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PULSAR

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Acronyms

AFS	Annual Financial Statements
AGFIS	Albanian Government Financial Information System
APSAS	Armenian Public Sector Accounting Standard
BFD	Budget Framework Document
BiH	Bosnia and Herzegovina
CAPSAP	Corporate and Public Sector Accountability Project
CFS	Consolidated Financial Statements
CIPFA	Chartered Institute of Public Finance and Accountancy
CITF	Centre of Informational Technologies in Finance of Republic of Moldova
CoA	Chart of Accounts
COFOG	Classification of the Functions of Government
EduCoP	Education Community of Practice
EU	European Union
EU IPA	European Union Instrument for Pre-Accession Assistance
FBiH	Federation of Bosnia and Herzegovina
FinCoP	Financial Reporting Community of Practice
FMIS	Financial Management Information System
GDP	Gross Domestic Product

GFFBP	Global Framework of Fiscal Balance and Policies of Bosnia and Herzegovina
GFMIS	Government Financial Management Information System
GFS	Government Finance Statistics
GFSM	Government Finance Statistics Manual
GIZ	German Development Agency
EPSAS	European Public Sector Accounting Standards
IASB	International Accounting Standards Board
IDA	International Development Association
IBRD	International Bank for Reconstruction and Development
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
INTOSAI	International Organization of Supreme Audit Institutions
IPSFA	International Public Sector Financial Accountability (Index)
IPSAS	International Public Sector Accounting Standards
ISA	International Standards on Auditing
ISSAI	International Standards of Supreme Audit Institutions
LMFPP	Law on Public Financial Management and Responsibilities of the Republic of Kosovo
LSG	Local Self-Government
MoFE	Ministry of Finance and Economy
MoF	Ministry of Finance
MoFT	Ministry of Finance and Treasury
MTBP	Medium-Term Budget Program
MTEF	Medium-Term Expenditure Framework
NAR	Nakhchivan Autonomous Republic
NPSAS	National Public Sector Accounting Standards
PAR	Public Administration Reform
REFA	Expenditure and Financial Accountability
PEMPAL	Public Expenditure Management Peer Assisted Learning network

PFM	Public Financial Management
PFMIS	Public Financial Management Information System of the Republic of Moldova
PPP	Public-Private Partnership
PSA	Public Sector Accounting
PULSAR	Public Sector Accounting and Reporting Program
RoB	Republic of Belarus
RoG	Republic of Georgia
RoK	Republic of Kosovo
RoM	Republic of Moldova
RoNM	Republic of North Macedonia
RoS	Republic of Serbia
RS	Republika Srpska
SAI	Supreme Audit Institution
SECO	Swiss State Secretariat for Economic Affairs
SIGMA	Support for Improvement in Governance and Management
SIMFK	Financial Management Information System of the Republic of Kosovo
SME	Small and Medium Entrepreneurship
SMG	Strategic Management Group of the Republic of Albania
SOE	State-Owned Enterprises
SUFI	Financial Information Management System of the Republika Srpska
TGL	Treasury General Ledger
TSA	Treasury Single Account
UNDP	United Nations Development Program
USAID	United States Agency for International Development
WB	The World Bank Group



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About PULSAR

The Public Sector Accounting and Reporting (PULSAR) Program, launched in 2017, is a regional and country level program in 13 beneficiary countries of Europe and Central Asia. Its objective is to support the enhancement of public sector accounting and financial reporting frameworks in line with international standards and good practices to improve government accountability, transparency, and performance.

The objectives and scope of the PULSAR Program are jointly determined by the PULSAR Partners - Austria, Switzerland, and the World Bank - who also provide institutional support for its implementation and mobilize the resources needed for its activities. Beneficiary countries help shape the program through regional cooperation platforms and inputs to two Communities of Practice: FinCoP on Financial Reporting, and EduCoP on Education.

More information about the PULSAR program and its publications is available online at: www.pulsarprogram.org.



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INTRODUCTION

The Public Sector Accounting and Reporting (PULSAR) is a regional and country-level program targeting the Western Balkans and the European Union (EU) Eastern Partnership countries to support the development of Public Sector Accounting (PSA) and financial reporting frameworks in line with international standards and good practice. Beneficiary countries include Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Croatia, Georgia, Kosovo, North Macedonia, Moldova, Montenegro, Serbia, and Ukraine.

The PULSAR Partners, Austria, Switzerland, and the World Bank, jointly established the objectives and scope of the PULSAR Program. They provide institutional support for its implementation and mobilize the resources needed for its activities. Beneficiary countries also have an opportunity to shape the Program through regional cooperation platforms and input to Communities of Practice.

PSA is a key enabler for good governance and economic growth. Financial information is of critical importance for both accountability and decision-making purposes, in particular when it comes to

investment in public infrastructure. Studies by the International Monetary Fund¹ (IMF) show that governments which use high quality accrual basis accounting information are economically more successful than those merely considering budget execution.

Not surprisingly, the number of countries implementing accrual accounting in general and using the International Public Sector Accounting Standards (IPSAS) as the principal reference, has increased significantly over the last decade. A recent survey (International Public Sector Financial Accountability (IPSFA) Index: 2020²), conducted by the International Federation of Accountants (IFAC) and the Chartered Institute of Public Finance and Accountancy (CIPFA), shows that by the end of 2020 – at a global level – 49 jurisdictions presented their financial statements on a full accrual basis and 66 more on a partial accrual basis. A total of 93 jurisdictions, which is approximately half of the countries worldwide, used the IPSAS at least as a reference. The survey also shows that there has been a shift from partial accrual to full accrual, which is likely to continue to be observed over the next decade.

¹ International Monetary Fund: Fiscal Transparency, Accountability, and Risk (2012), and Fiscal Monitor: Managing Public Wealth (2018).

² The International Public Sector Financial Accountability Index is available at: <https://www.ifac.org/knowledge-gateway/supporting-international-standards/discussion/international-public-sector-financial-accountability-index-2020>

Since PULSAR beneficiary countries are no exception to the global PSA trends, this book and the recent PULSAR stocktaking study³ show that a clear majority of PULSAR countries are in a transition process from cash to accrual accounting. Within this process, IPSAS play a crucial role, which is diverse and ranges from adopting IPSAS directly as national standards, to adopting them indirectly by considering them mainly as a reference for the development of national general accounting principles.

While surveys, such as the IPSFA Index, are capable of grasping overarching trends, they do not manage to give a comprehensive picture of the status of PSA reform in individual jurisdictions, which vary considerably from country to country.

In order to get a more nuanced picture of individual country contexts, it is important to harness local knowledge from each country to tell their individual PSA stories. This book aims to share these individual stories in a harmonized manner and discuss the relevance of the continuation of PSA reforms across PULSAR's beneficiary countries given their positive impacts in general on transparency and accountability of the countries. The stories told by the countries themselves⁴ help to identify key lessons learned and recommendations, which are presented in the last chapter of the book.

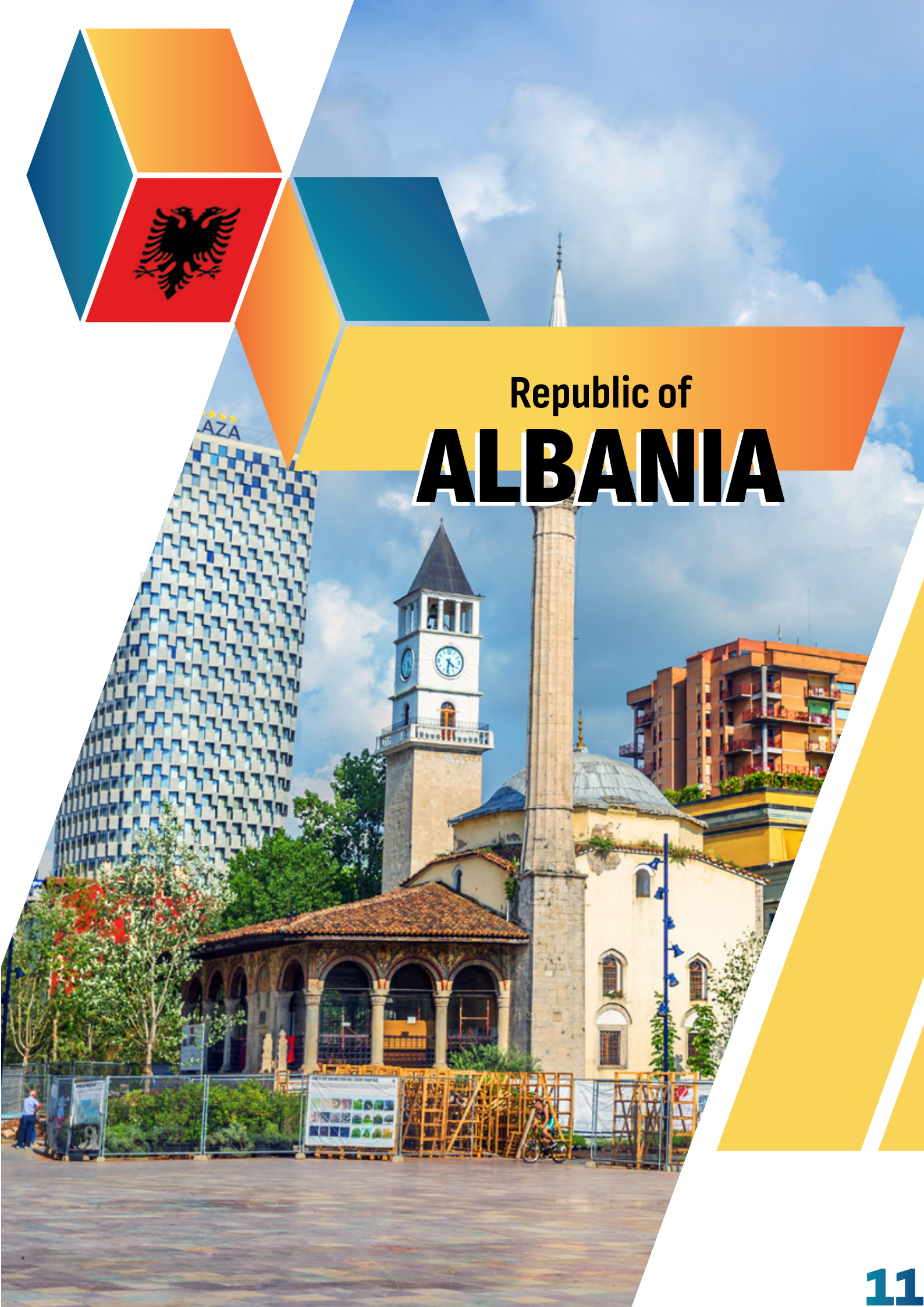
It should also be noted that given that the PSA reforms are progressing in one way or another in all PULSAR beneficiary countries, the stories will continue to evolve. The current stories are not meant to present a final result, but a current state of work in progress. In fact, since PSA serves the needs of user of financial information, the further development of such needs will also lead to an ongoing development of the IPSAS and their implementation in countries around the world, as well as in the PULSAR beneficiary countries.

³ World Bank (2020). Stocktaking of public sector accounting and reporting environment in PULSAR beneficiary countries. The publication is available at: <https://cfrr.worldbank.org/publications/stocktaking-public-sector-accounting-and-reporting-environment-pulsar-beneficiary>

⁴ The book relates the experience of 12 PULSAR beneficiary countries, which were prepared directly by PULSAR country representatives, including three different jurisdictions of Bosnia and Herzegovina (Federation BiH, BiH institutions, and Republika Srpska). It is worth mentioning that the only PULSAR country not included in this publication is Croatia, since the country input has not been timely prepared and submitted to PULSAR team.



Republic of **ALBANIA**



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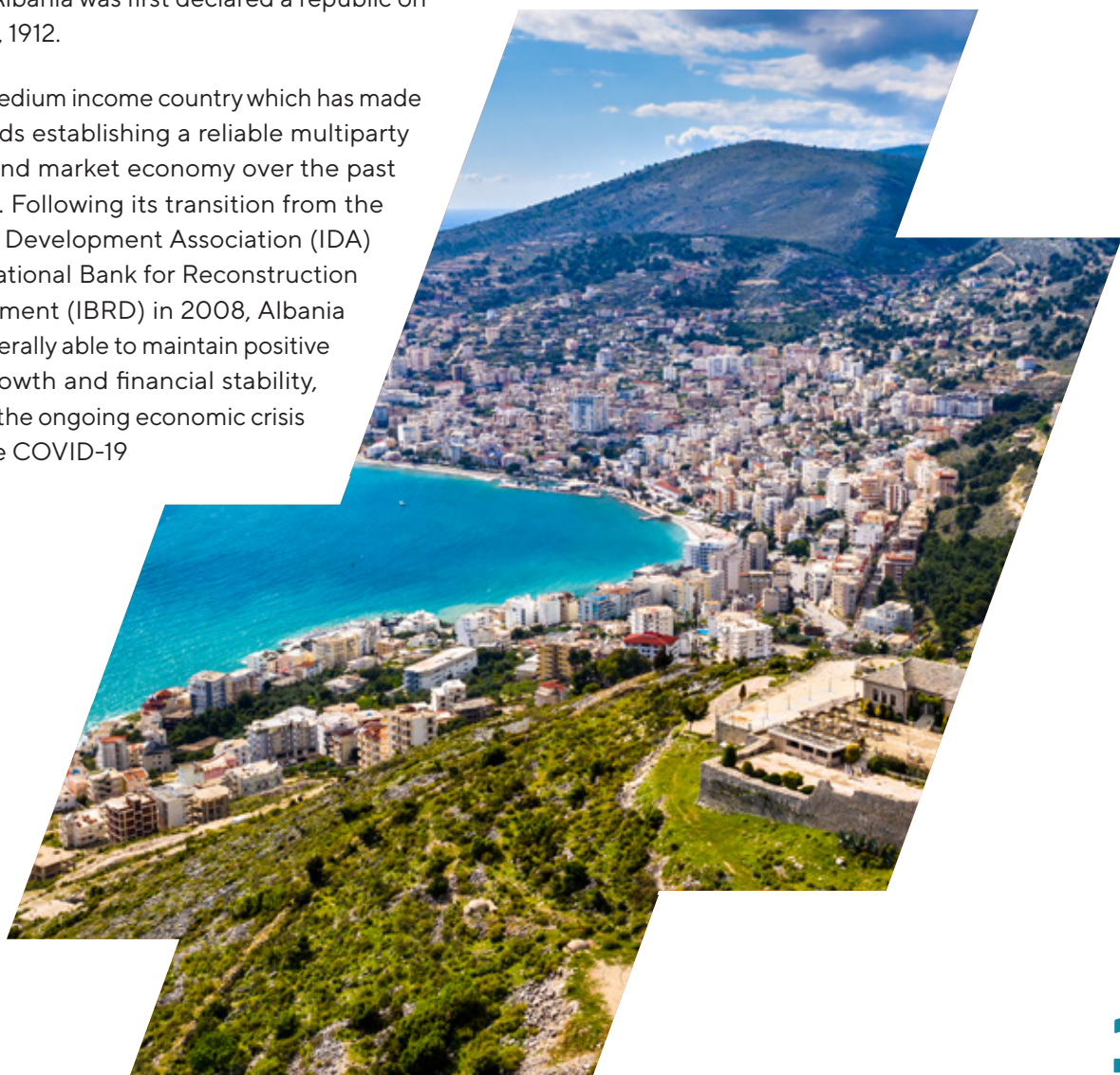
Introduction

The Republic of Albania is an independent state in southeastern Europe. It lies in the southwestern part of the Balkan Peninsula and shares its borders with Montenegro to the north and northwest, Kosovo to the northeast, North Macedonia to the east, and Greece to the south and southeast. Albania has a coastline on the Adriatic Sea to the west and the Ionian Sea to the southwest. The population of Albania is 2,893,000, 46% of which live in rural areas.

Albania is a parliamentary republic, with the Prime Minister playing the dominant role in managing state affairs. Albania was first declared a republic on November 12, 1912.

Albania is a medium income country which has made strides towards establishing a reliable multiparty democracy and market economy over the past two decades. Following its transition from the International Development Association (IDA) to the International Bank for Reconstruction and Development (IBRD) in 2008, Albania has been generally able to maintain positive economic growth and financial stability, regardless of the ongoing economic crisis caused by the COVID-19 pandemic.

In recent years Albania has focused on supporting recovery and growth in a challenging external environment, expanding and supporting social benefits in the country, and reducing vulnerabilities to climate change. Key challenges to Albania's progress include: (i) fiscal consolidation and enhancement of public expenditure management; (ii) regulatory and institutional reform; (iii) a reduction in the infrastructure gap; and (iv) the enhancement of social protection systems and key health care services.



2.1 Political system, territorial, administrative, and fiscal organization

Albania is a parliamentary republic, with the President of the Council of Ministers (Prime Minister) taking a lead role in the management of state affairs. The Council of Ministers is approved by the Parliament once every four years. Parliament is elected in general parliamentary elections. The President is the head of state and is elected by Parliament every five years.

The judiciary system is comprised of the court system of Albania. The Constitutional Court is the highest body in the judiciary. It is composed of nine members, who rule on constitutional disputes and issue final interpretations of the Constitution.

The administrative arrangement of Albania has gone through several geographical and structural changes. On July 31, 2014 Parliament adopted a new administrative and territorial organization, dividing the country into 12 counties, 61 municipalities, and other sub-units provided for in Law 115/2014 "On the administrative and territorial arrangement of local governments in Albania."

The government administration is the organizational and professional apparatus impartially serving the public interest by implementing legislation in force, delivering public services, and developing and implementing general government policy. It consists of: (i) the Prime Minister's office; (ii) ministries and agencies under the Prime Minister; (iii) direct service delivery entities; (iv) autonomous agencies; and (v) prefects' administration.

Each ministry is headed and represented by a minister. The minister reports to the Council of Ministers and Parliament on the entire activity of his or her ministry, subordinate institutions, and autonomous agencies within their respective area of government activity.

Subordinate institutions may be established to perform administrative functions specified within their area of responsibility. These are established when their performance requires a higher degree of specialization related to the direct implementation of the law, delivery of public services to the population, or internal services to a government administration or ministry.

Territorial branches are administrative structures under a ministry or subordinate institution that perform administrative tasks in one or more local governments. Direct service delivery units are administrative units through which a ministry or a subordinate institution delivers public services to a third party directly. The prefect's administration supports a prefect in the exercise of his or her powers as specified in the law.⁵

Autonomous agencies are established and dissolved by law and have legal authority in their relations with third parties. An autonomous agency is established only if certain administrative functions can be performed better by such an organization than by a ministry or a subordinate institution, in line with the principles of economy, efficiency, and effectiveness.

Each public entity has an obligation to establish a Strategic Management Group (SMG) within its institutions, with the participation of the managerial level of the entity. The SMG is an integral element of public accountability and governance. It plays a key

⁵ Based on the law no. 107/2016 "For the region prefect," the objective of the prefect of the region is to guarantee the implementation of the political program of the Council of Ministers at the regional level.

role in the integrity of the public entity's financial information, its internal control system, and its ethical conduct. It also provides support and advice to the head of the unit and oversees the performance of the public unit.

The SMG consists of the head of the unit (who is also the chair of the group), deputy heads, authorizing officer, executive officer, and all other senior managers (the highest level depending on the organization of the public unit). The internal audit director of the unit attends the meetings as an observer and provides his or her contribution to issues related to financial management. Group decisions must be taken collegially and objectively with the public interest in mind and in accordance with public sector ethical standards. These decisions should be documented and made available to unit management.

detailing the budget plan, budget execution performance, government accounts, public debt, concession arrangements which include Public-Private Partnerships (PPPs), and liabilities.



2.2 Ongoing PFM reforms

The goal of the Albania sectoral Public Financial Management (PFM) Strategy for 2019-2022 is to ensure that the Albania public financial system promotes transparency, accountability, fiscal discipline, and efficiency of the use of public resources, with the aim of improving service delivery and economic development in the country. Specifically, goal number five of the strategy "Public finance transparency" aims at improving public finance information coverage, quality, and accessibility.

While progress has been made in the strengthening the Institute of Statistics, there has been some deviation as it is composed of complex sub-actions requiring effective coordination among three different institutions: the Bank of Albania, the Ministry of Finance and Economy (MoFE), and the Institute of Statistics. A comprehensive, standardized system on government unit statistics is needed, coupled with policy revisions, standard procedures, and relevant templates.

In-year budget execution reports, semestral macroeconomic, fiscal, budgetary performance, and end-of-year reports have been improved. However, in the context of increasing public expenditure transparency and integration, the MoFE will make efforts for preparing a more comprehensive report

An objective of the Albania sectoral PFM strategy for 2019-2020 is to merge national accounting practices with IPSAS standards. The government aims to gradually adopt IPSAS, either fully or partially, considering the context of Albania; however, no specific date about completion of the process has been provided yet. A gap assessment was conducted in 2017 to compare the current regulatory framework in Albania with IPSAS, which serves as a basis for any further actions under this component.

It should be noted that the PSA reform is an ambitious goal, and it is difficult to make accurate timeline projections regarding its implementation. Therefore, such implementation will continue gradually with a focus on establishing an appropriate reform-enabling environment.

A special accounting function was established within the financial management and control harmonization department of the MoFE in 2018, with the responsibility to adopt the PSA methodology and develop laws and regulations on corporate accounting. This structure will support the transition process to accrual accounting through the adoption of an IPSAS-compliant regulatory framework.

The development of regulatory and legal frameworks on accrual accounting continues to be a priority in the PFM strategy, albeit for a longer time horizon than originally envisaged.

3

Budgetary system

3.1 Authorities

The following are the authorities responsible for budget planning, adoption, and implementation:

- ◆ The MoFE leads the medium-term budget program (MTBP) preparation process, as well as budget execution and monitoring. The respective budget of every entity is set in “annual budget law” tables, but the MoFE takes the leading role in this process.
- ◆ The SMG for general government units leads the preparation of budget program submissions for the respective unit, as well as budget execution and monitoring at the budget program level.
- ◆ The program management team prepares budget submissions under their respective budget programs and submits them to the SMG for review.⁶ It is also responsible for the execution of the program budget and the development of monitoring reports.
- ◆ The execution officer at each general government unit ensures the quality of expenditure planning as a part of budget submissions, and coordinates compliance with financial management rules, bookkeeping, and the preparation of financial statements for the unit.
- ◆ The structure responsible for strategic coordination at the Prime Minister’s office ensures the Government’s priorities for strategic budgeting policies.
- ◆ The ministry responsible for European integration ensures, during strategic MTBP preparation with central government units, that all obligations under the EU integration process have been reflected.
- ◆ The Council of Ministers adopts key policy directions and submits the draft annual budget to Parliament.
- ◆ Parliament, by a special law, approves budgetary revenues and appropriations for central government units and unconditional transfers for local government units and their special funds.
- ◆ If the National Assembly does not approve the proposed budget by the day before the start of the budget year, the Council of Ministers shall authorize, before the beginning of the budget year, the implementation of an interim budget for the period from the first day of the budget year until the end of the third month of the budget year.

3.2 Budget basis and approach

The expenditure and revenue recognition method according to the budget law is as follows:

- ◆ Current and capital expenses in the fiscal year are recognized when they are incurred, regardless of the date of payment (thus, on an accrual basis).
- ◆ Tax revenues and non-tax revenues, including proceeds from sales of assets, are recognized when they are collected (thus, on a cash basis).

In late 1990s, like many other developing countries, Albania began to transition from a budget management system that was based on historical expenditures and inputs to a program- and performance-based system adopted by most developed countries. Key achievements in that period included the development of a three-year Medium-Term Expenditure Framework (MTEF) in 1997 and the introduction of budget programs for budget classifications in 2002.

⁶ The program management team is a unit created by order of the line minister, with representatives for each budgetary program.

With international technical assistance, several pilot ministries prepared medium-term budget submissions for the first time in 2003, based on program- and performance-based budgeting principles. In 2006 a complete MTBP document was prepared based on programs, goals, and outputs by all line ministries at the time.

