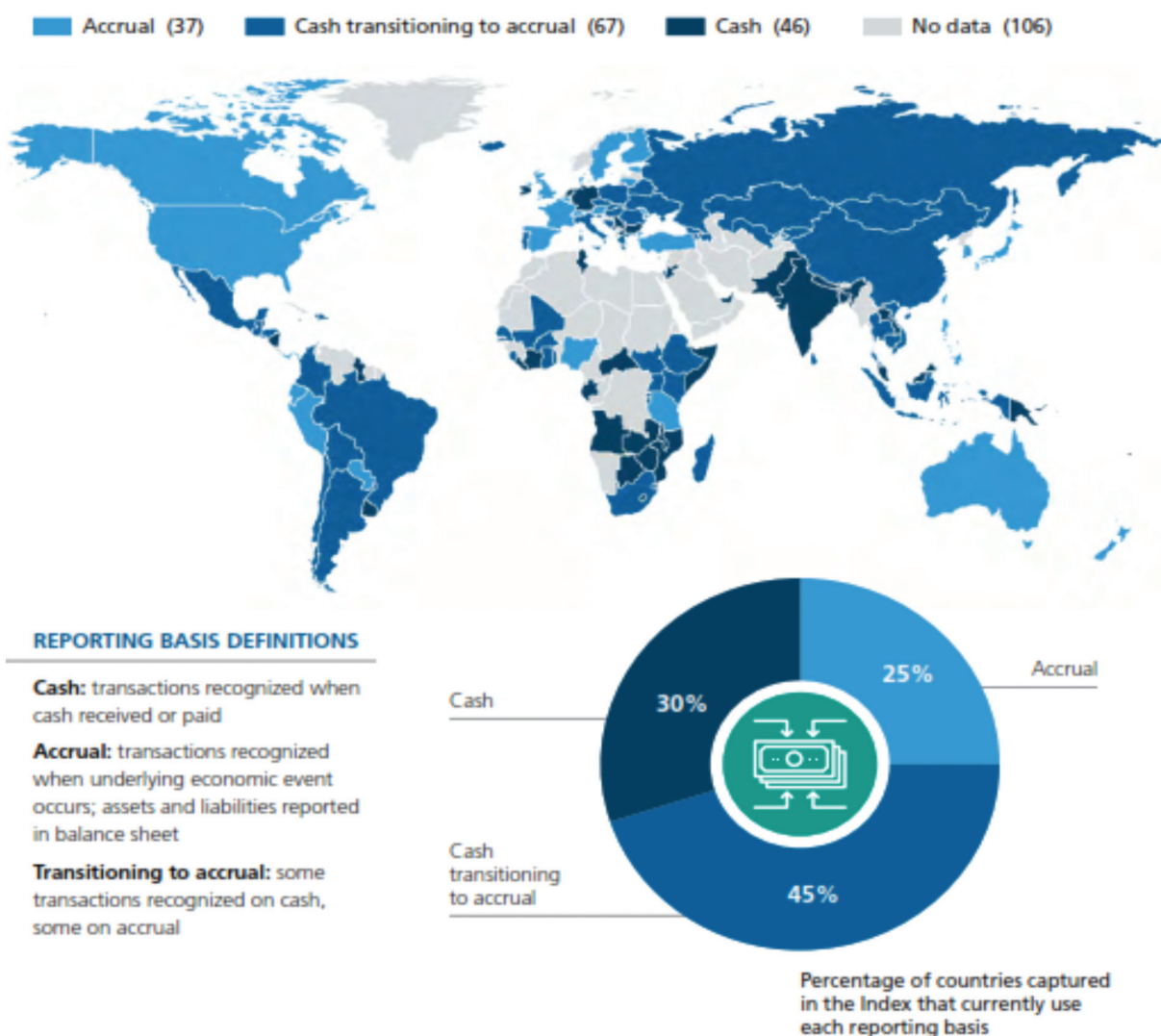
The IPSAS Board (IPSASB) adopts the IPSAS for public entities which requires that financial statements are prepared based on either accrual or cash-based accounting. Accrual based IPSAS relies on the International Financial Reporting Standards (IFRS) adopted by International Accounting Standards Board (IASB) which is geared towards the needs of the private sector. IPSAS accrual also contains issues specific to financial reporting in the public sector which are not included in the IFRS.