In 2008, the law No. 9936, “On managing the budget system in the Republic of Albania” (Albania Organic Budget Law) was passed, which codified the entire MTBP management process. This enabled the management of public expenditures based on programs and performance.

4

Accounting system

4.1 Authorities

4.1.1 Standard setters/regulator

The MoFE is responsible for managing public finance in Albania. It is composed of several directorates general, which include the treasury, budget, public debt, fiscal policy, and the central unit for public financial internal control harmonization. All the acts issued by the MoFE are considered administrative acts, which are applicable to all government institutions and must be circulated formally for comments prior to final adoption.

The budget law specifies that the MoFE is responsible for establishing the accounting system, mandatory for all general government units. The MoFE drafts public accounting and reporting standards, in accordance with internationally accepted standards, bylaws, and methodologies in the field of public accounting, which are approved by the public internal financial control board. For every IPSAS to be adopted, the MoFE must consider any direct implications and impact the standard will have on Albania accounting policies. Crucial issues form the basis of changes to accounting policies, which must be reflected in the accounting manuals published by line ministries.

4.1.2 Preparer of financial statements

Public sector financial statements are prepared separately for each government entity. Executive officers are the managerial officials responsible for the implementation of rules on financial management, accounting, and the preparation of entity financial statements.

An executive officer is responsible for, and reports directly to, the authorizing officer of each entity to ensure the quality of the final budget document. They coordinate:

- ◆ The preparation of the public entity budget.
- ◆ The periodical report on decision-making leading to the achievement of objectives.
- ◆ The preparation and report on Annual Financial Statements (AFS) of the public entity in accordance with legal requirements and rules approved by the MoFE.
- ◆ The maintenance of the accounting system.
- ◆ Decision-making reporting on the achievement of objectives.
- ◆ Full, accurate timely accounting of all transactions.

4.1.3 Approver of financial statement

The authorizing officer for each public entity is responsible for the implementation of financial management systems and controls in all units, structures, programs, activities, and processes under their management, in accordance with the principles of lawfulness, sound financial management, and transparency. They are accountable for the planning, management, accounting, and financial reporting of the entity activity, and also prepare and monitor the systems required to preserve and protect the assets and records of the entity against loss, theft, and misuse.

Under the laws of Albania, financial statements are approved by the executive officer and the authorizing officer under a two-signature protocol.

4.2 Accounting basis

Albania has made a commitment to gradual adoption of a modern PSA system based on IPSAS. PSA is currently on a cash basis with accrual accounting elements relating to assets and liabilities. Under the Albania PFM strategy, the Government will make a gradual transition toward accrual accounting to conform with IPSAS.

Based on the experience of other countries which have successfully implemented accrual accounting reforms, and also on the essential features of the Albania public sector regulatory framework, IPSAS will be implemented to reflect local considerations.

As such, an indirect approach to the implementation of IPSAS will be used, which will allow for maximum flexibility. This approach will also lead to the full application of accrual accounting, while prioritizing those standards that would help Albania achieve higher levels of transparency and accountability as soon as possible.

4.3 Integrated Financial Management Information System

The government financial information system (AGFIS) is used for budget execution and financial reporting. In recent years other IT systems have been implemented and integrated with AGFIS. The systems include

- ◆ System for national and sectorial strategy planning.
- ◆ System for the management of external funds.
- ◆ System for human resource management and payroll.
- ◆ System for public procurement management.

All the modules of AGFIS are fully operational (budget, commitments, payables, cash management, fixed assets, and general ledger). AGFIS is used by 36 district treasury offices which perform the execution of budget transactions for general government units. To compensate for any gaps in the operation of the system, especially for receivable and inventory management, many entities - especially local governments - use other IT systems. AGFIS supports cash and accrual accounting and produces reports on budget execution and finance.

The Government is in the process of replacing older IT systems with the AGFIS system, which is Oracle-based. This implementation process has already started in some ministries and agencies, including the Tirana municipality, and is expected to roll out across larger general government units shortly. AGFIS will support the provision of necessary information for accrual accounting (which is why the accrual accounting implementation strategy is synchronized with the IT system rollout). The PFM strategy for 2019-2022 stipulates that the Government will continue to provide new budgetary institutions with direct access to the AGFIS system for budget execution, accounting, and financial reporting purposes. The implementation of IPSAS will follow AGFIS activity to better use resources.



4.4 Asset management

Asset management for public entities consists of preserving, trading, and disposing of the assets controlled by those entities. Asset management procedures for public authorities in Albania are laid down in instruction No. 30 of December 27, 2011. The instruction classifies assets into operational and lease assets for management and recognition purposes.

The AGFIS system includes an asset management module, which manages recognition procedures for assets, including detailed historical information, asset revaluation, the sale of assets, and any other related issue. To date, fifteen budgetary units have direct access to AGFIS for their budget execution process and financial reporting, including asset management functions.

Only eight budgetary institutions have fully completed the migration of historical information. Under that module, assets are detailed per the single asset principle. Budgetary institutions can divide and/or group assets in this module per their cash generation capabilities. Assets may be: (i) reclassified; (ii) sold; (iii) depreciated/amortized; (iv) capitalized in recurrent expenses; (v) replaced; or (vi) subject to other adjustments resulting from fair value measurements. These assignments may be performed in AGFIS and applied to any asset.

The other seven institutions, which have not yet completed their asset data migration, faced the following issues:

- ◆ Missing information on the assignment date for the assets in use.
- ◆ Amalgamations of institutions and delays resulting from asset valuation.
- ◆ Missing information on the date when an asset was taken over by the public sector entity.
- ◆ Other details on the process of valuation by the asset valuation committee.

Migration of asset data to the AGFIS system increases the reliability and accuracy of accounting records under the asset line in consolidated financial reports.

4.5 Debt reporting

The Albania government has made significant efforts at managing the increase in public expenditures and debt. The debt-to-GDP (Gross Domestic Product) ratio was 57.7% in 2010 and increased to 72.7% in 2015; with cost reduction measures it fell to 67.7% in 2018, and further to 66.3% as of end of 2019. This decreasing trend was not continued in 2020, due to dual shocks of the November 2019 earthquake and the COVID-19 pandemic. Broader PFM reforms will build on the efforts made by the government to reduce debt relative to GDP to ensure the long-term sustainability of public finances.

The government has prioritized the implementation of a new debt management system to manage debt consolidation efforts. A broader undertaking of government receivables initiatives will support its efforts to collect owed funds in a timely fashion.

A specialized system is used by the general directorate of public debt and foreign aid coordination to record and report external and domestic debt. It records and reports all the debt instruments issued or signed by the Minister of Finance in accordance with law no. 9665 of December 18, 2006, "On state borrowing, state debt and state's loan guarantees in Albania" amended by law no. 181/2014 of December 24, 2014.



One major area of consideration is tax collection and other obligations owed to the government. Not all obligations will be collected during the implementation of these reforms, which could be for legitimate reasons such as the collapse of a company by the time it has managed to pay its tax liabilities.

4.6 Consolidation

The presentation of fiscal indicators for general government and interdependent extrabudgetary units is based on the consolidation method, which involves the presentation of financial statistics for a group of entities as if they were a single entity. The following is the consolidation procedure in line with IPSAS 35, with information on Albania-specific issues:

- ◆ The parent entity begins consolidation as of the date it has received control of the subsidiary entity. All entities that are part of general government units are included in the consolidation process.
- ◆ Consolidation practices should be harmonized, and accounts should be represented for all entities under consistent accounting policy.
- ◆ Foreign operations should be translated into the national currency; all financial and operational records are to be kept in the national currency.
- ◆ A line-by-line combination of the performance statement and the financial position statement of the controlling and controlled entities should be drafted.
- ◆ The elimination of balances and transactions between or within the government sector should be carried out on a monthly basis. This applies to private sector entities as well.
- ◆ The elimination of controlling entity's investments in the controlled entity should be carried out by presenting the entity's net assets. This elimination is conducted on an annual basis in reference to the preparation of AFS.

The consolidation of government performance operations involves the elimination of intergovernmental unidirectional transfers (for example, where there is no return of the given monetary units). Such transfers are primarily considered government grants.

4.7 Transparency and accountability

Transparency and accountability are an essential pillar for the efficient operation of a modern economy and the improvement of social well-being. To ensure that powers delegated to the executive branch are not misused or abused, public authority performance is assessed in relation to PFM. This can be achieved by setting necessary rules to ensure transparency and by holding to account the strategic structures that have caused the misuse of PFM.

The directorate general of the treasury ensures that the criteria for transparency are fully addressed through the establishment and maintenance of government fiscal indicator financial reports, which are published in a timely fashion on the MoFE website. The general directorate ensures that the reliability of financial information is based on accurate data through the automatic generation of information by the AGFIS system. The reports are prepared based on national and international methodologies.

Pursuant to the financial reporting requirements laid down in the organic budget law, the directorate general executes the financial reports and provides relevant information for other financial and statistical reports delegated to MoFE departments. The published report contributes to fiscal transparency for power delegators, the general public, or any parties interested in external and internal information.

The reports that the Directorate General of Treasury publishes contributing to the fiscal transparency criteria for the society or interested parties are listed in Table 1. Beyond the reporting made by the Directorate General of Treasury, that DG also reports partial information in the context of the delegated reporting made by other MoFE departments, as shown in Table 2.

Table 1. Reports published by the Directorate General of Treasury

Report Title	Frequency of Report Publication
Fiscal indicator tables and fiscal bulletin	Monthly and quarterly
Capital expenditures (public investment)	Monthly
Budget commitments	Monthly
Central government operations – government fiscal statistics	Monthly
Government Finance Statistics (GFS)	Annual
Financial statements	Annual

Table 2. Reports published by the MoFE departments

Report Title	Frequency of Report Publication
Public entity report performance measurement	Annual
Budgeted funds and current funds allocated to three-digit economic accounts	Annual
PFM reporting	Annual
Other reports to international organizations (IMF, WB, KB, EC)	Upon official request
Specific reports based on individual official requests	Upon official request
Arrears reporting	Quarterly

The directorate general has recently implemented automated integration and approximation of management decision-making with treasury operations and financial processes in the government financial information system and AFMIS. The treasury operations department has cooperated with the business process department on this issue. Financial and treasury operations of public entities are monitored to identify any ongoing issues.

An effective PFM tracking procedure will help accurately identify any recurrent economic and financial bottlenecks, which are then recorded in the reports meeting the transparency criteria. The performance appraisal identifies issues pertaining to public authorities in terms of invoice payment delays and overdue commitments, including procurement and contract award phases. This process also identifies whether such time constraints are addressed in line with the organic budget law and budget instructions.

With funding from the Swiss State Secretariat for Economic Affairs (SECO), the World Bank Group (WB) is supporting the MoFE in the implementation of PSA development reforms in line with best international practices, with the overall aim of improving decision-making, accountability, transparency, and performance in the public sector.

The main goal of this support is to achieve the following two objectives:

- ◆ Develop PSA and financial reporting in line with IPSAS.
- ◆ Develop professional capacities and accounting skills for the MoFE and public sector finance practitioners.

IPSAS standards have specifically been developed for the public sector but remain in line with private sector accounting standards. These standards diverge only

when there is divergence related to specific public sector characteristics.

Albania has already started the transition to accrual accounting principles in the public sector. The original decision on this approach was made in 2007 after the WB review and was presented in the report on public sector financial reporting in Albania. That report concluded that a partial adoption of accrual IPSAS in the most critical areas was the best approach to implement accrual accounting in the public sector. While full adoption of IPSAS is the desired goal, significant progress can be made through partial adoption of IPSAS by identifying the most appropriate standards that can be adopted at present and preparing for further implementation of the rest of the standards in the future.

IPSAS implementation has been organized into five stages as shown in Table 3.

Table 3. Five stages of IPSAS implementation

#	Period	Objectives
1	2020	<ul style="list-style-type: none"> ◆ Initiating and establishing legal frameworks. ◆ Conducting IPSAS review and translation. ◆ Initiation of capacity building activities. ◆ Establishment of the government framework. ◆ Alignment with the Integrated Financial Management Information System (IFMIS) distribution. ◆ Review of current processes and procedures regarding access to available information.
2	2021-2025	<ul style="list-style-type: none"> ◆ Applying material balances. ◆ Revising accounting guidelines. ◆ Revising processes for the recognition, and measurement of fixed assets, PPPs, and debt costs.

#	Period	Objectives
3	2022-2025	◆ Implementing IPSAS standards, with the aim of implementing first stage activities to ensure transparency and accountability.
4	2024-2026	◆ Adapting and implementing standards; and ◆ Developing processes and procedures for explanatory notes.
5	2025-2027	◆ Consolidation.

During the final stage it might be useful to consider whether IPSAS 33, “First time adoption” should be applied to the previous three years to allow for the presentation of financial statements, even though the information might not be complete. This would allow for maximum flexibility regarding time-limits. However, given that the goal is not full application of all IPSAS, this standard is not essential.

The standards that have been selected for the first three stages aim to address the government’s goal of preparing public financial statements that provide essential information on government assets and liabilities.

The implementation of this project consists of three components:

- ◆ PSA and financial reporting development in line with IPSAS.
- ◆ The development of public accounting officials’ capacity and professional skills.
- ◆ Project implementation support.

Key players in the project include the MoFE, public fund users, Institute of Statistics, and the Supreme Audit Institution (SAI). The MoFE is responsible for developing, coordinating, and measuring the project. The SAI will ensure project success through the audit of the government’s AFS.

Other stakeholders, such as universities and professional accounting organizations (PAO), also have an important role in the project as potential partners. Their contributions will include IPSAS knowledge development, curricula and material development, and the provision of trainers and certification. A major priority is the cooperation between the Government, universities, and PAO through active participation in project committees, respective seminars, and the implementation of activities.



6

Impact of PSA reform implementation on other systems

High quality public sector financial reporting information is the basis for a properly functioning public sector. The improved quality of financial reporting information in Albania will have a significantly positive impact on citizens and the broader international community.

Accrual accounting recognizes the relationship between economic stock and flows and coordinates interactions between them. Transactions are recognized when they occur in the relevant period rather than when cash is paid, resulting in a more accurate account of incurred expenses. Likewise, tax revenues will be recognized in the year they accrue regardless of when cash is received.

This method of accounting will have the following impact and benefits:

- ◆ Increased transparency and accountability in decisions made by jurisdictions for donors, citizens, and investors. Added transparency will include operational management programs and practices; for instance, the full cost of individual PPPs will be made available to the public, with analysis of current and future fees.
- ◆ More complete information facilitates decision-making processes. A better understanding of all assets and liabilities is valuable for effective medium-term financial planning. This is reflected in a more effective use of public funds to deliver enhanced results for citizens.
- ◆ A complete inventory of assets and stock, which will allow entities to assess whether those assets are being used effectively, efficiently, and economically in the delivery of public services.
- ◆ The application of a consistent accounting framework by all government entities, which will enable the comparability and identification of best practices. These can then be replicated by other government entities.
- ◆ The application of an internationally recognized reporting framework, as well as government financial statements prepared on an accrual basis. This will lead to a more accurate credit rating system and streamlined foreign direct investment.



7

Challenges and lessons learned of the PSA reform implementation

PFM reform efforts have considered the experiences of relevant countries in recognizing that a successful strategy should address both legal and institutional issues. Based on insights from previous accrual accounting implementation efforts in 2007, it is insufficient to simply set new public sector financial reporting standards without implementing a new legal framework through better resourced institutions.

Reforms efforts have considered the capacity of Albania to deliver the proposed activities. In some cases, a more direct activity applied on an ongoing basis is preferred to a difficult activity that could require specialized resources; for example, contract assessments to identify PPP-related liabilities.

Priorities for PFM reform are therefore focused on activities that, while challenging, can: (i) be achieved by 2027; (ii) are based on the skills and expertise gained from previous experiences; and (iii) demonstrate progress and yield tangible results.

Reform efforts also identify areas of interdependency with other programs and the need to build capacities and skills that are in line with the AGFIS project. This poses a risk to the achievement of the main reform goals and reinforces the need for a centralized approach to the development of standards and guidance in support of their application.

Other challenges that might emerge during PSA reform may include:

- ◆ Reform programs that could be undertaken by Albania simultaneously, which would require the careful coordination and management of issues affecting more than one program.
- ◆ Reform could take a longer time than anticipated to yield expected outcomes and conclusions.
- ◆ As often happens with long-term project management, there is a risk that new ideas and requirements might come up during the implementation of the project.
- ◆ The implementation of reforms is based on a core staff. This necessitates putting a large trust in a small number of people, running the risk of management staff rotation.



8

Next steps in the PSA reform implementation

In accordance with the public sector institutional framework in Albania, the government has identified and set several specific objectives in line with the PFM strategy for 2019-2022. Several steps will be taken in the near future:

- ◆ The development of PSA and financial reporting in line with IPSAS.
 - The current PSA legal and regulatory framework will be assessed by conducting a gap analysis between national standards and IPSAS. The results of this assessment will include a roadmap for the further development of legislation and guidelines, accounting for characteristics of the government. IPSAS will be translated into the Albanian language, and accounting legislation and application guidance will be adopted at the national level.
 - The national chart of accounts (CoA) will be revised and amended. This will include the review and, if necessary, adjustment of the national CoA so that it is fully in line with accrual accounting and statistical needs.
- ◆ The development of MoFE capacities and professional skills for public sector accountant officers.
 - Technical capacities of the financial reporting unit and the central harmonization unit at the MoFE will be built up. Actions will include: (i) the determination of institutional responsibilities; and (ii) the establishment of a workplan for the units.
 - Professional accounting skills will be developed, and a sustainable PSA training mechanism will be established. In order to improve professional accounting skills and develop local training capacities, the following activities have been envisaged under this topic: (i) training of a selected number of finance officers who will receive an internationally recognized qualified professional certificate; (ii) training of a sufficient number of trainers under a “training of trainers” approach; and (iii) institutionalizing a training and certification program at a local institution to ensure the sustainability of public accounting skill development in the long run.
 - The training envisages a two-year program for a group (25 students in English) to be professionally qualified on IPSAS standards. Several candidates will be selected from that group to receive additional methodological training to become trainers themselves. An ongoing training and certification mechanism will be established and institutionalized at local institutions. A dedicated working group, composed of all essential stakeholders, will be established to determine training content, and prepare the relevant legal framework regulating public sector accountants’ training.



9

International assistance received

The implementation of IPSAS in Albania is being supported by SECO and the World Bank. In 2017 the WB conducted a comprehensive assessment of Albania's readiness for IPSAS implementation. The assessment included a detailed review, with the following conclusions:

- ◆ The legal framework on PSA and reporting is complex, fragmented, and unclear.
- ◆ Unlike the private sector, in which the Institute of Authorized Statutory Auditors provides professional education and training programs on corporate financial reporting and auditing, such a service is missing in the public sector.
- ◆ The number of accounting staff is limited. On average, there are only two accountants for each public sector entity. Efforts for attracting capable public sector finance professionals or for retaining key talents in the public sector are minimal because the private sector can provide significantly higher wages.
- ◆ Public sector budgeting is done on a cash basis, even though there is information on fixed assets, receivables, and payables, but this information is not included in the budget. This prevents the MoFE from performing effective supervision and monitoring of budget execution.

The WB is also supporting many other capacity building efforts, including the forestry accounting project and the road asset management system. These will naturally be important for the development and implementation of fixed asset accounting across government entities.





Republic of
ARMENIA

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1

Introduction

The Republic of Armenia is one of three countries situated in the South Caucasus region. The capital of Armenia is Yerevan. It achieved independence on September 21, 1991. The territory of the country is

29,743 square kilometers, and the population is about 3 million. In 2019, the nominal GDP of Armenia was US\$ 13.7 billion, with a GDP per capita of US\$ 4,615.

2

Structure and functioning of the public sector

2.1 Political system, territorial, administrative, and fiscal organization

Armenia is a parliamentary republic, the territory of which consists of the capital Yerevan and 10 regions ("marz" in Armenian). Public services are provided by:

- ◆ State bodies.
- ◆ 1800 state non-commercial organizations.
- ◆ Communities.

- ◆ Community non-commercial organizations.
- ◆ State owned enterprises.
- ◆ State-owned funds.

Local self-governance is exercised in communities. Taxes in Armenia are divided into two groups: state taxes (i.e., profit and income taxes) and local taxes. State taxes are paid to state budget. Local taxes (i.e., property and land taxes) are paid into local budgets and are their main source of revenue.

2.2 Ongoing PFM reforms

The reform strategy in the PFM system for 2019-2023 was approved by government decree N 1716-L on November 28, 2019, and includes reforms in the following fourteen sectors:⁷

1. Forecasting the main macroeconomic and budget indicators and financial risk accountability.
2. State revenue policy and tax administration.
3. Strategic planning, the MTEF, and the state budget.
4. Budget execution process controls and the treasury system.
5. Public debt.
6. Public sector accounting.
7. Corporate accounting and audit.
8. Financial management and control of the state non-commercial organizations.
9. Public procurement.
10. Public internal financial control and financial-budgetary oversight.
11. Public assets and public investment management.
12. Financial management in local government bodies.
13. External and legislative controls.
14. Government financial management information system (GFMIS).

The reform measures set for the PSA sector are:

- ◆ Monitoring of the financial statements of public sector organizations by the Ministry of Finance (MoF).
- ◆ Reviewing the methodology of PSA (as needed).

- ◆ Implementing the qualification process for chief accountants of public sector organizations,
- ◆ Developing a methodology for the consolidation of financial statements.
- ◆ Implementing a software program for the purpose of consolidating financial statements and preparing interim Consolidated Financial Statements (CFS) at the ministerial level.

The details of all PSA reforms in Armenia planned for the period of 2019-2023 are presented in a report.⁸



⁷ Government Decree N 1716-L 11/28/2019, <https://www.arlis.am/DocumentView.aspx?DocID=137596>

⁸ Available at: https://minfin.am/website/images/files/PFM_Report_Eng_FV%203.xlsx

3

Budgetary system

3.1 Authorities

Every year, each ministry provides its budget application for the next year to the MoF. The MoF consolidates all applications, discusses the proposed budgets with corresponding ministries, and presents the final version of the draft state budget law to the Government for approval. After approval, the draft state budget law is presented to the Parliament for discussion and approval.

There are also quarterly budget execution reports, which are similarly provided by the ministries to the MoF, consolidated, and presented to the Parliament for approval. The steps in this process are regulated by Armenia law on the budget system.⁹

3.2 Budget basis and approach

The budget in Armenia is cash-based, and the budgeting method is program-based.

4

Accounting system

4.1 Authorities

4.1.1 Standard setters/regulator

The MoF acts as the standard setter for PSA standards. According to the Armenian law on the accounting of public sector organizations, the regulator in this

sphere is the MoF, which within the scope of its powers shall approve: (i) the PSA standard of the Republic of Armenia (APSAS); (ii) the CoA of organizations and the instructions for the application thereof; and (iii) the illustrative model of accounting policy, illustrative set of financial statements of organizations, and other legal acts provided for by law.¹⁰

⁹ Available at: <https://www.arlis.am/DocumentView.aspx?DocID=140926>

¹⁰ Available at: <https://www.arlis.am/DocumentView.aspx?DocID=138995>

4.1.2 Preparer of financial statements

There are three levels of financial reporting in Armenia:

- ◆ Entity (or public sector organization) level. All public sector entities are obliged to prepare separate financial statements based on analytical and synthetic accounting data.
- ◆ Ministerial level. In cases provided for by legal acts regulating accounting, the controlling organizations are obliged to prepare and submit CFS. The controlling organizations shall prepare their CFS only in cases where it is prescribed by law or by the MoF.
- ◆ State level. The financial statements of the RA, as a whole entity, shall be prepared by the MoF.

Requirements for presenting information in the financial statements are prescribed by APSAS.

4.1.3 Approver of financial statement

Financial statements shall be signed by the head of the organization and its chief accountant, unless otherwise prescribed by law or by the MOF.

4.2 Accounting basis

The basis of accounting of APSAS is full accrual accounting. The MoF has divided all public sector organizations into three groups:

- ◆ For the first group, the transition to the new accounting system was mandatory as of January 1, 2016.
- ◆ For the second group, January 1, 2017.
- ◆ For the third group, January 1, 2018.¹¹

Thus, full accrual basis accounting has been mandatory for all public sector organizations in Armenia since January 1, 2018.

4.3 Integrated Financial Management Information System

Currently, there is no IFMIS in Armenia, but its development has been initiated by the government. The GFMIS is one of the elements of the PFM strategy for 2019-2023. There are several different operating software programs which support different components of PFM. On the level of public sector organizations, accounting is supported by a local Armenian software program called AS Accountant-Public Sector.¹² Other software is also used. Currently, the consolidation of financial statements is not being implemented. It will be a component of GFMIS and is planned to be mandatory by 2024.



4.4 Asset management

There is currently no integrated asset management system. However, it will be also included in the GFMIS. The state property committee of Armenia has its own registry of all state properties. Nevertheless, it is not yet connected to any accounting system.

¹¹ Available at: <https://www.arlis.am/DocumentView.aspx?DocID=124498>

¹² Available at: <https://www.armsoft.am>



4.5 Debt reporting

The Debt Management and Financial Analysis System, as well as Excel spreadsheets, are used for recording central government debt data. Provisions, employees and social benefits, leasing and concessions operations, and contingent liabilities are not reported.

4.6 Consolidation

PSA in Armenia is maintained based on the APSAS, which is mainly based on IPSAS. As such, the control principle is used for consolidation purposes. There are two levels of consolidation: at ministerial and state levels. The CFS at the state level will include all public sector organizations, communities, and State-Owned Enterprises (SOEs). Currently, financial statements of public sector organizations are not being consolidated in Armenia due to lack of corresponding software, which will be developed in the scope of GFMIS during the 2019-2023 period.

4.7 Transparency and accountability

Financial statements are published if required by law; for example, the Audit Chamber is obliged to publish its financial statements based on the law on the audit chamber. In accordance with the law on internal audits, the internal audit of financial statements should be completed by internal audit functions (within the relevant department or outsourcing company) in corresponding public sector organizations. The external audit of financial statements is conducted by the Audit Chamber. In addition, the MoF monitors financial statements as an authorized state body.

5

Description of the PSA reform and its implementation status

PSA reform in Armenia can be conditionally divided into 3 phases:

- ◆ Introduction of new accounting systems at the entity (or public sector organization) level.
- ◆ Consolidation of financial statements at the ministerial level.
- ◆ Consolidation of financial statements at the state level.

PSA reform is now in its first phase during which public sector organizations are maintaining accounting and preparing financial statements according to APSAS. In order to increase the quality of the financial statements prepared by public sector organizations, MoF, as the authorized state agency, is monitoring financial statements to identify the mistakes made and to suggest corresponding corrections. Based on the most frequent mistakes made by public sector organizations, MoF periodically prepares professional

journals on PSA methodology (up to date eleven journals have been prepared) and presents them to all public sector organizations in order to provide the necessary methodological assistance. MoF also organizes on-site visits to provide methodological assistance to the public sector organizations.

The quality of accounting data is also related to the knowledge and professionalism of chief accountants. Therefore in 2020 MoF introduced the Public Sector Accountant qualification system; to date 184 people have achieved the qualification of Public Sector Accountant.

The aforementioned measures aim at increasing the quality of financial reporting of entities which can be consolidated on both ministerial and state levels. For the consolidation of financial statements, the introduction of a special software is included in the scope of GFMIS in 2019-2023.



6

Impact of PSA reform implementation on other systems



APSAS implementation has raised internal controls in public sector organizations; however, the impact on budget execution, debt reporting, and other PFM systems will be shown during the preparation process of CFS at the state level.

7

Challenges and lessons learned of the PSA reform implementation

Several key lessons and takeaways have been gained from the initial PSA reform implementation:

1. A bottom-up approach is critical to ensure well prepared financial statements on the level of individual public sector organizations, resulting in a reliable CFS.
2. Capacity building is crucial.
3. Adequate software should be designed to support accounting and consolidation.

8

Next steps in the PSA reform implementation

The next steps in the PSA reform efforts are:

1. Embedding a qualification system for public sector accountants.
2. Implementing software for the consolidation of financial statements.
3. The monitoring of financial statements by the MoF.

9

International assistance received

The WB has assisted in the development of PSA legislation in Armenia.





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1

Introduction

The official name of Azerbaijan is the Republic of Azerbaijan. It lies at the confluence of Western Asia, the Middle East, and Eastern Europe. The population is estimated at more than 10 million (as of February 2020), with a territory of 86,600 square kilometers. By both indicators Azerbaijan is the largest country in Transcaucasia.

It shares a land border with Russia, Georgia, Iran, and Armenia. The Nakhchivan Autonomous Republic (NAR) borders Turkey to the northwest, Iran to the southwest, and Armenia to the northeast. The territory of Azerbaijan extends about 400 kilometers from north to south and 500 kilometers west to east.

Azerbaijan is an agrarian-industrial country with a developing economy. The subsoil of Azerbaijan contains valuable minerals which include oil and natural gas, salt, copper ore, gold, and molybdenum. The Republic also has a variety of raw materials for the finishing industry, including marble, kaolin, tuff, and dolomite.

Sectors of the economy, such as the oil and fishing industries, maritime transport, and ship repair, are closely connected with the natural resources of the Caspian Sea. Agricultural specialties include viticulture, horticulture, tobacco farming, vegetable farming, cattle breeding, and silkworm farming.

Exports to other countries include products of the chemical and fuel industries, non-ferrous and ferrous metallurgy, machine building and metal processing, and light industry. The growth of Azerbaijan's GDP comes mainly due to the increase of extraction and export of hydrocarbon raw materials (which is conditioned, in particular, by the commissioning of the Baku-Tbilisi-Ceyhan oil pipeline in 2005 and the beginning of gas extraction at the Shakh-Deniz field at the end of 2006). Recently, gold mining has also commenced.



2

Structure and functioning of the public sector

2.1 Political system, territorial, administrative, and fiscal organization

Azerbaijan is a unitary state in the form of a Presidential Republic. It is divided into 66 districts, 11 cities of republican subordination, and one autonomous Republic, the NAR. The head of state is the President, who is elected by popular vote for 7 years and appoints all government officials of the executive branch. The supreme legislative body of Azerbaijan is the unicameral National Assembly of Azerbaijan (Milli Mejlis) with 125 parliamentarians, elected by popular vote for 5 years in single-mandate constituencies.

The official language is Azerbaijani. The Manat is the national currency and is subdivided into 100 qapiks. The fiscal policy of Azerbaijan is determined by the Constitution, the Budget Code, and a set of laws, which establish the functions of individual bodies in the budget process and legislation. Fiscal policy is aimed at addressing the following issues:

- ◆ Determining the sources of formation of state budget revenues.
- ◆ Guaranteeing the conditions for the formation of all kinds of financial sources.
- ◆ Establishing a suitable distribution and application of financial resources.
- ◆ Determining the structure of the consumable part of the budget.
- ◆ Determining the amount of spending.
- ◆ Sorting between the budgets of different levels.
- ◆ Forming, regulating, and inducing economic and social processes by financial methods.
- ◆ Determining the federal budget's share of the total consolidated budget.

- ◆ Determining public debt management objectives.
- ◆ Determining the budget deficit or surplus.
- ◆ Establishing financial mechanisms and their development in accordance with changing goals and objectives.

The budget system in Azerbaijan consists of the state budget, the budget of the NAR, and local budgets.

In the tax system of Azerbaijan, taxes are divided into local (municipal), state, and NAR taxes. State taxes are all paid in the territory of Azerbaijan. Taxes of the Autonomous Republic are for the NAR, determined by their laws and paid in that territory. Local (municipal) taxes are defined by code and relevant law, which are applied by the decisions of the respective municipalities and paid in their respective territories.

The State Revenue Service of the Azerbaijan is a single centralized system that consists of the Tax Agency under the Ministry of Economy and territorial tax authorities, which report directly to that Ministry. The government, by applying certain customs policy functions, has the power to restrict or extend access to the domestic market of imported goods and services and to restrict or promote exports of goods and services from the state.

To ensure a unified regulation of the country's financial market, the Chamber of Financial Market Supervision, a public legal entity, was formed. This entity was created as part of the ongoing structural reforms aimed at the improvement of the business environment and serves to ensure transparency and strengthen the efficiency of public administration. To ensure transparency, the Chamber is governed according to collegial management principles, with the principles of operational and financial independence as a foundation.

The MoF is the central body of executive power, which carries out the financial policy of Azerbaijan and organizes the management of public finances.

2.2 Ongoing PFM reforms

The unified budget classification of Azerbaijan was approved by Decree of the Cabinet of Ministers of the Azerbaijan Republic No. 440 on October 11, 2014 and was prepared in accordance with the requirements of the IMF's Government Finance Statistics Manual of 2014 (GFSM 2014). It consists of four types of classifications:

1. Classification of budget revenues.
2. Functional classification of budget expenditures.
3. Economic classification of budget expenditures.
4. Administrative classification.

To determine the procedure for developing a medium-term budget expenditure structure, Presidential Decree No. 235 of August 24, 2018 approved the "Rules for medium-term expenditure structure." To

fulfill the requirements of these rules, the "Instruction on preparation of main forecasts and orders on new strategic initiatives of budget organizations for medium-term period" was approved by the Decree of the Board of the MoF No. Q-01 on January 31, 2020. This instruction regulates the process of preparing and submitting to the MoF the main forecasts and orders on new strategic initiatives of budget organizations for the medium-term.




3

Budgetary system

3.1 Authorities

The MoF:

- ◆ Proposes ways of implementing unified state financial, budgetary, accounting, and tax policy, and oversees the implementation of this policy.
- ◆ Carries out the preparation of the state budget plan and its implementation.
- ◆ Carries out activities to improve the system of budgeting and expenditure, budget, and tax forecasting.



The draft of the state budget of Azerbaijan is drawn up by the Cabinet of Ministers and submitted to the President. The President submits the state budget to the Milli Majlis, which in turn approves it.

The state budget of Azerbaijan is the main financial document for the collection and use of necessary funds for the implementation of the duties and functions of the state and municipalities by the relevant state authorities. The budget includes an annual financial plan, and the fiscal year lasts from January 1 to December 31.

The Budget Law of Azerbaijan:

- ◆ Provides for the establishment of legal, economic, and organizational standards for the organization of the budget system.
- ◆ Sets the main principles of the state budget with local budgets and non-budgetary state funds.
- ◆ Establishes the basis for the drafting and approval of the budget, as well as the execution of the budget and control over its execution.

The purpose of the state budget system is to solve social, economic, and other programs and ensure the collection and use of material funds in the manner prescribed by law for the implementation of state functions.

3.2 Budget basis and approach

The Agency of the State Treasury under the MoF is the executive body responsible for:

- ◆ Executing the state budget and the accounting of financial transactions.
- ◆ Making commitments on budgetary expenditures to budgetary organizations on behalf of the state.
- ◆ Exercising current supervision in the field of management from a single center of state-owned financial resources, their receipt, and intended use.

The budget is compiled on a cash basis.

4

Accounting system

4.1 Authorities

4.1.1 Standard setters/regulator

The MoF is the body responsible for the generalization of practices and dissemination of experience in the application of IPSAS, International Financial Reporting Standards (IFRS), and IFRS for Small and Medium Entrepreneurship (SME).

The Accounting Law, as of June 29, 2004, regulates the organization and maintenance of accounting, including the preparation and presentation of financial statements by the legal entities operating in the territory of Azerbaijan, regardless of their ownership or organizational-legal form, as well as by people engaged in business without a legal entity.

The main objective of state regulation in accounting in Azerbaijan is to ensure the preparation of financial reports and accounting in the country on the basis of IPSAS, IFRS, IFRS for SME, and more specific accounting rules.

4.1.2 Preparer of financial statements

There are three separate financial report frameworks:

- ◆ AFS by commercial organizations are prepared on the basis of IFRS or IFRS for SME.
- ◆ Budget organizations and municipal bodies are prepared on the basis of IPSAS.
- ◆ Entities with one or more subsidiaries prepare CFS.

4.1.3 Approver of financial statements

In accordance with the Decree of the Collegium of the MoF No. Q-13 of December 25, 2018, on “Approval of the rules of accounting in accordance with IPSAS”, the person approving the financial statements is the head of the organization and chief accountant. The CFS are approved in the same manner.

4.2 Accounting Basis

The Decree of the Collegium of the MoF No. Q-13 of December 25, 2018, on “Approval of the rules of accounting in accordance with IPSAS” establishes the rules of accounting in accordance with the IPSAS. According to these rules and the requirements of IPSAS, accounting by organizations is based on the accrual method.

The Decree of the Collegium of the MoF No. Q-08 of March 10, 2020, on “Rules for accounting of budget funds allocated on the basis of economic classification,” in accordance with the “Unified budget classification of Azerbaijan on the relevant accounts and sub-accounts of the CoA of organizations financed from the state budget and preparing financial statements in accordance with international accounting standards for public organizations,” establishes the rules for accounting of budgetary

funds allocated on the basis of economic classification, according to the “Unified budget classification of Azerbaijan on the relevant accounts and sub-accounts of the CoA of organizations financed from the state budget and financial statements in accordance with IPSAS.”

4.3 Integrated Financial Management Information System

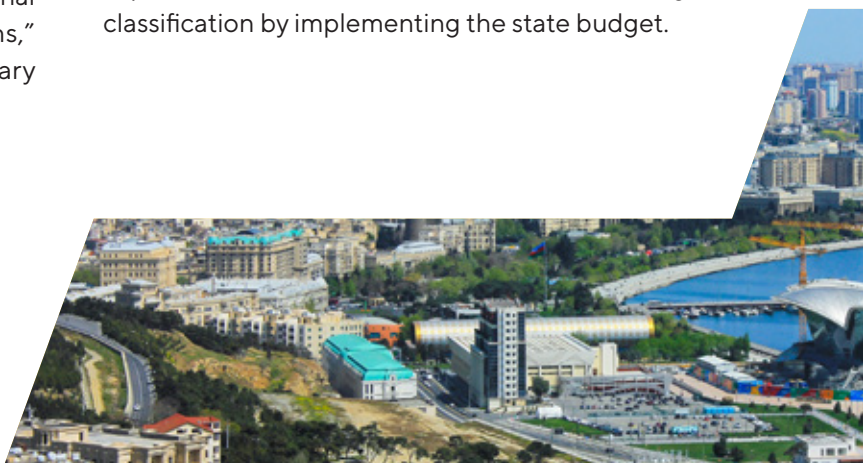
As reforms are implemented bringing accounting in line with international standards, modern accounting, and reporting, the introduction of a new centralized and user-oriented information system, improved management skills, and the development of software to implement automated reporting processes are the most important activities.

To ensure the implementation of the Presidential Decree No. 798 of July 24, 2019, the MoF issued the Order No. I-107 on June 30, 2020, on the Approval of the Action Plan to increase the use of electronic tools for bookkeeping and compilation of financial statements.

This action plan includes the application of IFRS, IFRS for SME, and IPSAS, as well as the application of accounting rules in accordance with these standards and the preparation of CFS.

4.4 Asset management

The State Treasury Agency under the MoF ensures the receipt of budget revenues and the intended use of expenditures in accordance with the unified budget classification by implementing the state budget.



To ensure accounting at a higher level and, consequently, automation of the process of preparing financial and other reports, the system “Financial and Accounting Reports for Budgetary Organizations” was created as part of the MoF project “Reporting in the Corporate and Budgetary Industries.”

The application of this system ensures that accounting in organizations financed from the budget is implemented based on uniform principles of international accounting standards. The preparation of financial statements is implemented in accordance with the standards and in an automatic mode followed by timely submission.

All the above tasks and objectives create the conditions for more effective management of financial and human resources, prevent unnecessary loss of time and inefficient spending, and ensure the prompt execution of documents in organizations.

According to the “Regulations of the State Service for Property Issues under the Ministry of Economy of Azerbaijan,” approved by the Decree of the President of Azerbaijan no. 1017 dated May 12, 2020, the management of state property is related to the activities of the State Property Service.

4.5 Debt reporting

The Agency for State Debt and Financial Obligations Management under the MoF services the state debt and created debt under the state guarantee. To maintain the financial and economic balance

in the country’s economy at the expense of state funds, the Agency provides liquidity to financial and banking organizations that have an important role in the financial, banking, and payment systems of the country, as well as to non-financial entities of strategic importance (placing time deposits with them or receiving fixed-term debt securities issued by them).

4.6 Consolidation

In accordance with the requirements of the “Rules of preparation of reporting period and presentation of financial statements for budgetary organizations” approved by the Decision of the Board of the MoF no. “Q-11” of April 15, 2013, budgetary organizations that prepare CFS must submit reports to the MoF not later than June 30 of the following year.

4.7 Transparency and accountability

In accordance with the law, for those organizations that do not submit reports in this period or do not form reports in accordance with the standards, a system of penalties was introduced which are a qualitative measure of direct incentives. Accounting software based on the IPSAS is provided to all budgetary organizations free of charge. Thus, at the level of budgetary organizations, the reporting process has been automated.



5

Description of the PSA reform and its implementation status

Resolution 440 of the Cabinet of Ministers of Azerbaijan, "Approving single budget classification of Azerbaijan," was adopted on October 11, 2018. This budget classification fully complies with the GFS standards. The classification is mandatory for all budgetary organizations.

The GFS statistical reporting system uses the following coding to identify types of transactions, other economic flows, and stocks of assets and liabilities:

- ◆ Codes starting with number one refer to income.
- ◆ Codes starting with number two refer to expenses.
- ◆ Codes starting with number three refer to transactions with non-financial assets, financial assets, and liabilities.

The resolution "Approving Single Budget Classification of Azerbaijan" consists of three segments:

1. Classification of budget revenues.
2. Functional classification of budget expenditures.
3. Economic classification of budget expenditures.

The segment "Economic classification of budget expenditures" consists of the following sections:

- ◆ Salary

- ◆ Purchase of goods (works and services)
- ◆ Depreciation
- ◆ Payment by interest
- ◆ Subsidies
- ◆ Grants and other payments
- ◆ Social payments
- ◆ Non-financial assets
- ◆ Transactions on financial assets
- ◆ Transactions on liabilities

As a result of Azerbaijan's integration into the world economy and an increase in foreign investment, primarily from the EU, the development of uniform rules for financial reporting understandable to external users has become necessary. This has also led to the urgency of developing a new concept of national accounting and the need to reform it in accordance with IFRS, IFRS for SMEs, and IPSAS.





The main goals of the reforms are:

- ◆ To organize a full transition of the state and corporate sector reporting to international standards.
- ◆ To ensure full transparency of enterprises and facilitate their access to the international market.
- ◆ To create a fundamentally new institutional framework for the development of accounting and auditing, as well as for the state to perform the relevant regulatory functions.

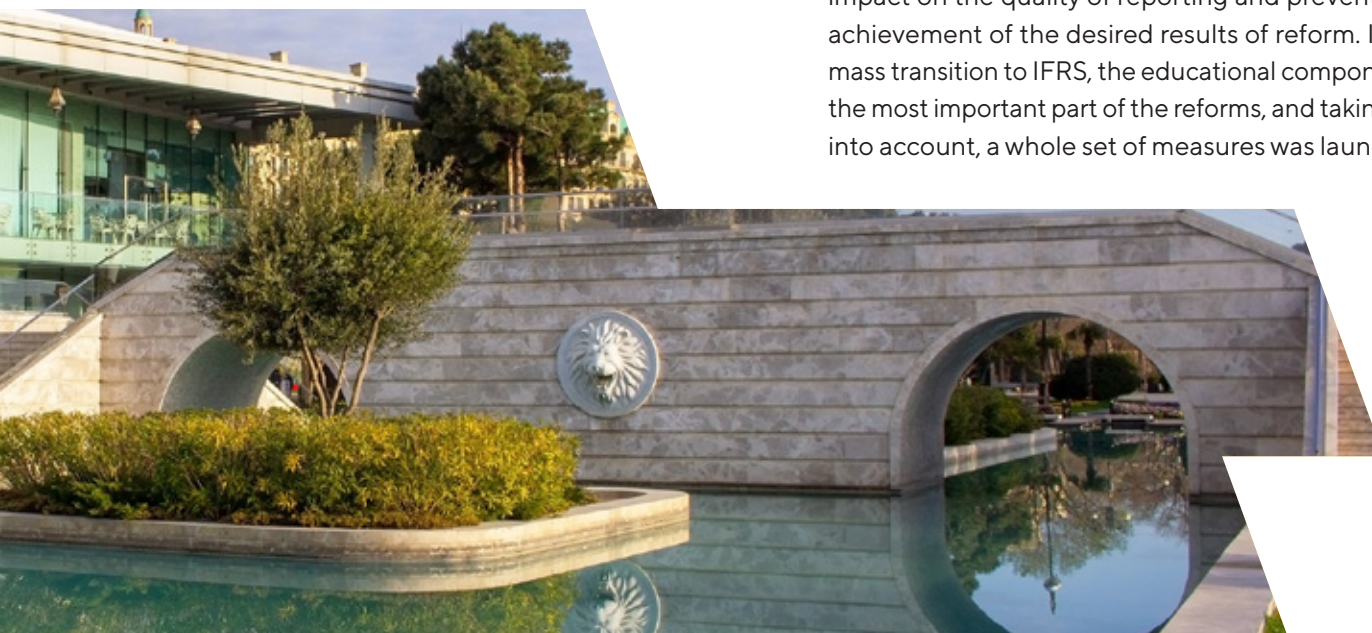
Accounting reform in Azerbaijan involves the following stages:

- ◆ **First stage.** Adoption of a package of legislative acts regulating the activities of accounting subjects in the preparation and presentation of financial statements in accordance with international standards.
- ◆ **Second stage.** Development and implementation of a set of measures, reflected in the relevant normative and legal acts, on the submission of new financial statements by accounting subjects in accordance with the legislation of Azerbaijan.

- ◆ **Third stage.** Implementation of a continuous learning process to acquire the necessary knowledge on the preparation of new financial statements by accounting entities and the implementation of external and internal audits to ensure the quality and timely submission of these reports.

As a result of this reform, the legal and methodological framework for the formation and presentation of statements based on the IFRS, IFRS for SMEs, and IPSAS was fully established. This, in turn, created the preconditions for the transition to the second stage of reform. In accordance with the Accounting Law, annual reporting was organized in 2009 from commercial organizations (excluding small businesses) and in 2010 from non-profit organizations.

As a result of the second phase of reform, all the necessary conditions and institutional frameworks were created for the formation of reporting by organizations based on international standards. At the same time, the implementation of the standards has revealed several problems that require immediate solutions. First is the lack of qualified personnel in the field of accounting and audit. This, in turn, has a direct impact on the quality of reporting and prevents the achievement of the desired results of reform. In the mass transition to IFRS, the educational component is the most important part of the reforms, and taking this into account, a whole set of measures was launched.



6

Impact of PSA reform implementation on other systems

The unified budget classification of Azerbaijan was prepared in accordance with the requirements of the IMF. By the decision of the Collegium of the MoF no. Q-08 of March 10, 2020, the rules for the accounting of budget funds allocated on the basis of economic classification were approved.

Amendments to the Accounting Law were adopted on May 4, 2018. According to this law, international standards are applied directly, including for budgetary organizations and municipalities which prepare financial statements based on IPSAS.



7

Challenges and lessons learned of the PSA reform implementation

There are no problems with the implementation of IPSAS standards. Within the framework of the Corporate and Public Sector Accountability Project (CAPSAP), trainings on preparation of financial statements were organized for accountants of budgetary and non-governmental organizations.