The International Public Sector Financial Accountability Index (The Chartered Institute of Public Finance and Accountancy, hereinafter CIPFA) collects, verifies, and analyses current financial reporting and budgeting frameworks used by federal and central governments around the world.⁹ The Index currently contains data from 150 jurisdictions presented in the figure below.

⁸ The MoF Decree No. 1321 on Accounting Framework for Autonomous Republic and Local Government Organizations.

⁹ <https://www.ifac.org/system/files/uploads/IFAC/IFAC-CIPFA-Public-Sector-Index-2018-Status.pdf>

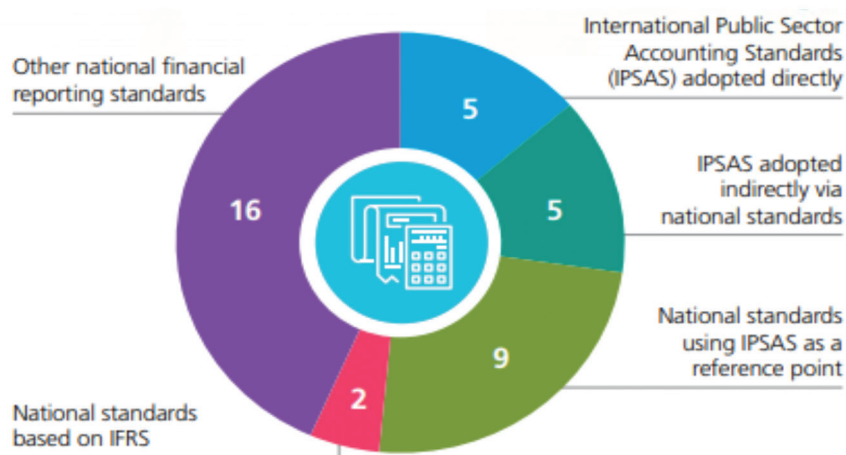




Accrual reporting frameworks are developed in various ways, many making use of international standards. Specifically, governments make use of International Public Sector Accounting Standards (IPSAS) in three main ways:

- **Directly:** implementing IPSAS without altering any of their requirements;
- **Indirectly:** implementing IPSAS through a national endorsement process, adjusting for any specific jurisdictional features;
- **Reference point:** developing national standards that use IPSAS as a guidance source.

Of the 37 governments that currently report on accrual, 19 (51%) are using IPSAS in one of these three ways:



According to the CIPFA research, application and influence of the IPSAS is increasing. By 2023 out of 98 countries on accrual 72 (73%) will implement IPSAS in the following way:

- 31 countries: direct;
- 14 countries: indirect;
- 27 countries: through the national standards.

Additional information with respect to the application of IPSAS in the European Union (EU) is provided in Annex 2. It shows that 17 EU member states have used IPSAS to some extent in shaping their accounting system and 11 do not include it at all.

3. AUDIT FINDINGS ON THE PROGRESS ACHIEVED

The assessment of 'progress' refers to the effectiveness of the management of the process to implement IPSAS. This chapter concludes that overall quality of the strategic and detailed planning for IPSAS implementation was found to be poor. Section 3.1 and 3.8 report on observed shortcomings.

3.1. LACK OF A DETAILED AND COMPREHENSIVE STRATEGIC PLAN

One of the important preconditions for successful achievement of the reform objectives is to have a well-designed strategic plan which prioritises the tasks to be performed. It contributes to efficient use of resources and mobilises the staff, stakeholders and other related parties around the common vision.

The global research on Implementation of IPSAS: Current Status and Challenges performed by the ACCA in 2017 confirmed the necessity of a strategy with a realistic dates, objectives and resources in the process of implementation.¹⁰

The key strategic planning document observed to date is the MoF Order No. 701 of 2009 and its annexes as amended in 2017 by the Order No. 485.

It has been found that there was no documented strategic plan for the implementation.

Despite the fact that the Order of No. 701 of 2009 and order No. 485 of 2017 contained some features of a strategic plan, these documents lacked details, were not substantiated and comprehensive enough. Key elements of the standard strategic plan were missing in these documents, such as:

- Comprehensive objectives that specify the goals to be achieved over a short- and long-term period;
- KPIs that are actionable and quantifiable to be able to accurately measure the progress towards short- and long-term goals;
- Major initiatives and activities to be implemented that will help to advance on KPIs and reach determined goals.

The lack of a strategic plan and the listed elements negatively affects the implementation process and successful and timely achievement of the objectives.