Together with the Ministry of Education, in all higher educational institutions of Azerbaijan the training of specialists in accounting and auditing, retraining of the teaching staff, and master's and bachelor's programs were organized.

Since 2010, the entire educational process in Azerbaijan related to accounting and auditing has been organized in accordance with international accounting standards.

Within the framework of the CAPSAP project, the Scientific and Training Center under the MoF was transformed into a Training Center, which organizes uninterrupted retraining and advanced training of all accountants, with further mandatory certification.

8

Next steps in the PSA reform implementation

Priority tasks of the current stage of reforms include strengthening the educational component of the reforms and the creation of a comprehensive system of training and retraining of accountants and auditors. The types of required education will include:

- ◆ General education (specialized secondary and university).
- ◆ Professional education for auditors and accountants (reporters).
- ◆ Training of lecturers and trainers.
- ◆ Education for junior accountants.
- ◆ Specific training in specialized areas such as accounting, auditing, and public accounting.
- ◆ Education of other participants in the system, including employees of regulatory agencies and think tanks.

The Decree of the Cabinet of Ministers of Azerbaijan no. 237 of May 22, 2019, on the approval of the rules for the organization of the process of issuing a certificate of professional accountants, examinations, and maintenance of the state register of certified professional accountants was adopted. This decree approves the rules for organizing the process of issuing a certificate of professional accountant, setting examinations, and maintaining the state register of certified professional accountants. There is a mandatory Certification for Public Sector Accountants, which is designed for candidates working as financial professionals in public sector organizations, who are not yet familiar with the details of IPSAS.

9

International assistance received

There is no international assistance for the implementation of IPSAS standards. From 2009 to

2015, the CAPSAP was implemented, jointly funded by the WB and the Government.



Republic of **BELARUS**



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1

Introduction

The Republic of Belarus (RoB) is a landlocked state in eastern Europe with an area of 208,000 square kilometers, bordering Latvia, Lithuania, Poland, the Russian Federation, and Ukraine. The capital is the city of Minsk. As of January 1, 2020, the population was 9.4 million people. The urban population makes up 77% of the population, with 2.2 million people living in Minsk.

The GDP of the RoB in 2019 amounted to \$63.2 billion, an increase of 1.2% over 2018. Inflation for 2019 was 4.7%, down 0.9% from the previous year. The annual growth of investment in fixed capital has been in the range of 5–6% for several years, and in 2019 amounted to 27.8 billion Belarusian rubles.

The RoB also recently achieved a high level of human development. According to a United Nations Development Program (UNDP) report ranking 189 countries, the RoB ranked 50th in the human development index in 2019. The RoB ranked 49th out of 190 in the 2019 “Doing Business” ranking of countries with a favorable business environment.



2

Structure and functioning of the public sector

2.1 Political system, territorial, administrative, and fiscal organization

The RoB is a unitary democratic state governed by the rule of law, with a government in the form of a presidential republic. The President of the RoB, as the head of state, has considerable powers. In particular, the President: (i) signs the law on the republican budget adopted by the Parliament; (ii) approves the rearrangement of allocations provided for in the annual national budget for the current fiscal year; (iii) approves the state investment program; and (iv) issues other decrees and orders that are binding on the entire territory of RoB.

Under the President is the State Control Committee, which exercises state control over the republican budget, the use of state property, and the execution of acts of the President, Parliament, the Government, and other state bodies that regulate state property relations. It also manages economic, financial, and tax relations.

Legislative power in accordance with the Constitution is represented by Parliament or National Assembly, consisting of two chambers: the House of Representatives and the Council of the Republic.

The judicial branch in the RoB is represented by the judiciary, which is independent of the legislative and executive branches.

Centralized executive power is exercised by the Government, which is the central body of state administration, represented by the Council of Ministers of the RoB.

The structure of local, decentralized governing bodies consists of three levels:

- ◆ The regional level (six provinces and the city of Minsk).
- ◆ The district ("basic") level (118 districts and 10 cities of province subordination).
- ◆ The primary level (1,152 village and 30 settlement councils, 104 cities of district subordination).

Under the Constitution, each level of government is empowered to exercise control over the activities of subordinate governments that report to them.

Local governments are an integral part of the national political and administrative structure. Each level of local government is represented by two institutions:

1. Councils of Deputies (bodies of Local Self-Government (LSG)), which are elected at the local level.
2. Executive committees (local government bodies), whose heads are appointed centrally and are directly accountable to the higher management bodies.



Executive committees are responsible for providing services at the local level, including the oversight of service providers (schools, hospitals, etc.) and the preparation and execution of local budgets. Elected Councils of Deputies represent the views and preferences of the local population, approve local budgets, and are involved in the preparation and adoption of regulatory legal acts at the local level. They also have the right to establish local taxes and duties and to make decisions on borrowing.

2.2 Ongoing PFM reforms

The RoB is involved in the process of reforming PFM. To ensure the long-term balance and sustainability of the budget system and improvement of the quality of PFM, the Council of Ministers approved the strategy for reforming the PFM system by Decree No. 1080 on December 23, 2015.

To implement the strategy, an international technical assistance project “Improving the efficiency and transparency of PFM system in the RoB” was implemented from 2013 to 2017. Since 2017, the project “PFM Modernization” is being implemented, which aims to assist the MoF in reforming the PFM systems, including the development and implementation of a new IFMIS.

The main objectives of this project are: (i) strengthening the strategic orientation of budgeting; (ii) consolidating funds in the Treasury Single Account (TSA); (iii) increasing budget transparency; and (iv) implementing the IT system for PFM.

The government program “Public finances management and regulation of financial markets” for 2020-2025, which defines the main activities and key indicators of reforming the PFM system, was approved by the decree of the Council of Ministers No. 143 on December 3, 2020.

3

Budgetary system

3.1 Authorities

The MoF develops a draft national budget for the next fiscal year, which together with calculations and related data is submitted for consideration and approval to the Government.

The draft law on the republican budget and estimated figures on the consolidated budget for the next fiscal year, considered and approved by the Government, are submitted to the President.

The President introduces a draft law on the national budget for the next fiscal year to the House of Representatives of the National Assembly. This draft law is considered by Parliament in accordance with the Constitution, the Budget Code, and the rules of the chambers of Parliament. The law on the national budget for the next fiscal year is to be adopted no later than December 1.

Local executive and administrative bodies submit a draft decision on the budget for the next fiscal year for consideration by the relevant local Council of

Deputies. Draft decisions of local Councils of Deputies on the budget are considered by the relevant standing committees.

3.2 Budget basis and approach

The budget of the RoB is formed on a cash basis by indexing expenditures with a detailed breakdown by budget classification (the economic classification of expenditures).

To ensure the long-term balance and sustainability of the budget system and to improve the quality of PFM in accordance with the strategy for the reform of the PFM systems, the development of medium-term budget planning and results-oriented budgeting is carried out.

In order to determine the amount of funds required to perform the functions of state bodies as well as economic and social development, drafts of the

republican budget and local budgets for the next fiscal year and drafts of the medium-term financial program for three years are also carried out.

The RoB is developing a nationwide system of indicators that characterize the activities of customers, considering their tasks and functions performed in accordance with the law, as well as an internal audit system. The measures taken to develop results-based budgeting will continue to aim at increasing program expenditures, while considering budget capabilities. It is expected that the share of program expenditures will make up 65% of total expenditures of the consolidated budget from 2021 onward.

To date, more than 30 state programs have been approved and are being implemented in the RoB. To improve the quality of state programs, a comprehensive analysis of their structure and content, evaluation of established goals, objectives, aggregate targets, and target indicators is expected.

4

Accounting system

4.1 Authorities

4.1.1 Standard setters/regulator

The unified national policy in the field of accounting and reporting is determined by the President. The Council of Ministers ensures a unified state policy in the field of accounting and reporting.

The MoF implements the unified national policy in the field of accounting and reporting, including:

- ◆ General methodological guidance of accounting and reporting in organizations (except for the National Bank, commercial banks, bank groups, and bank holdings).
- ◆ Approval of national standards of accounting and reporting and other regulatory legal acts, which are mandatory for organizations (except for the National Bank, commercial banks, and bank holdings).
- ◆ Representation of the RoB in international organizations dealing with issues of accounting and reporting.

- ◆ Implementation of other functions in the field of accounting and reporting in accordance with the legislation of the RoB.

The National Bank of the RoB regulates accounting and reporting issues in the financial and banking sector. Republican bodies of state administration provide methodological guidance in the field of accounting and reporting.

4.1.2 Preparer of financial statements

Each budget organization at the republican and local levels, as a recipient of budgetary funds, prepares and submits accounting statements to their superior organizations.

Managers of funds of the republican and local budgets prepare and submit consolidated accounting reports to the MoF or a local financial authority. The local financial body submits reports on the execution of local budgets and consolidated reports of budgetary organizations financed from local budgets to the MoF.

The MoF prepares reports on the execution of the republican budget and the consolidated budget of the public administration sector, as well as consolidated reports on certain financial indicators, including: (i) the number of accounts receivable and payable of budgetary organizations, including overdue debts; (ii) the value of fixed assets; and (iii) inventories of budgetary organizations.

4.1.3 Approver of financial statements

Financial statements (individual and consolidated), prepared in accordance with the legislation of the RoB, are signed by the head and chief accountant of the organization, who produces the statements.

The quality and timeliness of reporting is monitored by the manager of budgetary funds.

Reports on the execution of local budgets for the fiscal year under review are submitted by local executive and administrative bodies for consideration and approval by the local Councils of Deputies.

The report on the execution of the republican budget is approved in the form of a law by the Parliament and signed by the President.

4.2 Accounting Basis

The current accounting methodology of budgetary organizations is based on the application of a modified accrual method, which does not fully ensure the application of the accrual method at a level consistent with international practice.

According to the national accounting framework, budgetary organizations reflect in their accounting:

- ◆ Accrual of expenses related to the implementation of the main activity (payment for labor, consumption of services, inventories).
- ◆ Accrual of incomes from the provision of paid services.
- ◆ The value of non-financial assets available in the organization (fixed assets, inventories, advances).
- ◆ The amount of the organization's financial assets (cash, receivables from paid services, financial investments).
- ◆ Accrual of certain liabilities for goods, works, or services received.

Financial and state treasury bodies account for operations on budget execution using the cash method, with some elements of the accrual method (the provision of budgetary borrowing).



Budgetary organizations are bodies financed from the budget and created to service to the population by providing health care, education, culture, and other services. These organizations carry out accounting of operations for their current activities to render these services.

Financial and state treasury bodies are organizations that are part of the MoF system, whose functions include budget execution and cash services for budget execution. They carry out the accounting of operations relating to budget execution (accounting of budget revenues, budget expenditures, and sources of financing for the budget deficit).

4.3 Integrated Financial Management Information System

Currently, the process of accounting and reporting is decentralized and is carried out by each budget organization independently with the help of autonomous software products. Eight different software products are used in the public administration sector to automate these processes. The choice of software product and its installation is made directly by each organization.

The software products used are reliable and provide timely and complete information on financial transactions with budgetary and extra-budgetary funds, but there is no single standardized software that allows centralized access to the accounting data

of budgetary organizations. Financial statements from the fund's manager are transmitted to the MoF or a local financial body through special software in electronic form (interfaces) for the subsequent consolidation of information in a separate software product.

The processes of accounting for budget execution in local financial bodies and state treasury bodies, as well as other processes related to PFM (budget planning and execution), are carried out in the automated system of financial settlements of the MoF. This system allows users to keep records of operations relating to the budget execution, including: (i) budget revenues; (ii) budget expenditures; (iii) the inflow of funds to the budget; and (iv) the provision of borrowing at the expense of budget funds. At the same time, accounting for individual schools, hospitals, universities, and museums is carried out by these organizations in their own accounting systems.

4.4 Asset management

The State Treasury Agency under the MoF ensures the receipt of budget revenues and the intended use of expenditures in accordance with the unified budget classification by implementing the state budget.

To ensure accounting at a higher level and, consequently, automation of the process of preparing financial and other reports, the system "Financial and Accounting Reports for Budgetary Organizations" was created as part of the MoF project "Reporting in the Corporate and Budgetary Industries."



The application of this system ensures that accounting in organizations financed from the budget is implemented based on uniform principles of international accounting standards. The preparation of financial statements is implemented in accordance with the standards and in an automatic mode followed by timely submission.

All the above tasks and objectives create the conditions for more effective management of financial and human resources, prevent unnecessary loss of time and inefficient spending, and ensure the prompt execution of documents in organizations.

According to the “Regulations of the State Service for Property Issues under the Ministry of Economy of Azerbaijan,” approved by the Decree of the President of Azerbaijan no. 1017 dated May 12, 2020, the management of state property is related to the activities of the State Property Service.

4.5 Debt reporting

At present, the MoF does not prepare a balance sheet. Public debt reporting covers domestic and foreign debt as well as contingent liabilities. The cash method is used in budget execution reporting. The MoF prepares and publishes information, following IMF special data dissemination standards, on internal and external debt obligations of the central government as well as the amount of guaranteed debt.

4.6 Consolidation

CFS are prepared at the central level of government based on the statements of subordinate organizations. The consolidation of financial statements is created automatically using a specialized software product, but the exclusion of consolidated items is conducted manually. The consolidated statements are transmitted through special software to the financial authorities for the subsequent consolidation of individual indicators.

At the state level only the report on the execution of the consolidated budget of the public administration sector is prepared. This report reflects the amount of revenues and expenditures on a cash basis and the sources of financing of the budget deficit. It includes: (i) the republican budget; (ii) the local budget; (iii) extra-budgetary funds; (iv) extra-budgetary funds of budgetary organizations; and (v) information on revenues, expenditures, and sources of financing of the general government sector.

State-owned commercial organizations are not included in the consolidated report. The balance sheet, which contains consolidated information on all assets and liabilities of budgetary organizations, as well as assets and liabilities of the Government and local executive and administrative bodies, is not prepared.

Information about non-financial assets of all budget organizations is provided by compiling consolidated reports on: (i) the movement of fixed assets; (ii) the movement of tangible assets; and (iii) the balance of receivables and payables accounts.

4.7 Transparency and accountability

At present, the laws of the RoB do not stipulate a requirement to conduct an audit of accounts or to publish financial statements on the internet or in other resources.

The institutional responsible for ensuring compliance with the budget legislation is the State Control Committee of the RoB, which serves as the SAI. It audits the report on the execution of the republican budget for the reporting financial year and prepares their respective audit report. These reports are then made available to the public.

The MoF and local financial authorities are responsible for monitoring the execution of budgets, as well as compliance with uniform methodologies of accounting and reporting.

5

Description of the PSA reform and its implementation status

The resolution of the Council of Ministers no. 82 “On reforming the national system of accounting and reporting in the public administration sector” of February 9, 2019, approved the concept of reforming the national system of accounting and reporting in the public administration sector. The main goal of this initiative is to improve the quality and transparency of information about the financial position and performance of public administration entities.

Reform of the public administration sector is carried out in the following directions:

- ◆ The development and implementation of a single CoA integrated with the budget classification.
- ◆ The convergence of the national accounting and reporting system with IPSAS, which is carried out through the development and implementation of new national accounting and reporting standards, that are, in turn, aligned with IPSAS.

At present, within the preparation and implementation of the pilot project, the MoF has developed and approved: (i) a single CoA integrated with the budget classification; (ii) methodological recommendations on its application; (iii) transitional tables to ensure the transfer of accounting balances to the respective accounts of the single CoA; and (iv)

financial statements templates and methodological recommendations on their preparation, as well as other materials.

New national accounting standards are developed in line with IPSAS framework. They are being adapted to the practice of accounting in the RoB, and clearer rules and requirements are being defined in the national standards. This approach will preserve the best practices and features of the national accounting and reporting system of the public administration sector and provide a more flexible implementation of international best practices. Furthermore, the preparation of national standards in a user-friendly form will facilitate their implementation.

The development of national standards will be carried out in several stages. During the first stage (2019-2020), the MoF prepared draft national standards that established the fundamental approaches to accounting and reporting in accordance with IPSAS.¹³ They also held public discussions and considered their practical implementation and use.



¹³ IPSAS 1, 2, and 3.

During the second stage (2021-2027), standards will be developed that: (i) lay the foundation for the recognition and valuation of assets, liabilities, income, and expenses; (ii) determine the approaches to the preparation of financial statements; and (iii) set the procedure for consolidation in the public administration sector.

National standards based on IPSAS, which are not currently relevant to the RoB, will be developed during the last stage (from 2028 onward, as needed).

The MoF will submit an annual report to the Government on the implementation of these reforms. The coordination of activities within the framework of these reforms is carried out by the interdepartmental council for the implementation of the strategy of reforming the PFM system of the RoB.

Technical assistance to the ongoing reforms is provided by an interdepartmental working group on improving accounting and reporting in the public administration sector, including managers and specialists of accounting services of state agencies, other state organizations, local financial authorities, state treasury bodies, and representatives of the

scientific community. The MoF is developing the legislative and methodological framework to bring the national accounting and reporting system closer to IPSAS.

Operational support will be provided to specialists in accounting and reporting. The functions of advisory support, operational information, and explanatory work will be assigned to organizations that perform centralized accounting and reporting on budgetary organizations.

One of the key factors in the effective implementation of reforms is the development of human resources. The implementation of advanced training for specialists in the public administration sector belongs to the state educational institution "Center for advanced training of managers and specialists of the MoF." The availability of resources at this center and the staff of specialists working as teachers will allow for the high-quality training of specialists.

The main burden of implementing these higher education programs is entrusted to the "Belarusian State Economic University," which is the leading institution for training specialists in PSA.

6

Impact of PSA reform implementation on other systems

Currently, not all information on PFM is included in the state accounting or reflected in financial statements. A significant part of it is stored in separate analytical systems. These are separate software systems that provide registration (but not accounting) of the state debt, state shares in the equity capital of enterprises, shares owned by the state, and other information. Therefore, it is quite difficult to form a comprehensive assessment of financial indicators or

the performance of individual organizations and the public administration sector as a whole.

The introduction of IPSAS principles into PSA will make it possible to consolidate this information in a single system, considering international approaches and requirements. It can then be used when making rational management decisions related to the PFM process.

7

Challenges and lessons learned of the PSA reform implementation

The RoB has identified the following challenges to the implementation of PSA and reporting reforms:

- ◆ Finding a balance between international requirements and national characteristics when implementing reforms.
- ◆ Limited resources to support the implementation of ongoing reforms.
- ◆ Insufficient knowledge and experience in the transition to the new standards, and a lack of knowledge of IPSAS among all participants in the reform process.

The application of national standards corresponding to IPSAS requires additional training and new skills, as the approach to the preparation of information changes. These new approaches require that specialists in accounting services use professional judgment in analyzing operations and demonstrate

readiness to not only document their professional judgment, but also to defend it in front of supervisory agencies. Other factors include:

- ◆ The transition time to the new principles of accounting and reporting.
- ◆ Resistance to change within organizations.
- ◆ The lack of necessary information and technological infrastructure for collecting and presenting information in accordance with the new accounting and reporting standards.
- ◆ The large number of specialists who will need to be trained in the application of new national standards and the new accounting and reporting rules.



8

Next steps in the PSA reform implementation

At present the MoF is actively preparing for testing the new single CoA, integrated with the budget classification. The purpose of this pilot project is to: (i) check the adequacy of the envisaged ledgers, analytical attributes, and manuals; (ii) check the completeness of the list of budget classification codes corresponding to the ledgers; and (iii) check the application of the single CoA when reflecting accounting operations of public administration sector organizations, in preparation of subsequent interim and AFS.

The MoF has developed a list of organizations participating in the project and representing various organizations in the public administration sector, including budgetary organizations, local financial authorities, state treasury bodies, and rural executive committees.

Work is underway to prepare the software for the pilot project. To this end, all the necessary methodological documentation has been prepared.

The expected result of the pilot project will be the preparation of draft regulations of the MoF on the single CoA and its application, on the forms of accounting statements, and on the procedure for their preparation.

In addition, national standards will continue to be developed to reform the national system of PSA and reporting.



9

International assistance received

In order to implement the international technical assistance project “Improving efficiency and transparency of the PFM System in the RoB,” WB Trust Fund funds were received. These funds were used to attract international consultants who: (i) analyzed and assessed the differences between the national system of PSA and reporting, and IPSAS; (ii) provided recommendations on the best way to implement the reforms; and (iii) developed a methodology to bring the national system closer to IPSAS.

In 2017, the International Bank for Reconstruction and Development approved a loan to implement the “PFM Modernization” Project. Within the framework of this project, international experts were engaged identifying approaches to reform and implement

the national accounting and reporting system in the public administration sector. They also worked on (i) integration of the single CoA with the budget classification; (ii) development of financial statements’ templates that are compliant with IPSAS; (iii) development of methodological recommendations on its preparation; and (iv) revision and commenting on draft national accounting standards developed by the MoF.



An aerial photograph of Mostar, Bosnia and Herzegovina, showing the historic stone bridge over the turquoise Neretva River. The city's red-tiled roofs and stone buildings are visible, along with a forested hill in the background under a cloudy sky. The image is framed by large, overlapping geometric shapes in yellow, orange, and teal.

BOSNIA AND HERZEGOVINA

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1

Introduction

Bosnia and Herzegovina (BiH) is located in southeast Europe in the central part of the Balkan Peninsula. It borders Croatia to the north, west, and southwest, and Serbia and Montenegro to the east and south. The territory of BiH covers an area of 51,222.84 square kilometers, and it has a coastline of about 21 kilometers.

BiH is administratively divided into the Federation of Bosnia and Herzegovina (FBiH) and Republika Srpska (RS). The FBiH is divided into 10 cantons, and the cantons into municipalities. RS is administratively divided into municipalities. The Brcko District, which exists under the sovereignty of BiH and falls under their Institutions, is a unit of LSG with its

own Institutions, laws, and regulations, and is not covered in this book. According to the 2013 census, the population of BiH is 3,531,159.

The convertible mark (symbol KM, international symbol BAM) has been a legal currency since 1998, which by decision of the currency board has coverage in Europe. The fixed exchange rate is 1€=1.96KM.



2

Structure and functioning of the public sector

2.1 Political system, territorial, administrative, and fiscal organization

BiH is a democratic state that functions in accordance with the Constitution and is based on free and democratic elections. It is a complex state that has two entities: the FBiH and the RS.

2.1.1 Federation of Bosnia and Herzegovina

In BiH, the principle of separation of powers into executive, judicial, and legislative is applied. Executive power at the state level is exercised by the President and the Council of Ministers, legislative power is exercised by the Parliamentary Assembly, and judicial power is exercised by the Court and Prosecutor's Office.

Executive power at the entity level of the FBiH is exercised by the President and two Vice Presidents and the Government. Legislative power is exercised by the Parliament, and judicial power is exercised by the Supreme Court.

Legislative power in the FBiH is exercised by the Parliament of the Federation, which consists of the House of Representatives and the House of the People. Executive power is exercised by the Government, while judicial power is exercised by the Constitutional Court, the Supreme Court, the Court of Human Rights, and cantonal, municipal, and basic courts.

The FBiH is administratively divided into ten cantons that have their own competencies that are not explicitly entrusted to the federal administration. State administration tasks are performed by federal and cantonal ministries and LSGs. Each canton and municipality has its own legislative, executive, and judicial bodies.

Executive power at cantonal level is exercised by the Prime Minister of the Canton and the Canton Government, legislative power is exercised by the Canton Parliament, and judicial power is exercised by the Canton and Municipal Courts.

2.1.2 Republika Srpska

Executive power at the RS entity level is exercised by the President and two Vice Presidents of the RS and the Government of the RS. Legislative power is exercised by the National Assembly and the Council of Peoples, and judicial power is exercised by the Supreme Court, district courts, and basic courts.

The Constitution of the RS stipulates that it is a territorially unified constitutional and legal entity, which ensures human rights and fundamental freedoms. All state functions and powers belong to the RS, except for those which, according to the Constitution of BiH, have been placed within the exclusive authority of BiH institutions.

Article 69 of the Constitution prescribes that state powers in the RS shall be based on the principle of division of powers. The National Assembly shall call elections for members of the Parliament and for the President. It also controls the work of the Government and other bodies and elects and dismisses officials in accordance with the Constitution and the law.

The National Assembly can vote for a no-confidence motion against the Government of the RS. The President proposes to the National Assembly a candidate for Prime Minister. The President also promulgates laws with their decree, which is passed by the National Assembly. During a state of war or emergency, if the National Assembly is unable to meet, the President shall issue decrees with legal force and appoint and dismiss officials. The Government proposes laws and other regulations adopted by the National Assembly. Ministries and other bodies are independent in exercising certain competencies.

The adoption of laws and other regulations in the field of direct taxes and non-tax revenues (fees, charges, penalties, etc.) is the exclusive responsibilities of the RS. The group of direct taxes includes: (i) profit tax; (ii) income tax; (iii) property tax, and; (iv) taxes paid on the use, possession, and carrying of certain goods. Indirect taxation is governed by regulations adopted at the level of the BiH institutions.

The RS Law on borrowing, debt and guarantees regulates the manner and procedure, as well as restrictions, on borrowing and issuing guarantees of the RS, LSG units, and social security funds.¹⁴ LSG units may borrow or issue a guarantee based on the decision of the local assembly with the previously obtained consent of the MoF of the RS upon the fulfillment of legal conditions. There is no restriction in terms of the right of LSG units to be recipients of donations, except for the required registration of transfers from abroad.¹⁵

Executive power in the Brcko District is exercised by the Brcko District Government, legislative power by the Brcko District Assembly, and judicial power by the Court and the Prosecutor's Office.

2.2 Political system, territorial, administrative, and fiscal organization

In accordance with the prepared public finance improvement strategy in the Institutions of BiH for the period 2021-2025, PFM reforms include the following:

- ◆ Budget preparation at the program level.
- ◆ Budget execution and accounting function.
- ◆ Public procurement systems.
- ◆ Debt management systems.
- ◆ Development of internal financial control and internal audit in the BiH Institutions.
- ◆ Strengthening the external audit functions, i.e., the Office for Audit of Institutions of BiH.
- ◆ Improvements in the system of collection of revenues from value-added taxes and excise taxes.
- ◆ Macroeconomic projections and data consolidation.

In line with the above, reforms are also being implemented in the entity governments – FBiH and RS. The direct connection with the PSA system is realized with the budget preparation reforms at the program level, the budget execution, and the debt management system.

In March 2021, the Government of the FBiH adopted the PFM strategy of the FBiH 2021-2025 and submitted it to Parliament. It defines the following:

- ◆ Application of new fiscal rules on borrowing and guarantees.
- ◆ Improving the legal framework of public revenues and the business environment, combating the informal economy.

¹⁴ "Official Gazette of the RS," No. 71/12, 52/14, 114/17, 131/20 and 28/21.

¹⁵ The recipient/user shall report the donation agreement to the registry maintained by the Ministry of European Integration and Regional Cooperation, and if necessary, will submit a report on the use of earmarked funds, in accordance with the Law on Public Sector Donations, "Official Gazette of the RS," No. 96/05.

- ◆ Planning and budgeting:
 - Improvement of medium-term planning.
 - Establishment of an efficient system for measuring the impact of budget programs.
 - Improvement of models for macroeconomic projections.
- ◆ Improving the budget execution system.
- ◆ Improving the system of internal financial controls in the public sector.
- ◆ Ensuring constitutional and legal frameworks for the independent functioning of external audit.
- ◆ Strengthening commitment control and cash management.
- ◆ Introduction of IPSAS for the public sector.
- ◆ Improvements of the Treasury IT system.

There is an ongoing EU-funded project “Further support to the PFM in BiH” for the introduction of program budget that was initiated at the end of 2020. The project implementation is planned throughout 2023 and 2024 at the federation level, with subsequent implementation planned at the level of cantons, cities, and municipalities.

In June 2021, the Government of the RS adopted the PFM strategy of the RS 2021-2025. The strategy will provide a comprehensive and integrated framework for planning, coordinating, and implementing a set of sustainable and interlinked reform activities, which should ensure the achievement of the following key objectives in the long term:

- ◆ Improving fiscal and macroeconomic stability.
- ◆ Developing a good system and practice of PFM.
- ◆ Increasing the efficiency of public resource management.
- ◆ Improving the efficiency of service delivery.
- ◆ Increasing the transparency of public finances and accountability.

The strategy includes the following six areas of action / pillars:

- ◆ Pillar I: Fiscal framework.
- ◆ Pillar II: Public revenues.
- ◆ Pillar III: Planning and budgeting.
- ◆ Pillar IV: Budget execution.
- ◆ Pillar V: Internal control.
- ◆ Pillar VI: External audit.

3

Budgetary system

BiH has a single and complex system of public finances. The government sector in BiH includes the Institutions of BiH, the entity governments (FBiH and RS), the Brcko District, cantonal and city/municipal authorities, and extra-budgetary funds. Public enterprises are not included.

In terms of financing, direct taxes are collected and distributed in the FBiH, RS and Brcko District, while the Institutions of BiH, namely the Indirect Taxation Authority and its Steering Board, the BiH Council of Ministers, and the BiH Parliamentary Assembly are responsible for the regulation, identification, control,

and collection of indirect taxes. Revenues collected from indirect taxes is then shared between the Institutions of BiH, the entities, and the Brcko District.

Given the existing structure, there is no single framework for PFM. Instead, there are four different PFM systems. Budgets in BiH at the level of Institutions, the two entities, and the Brcko District are formulated according to the multi-year frameworks and in accordance with the law.

The medium-term framework, known as the global framework of fiscal balance and policies (GFFBP), is published in the middle of the year to offer information and set parameters for the BiH Institutions, entities, and the Brcko District. The adoption of the GFFBP falls within the remit of the Fiscal Council, which consists of the Chairman of the BiH Council of Ministers, the RS and FBiH Prime Ministers, and the state and entity-level finance ministers. The Governor of the Central Bank and the mayor of the Brcko District have observer status. The Fiscal Council Advisory Group, consisting of members appointed by the three Prime Ministers and experts from the three Ministries of Finance and the Finance Directorate of the Brcko District, is in charge of drafting the GFFBP.

The GFFBP covers the forthcoming three-year period and contains a summary of proposed fiscal policies for BiH Institutions, entities, and the Brcko District, and provides a basis for the Ministry of Finance and Treasury (MoFT) of BiH to prepare medium-term budgetary frameworks outlining overall fiscal projections as well as economic and organizational classifications for individual budget proposals.

In the FBiH, the preparation and drafting of the budget are based on the Budget Framework Document (BFD) containing macroeconomic projections and forecasts of budget funds and expenditures for the next three years. Upon the proposal of the Federal MoF, the Government adopts, by May 31, economic and fiscal policy guidelines for the three-year period containing:

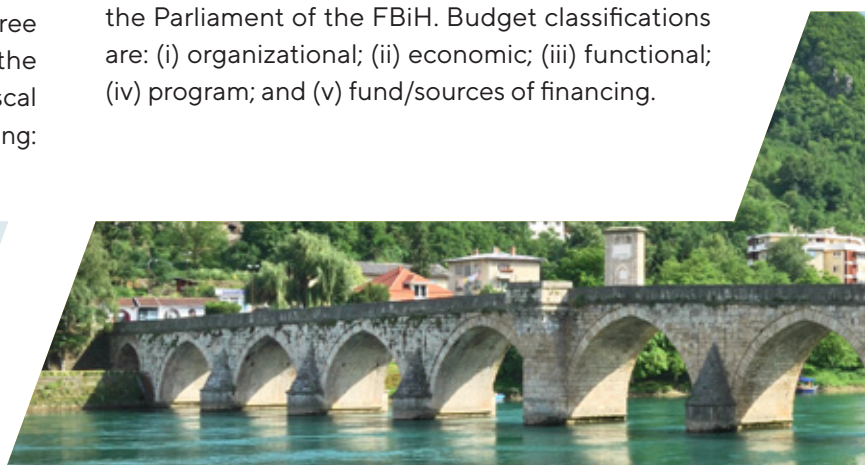
- ◆ Strategic goals of economic and fiscal policy of the Federation.
- ◆ Basic macroeconomic indicators of the Federation.
- ◆ Basic indicators of economic and fiscal policy of the Federation.
- ◆ Assumptions of social and economic development for the budget year and for the next two years.
- ◆ An estimate of budget revenues and projected changes in public debt and a public debt management strategy.

Based on the fiscal policy guidelines, the Federal MoF submits to budget users instructions on the manner and elements of drafting budget proposals for the subsequent year. The Federal MoF considers revenue estimates and requests for approval of expenditures of budget users and, after consulting and negotiating with budget users, proposes the amount of funds for each budget user.

The budget consists of a general and special part and a capital budget, as follows:

- ◆ The general part of the budget consists of the Income and Expenditure Account, Capital Receipts and Expenditure Account, and the Financing Account.
- ◆ The special part of the budget consists of a plan of expenditures and expenses of budget users, expressed by types, allocated to current expenditures and capital investments.
- ◆ The capital budget consists of allocations for capital investments by years and by sources of financing.

The budget is adopted at the level of a fiscal year by the Parliament of the FBiH. Budget classifications are: (i) organizational; (ii) economic; (iii) functional; (iv) program; and (v) fund/sources of financing.



3.1 Authorities

Budgetary authorities include the following entities:

◆ MoFT

The MoFT is responsible for the overall budget policy in the Institutions of BiH and coordinates all beneficiaries within the budget process throughout all the phases of the budget process. The key sectors for budget planning and execution are the Budget Sector and the Treasury Sector. The Council of Ministers of BiH adopts the draft budget of the Institutions of BiH, after which it is approved by the President and sent to the Parliamentary Assembly of BiH for adoption.

◆ Federal MoF

The MoF of the FBiH (the Federal MoF) is also responsible for drafting laws in the financial sector, including the budget regulations. The MoFT is the main central body in the FBiH in terms of the budget process. The Federal Government approves the draft budget, after which it is sent to the Parliament of the Federation for adoption.

◆ MoF of RS

The MoF of the RS coordinates all budget phases of the budget process in relation to all direct and indirect budget beneficiaries. The MoF of the RS is also responsible for legislation concerning the budget process. The Government of the RS approves the draft budget, after which it is sent to the National Assembly for adoption.

◆ Finance Directorate of the Brcko District

The finance directorate of the Brcko District of BiH is responsible for budget policy, process, and legislation. They are a financial institution that prepares the annual budget, monitors its execution, and prepares quarterly and annual reports.

In the FBiH, all budget users, i.e., ministries and other administrative bodies, are responsible for budget planning, adoption, and execution. Budgets are approved by the Parliament of the FBiH, legislative bodies of the cantons, and city and municipal councils.

The MoFT submits to the Government the draft budget for the next fiscal year by October 15 of the current year. By November 1, the Government determines the Draft Budget and submits it to the Parliament for adoption, and the Parliament adopts the budget by December 31 of the current year.

The Federal MoF, the MoF of the cantons, and the city and municipal councils oversee the budget execution, which is conducted based on the Law on budget execution for the level of the Federation, cantons, and LSGs.

In the RS, the budget preparation and adoption process is performed according to the budget calendar defined by the Law on the budget system.¹⁶ The budget system consists of the following budgets: (i) RS itself; (ii) municipalities and cities; and (iii) mandatory social security funds.

The RS budget preparation procedure for the following year begins in February of the current year, when the MoF of the RS establishes a working group for the preparation of the BFD. After that, budget users receive instructions for the preparation of budget spending priorities and are asked to submit



¹⁶ "Official Gazette of the RS", no. 121/12, 52/14, 103/15 and 15/16.

their budget requests for the upcoming three years. Based on the received requests and their detailed analysis, the MoF prepares, and the Government of the RS adopts, the BFD. The MoF sends to budget holders the initial budget limits set out in the BFD for the next three years.

Subsequently, budget holders submit to the MoF budget requests, and a draft/proposal of the basic budget of the RS for next year is prepared.¹⁷ The MoF then submits it to the Government for consideration and adoption. The draft/proposal of the budget of the RS adopted by the Government is submitted to the National Assembly for consideration and approval. Prior to the parliamentary debate, these documents are discussed before the respective committees. The National Assembly decides on the adoption of the budget for the next fiscal year. The adopted budget is then submitted to the Council of the People for consideration and approval, with the aim of determining the potential violation of national vital interests in the RS. After all the procedures within the authority of the legislative power have been carried out, the decision on the approval of the budget and the Law on budget execution of the RS is published in the Official Gazette of the RS.

After the adoption and publication of the BFD, the administrative bodies of LSG units in charge of finance (departments of finance/economy) send instructions to their budget users for the preparation of the draft budget. Budget holders submit budget requests for the next fiscal year in accordance with the provided instructions. The authorized executive bodies of LSG units determine the draft budget and submit it to the MoF. The MoF analyzes the submitted draft budget and makes recommendations on it.

According to the received recommendations, the authorized executive body of the LSG unit submits the draft budget to the municipal or city assembly for consideration. After the assembly considers the draft budget, the executive body of the LSG unit determines the budget proposal and submits it to the MoF for approval. After obtaining approval from the MoF, the municipal or city assembly considers

the budget proposal and passes a decision on the adoption and decision on the execution budget for the next fiscal year. These decisions are published in local official gazettes.

The departments for financing compulsory social insurance funds analyze the BFD, prepare the draft budget for the next fiscal year, and submit it to the MoF for an opinion. The Government of the RS provides its approval on the budget proposal, while the authorized body of the fund (managing board) passes the decision on the adoption of the budget for the next fiscal year.

Budget execution is done in accordance with the provisions of the Laws on budget system and on budget execution of the RS, as well as the decisions on execution of the budget of the municipality or city for the next fiscal year. The laws/decisions on budget execution are prepared and enacted every year during the adoption of the budget.

3.2 Budget basis and approach

The budget of the Institutions of BiH in accordance with the Law on financing of institutions is planned and executed on a modified accrual basis (revenues are planned and recorded in the period in which they become available and measurable, and expenditures are recognized at the time of incurrence of liability). The budget is planned according to organizational, economic, functional, and program classifications. Budgets of the entities and cantons are also planned and executed on a modified accrual basis.

In the FBiH, the budget consists of a general and special part and a capital budget. Currently, a line-item budget is used; however, the plan is to replace it with a program budget in which funds are allocated based on defined goals and expected program results. The program budget will enable budget users to group activities into a series of programs, and each program has defined operational goals and desired results.

¹⁷ Unlike the BFD, the annual budget is a budget in the narrow sense of the word, and it does not cover all segments, i.e., separate accounting funds, which are included in the CFS.

When planning and executing the budget of the RS, LSG units, and mandatory social insurance funds, a modified accounting approach is applied. For budget purposes, only collected revenues are planned and reported (cash or cash equivalents, non-cash transfers of funds to a bank account, or compensation or settlement payments), while expenses are recognized on the basis of assumed/accrued liabilities. Depreciation costs or expenditures based on adjusted asset value are not included in the budget because they do not require a cash outflow in the future. Receipts and expenditures for

financial assets and receipts from non-financial assets are monitored on a cash basis, and expenditures for non-financial assets are monitored on the basis of commitments.

Budget users submit budget requests in the form of programs, but for now the budget of the RS is adopted and published in the Official Gazette of the RS in a line-item format according to the organizational, economic, and functional classification, without classification into programs.

4

Accounting system

4.1 Authorities

4.1.1 Standard setters/regulator

The accounting function in the Institutions of BiH is prescribed by the Law on financing of institutions, which stipulates that the MoFT shall prescribe the Rulebook on Accounting and Financial Reporting until the adoption of IPSAS. The MoFT has adopted the Rulebook on Accounting in BiH Institutions. The situation is similar with the other entities, as the accounting regulator for the entire public sector is the MoFT.

For the FBiH, the Government issues a decree on accounting for the budget of the Federation. The Federal MoF ensures the implementation of uniform accounting procedures and enacts regulations on

bookkeeping, as well as the content and manner of financial reporting for all budget users and extra-budgetary funds.

Pursuant to the Law on accounting and auditing of the RS, the financial statements of legal entities and SOE in the RS are prepared in accordance with regulations in the field of accounting and auditing, which include:¹⁸

- ◆ IFRS.
- ◆ IFRS for SMEs.
- ◆ International Standards on Auditing (ISA).
- ◆ IPSAS.
- ◆ International Valuation Standards.
- ◆ International Standards for Professional Practice of Internal Auditors.

¹⁸ "Official Gazette of the RS", No. 94/15 and 78/20.

- ◆ Conceptual Framework for Financial Reporting.
- ◆ Code of Ethics for Professional Accountants (hereinafter: the Code).
- ◆ Accompanying guidelines issued by the International Accounting Standards Board (IASB).
- ◆ All accompanying instructions, explanations and guidelines issued by the IFAC.

The Law on amendments and supplements to the Law on accounting and auditing of the RS, which entered into force on January 1, 2021, provides more precise provisions regarding the application of regulations in the field of accounting and auditing. Financial statements are prepared in accordance with the translated regulations, preceded by the decision on the date of their application. The translation of these regulations in the RS is done by the authorized professional association - the Association of Accountants and Auditors of the RS - in accordance with the signed agreement and authorizations. This association passes a decision which determines the date of their application, which, together with the text of the regulations, is published on their website and the website of the MoF.

4.1.2 Preparer of financial statements

Each institution or budget beneficiary prepares reports in accordance with the Rulebook on Financial Reporting of the BiH Institutions, while aggregated or consolidated reports for the BiH Institutions are prepared by the MoFT. Entity-level reports are prepared in the same way.

In the FBiH, budget users shall submit periodic quarterly reports to the Federal MoF within 30 days after the end of the accounting period. Cantonal MoFs consolidate financial statements at the cantonal level, and the Federal MoF consolidates reports at the federal level. The Federal MoF shall submit for the Government's consideration periodic consolidated financial reports for all levels of government within 40 days of the end of the accounting period, as well

as for the period of January 1 to December 31 until April 25 of the current year.

In RS, the Law on accounting and auditing and the Law on budget system set the obligation to prepare and present individual and CFS.¹⁹ The format, content, manner of preparation, and presentation of the financial statements of budget beneficiaries are prescribed in detail by the Rulebook on financial reporting of budget beneficiaries.²⁰ The prescribed financial statements represent a standardized, structured, and aggregated presentation of information on: (i) assets; (ii) liabilities; (iii) revenues and receipts; (iv) expenditures and expenses; and (viii) the execution of the officially adopted budget. This Rulebook also requires preparation of financial reports on monthly, quarterly, and annual financial reports.

This Rulebook prescribes two sets of AFS for individual budget beneficiaries and for certain government units. Individual budget beneficiaries have different obligations in terms of annual financial reporting depending on the degree of inclusion in treasury operations. The prescribed formats of annual reporting of individual beneficiaries are not general-purpose financial statements or a balance sheet, but financial reports that provide information on assets and liabilities, revenues and receipts, expenditures and expenses, and any deviations from the financial plan.

Under the provisions of the Rulebook, government units are defined at the following three levels: (i) RS-wide; (ii) local; and (iii) the funds of mandatory social insurance. Therefore, AFS are prepared for:



¹⁹ "Official Gazette of the RS", No. 121/12, 52/14, 103/15, and 15/16; "Official Gazette of the RS", No. 94/15 and 78/20.

²⁰ "Official Gazette of the RS", No. 15/17.

- ◆ The consolidated AFS for the beneficiaries of the RS-wide budget.
- ◆ The consolidated AFS for beneficiaries of the municipal and city budget (64 units).
- ◆ The AFS for the mandatory social insurance funds (4 funds).

The AFS prepared at the level of central and local authorities, as well as mandatory social security funds, are general purpose financial statements prescribed by IPSAS. This series of AFS, apart from the classis set, are prepared as categories recognized on the accrual basis. This also includes budgetary financial statements, as well as financial statements by accounting funds. The MoF of the RS prepares the comprehensive consolidated AFS of the beneficiaries of the budgets, municipalities, cities, and funds.

4.1.3 Approver of financial statement

Budget execution reports for the BiH Institutions (annual and semi-annual) prepared by the MoFT are approved by the BiH Council of Ministers, President, and Parliamentary Assembly, while quarterly reports are approved by the BiH Council of Ministers.

In the FBiH, the Federal MoF shall timely submit to the Government a report on the execution of the Budget for the previous year, which the Government shall then submit for adoption to the Parliament within six months of the end of the fiscal year at the federal level. At the cantonal level financial reports are approved by

the cantonal assembly, and at the local government level by municipal and city councils.

In RS, the Minister, heads or mayors of municipalities, directors of funds, and persons in charge of accounting are responsible for the truthfulness and accuracy of the information presented in the AFS, as well as the reliability and timeliness of financial statements by individual budget beneficiaries. The annual and periodic financial statements are signed by the person responsible for compiling the report and the head of the reporting entity.

4.2 Accounting basis

The accounting function in the BiH Institutions is set by the Law on financing of institutions, which prescribes the application of modified accrual accounting (revenues are recorded in the period in which they become available and measurable, and expenditures are recognized at the moment of incurrence of liability). The modified accounting principal is also applied at the entity level.

In the FBiH, budget accounting is conducted based on the principle of double-entry bookkeeping according to the schedule from the analytical CoA. The CoA, in turn, consists of classes, main categories, subcategories, main groups, subgroups, and analytical accounts. Financial changes, i.e., transactions in the budget, are accounted for and recorded in the analytical accounts.



The recognition of revenues, receipts, expenses, and expenditures is based on the modified accrual accounting basis. Revenues and receipts are recognized in the period when they are measurable and available, i.e., when they are paid to the TSA. Expenses and expenditures are recognized based on the incurrence of a business event (liability) and in the reporting period to which they relate regardless of the payment.

Budget beneficiaries in the RS, in accordance with the applicable regulations, apply accrual basis IPSAS when preparing and presenting financial statements. The mandatory application of IPSAS in the preparation and presentation of financial statements from budget beneficiaries was introduced in 2006. As of the reporting year 2013, with the application of IPSAS 23 "Revenue from non-exchange transactions" (i.e., taxes and transfers), the financial statements of the RS, municipalities, cities, and funds also contain information on incurred and settled tax receivables.

In accordance with IPSAS and in addition to the preparation and presentation of general-purpose financial statements, authorities in the RS also prepare and present budgetary financial statements. A modified accrual approach is applied in budget planning and execution. For the purpose of the budget reporting, only the following actually collected revenues are reported: (i) cash or cash equivalents; (ii) non-cash transfer of funds to a bank account; (iii) compensation; or (iv) other types of settlement payments in accordance with the Law on payment operations.

Expenditures are recognized based on assumed/accrued basis. In turn, receipts and expenditures for financial and non-financial assets are recognized on a cash basis, while expenditures for non-financial assets with assumed liabilities are planned and monitored through the budget.

4.3 Integrated Financial Management Information System

The financial management information system (FMIS) in the BiH Institutions is based on the Oracle platform, which ensures a real time connection with the beneficiaries of the budget. The system has two general functions:

- ◆ The first is to ensure the financing of budget beneficiaries according to the established allocation with prescribed restrictions.
- ◆ The second is related to cash management and daily settlement of bank accounts and recording of all revenue and expenditure transactions through the Treasury General Ledger (TGL).

The existence of a treasury system and rules related to the information system ensures strict control of cash flows. These rules imply the existence of requirements for authorized persons who can access the system and of approval procedures that must be followed.

The establishment and development of treasury operations in BiH Institutions were done in phases by successively expanding the functionality of the system. The following subsystems have been implemented so far:

- ◆ Oracle eBS MoFT - Auxiliary ledgers for records and monitoring (reporting) on financial activities and business processes of budget beneficiaries, including (i) Purchasing Orders - PO; (ii) Accounting Payables - AP; (iii) Cash Management - CM; (iv) Accounting Receivables - AR, (v) Fixed Assets - FA; (vi) Oracle Treasury (Public Debt Management Module), (vii) Inventory - INV; (viii) Expenses - (Treasury Operations Management Module); (ix) TGL.