RECOMMENDATION TO THE MOF AND THE BOARD

In order to manage the resources efficiently, to mitigate the potential risks, and communicate clearly on the direction and vision with engaged stakeholder there is a need to prepare a strategic plan which shall include the following information: costs and expected benefits, preferred approach for IPSAS adoption, PKIs, risks and their mitigation measures.

¹⁰ ACCA (2017), IPSAS Implementation: Current Status and Challenges, p. 26.

3.2. LACK OF AN APPROVED ACTION PLAN

To achieve the strategic objectives it is necessary to have detailed plan for IPSAS implementation which shall outline the activities, tasks, KPIs and dates. To monitor the progress in achieving the strategic objectives the action plan should also contain mechanisms for control and supervision.

No detailed and comprehensive IPSAS implementation or operational plans were seen or exists.

In 2009 the MoF engaged a consultant to prepare a “Final detailed action plan for Implementation of IPSAS”. The plan was adopted by MoF, but was not approved. The document included detailed operational plan setting out actions, responsibilities, milestones of the reform. The plan has not been updated since 2009. Respectively, it is outdated and the following issues are not on track:

- Define the accounting policies and other necessary measures for implementing accrual approach;
- Develop for property, plant and equipment accounting procedures to comply it with IPSAS 17, inventory and public sector non-financial assets valuation;
- Application of all other IPSAS, the requirement to consolidates SOEs and General Government Sector etc.

Although the action plan did include the day-to-day activities over a specified timeframe, it did not contain information of other key components of the action plan, such as:

- Allocation of resources to drive the implementation process;
- Approaches to monitor the strategy implementation.

RECOMMENDATION TO THE MOF AND THE BOARD

In order to achieve the strategic goals and ensure that the action plan is aligned with the reality, it is recommended to prepare a new more detailed action plan with realistic dates and timeline, which shall include responsibilities, costs, expected results and monitoring mechanisms.

3.3. POOR CONSIDERATION OF RESOURCE REQUIREMENTS

IPSAS implementation process can be managed effectively through a detailed analysis at the planning stage, identifying the resources required to implement the standards and the sources of their acquisition. Timely provision of resources contributes to the smooth implementation of the implementation process.

We were unable to see evidence of a comprehensive determination of a resource envelope for IPSAS implementation. The absence of a detailed and costed IPSAS implementation operational plan also indicates that resource requirements were thoroughly assessed and addressed.

The MoF did not identify and budgeted necessary resources for the reform in 2009, though PFM’s annual reports starting from 2015, provide some information about the training, infrastructure, materials/publications/transposition, wages/salaries etc. However, these costs are not detailed enough and



identified by respective/appropriate cost drivers. MoF could not provide information regarding the disbursement of approved resources on yearly basis. In addition, MoF has not yet identified future costs associated with the reform that will be incurred after the Implementation of IPSASs are finished.

We observed bottlenecks in IT and human resources that have adversely affected the progress of implementation and consider them to be significant:

- IT-enabled accounting system to support the preparation of the whole government accounts is not ready yet and may not be available by 2020, January 1. Until now, only the modules for payments are adopted in accordance with the accrual method.
- Key audit findings from SAO's financial audit reports indicate that human capital requires additional investment in Georgia. There is some scope for trainings in IPSAS to be better organised. For example, finance and accounting staff are certified as having been trained without any form of testing. Certification is based only on attendance and there is no method of checking the trainings have been effective.

The issues described above relating to human resources, the flaw in the financial information system, and the findings in the SAO's reports are a hindrance in the implementation of standards and have a significant impact on the pace and quality of the implementation process.

RECOMMENDATION TO THE MINISTRY OF FINANCE

- In order to implement the process in a timely and quality manner, the Ministry of Finance should identify the resources needed to implement the IPSAS, the assessment should include the financial, human and technological resources required for the implementation.

Accurate and complete information on the resources needed for the implementation process should be timely provided to the Government of Georgia and those responsible for implementing the standards in order to reduce the risks associated with the standards implementation process.

3.4. LACK OF SUPERVISORY FUNCTIONS OVER THE IMPLEMENTATION PROCESS

Implementation process requires clear delineation of responsibilities of engaged parties. The law should define the supervisory institution which will control and monitor the implementation process. It is also important to document adopted management decisions and measures taken.

During the implementation process no supervisory institution have been defined which would monitor the adequacy and effectiveness of the decisions adopted and measures performed by the Treasury Service.

Although the IPSAS Board was formed by the GoG decree, it is an advisory body accountable for preparing recommendations and additional accounting instructions.¹¹ These recommendations are not mandatory. Thus the Board has no supervisory power.

¹¹ GoG Decree 19 February 2010, No. 38. The Board consists of 7 members and mostly comprises of the deputy ministers and head of departments.

The audit found that during the implementation process the Board decisions have mostly been undocumented:

- The Board did not meet regularly. So far only two board meetings are documented.¹² The audit team has not been provided with evidences confirming/proving that substantial recommendations and decisions were made by the Board.
- The board is accountable to the GoG by providing performance reports biannually. These reports have not been presented to the GoG.

As a result, the Board contribution to the implementation is little due to the insufficient legal mandate.

According to the MoF, at the last phase of the reform it is intended to strengthen the Board mandate to increase its effectiveness.

RECOMMENDATION TO THE GOG

There is a need to strengthen the institutional and governance arrangements intended to oversee the implementation of the standards:

- The Board should be given appropriate authority to oversee the implementation and to make executive decisions in this regard.
- The Board should be reconstituted under clear terms of reference that set out its role, objectives, responsibilities, authorities and accountability.
- There should also be clear minimum requirements specified for the operations of the Board, in particular for the conduct of its meetings and the documentation of its deliberations and decisions.
- The board should deliberate at least twice a year to assure that the action plan and set objectives are aligned.

3.5. NO CONSIDERATION OF CHALLENGES ASSOCIATED WITH THE FULL IMPLEMENTATION

Full implementation of IPSAS is related to several difficulties and challenges. Therefore it is important that the strategy and action plan contains information about the IPSAS 33 and the application of transitional exemptions included thereof.

IPSAS 33 “First time adoption of the accrual accounting” grants transitional exemptions to entities adopting accrual basis IPSASs for the first time, providing a significant reliefs in the along their journey to implement IPSASs. In particular, IPSAS 33:

- a) Allows first-time adopters three years to recognize and measure assets and liabilities;
- b) addresses situations when reliable historical cost information about assets and liabilities is not available;
- c) addresses the presentation of comparative information in transitional IPSAS financial statements and an entity's first IPSAS-compliant financial statements.

¹² The last documented meeting was held in 2010.



The challenges, difficulties and subsequent costs associated with the implementation of standards and preparation of consolidated financial statement are not assessed. During the course of the audit the team was unable to see any evidence of the application of IPSAS 33.

It should be noted that according to MoF at the early stage of the reform possibility to apply IPSAS 33 could not have been considered because this standard was adopted in 2015. MoF plans to consider the application of transitional exemptions under IPSAS 33.

3.6. NO CONSIDERATION OF THE INDIRECT REFERENCE APPROACH

While choosing a standard implementation method, it is important to analyze which method will be the most beneficial, as well as the expectations, requirements, and possible costs that may arise from each approach.

As mentioned above, the Ministry of Finance planned to implement standards by direct reference approach, which implies full reflection of IPSAS in Georgian legislation. In none of the documents prepared by the Ministry of Finance does it explain why the direct method of implementing the standards was chosen.

Potential benefits of using the indirect standard-setting method are:¹³

- **Ability to tailor the accounting rules to local circumstances** as IPSAS may require a treatment and/or disclosure that is either not relevant for local decision-makers or is not efficient from the cost and benefit perspective. For example, the disclosure Roadmap - Introduction of IPSAS on local government level in Georgia 6 requirements of IPSAS might be too extensive and burdensome to prepare, especially for smaller municipalities, while providing little value for the users. On the other hand, IPSAS may not require certain disclosures that would be of great interest to the Georgian public.
- **In certain accounting areas IPSAS allows choice between different accounting treatments** but in order to prepare consolidated financial statements for the whole public sector, the same accounting policies should be used by all public sector entities. Therefore, any such choices should be taken centrally, in the Ministry of Finance, rather than by each public sector entity individually. That means that the choice offered by IPSAS has to be restricted by local guidelines anyway.
- **Although IPSAS offers a three years transitional period and a number of exemptions (see more in section 2.2 below) that may not be sufficient** and Georgian public sector entities (especially smaller municipalities) may not be able to achieve full compliance during that time (which may result in qualified auditor's reports, in case the financial statements will be subject to audit). Using "indirect reference" approach and locally tailored guidelines, would allow to set a realistic pace and potentially skip some excessive and less relevant requirements that do not add much value in the Georgian environment.