Subsystems that are not part of Oracle eBS include:

- ◆ Budget Planning Management Information System.
- ◆ Information system for coordination and monitoring of international economic assistance.
- ◆ Information system for recording and monitoring of concluded international agreements (SOFI).

- ◆ Centralized Payroll Calculation Information System for the BiH Institutions (COIP).

A DRS (Disaster Recovery System) has been established to ensure the security, stability, and data protection of the FMIS in BiH Institutions. entity and cantonal FMIS are also based on Oracle solutions.

Budget Planning Management Information System, implemented in 2013, supports the entire budget preparation cycle, multi-year budget planning, and annual federal budget preparation in the FBiH. Budget users enter their requests and submit them to the MoF, which uses the same application to check the received requests and approve funds. At the cantonal level, financial plans of budget users are prepared with the help of “e-budget” software, which was introduced with the support of the U.S. Agency for International Development (USAID) Federal Acquisition Regulation project.

Budget execution is monitored through an Oracle based accounting system. In addition to Oracle systems, FBiH also utilizes a treasury FMIS and a centralized payroll calculation software for employees working with budget users.

The Law on the single register of fees and taxes in the FBiH (adopted in the House of Representatives of the FBiH) is still being considered in Parliament. This law would establish and manage the register of fees and taxes in the FBiH. The register will be available on the website of the Federal MoF and regularly updated to promote fiscal transparency. Considering that the Federal MoF is the manager of the register, it is planning to develop a software platform that will enable a more efficient way to administer the register.

The framework for the management of accounting in the budget sector of the RS is a treasury system of operations, also known as the SUFI program, which is implemented both at a central and local levels.²¹ The beneficiaries of the RS’s budget enter financial transactions into SUFI directly or through treasury branches. Treasury operations include:

- ◆ Opening and maintaining accounts that are part of the TSA.

- ◆ Allocating public revenues in accordance with the Law on the budget system of the RS or other laws governing the affiliation and distribution of public revenues.

- ◆ Transferring public revenues from public revenue accounts to the transaction accounts of public revenue users.

- ◆ Managing funds into the TSA system, including budget revenues, current and capital grants from the country and abroad, transfers received from other budget units, receipts for non-financial assets, receipts from financial assets and borrowings, and funds from other financial transactions.

- ◆ Managing the payment or transfer of funds on behalf of budget beneficiaries.

The treasury operations system operates through auxiliary books or modules, as follows:

- ◆ Procurement module (used to reserve budget funds/purchase orders).

- ◆ Liabilities module (incoming invoices, i.e., liabilities and payments).

- ◆ Reconciliation module (entry of payment statements).

- ◆ Receivable module (outgoing invoices)

- ◆ Treasury General Ledger.

The TGL provides records of all transactions and business changes, revenues and expenditures, receipts and expenditures, assets, and liabilities, in accordance with the prescribed classifications.

4.4 Asset management

After the adoption of the Law on state property by the Parliamentary Assembly of BiH, a legal basis for the establishment of a register of state property will be created. The MoFT has established accounting records of assets that BiH Institutions procure from the budget, receive from donations, or procure from project funds.

²¹ A small part of beneficiaries of the national and local budgets still operate outside of the treasury. The process of introducing health care institutions into the treasury operations is underway.

In the FBiH, implementation of the fixed assets module started in Q1 of 2021 within the treasury FMIS application, which is used to maintain the main ledger and other accounting records. The module will enable asset management through the following functionalities:

- ◆ Complete information on fixed assets: number of fixed assets, description, inventory number, serial number, location, employee, account, lease, warranty, producer, purchase order, invoice, financial information, car insurance policies, etc.
- ◆ Mass processing of transactions: addition, adjustments, transfer, depreciation, write-off and re-entry into use, reclassification, revaluation.
- ◆ Monitoring the value of assets in preparation.
- ◆ Import of fixed assets transactions from external systems (opening balances).

It is expected that the module will be fully implemented and made available to all users by the end of this year.

In RS, there is no independent or integrated asset management system. Each budget beneficiary manages and records the assets it has acquired. The PFM strategy for 2021-2025, which is being developed under pillar IV, provides for activities to obtain and implement a single information system for recording non-financial assets in the public sector. Furthermore, it would spur the adoption of a special act reforming the accounting coverage of fixed non-financial assets in the public sector, which would provide improved coverage and quality of information on the total value of fixed non-financial assets as well as more effective asset management in general.

4.5 Debt reporting

Pursuant to the Law on debt, borrowing, and guarantees of BiH and the Law on financing of institutions, the MoFT is authorized to manage and report on the external and internal debt. Reports on the execution of external debt are adopted by the Parliamentary Assembly within the report on the execution of budget of the BiH Institutions on a semi-annual and annual basis, while the report on

the external debt is prepared and published on a quarterly basis.

External debt reports contain the following information:

- ◆ External Debt Stock of BiH.
- ◆ Trends in BiH external debt and the external debt to GDP ratio of BiH.
- ◆ External Debt Stock of BiH by creditors.
- ◆ External Debt Stock of BiH according to the period of liability incurrence.
- ◆ Currency structure of BiH external debt.
- ◆ Structure of interest rates on BiH external debt.
- ◆ Structure of services external debt obligations of BiH according to the allocation of liabilities.
- ◆ Serviced external debt obligations of BiH by creditors and structure of liabilities,
- ◆ Debt stock with External Government Guarantees.
- ◆ BiH external debt risk indicators.

In the FBiH, the Federal MoF manages, monitors, and plans new borrowings in the Federation, and is responsible for conducting borrowing and debt management procedures. It also establishes and maintains the registry of debt and issued guarantees in the Federation. The report on debt and guarantees in the Federation is published once a year in the "Official Gazette of the FBiH" no later than June 30.

The annual report on external and internal debt contains:

- ◆ Balance of total debt of the FBiH by year and percent share of GDP.
- ◆ Balance of the total debt of all levels of government (Federation, cantons, cities, municipalities, and public companies) by years.
- ◆ Structure of internal and external debt.
- ◆ Information on guarantees in the FBiH.
- ◆ Debt and debt servicing for the reporting year.

In RS, the TGL records all obligations of the RS and budget beneficiaries. Beneficiaries are obliged to record and approve all payment obligations in the treasury operations system, including: (i) obligations

based on the compensation of employees; (ii) other obligations arising in connection with business operations; (iii) obligations within their authority (e.g., the pension and disability insurance fund, the Ministry of Labor and Veterans; disability protection).

IPSAS covers the accounting of assets for certain forms of PPP, such as concession agreements. Eurostat has issued more detailed instructions regarding the recognition of various forms of PPP (including concessions), which are not necessary IPSAS compliant. This would require development of additional regulation on the topic in the future. Contingent liabilities are not recorded in the balance sheet but are disclosed in the notes to the financial statements. All liabilities of municipalities/cities and their budget beneficiaries are recorded in the general ledger of local treasuries.

The Law on budget system and the Law on borrowing, debt, and guarantees require the MoF of the RS to submit information on the debt for the previous year to the Government by June 30 of each fiscal year. These reports are also submitted to the National Assembly at a later time.

4.6 Consolidation

The MoFT prepares a report on budget execution for BiH Institutions, within which a consolidated report is prepared according to the IMF methodology. The execution report based on the methodology is also prepared by the entities, and the state consolidated report is prepared by the Central Bank of BiH.

In the FBiH, cantonal MoFs consolidate financial statements at the cantonal level, and the Federal MoF consolidates reports at the federal level. The Federal MoF submits to the Government periodic consolidated financial reports for all levels of government (Federation, cantons, municipalities, and extra-budgetary funds) within 40 days of the end of the accounting period, and for the period from



January 1 to December 31, until April 25 of the current year. SOEs are not included, and consolidation is carried out manually.

In RS, consolidated AFS are prepared by the following government units in accordance with the Law on the budget system and the Rulebook on financial reporting of budget beneficiaries:

- ◆ Beneficiaries of the budget of the RS at central level.
- ◆ Beneficiaries of the municipal / city budget at subnational level.
- ◆ Beneficiaries of the budget of the mandatory social security funds budget.

The CFS of a particular government unit includes the financial statements of all controlled budget beneficiaries. In addition, the annual CFS includes the carrying amount of net assets of other entities (financial and non-financial public entities that are not budget beneficiaries) under the control or significant influence of that government unit. The MoF of the RS is committed to the continuous improvement of the scope of consolidation.²²

Financial statements of budget beneficiaries are combined on the “line by line” principle, in accordance with the provisions of IPSAS 35 “Consolidated financial statements.” The consolidation procedure also includes eliminations of effects of transactions carried out between consolidated entities to avoid duplications.

²² Significant efforts in the coming years will be focused on the inclusion of health care institutions in the consolidated statements of the RS, municipalities, cities, and funds in order to achieve full coverage. The process is taking place in accordance with the reform of the health sector, which, among other things, should result in the introduction of health institutions into treasury operations and consolidation. For now, six institutions are included through the pilot project.

The financial statements of other public sector entities (for-profit and non-profit legal entities other than budget users) are not subject to consolidation within the scope of IPSAS 35. The inclusion of those entities in the CFS is possible by adding net assets/capital from their balance sheet to the consolidated balance sheet of the government unit under whose control or significant influence the entity is.

When it comes to the preparation of the annual CFS for the beneficiaries of the budget, the data of the majority of budget beneficiaries (more than 90%) are contained in the SUFI. For the rest of the budget beneficiaries and controlled entities, the data are included in the CFS, via Excel spreadsheets, and inserted in parallel into a special SUFI module, called the "Consolidation general ledger." The comprehensive annual CFS of the beneficiaries of the budget of the RS, municipalities, cities, and funds is prepared using Excel spreadsheets.

4.7 Transparency and accountability

All financial reports (quarterly approved by the BiH Council of Ministers and semi-annually and annually approved by the BiH Parliamentary Assembly) are published on the website of the MoF. The annual report on the budget execution of the BiH Institutions as well as individual reports of budget beneficiaries are subject to external audit performed by the audit office of the BiH Institutions. The entity audit offices perform an annual audit of the entity and cantonal institutions in accordance with the audit plan.

Transparency and accountability of PFM systems is strengthened by the following measures:

- ◆ The budget, amendments, and supplements to the budget, and the decision on temporary financing shall be published in the Official Gazette within ten days adoption.
- ◆ The Law on budget execution is published in the Official Gazette within ten days of adoption.

- ◆ Any use of the current reserve of the Government shall be published in the Official Gazette within ten days from the decision of the Government.
- ◆ Periodic and annual reports on budget execution are published on the official website of the Federal MoF within ten days of their submission.
- ◆ Decisions on debt and borrowing shall be published in the Official Gazette within ten days of their adoption.

Internal audits in the Federation are performed by establishing internal audit units within organizations that meet one of the required conditions, and in accordance with the Law on internal audit in the public sector in the FBiH. For organizations that do not meet the requirements, internal audits will be performed by the internal audit units established in the Ministries of Finance., i.e.,

Beneficiaries of the RS budget are obliged to submit annual reports to the authorized ministry or the MoF of the RS, if they are not under the competencies of a ministry, by the end of February of each reporting year. After the aggregation of data, the authorized ministry compiles aggregate formats and submit them to the MoF no later than March 10th. The MoF prepares annual CFS of the beneficiaries of the RS budget for the previous year by April 30th and submits them to the register of financial statements (Register) maintained by the Agency for Intermediary and Information Services and the supreme office for public sector auditing, in its capacity as the SAI of RS.

Beneficiaries of the LSG units' shall submit the prescribed forms of annual reports by the end of February of the current year for the previous reporting year to the authorized department of finance. The departments of LSG units shall submit prepared annual (consolidated) financial statements for the previous year to the MoF of the RS no later than on April 5th of the current year, with the obligation to submit these statements to the Agency for Intermediary and Information Services' Registry by April 30th of the current year.

Authorized departments for the finance of mandatory social insurance funds are required to prepare annual financial statement forms, previously approved by the funds' managing boards, and submit them to the Agency for Intermediary and Information Services' registry by the end of February of the current year for the previous year (because they are not considered consolidated reports). The mandatory social insurance funds are also obliged to submit financial statements for the previous year to the MoF no later than April 5th of the current year.

Furthermore, pursuant to the Law on the budget system, the MoF of the RS shall submit consolidated reports on the execution of the budget to the Government on a quarterly basis, while the Government submits semi-annual and annual reports to the National Assembly.²³ Consolidated reports on the execution of the budget of the RS, adopted by the National Assembly, shall be published on the website of the MoF.

Pursuant to the provisions of the Law on audit of the public sector of the RS, the SAI of the RS shall perform financial audits, performance audits, and other specific audits.²⁴ The coverage of SAI's audit function include:

- ◆ The National Assembly.
- ◆ The Office of the President.
- ◆ The Government, ministries, and other RS bodies.
- ◆ Organizations and institutions financed from the budget.

- ◆ Funds and other extra-budgetary institutions established by law.
- ◆ Budgets of municipalities and cities.
- ◆ Any funds for the implementation of projects, realized in the form of loans or donations on behalf of the RS, which are provided to any institution by an international organization.
- ◆ Funds allocated to institutions or organizations from the budget, as well as public and other enterprises in which the state has a direct or indirect ownership share.

The SAI applies International Standards of Supreme Audit Institutions (ISSAI), issued by the International Organization of Supreme Audit Institutions (INTOSAI).

The Law on the public sector internal financial controls of the RS regulates: (i) the system of internal financial controls in the public sector; (ii) internal audits in the public sector; and (iii) financial management and control, methodology, standards, and other issues relevant to the establishment, development, and implementation of internal financial controls.²⁵ In their work, internal auditors apply the international standards for the professional practice of internal auditors, issued by the Institute of Internal Auditors.

²³ In addition to the beneficiaries covered by the budget of the RS, the consolidated report also includes a number of budget beneficiaries who operate outside of the TGL and have their own transaction accounts.

²⁴ "Official Gazette of the RS," No. 98/05 and 20/14.

²⁵ "Official Gazette of the RS," No. 91/16.

In February 2021, the Council of Ministers of BiH adopted the strategy for improving PFM in the BiH Institutions for the period 2021-2025. The strategy includes, among other measures, “Improving Accounting and Financial Reporting” with activities that include preparation of a roadmap for the application of IPSAS, preparation of standards for consolidated fiscal reporting, and the development and strengthening of the accounting profession in BiH Institutions.

In accordance with the decision on the establishment of the working group for the development of the strategy, the monitoring and annual reporting of the Council of Ministers on activities in the implementation of the reform is performed by the working group.

The strategic framework for Public Administration Reform (PAR) envisages that in accordance with the constitutional competencies, each level of government shall develop its own PFM strategy to define a strategic framework for reform of the management of public finances in BiH.

This is the second PFM strategy for the BiH Institutions, and it represents a continuation of activities from the period 2017-2020. Previous reforms and projects in the field of budget and accounting include:

- ◆ **Strengthening PFM.** The Project was implemented in the period 2005 - 2011. The reform included the introduction of medium-term budget planning, the introduction of a 10-step methodology, and the preparation of the Budget Preparation Manual.
- ◆ **Strengthening public finances.** In the period from 2013 - 2015, the Project was focused on redefining the budget program and indicators

focused on performance; the classification of the functions of government (COFOG) was introduced, and the CoA was updated.

- ◆ **Budget planning and information management system.** A centralized database was created during the reform process in the MoFT that allows budget beneficiaries to have direct access. It also improves the accuracy and quality of the budget while shortening the time for budget preparation and reducing the costs of managing, as well as coordinating financial operations of the government.

The relevant institutions of the FBiH have not yet adopted IPSAS for the public sector PFM reform strategy for the period 2021-2025 in accounting and auditing but are planning for the adoption and implementation of the IPSAS in the near future. The first step in this process is to develop a gap analysis, which should provide clear recommendations for changes to be made relating to the legal framework and accounting policies that can easily be matched with the standards. After that, the harmonization of more complicated standards could begin, along with determination of preconditions regarding legal and software changes.

The implementation of activities for the introduction of the IPSAS is planned as follows

- ◆ Activities planned in 2021 include the analysis of current legislation, development of GAP analysis, development of a roadmap for the introduction of IPSAS, IPSAS translation, and the beginning of implementation of the roadmap – taking place in the first phase in 2021 and the first two quarters of 2022.

- ◆ Activities of the second phase of the roadmap application are planned in the last two quarters of 2022, in 2023 and the first two quarters of 2024.
- ◆ Activities of the third phase of the roadmap application are planned for the last two quarters of 2024 and 2025.

The Federal MoF oversees the implementation of PSA reform.

The RS opted for the direct implementation of IPSAS through legal provisions. The MoF of the RS plays a key role in implementing the long-term PSA reform process.

The 1993 Law on accounting was the first piece of legislation to regulate this area in the RS. The beginning of the multi-year process of reform in the field of accounting started with the adoption of a subsequent law in 1999, which introduced for the first time the application of the International Accounting Standards (IAS), issued by IASB, and the ISA, issued by IFAC. The first practical step towards accrual accounting was the introduction of the treasury operation system in 2002.

The Law on accounting and auditing of 2005 supports and further strengthens the commitment to continue to apply IAS in the RS, including IFRS, explanations and guidelines issued by the IASB, and all accompanying instructions, explanations and guidelines issued by the IFAC. It also, for the first time, refers to IPSAS standards, the application of which became mandatory since 2006.

Major and significant changes in the field of accounting and financial reporting in the RS were introduced in 2011, through the adoption regulations that ensured a significant level of compliance with the EU Acquis, as well as international accounting and statistical reporting standards adopted by EU. This ensured the comparability of general-purpose financial statements prepared and presented by the public sector entities with those presented by other reporting entities. However, the modification in revenue recognition remained in place until 2013, when the implementation of IPSAS 23 began. In 2017, the MoF of the RS published new regulations governing the system of accounting and financial reporting of budget beneficiaries in order to harmonize: (i) accounting policies with the requirements of the new and amended IPSAS; and (ii) analytical chart of accounts with the GFS 2014 and ESA 2010 classifications.



6

Impact of PSA reform implementation on other systems

The implementation of the strategy for improving PFM in BiH Institutions (2021-2025), which will be the basis for the implementation of international accounting standards in practice, will create the conditions for appropriate fiscal and financial reporting to be directly used by statistical and other institutions. Comprehensiveness and comparability of data will be ensured, and the data for the preparation of national consolidated fiscal and financial reports will be included.

PSA reform will have an impact on all aspects of PFM, and more detailed impacts will be defined in the development of the GAP analysis and of the roadmap for the introduction of IPSAS.

The accounting system will: (i) be integrated with other systems; (ii) provide support to budget planning and execution, record tax collection and tax receivables; and (iii) provide a solid basis for compiling GFS data and reporting on debt and public investment

management. A single integrated CoA, structured in sufficient detail and in an appropriate manner to ensure the achievement of multiple information requirements, is another key tool that has a direct impact on various components of the PSA and PFM system in general.

An assessment of reliability and compliance with IPSAS is provided through the audit of financial statements. Its recommendations contribute to a more consistent application of IPSAS, as well as the improvement of the overall PSA system.

7

Challenges and lessons learned of the PSA reform implementation

The basic reform of public finances in BiH was implemented from 2000-2005 when treasury operations were introduced in the public sector at all levels of government and the transition to a modified accrual accounting basis in the public sector was implemented. Experience shows that the implementation of reforms in public finances supported by appropriate IT solutions significantly increases the success of the reform itself.

The introduction of IPSAS is a complex process that will require a certain level of knowledge of IPSAS, which will necessitate staff training and the experience of the countries that have implemented this reform. Given the high costs of reform implementation, we assume that international financial assistance will be needed.

The RS applies a continuous improvement approach in PSA and has practical experience in implementing IPSAS. Based on this experience, the achievements made and the difficulties that have arisen, it could be concluded that PSA reform is a long process. However, a proper strategic approach and integrated reform of all PFM elements can save time. Synchronization should be considered, otherwise the results achieved by the progress of only one segment will have limited usability.

The MoF of the RS plays a key role in the reform process. IPSAS are very complex to implement, and it should not be expected that accountants in small budget sector institutions would fully understand all IPSAS requirements. Therefore, it is necessary to operationalize IPSAS implementation through regulations, instructions, and procedures and to ensure continuous capacity building of accountants in the budget sector.

Another prerequisite for success is an adequate IT system, and a single integrated CoA for budget beneficiaries whose structure can meet the requirements of IPSAS. No matter how important the adoption of the accrual basis may seem, the cash basis records should not be lost as only a combination of reports on both bases provides complete information.

8

Next steps in the PSA reform implementation

As mentioned above, the strategy for improving PFM in BiH Institutions 2021-2025 has been prepared, and one of its activities includes preparation of appropriate standards for consolidated fiscal reporting as well as capacity building and improvement of fiscal consolidation for all levels of government in BiH, which will create conditions for overall national fiscal reporting.

The first step in the implementation of this reform is to develop a gap analysis, which shall provide clear recommendations for changes to be made relating to the legal framework and accounting policies that need to be aligned with IPSAS. The preparation of this analysis is planned for 2021.

It will be necessary to continue the development and improvement of accounting and financial reporting in the public sector by raising the quality of IPSAS implementation. To ensure the achievement of this goal, it will be necessary to maintain continuity in

the translation of IPSAS and the revision of current regulations in the field of PSA and financial reporting, including implementation of new IPSAS. It is also necessary to actively work on overcoming the weak links between the different modules of the existing system. The adopted PFM strategy 2021-2025 of the RS identifies specific activities and measures for the improvement of the PSA.



9

International assistance received

The EU project “Additional support in public finance reform” is ongoing, and the beneficiaries of this project are the finance ministries at the state and entity levels. One of the activities is the review and preparation of legislation for the transition to a full accounting basis, i.e., the implementation of IPSAS.

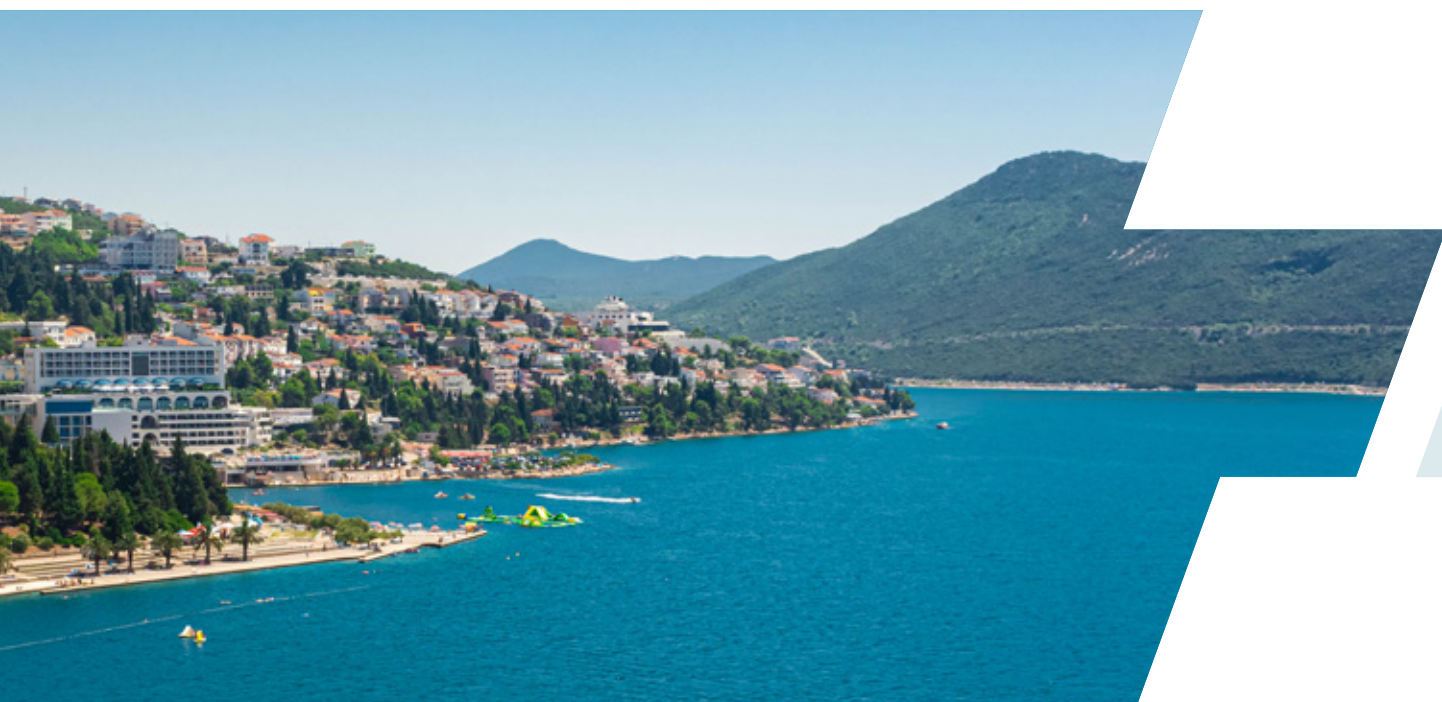
The development of a roadmap for the transition to full accrual accounting is planned under this project. The activity also includes recommendations on the dynamics, selection, and implementation of IPSAS.