Complete implementation of IPSAS may seem more attractive and easy, but meeting all its requirements need much more financial, human and time resources.

¹³ See also PwC (2018) Introduction of IPSAS on local government level in Georgia.

According to MoF, in line with the recommendations set out in the IMF report, the strategy document will be amended from 2020, and instead of full compliance (direct reference) with the IPSAS, financial reporting will be prepared based on IPSAS.

RECOMMENDATION TO THE MINISTRY OF FINANCE

For planning further steps in the implementation process, it is advisable to determine the necessary human, financial and time resources:

- Identify users, stakeholders and their expectations;
- It is advisable for the Ministry to consider alternative approaches. In particular, the indirect method of implementing standards, that needs to be well argued.

3.7. NO CONSIDERATION OF THE EXPECTED BENEFITS OF IPSAS IMPLEMENTATION

Before implementation process there should be assessed the expectations of the stakeholders and the expected benefits of IPSAS implementation. From which must be derived measures, human, financial and time resources needed.

The action plan did not adequately substantiate the benefits of implementing the IPSAS and no cost-benefit analysis was conducted.

Some indication of such a consideration is reflected within the implementation action plan attached to the IPSAS Order No. of 2009 (Order No. 701), which states that... *"The existence of the complete information will support the increase of public credibility and interest on state finance, will increase Georgian creditworthiness and will develop the process of attracting investments in public and private sectors."*

The expected benefits of IPSAS implementation would include:

- Improved stewardship of assets and liabilities;
- Availability of more comprehensive information on costs;
- Improved consistency and comparability;
- Increased transparency and accountability;
- The opportunity to address the revenue audit mandate gap;
- The expected improvement from moving from budget execution (cash in /out) reporting to comprehensive financial statements at entity and consolidation levels, which improves the budget planning process;
- Measures to ensure the IPSAS Financial Statements are of use to, and easily understood by Parliament.

The Action Plan and other official documents do not adequately substantiate the benefits of implementing the standards, hence the cost-benefit analysis of measures implemented and decisions made during the implementation process was not carried out.



RECOMMENDATION TO THE MINISTRY OF FINANCE

- In order to efficiently dispose of resources available in the process of standards implementation, it is appropriate to identify the benefits that can be derived from the implementation of standards, benefit realization plan. Conduct cost-benefit analysis, document the process, and take into account the results of future actions and decisions.

3.8. DEFICIENCIES IN ACCOUNTABILITY

In order to identify the work to be done to reduce costs and increase the productivity of the activities undertaken, it is necessary to use effective forms of project management, proper oversight of the ongoing process and evaluation of the progress made.

As for the monitoring mechanisms of the implementation process, some information about progress reports are available in PFM's annual reform reports. These reports are prepared by the MoF starting from 2009. PMF's annual reports are delivered in two parts. At first, the Report covers all the required activities, tasks and arrangements that Georgia plans to carry out within the IPSAS reform on specified time period. The second Report presents the execution status of these planned activities to assess whether some of the work remains to be done, or the process has been completed.

- The information about the activities that have been partially completed in previous years are not presented in following reports;
- The execution dates of certain activities do not match the ones in Implementation action plan;
- Costs associated with activities are not highlighted in the report;
- IPSAS implementation action plan is also not on track and remains to be updated in order to address slippages and delays.

All of the above shows that the reports prepared during the implementation process do not fully and clearly reflect the state of the process, which also complicates the Board's monitoring.

RECOMMENDATION TO THE MINISTRY OF FINANCE AND THE BOARD

In order to assess the real state of the implementation process and to carry out oversight functions by the Board:

- The Board should request reports on progress made in the implementation of standards, at least quarterly. These reports should include the results achieved and actions taken in response to instructions issued by the Board.



4. AUDIT FINDINGS ON THE LEVEL OF READINESS FOR IPSAS IMPLEMENTATION

The GoG implementation plan intended to implement full IPSAS. Currently, out of 40 standards, 26 of them are fully or partially transposed. Annex 1 contains the list of those standards implemented in Georgian legal framework by 2019. However, transposition of the standards alone does not imply implementation of the standards in practice. This chapter demonstrates shortcomings in the readiness of the GoG to implement the standards in practice.

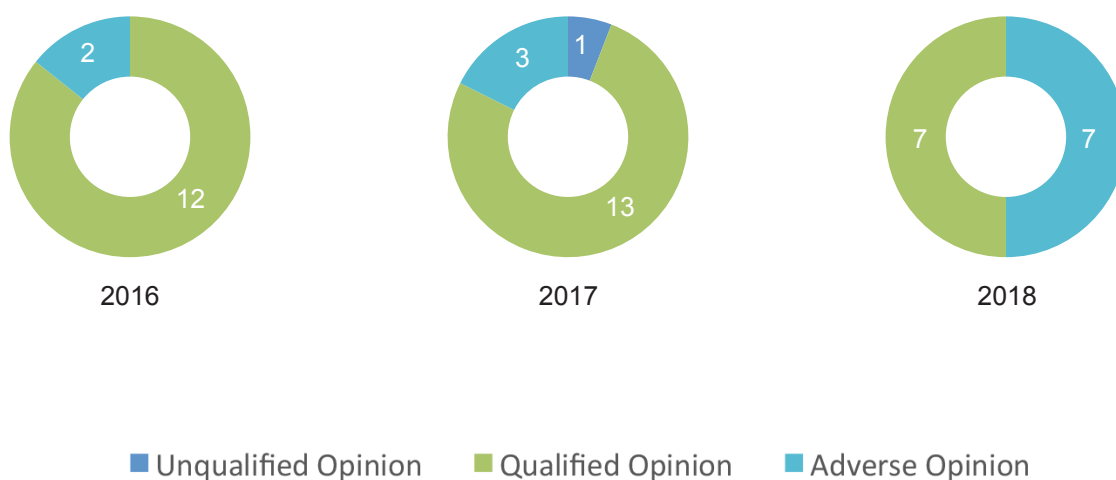
4.1. THE GOVERNMENT'S CONSOLIDATED FINANCIAL STATEMENT DO NOT CONSIDER INACCURACIES IDENTIFIED IN THE AUDITS

In preparing the consolidated financial statements of government, the inaccuracies and deficiencies identified in the separate audits performed by the SAO should be taken into account to avoid errors found at the entity level in the consolidated financial statements of the government.

The findings of the financial audit indicate that the standards have been misapplied and have not been complied with. Failure to address the shortcomings identified in the preparation of the consolidated financial statements of the Government may lead to its unfair presentation.

The following table provides information on the audits of the financial statements that have been prepared by the entities which are financed by the central budget:

Types of opinions



RECOMMENDATION TO THE MINISTRY OF FINANCE AND THE BOARD

For the fair presentation of consolidated financial statements, it is advisable:

- The Board and the Ministry of Finance review the audit results, determine the degree of impact on the consolidated financial statements and take into account the significant gaps at the entity level.
- The Ministry should develop appropriate guidance on systematic deficiencies identified by the SAO.

4.2. PERFORMANCE ON IPSAS READINESS INDICATORS

In order to assess progress and results, as well as to plan further measures, it is necessary to carry out an analysis of the IPSAS readiness indicators. The indicators are based on the experience of different countries in the implementation of the IPSAS, which can measure progress and measure the level of readiness to move to standards.¹⁴

The following provides information on indicators, current situation, and recommendations that will support the effective implementation of the IPSAS.

¹⁴ ACCA (2017), IPSAS Implementation: Current Status and Challenges“.