Some of the other non-standard activities are:

- ◆ Preparation of the methodology of the integrated budget system related to public policy, and

- ◆ Preparation and implementation of action plans for defining policy-based budget programs and other activities related to the program budget.

The Federal MoF is currently negotiating with international financial institutions to secure donor funds for the reform implementation. From April 2017, and for the next two years, in cooperation with the technical assistance mission of the IMF, reporting forms for all levels of government in the FBiH with IMF and the European System of National and Regional Accounts (2010) classifications have been successfully harmonized. The MoF of RS has not used international assistance to implement IPSAS.





GEORGIA



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1

Introduction

The Republic of Georgia (RoG) is located in the southwestern part of the Caucasus, on the eastern shore of the Black Sea. The capital is Tbilisi, and the state language is Georgian. The country has a total area of 69,700 square kilometers, and the national currency is the Lari (GEL). RoG is bordered by Russia to the north, Turkey and Armenia to the south, and Azerbaijan to the southeast.

Other general metrics of the country include the following:

- ◆ Population: 3.7 million
- ◆ GDP, current US\$: 15.9 billion
- ◆ GDP per capita, current US\$: 4,275
- ◆ Life expectancy at birth: 74.1

2

Structure and functioning of the public sector

2.1 Political system, territorial, administrative, and fiscal organization

RoG is a democratic republic. The highest representative body of the country is the Parliament, which exercises legislative power. RoG has a President who ensures the functioning of the country within the framework of the powers granted to them by the Constitution of RoG. The highest body of executive power is the Government, which implements domestic and foreign policy. The Government consists of the Prime Minister and the Ministers and is accountable to Parliament.

The foundations of the territorial and administrative arrangement of RoG are defined by the Constitution. The Government is authorized to appoint governors to ensure representation in the administrative-territorial units of the country. Citizens of RoG address matters of local importance through LSG representative and executive bodies.

There are six types of taxes in RoG, of which five are directed to the state and one to localities (the property tax). All six taxes are collected and administered by the Revenue Service (RS) of the MoF. Revenues collected in the form of property taxes go to the respective municipality. In the budgets of the Autonomous Republics, a certain part of the revenues received in

the form of income tax is transferred in accordance with the Budget Code. Municipalities are authorized to introduce local taxes and set rates in accordance with the law.

Municipalities are self-governing units and legal entities of public law. The decision on the establishment, abolition, or changing of boundaries of a self-governing unit shall be made by the Parliament upon the submission of the Government. The powers of the state government and the self-governing units are separated. The self-governing unit's own powers, defined by organic law, are complete and exclusive. They have their own property and finances, and independently determine their organizational arrangement in accordance with organic law.

There are eleven Ministries in RoG, one office of the State Minister, 69 Municipalities, two Autonomous Republics - Abkhazia and Adjara - and 352 SOEs. 179 SOEs are managed under the State Government, and the remaining 173 are owned by Local Governments. SOEs are established to perform essential functions of the government effectively. Their presence can significantly determine the stability of various sectors of the economy and can contribute to the sustainable development of the country. SOEs differ in their areas of activity, and some of the most important sectors include (i) transportation; (ii) logistics; (iii) communications; (iv) health; (v) construction; and (vi) tourism.

Within the structure of the MoF is the RS - a legal entity of public law, which administers taxes and fees, as well as tax and customs controls. RS consists of structural units that form a unified centralized system of service and performs its duties throughout RoG. International agreements ratified and entered into force by the Parliament have supreme legal force over the national tax code.



2.2 Ongoing PFM reforms

Priorities within the Georgian PFM reform agenda include the improvement of budget management, treasury activities, and the overall financial system by bringing them in line with IPSAS.

Considerable progress has been achieved within various areas of PFM:

- ◆ The TSA has been operating since 2005 and was significantly enhanced in 2015 to cover local entities and other institutions.
- ◆ The IMF Government Financial Statistics Manual was introduced in 2008 and was updated in 2019.

- ◆ A unified treasury code for taxes was introduced.
 - ◆ The State Audit Office, in its capacity of a SAI, has been transformed into a modern institution that conducts financial, compliance, and performance audits in accordance ISSAI.
 - ◆ The legal and methodological basis for internal audits has been established and is being implemented throughout the government, including in municipalities.
 - ◆ Internal control and accounting systems have been strengthened, with fully functioning electronic modules established for the budget, treasury, debt, and other related areas.
 - ◆ State and municipal procurements are carried out through the electronic state procurement system of RoG.
 - ◆ The MoF Treasury moved to active cash management (forecasting and investment) in 2017, resulting in hundreds of millions of additional GEL revenue to the state budget.
 - ◆ The process of IPSAS implementation is being actively developed.
- These activities combined with other important reforms at both the state and local levels have contributed to the financial stability of the country and the development of the economy.

3

Budgetary system

3.1 Authorities

The principles of formation of the budget system, and the rules for the preparation, review, approval, execution, and reporting of budget drafts, are defined and regulated by the Budget Code.

Responsible bodies for budget preparation, review, approval, execution, and reporting are:

- ◆ For the state (central) budget - the Government.
- ◆ For the budgets of the autonomous republics - the highest executive body of the respective republic.
- ◆ For the budgets of the LSG units - the relevant LSG executive body.

The State Audit Office inspects the execution of all budgets and the spending of budget allocations.

3.2 Budget basis and approach

The budgets of the central government, autonomous republics, and LSG units, as well as the budgets of legal entities of public law and non-entrepreneurial (non-commercial) legal entities provided by the Budget Code are executed by the cash method.

Budgets are planned and executed based on program classification. Allocations in the program budget are done according to priorities and programs/sub-programs. They include information on programs/sub-programs, their expected results and performance evaluation indicators, and information on capital projects. The methodology required for drafting the program budget is approved by the Minister of Finance in agreement with the Finance and Budget Committee of the Parliament.

4

Accounting system

4.1 Authorities

4.1.1 Standard setters/regulator

The Treasury Service of the MoF was given the mandate in 2005 to lead the accounting and reporting reforms in the public sector. For this purpose, the Accounting Methodology Division was established within the structure of the State Treasury. According to the Budget Code, they are responsible for the development of financial accounting and reporting methodology in accordance with international accounting and reporting standards.²⁶ In order to facilitate accounting reform in the public sector, the Georgian Public Sector Accounting Standards Board (GPSASB) was founded, which is a consultative body of the Government with representatives from public sector entities. It is responsible for making recommendations in the field of PSA and reporting.

4.1.2 Preparer of financial statements

At the central budget level, financial statements are prepared annually by public sector entities according to those IPSAS, which are already adopted directly through national regulations. After the end of the reporting year, spending units must present their annual CFS to the MoF by April 1st of the following year.²⁷ Based on this information, the MoF prepares CFS for central budget entities by July 1st, which are published on the Treasury's website.²⁸

Local budget entities prepare reports containing accounting information according to their accounting/reporting guidelines, which are based on the IMF GFS framework and budget classification. Controlled entities present these reports to the controlling entities. Starting in 2021, IPSAS-based accounting and reporting standards will be adopted for central and local governments.



4.1.3 Approver of financial statement

Financial statements of public entities at the central and local levels are approved by the directors and then submitted to their controlling entities. At the central budget level, CFS, prepared by spending units, are signed by the directors and submitted to the Treasury. At the local budget level, CFS prepared by spending units are approved by governors or officials who are responsible for managing those entities and then submitted to the Treasury.²⁹ Based on this

²⁶ The Budget Code does not strictly specify which standards Treasury should use to develop accounting and reporting regulations. In the regulations, which are approved by the MoF, it is stated that they are based on accrual IPSAS.

²⁷ Spending units are budget organizations set out in tier one of the Program Budgeting Classification.

²⁸ The Central Budget entities consist of (i) spending entities and other typical Budget organizations, which are not allowed to carry out economic activities; (ii) Legal Entities of Public Law which are entitled to make profits, and; (iii) Non-Entrepreneurial, Non-Commercial Legal Entities.

²⁹ These statements cover mainly budget execution information and provide little information on financial reporting

information, the Treasury prepares CFS for central budget entities, which includes local budget entities' financial information. These CFS are approved by the head of the Treasury and, for accountability and transparency purposes, are published on the Treasury's official website on an annual basis.

4.2 Accounting basis

The accounting and reporting framework for central government entities is conducted on a full accrual basis. The CoA covers all requirements of the implemented accrual basis IPSAS, taking into consideration the relevance of these standards in Georgian context.³⁰

The accounting and reporting framework for local government entities is based on the partial accrual method, by which expenses from exchange transactions are recorded on the accrual method, while revenues and expenses from non-exchange transactions are recorded on cash method. The CoA covers accounts which are consistent with IMF's GFSM classifications. This CoA gives them the possibility to record transactions based on the partial accrual method. From 2021 onwards, full accrual basis accounting and reporting frameworks (including CoA) for local government entities will be adopted as well.

4.3 Integrated Financial Management Information System

A centralized Public Financial Management Information System (PFMIS) is in place, in which all public sector entities at the central and local budget levels are involved (except for public schools and kindergartens). The aim of this system is to ensure transparency and accountability in public spending, to increase the efficiency and effectiveness of public entities, and to prepare information that is useful for decision-making purposes.

In order to have all public finance-related information recorded in one place, the system integrates the

following modules: (i) budget preparation and execution; (ii) TSA; (iii) debt management; (iv) accounting and reporting with a partially developed TGL; (v) procurement; and (vi) electronic Human Resource Management System (eHRMS).

Further development of this system envisages the implementation of the following activities:

- ◆ Expanding this system to cover those public entities, which are now outside of the PFMIS (public schools and kindergartens).
- ◆ Improving and simplifying business-processes and modernizing functionalities.
- ◆ Introducing a fully functioning accrual basis TGL, which will provide accrual basis information at centralized and decentralized levels of government.

The TGL will produce accrual information on assets, liabilities, net assets/equity, revenues, and expenses of public entities in real time, using IPSAS-based CoA. At this moment it is partially developed and covers all expenses and tax revenues on an accrual basis. Once the system is fully developed, it will provide IPSAS-based accrual information for all individual entities as well as for the government as a whole.

4.4 Asset management

There is no standalone or integrated asset management system in place. Public entities maintain records of their assets in their own accounting and reporting systems. Some public entities record these assets in their accounting software, while some make bookkeeping entries manually. Assets recorded by public entities are usually the ones that are used for their own purposes. Nonfinancial assets at the national and local levels are recorded in different public assets registers. In such registers, various kinds of fixed assets are recorded, such as buildings, lands, minerals, energy resources, cultural heritage assets (works of art, monuments, etc.), or infrastructure assets (bridges, roads, etc.).

The Government maintains a record of its holdings in all categories of financial assets, which are primarily

³⁰ IPSAS which are implemented are: IPSAS 1, 2, 3, 4, 5, 9, 12, 13, 14, 16, 17, 19, 20, 21, 23, 24, 26, 31, 32, 34, 35, 36, 37, and 39.

recognized in the amount of contributions made (acquisition cost), and in rare cases at fair (market) value. These financial assets are recognized in the financial statements of the MoF and other agencies which hold such assets.

4.5 Debt reporting

The MoF maintains complete, reconciled information on state external debts (bilateral and multilateral loans, Eurobonds issued by the Government), state guarantees, and state internal debts (Treasury Bills, Treasury Bonds, State Bonds, and related transactions). Following the Public Debt Law, the MoF provides information to the National Bank of Georgia on public debt and the loans on which state guarantees are issued. On a monthly basis, the MoF provides information on public debt statistics (balance, disbursements, grants, etc.) to Parliament, the Government, and the National Bank of Georgia. The state budget execution reports submitted to the Parliament include information on public debt (which covers the balance of public debt), changes in liabilities, disbursement, and the aggregated data of payments for the debt service, both for internal and external debt. State external and internal debts are also recorded in the financial statements of the MoF.

The fiscal risk report covers data for most PPP projects as contingent liabilities. Other types of contingent liabilities and guarantees are recorded in the financial statements of the budget organizations at the state budget level annually, in line with IPSAS 19 -

Provisions, Contingent Liabilities, and Contingent Assets. In order to record contingent liabilities and guarantees, the instruction includes the relevant “balance off accounts.” Disclosure of this kind of information is required using explanatory notes to the financial statements. Financial statements of central budget organizations also cover other liabilities, such as provisions, employee benefits, and leasing.

4.6 Consolidation

An automated system for consolidation has not been developed yet. Consolidation of public entities is based on fiscal arrangements at the central and local levels (central budget spending units cover all their controlled entities), budget organizations, Legal Entities of Public Law, and Non-Commercial Legal Entities.

Municipalities and the autonomous republics manage all of their controlled entities including Legal Entities of Public Law and Non-Commercial Legal Entities. These controlled entities submit their financial statements and other financial reports to their corresponding controlling entities, which, in turn, prepare their CFS and submit them to the MoF. A small number of public entities use accounting software, but most consolidate this information manually.

The MoF prepares CFS for central budget entities, which also include financial information of municipalities and autonomous republics as an appendix.



4.7 Transparency and accountability

Local budget entities prepare reports on accounting information according to their accounting/reporting guidelines, which are based on the GFSM framework, and present them to the municipalities and autonomous republics during the time frame defined by these controlling entities. AFS of

budget organizations at the central budget level are submitted to the State Audit Office for external audit.³¹ Annual reports on accounting information for municipalities and autonomous republics are not audited on an annual basis. To achieve comparability of PSA and reporting frameworks for the whole public sector, starting in 2021 an IPSAS-based accounting and reporting framework will be adopted for local budget entities as well.

5

Description of the PSA reform and its implementation status

IPSAS reform in RoG was initiated in 2005. For these purposes, the accounting methodology division was established at the State Treasury. During this transitional period of reform, a unified accounting and reporting methodology and a CoA for central and local budget entities was established. During the second stage, the CoA was linked to the budget classification, which itself was based on IMF methodology.

In 2009, with the support of the Georgian Government and international institutions such as the World Bank, the implementation process for accrual basis IPSAS in the Georgian public sector was launched. The objective of this reform was to: (i) strengthen PFM; (ii) introduce a more efficient and transparent PSA and reporting system, and; (iii) upgrade the quality of financial statements to comply with IPSAS.

The accrual accounting and reporting framework has several benefits, including, most notably, transparency

and understandability. With this in mind and the under the PFM Reform project, the IPSAS Implementation Strategy was prepared and approved by the Decree of the MoF, no. 701 of November 3, 2009. The Strategy envisaged a phased implementation to accrual basis IPSAS by 2020 and the publication of audited CFS for that time. Initially this strategy was intended for central government entities; later, it was revised to cover local governments entities as well (Decree of the MoF no. 485 of December 29, 2017).

Since the implementation of this strategy, several activities have taken place. IPSAS were translated into Georgian according to the official Memorandum of Understanding between the Treasury and IFAC. The translated standards were made accessible to all interested parties via the official webpage of the Treasury. Another step was to establish a legal framework and standards-setting body within the public sector. For this purpose, the GPSASB was established, which is a consultative body of the

³¹ According to the current SAO regulation, this institution is not yet obliged to conduct financial audit of the CFS of Central Budget Entities.

Government with the representatives of public sector entities. GPSASB is responsible for making recommendations about PSA and reporting issues.

Initially, the choice was made to implement IPSAS indirectly as national regulations by decrees of the MoF. This approach made it possible to increase the capacity of public sector accountants, as well as develop the IPSAS-based accounting and reporting framework in order to prepare high-quality financial statements in the public sector.

By the end of 2019, after intensive consultation and discussion with international experts and institutions, it was decided that IPSAS would be implemented directly without any modifications or deviations. In 2020, accounting and reporting regulations were approved, which cover 24 accrual basis IPSAS chosen based on their relevance to the Georgian public sector. CoA was also developed based on these 24 standards. CFS for central budget entities will be prepared based on these standards. They will also cover consolidated financial information of the local government entities, based on their accounting and reporting methodology.

The introduction of these standards and new CoA in local government entities will begin in 2021. Under this reform, it is envisaged that CFS, including central and local government financial information, will be prepared as well.

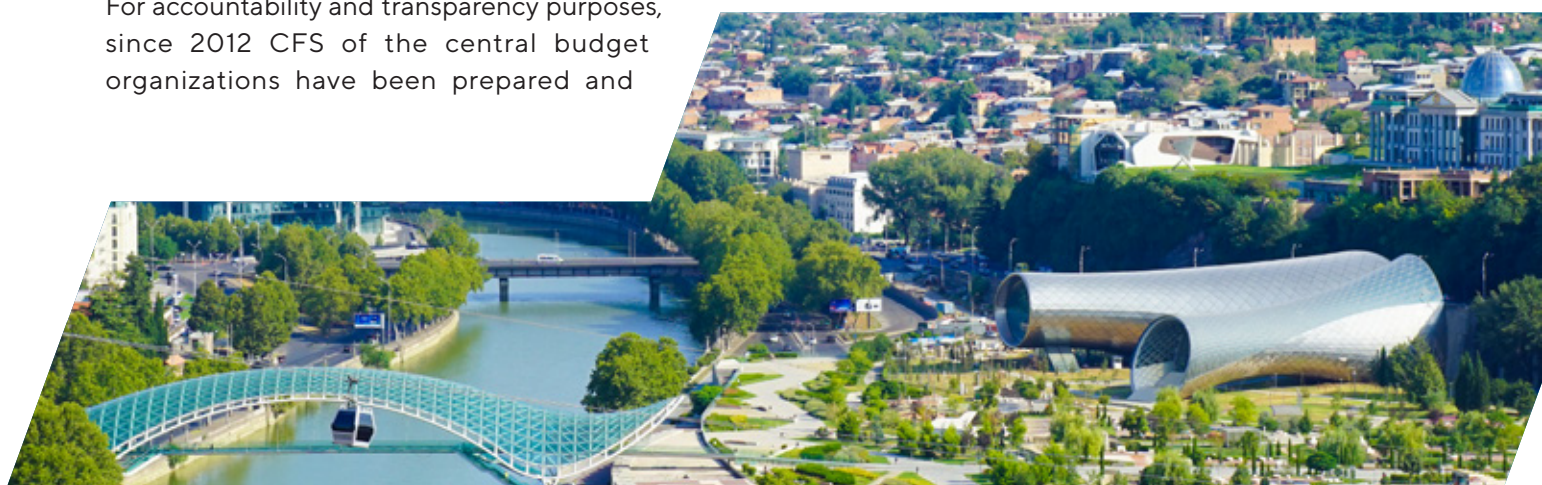
For accountability and transparency purposes, since 2012 CFS of the central budget organizations have been prepared and

published annually on the Treasury's website, taking into consideration requirements of gradually implemented accrual basis IPSAS.

To support the IPSAS implementation process in the Georgian public sector, several trainings and capacity building programs were conducted for the Treasury staff as well as for public sector accountants, utilizing the technical assistances of international organizations and the support of the Academy of the MoF. Selected trainers also conducted IPSAS trainings for public sector accountants. The Treasury, together with the Academy of the MoF, permanently conduct trainings and capacity building programs for public sector accountants and financial professionals in the field of PSA and reporting. Very intense theoretical and practical courses in IPSAS have been developed.

Some information about the progress of monitoring and evaluation reforms is covered in the PFM Reform reports. These reports are delivered in two documents:

- ◆ The first document is about the current annual plan, which covers all the required activities, tasks, and arrangements that Treasury plans to carry out within the IPSAS reform during the year.
- ◆ The second document presents the execution status of these planned activities to assess the work remaining to be done. Monitoring and evaluation are also one of the main functions of GPSASB.



6

Impact of PSA reform implementation on other systems

Reforming the fields of accounting and reporting and moving toward implementation of international standards is a broad and complex process. A systematic and consistent approach is important when implementing such a reform, and requires political will, broad stakeholder involvement, and technical knowledge.

In the case of RoG, improving accounting and transitioning to international standards is one of the most important topics in the PFM agenda and, as mentioned in the description of the reform, is one of the country's priorities. In parallel with accounting reform, it was important to develop budget performance reporting as well as technical and substantive debt management functionality.

To this end, in the framework of the Georgian PFM reforms, noteworthy progress has been made in several areas:

- ◆ Introduction of GFSM 2001 and later implementation of GFSM 2014.
- ◆ Adoption and enhancement of the TSA.
- ◆ Simplification of tax administration through a unified treasury code for taxes.
- ◆ Reform of internal and external audits, procurement services, and debt management software.



7

Challenges and lessons learned of the PSA reform implementation

The main challenges that have taken place during the PSA reform implementation process are the following:

- ◆ The relationship and contradictions between international standards and Georgian legislation.
- ◆ Consolidation procedures are not fully in place, which means that aggregation of financial data and the necessary adjustments for consolidation, such as the elimination of all internal balances and transactions between the organizations, has not taken place at a full scale.
- ◆ While all cash transactions are captured in the PFMIS, the TGL is still in the process of development; thus, accrual information about all revenue is not currently available.
- ◆ There are no certification and/or continuing professional development programs for public sector accountants in RoG, which directly affects the quality of accounting and financial reporting information.

IPSAS implementation activities require a substantial number of resources and proactive efforts to involve primary stakeholders in the process. Thus, the main lesson learned has been that when dealing with large scale reforms of accounting and reporting, international support matters. Without donor funding and support from international institutions, it would be much more complicated to implement IPSAS in the public sector.



8

Next steps in the PSA reform implementation

Future activities necessary for the implementation of PSA reform include the following:

- ◆ Implementation of IPSAS in the autonomous republics and LSG units.
- ◆ Preparation of CFS for the general government sector, and its publication on the website of the State Treasury with audit opinions.
- ◆ Development of a fully functioning TGL reflecting all transactions and other events on accrual basis, in real time, according to the IPSAS-based CoA. Once fully developed, TGL will provide an accurate, consistent, and timely reporting system in which revenues, expenses, assets, and liabilities will be reflected for the whole of government.
- ◆ Creation of a public sector accountants' certification and/or continuing professional development process.



9

International assistance received

PSA Reform is supported by many donors and international institutions such as the WB, EU, IMF, GIZ, and others. Since the launch of the accounting reforms in the Georgian public sector, these donors

have been providing grants or technical assistance to facilitate the IPSAS implementation process in the public sector.





Republic of **KOSOVO**



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1

Introduction

The Republic of Kosovo (RoK) is located in southeastern Europe, with a population of 1.9 million and an area of 10,887 square kilometers. It shares 702 kilometers of border with Serbia, North Macedonia,

Albania, and Montenegro. The GDP of RoK at current prices was \$8.29 billion in 2019. Real growth in 2019 was 4.94%, and GDP per capita was \$4,653.