TABLE 1. CURRENT STATE ON THE INDICATORS FOR READINESS

	Indicators of readiness	Current Situation	Recommendation
1	Utilisation of an 'IPSAS ready' Chart of Accounts	<ul style="list-style-type: none"> With the assistance of the International Monetary Fund, a draft version of 'IPSAS ready' Chart of Accounts was prepared during the course of the audit. It is intended to be applied from January 1, 2020. 	-
2	Accuracy and completeness of transposition of IPSASs into Georgian legislation	<ul style="list-style-type: none"> Key Audit findings related to transposed standards are not periodically analysed and addressed by MoF to identify areas for improvement. The compliance of the Georgian version of the standards with the original version has been reviewed and confirmed by IFAC. A number of the standards are yet to be translated and transposed¹⁵. Unified accounting policies have not been prepared. Periodic analysis of key findings in the SAO's financial audit reports, identifying weaknesses and identifying ways to improve them are not undertaken by the Ministry of Finance. 	<ul style="list-style-type: none"> Ministry of Finance to ensure translation and reflection of amendments to standards and new standards in legislation. It is advisable to develop uniform accounting policies and disseminate them to all budget organizations within the IPSAS.
3	Human capital – Adequacy of IPSAS competency and capability among Finance Staff	<ul style="list-style-type: none"> Evidence of IPSAS training resulting in formal certification is yet to be seen, although various documents state that up to 2,000 staff¹⁶ have been trained. No exams are held of trained staff and issued certificates. Key audit findings related to transposed standards and various expert studies by consulting firms indicate low competence among finance staff. 	<ul style="list-style-type: none"> There should be clarity on the levels of IPSAS proficiency of finance and accounting staff across government. Finance and accounting staff across government that are trained in IPSAS should be required to take tests in order to obtain IPSAS certification. There should also be a process to monitor the effectiveness of the training that is provided. The above allows to assess the level of competence of financial services staff. And it will help organizations plan the next steps and make the right decisions. There is also a need to provide detailed documented guidance to staff involved with the implementation. In particular, there is a need to introduce practice guides and notes on how to implement the transposed standards, as this will reduce the risk of the standards being interpreted differently by the various finance staff involved in implementation. The practice guides and notes will also help ensure the uniform Accounting Policies are properly adhered to during application. Where there are any areas to be clarified within the existing financial rules and regulations, the practice guides and notes will provide the necessary clarifications to guide the implementation.

¹⁵ Agreement for permission to translate and publish copyrighted materials (Handbook of IPSAS 2018 edition, IPSAS 41, IPSAS 42) from IFAC valid from May 8, 2019

¹⁶ Public Finance Management Reform in Georgia, Sept 2017, p105



	Indicators of readiness	Current Situation	Recommendation
4	Planned activities for preparation of IPSAS compliant opening balances	<ul style="list-style-type: none"> • Evidence of a work plan to achieve IPSAS compliant opening balances at Consolidated Financial Statement level was not seen. • IPSAS implementation at entity level was found to be on the basis of selected standards and unlikely to lead to fully compliant opening balances for the year of adoption. • No strategic action or operational working plan was seen for IPSAS implementation at Municipal and Autonomous government level. • No arrangements are planned for production of trial financial statements for the year prior to full implementation. 	<ul style="list-style-type: none"> • Prior to the full implementation of the standards, it is advisable to prepare IPSAS based trial financial statements, which will allow to assess whether the standards are properly applied and to prepare the appropriate standards based opening balances for the full-time IPSAS.
5	Procedures for consolidation are established	<ul style="list-style-type: none"> • The current consolidation process is characterized by shortcomings, and the information system required for consolidation is not fully developed and implemented; • Consolidation of financial statements is performed manually and therefore the MoF is deprived of the ability to eliminate internal group operations, which in itself does not ensure fair presentation of financial statements; • The creation of Integrated information system required for organizing consolidation and accounting may not be available by 2020 January 1. Until now, only the modules for payments are adopted in accordance with the accrual method. • Consolidation of financial statements for autonomous, municipal and state-level organizations not yet planned; • It should be noted that the implementation action plan for the preparation of the financial statements of autonomous and municipal level budget organizations is planned in accordance with Decree of MoF and/or Public Sector Accounting guidelines that are generally based on IPSAS and state-level budget organizations in line with IPSASs, which can complicate the process of compiling a country's consolidated financial statements. 	<ul style="list-style-type: none"> • With respect to Information Technology applications, the new implementation plan should include careful phasing of the completion and deployment of the new accounting modules as well as training in the use of these new modules. There will be a need to upskill individuals in accounting knowledge and also train them in the use of new accounting applications. • Under the Board supervision, for the consolidation of the financial statements, a consolidation plan should be prepared that maps all the planned levels of sub-consolidation and ensures intra-group balances are properly accounted for and netted-off where appropriate. The requirements of the adopted consolidation plan should as far as possible be built into the IFMIS system and into the wider IPSAS implementation plan.
6	Audit Mandate of the Supreme Audit Institution enables audit of consolidated financial statement in line with ISSAIs	<ul style="list-style-type: none"> • The mandate of the State Audit Office to conduct audits of all government revenues is limited. • Current legislation does not specify the timeframes for submission of consolidated financial statement by the Ministry of Finance to the Parliament and Audit Office 	<ul style="list-style-type: none"> • It is advisable, with the interaction of the legislature and other stakeholders, to define the MoF's obligation to prepare consolidated financial statements and the role of the Audit Office in conducting audit of these financial statements. Legislative changes are needed to fully prepare and audit the financial statements.

APPENDIX 1: LIST OF IPSAS IMPLEMENTED AT CENTRAL GOVERNMENT LEVEL AS AT 2019

IPSAS No.	Description
IPSAS 1	Presentation of Financial Statements
IPSAS 2	Cash Flow Statements
IPSAS 3	Accounting Policies, Changes in Accounting Estimates and Errors
IPSAS 4	The Effects of Changes in Foreign Exchange Rates
IPSAS 5	Borrowing Costs
IPSAS 6	Consolidated and Separate Financial Statements
IPSAS 9	Revenue from Exchange Transactions
IPSAS 12	Inventories
IPSAS 13	Leases
IPSAS 14	Events After the Reporting Date
IPSAS 16	Investment property
IPSAS 18	Segment Reporting
IPSAS 19	Provisions, Contingent Liabilities and Contingent Assets
IPSAS 20	Related Party Disclosures
IPSAS 21	Impairment of Non-Cash-Generating Assets
IPSAS 22	Disclosure of Financial Information About the General Government Sector
IPSAS 23	Revenue from Non-Exchange Transactions (Taxes and Transfers)
IPSAS 24	Presentation of Budget Information in Financial Statements
IPSAS 25	Employee Benefits
IPSAS 26	Impairment of Cash-Generating Assets
IPSAS 27	Agriculture
IPSAS 31	Intangible Assets
IPSAS 32	Service Concession Arrangements: Grantor
IPSAS 36	Investments in Associates and Joint Ventures
IPSAS 37	Joint Arrangements

Note: As reflected within Order No. 429.



APPENDIX 2: STAGES OF ADOPTION OF IPSAS ACROSS THE EUROPEAN UNION

The European Union announced the formal adoption of European Public Sector Accounting Standards (EPSAS) in 2015. EPSAS is based on IPSAS and is adapted to European public sector practice and in line with the budget process¹⁷.

The main driver behind the EPSAS implementation is to ensure uniform and comparable accrual basis accounting practices for all sectors of general government within the EU. This will enhance the quality of the data on which European System of Accounts (ESA) reporting is based, and consequently improves budget surveillance and fiscal monitoring at macro level to enable sound fiscal policy decision-making.

While the benefits of a unified accounting policy are not disputed in terms of comparing fiscal data, some countries still oppose the mandatory implementation of the EPSAS. However, due to differing positions, the EU has not yet indicated a date by which each of its member states will be obliged to adopt EPSAS.¹⁸

Certain countries within the EU had already decided to adopt IPSAS prior to the pronouncements of EPSAS and have made substantial progress towards full adoption. The United Kingdom has been applying accrual based standards using IFRS as the basis from 2008-2009, France moved to EPSAS from 2006.

An overview of the adoption of IPSASs in EU Member States is given in a study commissioned by the EU, which identifies five key approaches to implementing standards.¹⁹ The results of the study and these approaches are tabled below. The Table shows that 17 EU member states have used the IPSAS to some extent in developing the accounting system and 11 do not include it at all.

To what extent are the International Public Sector Accounting Standards (IPSAS) reflected in the accounting legislation applicable to your government?	Country
Accounting legislation applicable to your government specifies an explicit requirement to comply with the IPSAS framework as a whole	-
Accounting legislation applicable to your government makes explicit reference to IPSAS as the primary basis for developing your government accounting standards	Estonia, Lithuania, Portugal, Spain
IPSAS are in practice used as a primary basis for developing your government accounting standards although no explicit reference to them is made in the accounting legislation applicable to your government	Austria, Latvia, Slovakia, Sweden
IPSAS are in practice used as a source of inspiration (although not as a primary reference) for developing your government accounting standards although no explicit reference to them is made in the accounting legislation applicable to your government	Belgium, Croatia, Cyprus, Czech Republic, Denmark, France, Romania, Slovenia, United Kingdom
IPSAS are not used as a source of inspiration for developing your government accounting standards	Bulgaria, Finland, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, Malta, Netherlands, Poland

¹⁷ <https://www.epsas.eu/en/>

¹⁸ Main country against EPSAS mandatory implementation was Germany

¹⁹ PwC (2014) "Collection of information related to the potential impact, including costs, of implementing accrual accounting in the public sector and technical analysis of the suitability of individual IPSAS standards"



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