2

Structure and functioning of the public sector

2.1 Political system, territorial, administrative, and fiscal organization

RoK is a democratic republic based on the principle of the division of power and the establishment of checks and balances. The form of government is organized into the following:

- ◆ The Assembly of the RoK exercises legislative power.
- ◆ The President of the RoK is a national representative in the country and abroad and ensures the democratic functioning of the RoK institutions.

- ◆ The Government of the RoK is responsible for the implementation of laws and government policy and is subject to parliamentary oversight.
- ◆ The judiciary is a separate and independent branch of power, which exercises authority through the courts.
- ◆ The Constitutional Court is the independent body that safeguards constitutionality and renders a final interpretation of the constitution.
- ◆ The RoK has its own institutions to protect its constitutional order, territorial integrity, and public order and safety, which operate under the constitutional authority of the RoK democratic institutions.

The interaction among these branches of power is ensured through accountability between the executive and legislative branches. The general government includes 90 budget organizations, divided into two levels:

- ◆ Central level (52 budget organizations).
- ◆ Local level (38 budget organizations for municipalities).

The Government has the power to:

- ◆ Propose and implement domestic and foreign policy.
- ◆ Enable the economic development of the country.
- ◆ Submit draft laws and other acts to Parliament.
- ◆ Issue legal acts or rules necessary to implement the law.
- ◆ Propose the RoK budget.
- ◆ Instruct and supervise the work of administrative bodies.
- ◆ Instruct the activity and development of public services.
- ◆ Propose to the President nominations for appointment and the dismissal of heads of RoK's diplomatic missions.
- ◆ Propose amendments to the Constitution.
- ◆ Refer cases to the Constitutional Court.
- ◆ Exercise other executive functions that have not been assigned to other central or local bodies.

Ministries and other executive bodies are established, as necessary, for the performance of functions within the Government. The number of Government members is determined by internal regulation.

LSG is exercised through representative bodies that are elected in general, equal, free, and direct elections through secret ballot. The activity of LSG bodies is based on the Constitution and laws of the RoK and complies with the European Charter of LSG.

The municipality is the LSG basic unit in the RoK. Municipalities enjoy a high degree of LSG and encourage the active participation of all citizens in the municipal decision-making process. The law governs the establishment of municipalities, as well as their boundaries, powers, and methods of organization

and function. Municipalities are under obligation to observe the Constitution and the laws and comply with court judgments. They may set, specify, collect, and spend their own revenues and receive funds from the central government in compliance with the law.

2.2 Ongoing PFM reforms

Under the planned PAR, RoK intends to ensure a modern PFM system in line with international standards and best practices. This will result in the efficient and effective operation of all PFM phases.

Under the joint dialogue between the Government of RoK and the European Commission during the meetings of the PAR task force, financial support was provided through sector budget support under the EU Instrument for Pre-Accession Assistance (IPA) funds. The PFM reform strategy of RoK, along with an action plan for implementation, was adopted by the Government.



Four pillars and twelve priorities have been adopted in the strategy:

1. Fiscal discipline, which includes: (i) accurate projection of macroeconomic and revenue indicators; (ii) effective commitment controls; (iii) sustainable revenue collection.
2. Allocation efficiency, which includes: (i) the development of the MTEF; (ii) annual budget execution reliability and controls; and (iii) capital budget data quality.
3. Operational efficiency, including: (i) public procurement; (ii) strengthened internal audits; and (iii) strengthened external audits.
4. PFM-related issues, which include: (i) improving IT systems; (ii) budget transparency; and (iii) sustainable PFM capacity building.

3

Budgetary system

The MTEF is a resource management tool with the goal of:

- ◆ Enhancing budget predictability through increased domestic resource mobilization, expanded integration of donor finance into the budget framework, and ensured compliance with the agreed upon priority-based allocations.
- ◆ Increasing budget sustainability by ensuring that the cost of activity implementation is achievable within the medium-term resource package.

- ◆ Ensuring that donor financing is guided toward general budget support to increase flexibility in investment allocations and other expenditures.
- ◆ Strengthening a results-oriented budget that focuses on improved service delivery.

The MTEF consists of at least three years of priority planning and the implementation of a strategic plan. It is therefore a bridge between longer-term strategic planning and the annual budget process.

It must be in line with the multiannual macroeconomic framework, which includes aggregate government expenditure and revenue estimates. The MTEF is expected to evaluate recurring and capital investment expenditures during the relevant period.

The MTEF begins with a review of the previous year's performance and an evaluation of the current mid-term budget. It accounts for all available domestic and external resources and costs as well as implementation activities, setting targets and medium-term goals. The MTEF is being implemented, after approval by the Government and



the Parliament. The development of the MTEF in RoK is required by the PFM law.

The RoK budget is inclusive of all budget organizations, which include any institution at the central or local level receiving appropriations under the budget appropriation law. Budget preparation is preceded by the MTEF, which is the main document upon which the annual budget is drafted. The main goal of the MTEF is to provide a grounded analysis of the macroeconomic environment in the country, laying the foundation for budget planning in the coming years in line with the Government's strategic priorities.

The data and documentation stated in the RoK budget is comprehensive, transparent, and in accordance with the cash GFS classification system of the IMF.

3.1 Authorities

The budgeting timeline and participating authorities are broken down in Table 3. The steps in the budgeting process are shown in Table 4.

Table 3. Budgeting timeline and participating authorities

Timeframe	Authority
January to December	In order to effectively perform their responsibilities assigned in the Law on Public Financial Management and Responsibilities (LMFPP), budgetary organizations should have in place an on-going planning, budgeting, and assessment process. Budgetary organizations should, therefore, begin the planning of their annual budgets as early as possible in the year.
15 April	The MoF develops the MTEF, including macroeconomic estimates for the following three calendar years.
30 April	MoF issues budget circulars stating budget ceilings, and annual budget cycle guidelines and time-limits.
January to 15 June	Budgetary organizations prepare their draft budgets based on the MTEF priorities, budget ceilings and their needs, in consultation with the MoF staff.
15 June	Final deadline for filing budget submissions by the budgetary organizations.
15 June – 31 October	The MoF reviews budget submissions, consults with budgetary organizations, and holds budget hearings with the budgetary organizations (July-August).
15 June – 31 October	MoF submits to heads of budgetary organizations proposed original budget appropriations.
15 June – 31 October	MoF drafts the budget message and the consolidated budget of RoK in compliance with the legal requirements.
31 October	MoF submits the draft RoK consolidated budget, the Draft Budget Appropriation Law and the updated MTEF to the Government.
31 October	The Government submits the Draft Budget Appropriation Law and the draft consolidated budget to the Parliament.
31 December	The Parliament reads and holds hearings on the Draft Budget Law and the draft consolidated budget.
31 December	The final deadline for the Parliament to pass the legislation on budget appropriations for the following fiscal year.

Table 4. Steps in the budgeting process

Step #	Necessary action
1	Develop the projections for the MTEF budget period.
2	Coordinate preliminary projection indicators, including the inflation rate and the exchange rate for the MTEF budget period.
3	Review the financial resource allocation trends and assess budget expenditures by main economic category.
4	Prepare domestic debt projections for the MTEF period.
5	Assess the resources required to service domestic and external debt during the MTEF period.
6	Assess budget-funded capital investment trends and volume for the MTEF budget period.
7	Assess tax policy and tax administration and set objectives in those areas for the MTEF period.
8	Estimate privatization proceeds.
9	Develop a salary policy review for the MTEF period.
10	Assess employment trend and the amount of public sector salaries and estimate the reform impact on the salary policy.
11	Adjust the salary fund policy to the overall resource framework in order to ensure the required financial support.
12	Develop and present the social insurance policy for the MTEF budget period.

3.2 Budget basis and approach

The budget is kept on a cash basis and the budget lines are classified in accordance with IMF standards. The budget process in RoK uses two types of budgeting: bottom-up or increasing budgeting, and top-down or resource limiting budgeting.

Budgetary organizations must prepare their budgets on the bottom-up basis but are subject to top-down budget ceilings.



4

Accounting system

Under the LMFPF, the RoK Government uses cash basis accounting. Under the cash basis, information in financial statements show cash receipts, payments, and cash flows. Cash is managed through a TSA, which is a system of bank accounts that are used for the collection of revenues and the execution of expenditures. The TSA is managed and controlled by the treasury at the MoF.

Receipts are recognized when come into government control, meaning: (i) money that has been transferred to the treasury account at the Central Bank of RoK; (ii) money in commercial bank accounts pending transfer to the treasury account; and (iii) money collected by budgetary organization officers pending transfer to the treasury account. Payments are recognized when they are paid out of the TSA.

Advance cash outflows for goods and services (e.g., petty cash and official trips) are recorded as money requests and are recognized as cash outflows. Expenses out of petty cash and official trip advances are recognized upon justification of the aforementioned money requests. Under the law, deposits (money kept in good faith) are stated at net amount for the previous year's receipts and payments.

Expenditures are categorized by economic and functional categories as provided for in the budget law based on IMF's GFSM. To that end, the term "general government" refers to central and local institutions as budgetary organizations at both levels.

4.1 Authorities

4.1.1 Standard setters/regulator

The RoK treasury has been established under the MoF and is responsible for managing the RoK consolidated fund and ensuring compliance with all the responsibilities assigned to it by the LMFPF. Through secondary legislation aligning national legal requirements with IPSAS, the treasury is the regulator of budgetary organization accounting processes.

4.1.2 Preparer of financial statements

Budget organizations (at both the central and local levels) prepare their individual financial statements on an annual basis, complying with the financial rule on budget organization annual reporting. Budget organizations prepare their financial statements for all subordinate units.

The RoK treasury prepares, and the MoF adopts, the rules on budgetary organization reporting. These rules lay down the obligations, method, and form of reporting for budgetary organizations under the organic LMFPF and accrual basis IPSAS 2017 standards (effective as of 2020). However, actual financial reporting is still based on cash accounting.

The MoF prepares and the Government approves CFS which are subject to approval and audit by the Parliament of RoK.

Local budget entities prepare reports containing accounting information according to their accounting/reporting guidelines, which are based on the IMF GFS framework and budget classification. Controlled entities present these reports to the controlling entities. Starting in 2021, IPSAS-based accounting and reporting standards will be adopted for central and local governments.

- ◆ Any arrears for every budgetary organization in which the accounting is kept on a partial accrual basis.

4.3 Integrated Financial Management Information System

The RoK financial management information system (SIMFK) is a software that enables effective budget management and is alternatively referred to as an accounting book. It has been established within and is managed by the RoK treasury.

SIMFK is an integrated budgeting and public finance execution and reporting system. It is used by about 2,000 budget organization officers at the central and local level, who access the system per their respective authorities. SIMFK also includes a single CoA that has been adopted through regulation and is kept up to date with the changes made to international accounting standards and IMF classifications. Following adoption by Parliament, the budget is recorded in SIMFK as well as in other control levels.

The current expenditure controls in RoK include: (i) budget allocations; (ii) commitments; (iii) purchase orders; (iv) acceptance of goods; (v) expenses; and (vi) certification of expenses.

Financial reporting is also performed through SIMFK. Reports are generated on: (i) inflows; (ii) outflows; (iii) financial assets; (iv) nonfinancial capital assets; (v) custodian deposits; and (vi) public debt.

4.1.3 Approver of financial statement

In the case of decentralized organizations at the local and central level, the chief finance officer of a budgetary organization will record all transactions and keep accounting books in compliance with the respective regulations. They will then submit copies of the accounting books to the MoF.

The chief finance officer and chief administrative officer of budgetary organizations must submit the following to the director general of the treasury 30 days after the end of the fiscal year:

- ◆ Unaudited financial statements of the budgetary organization for the respective fiscal year.
- ◆ A confirmation in writing that the financial statements of the budgetary organization for the fiscal year in question are a true and fair representation of their finance and financial transactions.

4.2 Accounting basis

The RoK adopted the cash basis IPSAS in 2004. In some cases, financial reports are required to include:

- ◆ A full calculation of the assets held by the budgetary organization at the end of the fiscal year.
- ◆ An estimation of all contingent liabilities, including a risk assessment in relation to those contingent liabilities.



4.4 Asset management

Currently only fixed assets are managed through SIMFK, which ensures an accrual accounting linkage within budgetary organizations at the central and local level. Unlike nonfinancial assets, financial assets lack synergy because they are held separately on a special system called “e-pasuria.” There is secondary legislation governing nonfinancial asset management, which are managed by budget organizations in the same manner as they would record and maintain accounting books.

4.5 Debt reporting

Government debt is divided into domestic and foreign debt. Domestic debt entails government debt subject to RoK laws, while foreign debt includes debt subject to agreements with: (i) foreign governments; (ii) government agencies; (iii) international financial institutions; or (iv) other organizations under agreements, treaties, or conventions subject to a legal jurisdiction outside of the RoK. SIMFK includes accounting books on debt inflows and outflows, which are then included in financial reports. A specific annex presents the overall debt level, principal amounts, accrued interest, and debt maturities.

4.6 Consolidation

Cash is managed through a TSA. The TSA is a system of bank accounts that are used for the collection of revenue and the execution of expenditures, managed and controlled by the treasury. Secondary legislation adopted by the MoF requires budgetary organizations

to report to the treasury. The treasury consolidates budgetary and financial information on the general government, primarily through an automated process in SIMFK. Out-of-SIMFK consolidation covers receivables, payables, contingent liabilities, and number of employees. In general, consolidation is done only for budget organizations and does not include SOEs, which report separately based on the IFRS.

The treasury consolidates the annual financial report, which is approved by the Government and is submitted to Parliament no later than March 31. The report is audited by the national audit office no later than August 30.

4.7 Transparency and accountability

The law on PFM requires AFS to be approved by the Government and submitted to Parliament no later than 90 days from the end of the fiscal year. CFS are published in a timely fashion upon their approval by the Government. Following approval, the AFS are submitted for audit to the national audit office. Following audit, they are subjected to approval proceedings in Parliament.

Budget organizations are required by law to submit their individual AFS to the treasury no later than 30 days from the end of the fiscal year. Following receipt by the treasury, the statements are then submitted to the national audit office, and for each unit an audit report on the statements is issued. After being audited, individual financial statements are submitted to municipal councils for approval. All audit reports are published on the national audit office website.



5

Description of the PSA reform and its implementation status

The Government of RoK is committed to achieving sound PFM while further strengthening systems, ensuring: (i) fiscal discipline; (ii) functional efficiency; and (iii) the effective allocation of public resources in RoK. Given the importance of budgetary resources on public service delivery, the enhancement of the PFM system will have an impact on all service areas and will benefit all citizens.

In the long-term (the next 10 years), the main goal is to transition to accrual accounting. The PULSAR Program has trained and certified the first group

of IPSAS trainers, who will continue to train public officials under a medium-term plan, building financial officers' professional capacities.

A detailed plan will be developed in the strategy for PFM reform, which will specify the training needs of RoK institution staff to successfully transition to accrual accounting. The strategy will also lay out the plan for budget process management reform, including: (i) strategic planning and budget preparation; (ii) budget execution; (iii) accounting and reporting; and (iv) audit and supervision.



6

Impact of PSA reform implementation on other systems

Tax authorities apply an information system that enables them to monitor their activities, which are based on the application of the single CoA. This means that their accounting classification is synchronized with SIMFK, in which budgetary organizations also record their tax receipts.

The standardization and classification under IMF standards have enabled the RoK to implement the same accounting classification for all public institutions. Some of the PFM subsystems have detailed strategies, including: (i) the strategy for public finance internal controls; (ii) the procurement strategy;

and (iii) the strategy for the integration of the tax and customs administrations into a revenue agency. The subsystem strategies are being implemented. Given their significance for the entire PFM system, portions of these strategies are included in the strategy for PFM reform.



7

Challenges and lessons learned of the PSA reform implementation

No specific challenges or lessons learned have been identified so far, since the transition to accrual basis IPSAS has not started as yet.

8

Next steps in the PSA reform implementation

The next steps of the ongoing reforms include:

- ◆ Amending legislation and rules to enable the transition from cash accounting to accrual accounting.
- ◆ Training professional staff who will advance the reforms.
- ◆ Establishing SIMFK and a CoA that would implement accrual accounting principles and enable budget preparation, execution, and reporting.
- ◆ Training and certifying budget organization finance officers in IPSAS.

9

International assistance received

The PULSAR project has ensured that a RoK treasury team is being trained to enable PFM reforms. So far, the first group of IPSAS trainers have been certified.

The IMF and the SECO have also assisted the RoK treasury with the development of IMF standards-based reporting and the publication of GFS data.





Republic of
MOLDOVA



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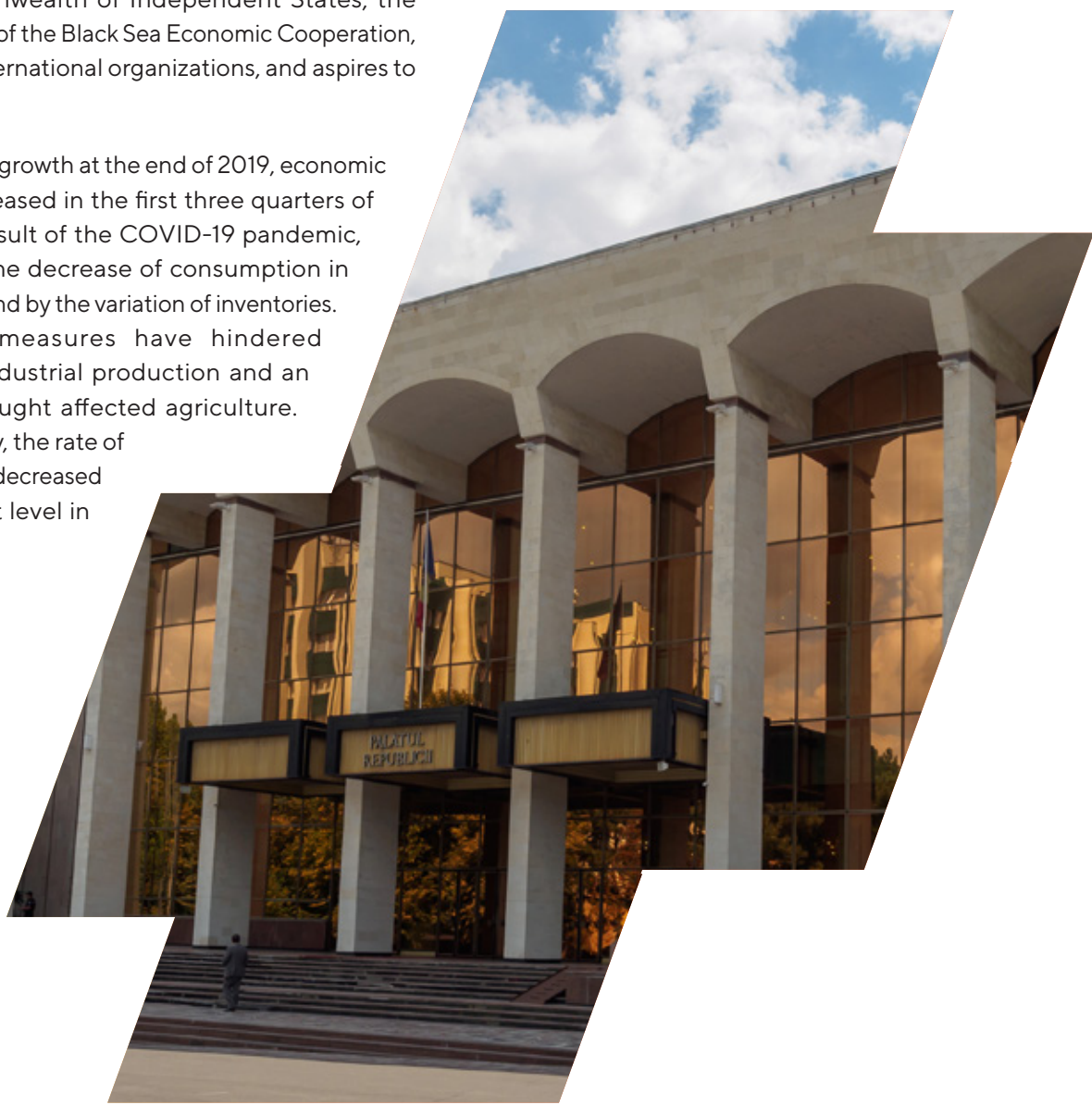
Introduction

The Republic of Moldova (RoM) is located in Eastern Europe, bordered by Romania and Ukraine. As of 2020 its population was 2.6 million, and its GDP was \$8.8 billion.

The RoM is a parliamentary republic with a President as head of state and a Prime Minister as head of Government. It is a member of the United Nations, Council of Europe, Partnership for Peace, World Trade Organization, Organization for Security and Co-operation in Europe, the GUAM Organization for Democracy and Economic Development, the Commonwealth of Independent States, the Organization of the Black Sea Economic Cooperation, and other international organizations, and aspires to join the EU.

After modest growth at the end of 2019, economic activity decreased in the first three quarters of 2020 as a result of the COVID-19 pandemic, marked by the decrease of consumption in households and by the variation of inventories. Lockdown measures have hindered trade and industrial production and an extreme drought affected agriculture. Subsequently, the rate of employment decreased to the lowest level in five years.

Public expenditure increased as authorities introduced measures to mitigate the pandemic, with social expenditures given priority. After the end of the lockdown the economy started to gradually recover, but most short-term indicators have remained negative.



2

Structure and functioning of the public sector

2.1 Political system, territorial, administrative, and fiscal organization

The RoM is a parliamentary state. Parliament has a single chamber, composed of 101 members elected on lists for a period of four years. The President is elected by the people in two rounds of elections. The institutions empowered to exercise state authority are:

- ◆ Parliament, as the political-legal institution exercising legislative authority.³²
- ◆ The Heads of State and Government, empowered to exercise executive authority.³³

The territory of the RoM is organized into administrative-territorial units of districts, cities, and villages. Local sectors are developed based on a framework status approved by Parliament and are approved by local councils. The administrative-territorial organization of the RoM is set on two levels:

- ◆ 902 villages (communes), sectors, and cities (municipalities).
- ◆ 32 districts of the Chisinau and Balti municipalities.

Thus, the RoM is divided into 32 districts, 5 municipalities and 2 regions with a special status. Villages form regional districts, and as such they represent first level budgets while districts represent second level budgets.

The national public budget is comprised of: (i) state budgets; (ii) state social insurance budgets; (iii) mandatory medical insurance funds; and (iv) local budgets.

The state budget, the state social insurance budget and the mandatory medical insurance funds form the central consolidated budget. Local budgets are comprised of budgets from the first level (902 mayor's offices representing villages and municipalities, with the exception of the municipalities of Chisinau and Balti) and of the second level (32 district budgets, the central budget of the autonomous territorial unit of Gagauzia, and the municipal budgets of Balti and Chisinau), which jointly form the local consolidated budget.

In the RoM, the state also exercises its functions through self-managed public institutions, state owned and municipal enterprises, and joint-stock companies for which the founders and shareholders are central or local public authorities.

Funding of activities is also performed through subsidies and allocations for the performance of state orders within the limits of budgetary allocations provided in the annual budget law. Such financial funds are managed through the single treasury account.

Vocational and higher education institutions are legal entities, which manage allocations received from the state budget according to the plan (state order) for the training of specialized staff by area of expertise, approved each year by the Government. They also receive income from the following sources:

- ◆ The rendering of services or production.
- ◆ The sale of didactic, scientific, and artistic literature, methodical papers, textbooks, and syllabi.
- ◆ Tuition fees, including from abroad, for studies, further professional training, and professional requalification on a contract basis.

³² Article 60 of the Constitution.

³³ Articles 84-88, 96, and 104-108 of the Constitution.

- ◆ Payments for the lease of premises, construction, or equipment.
- ◆ Donations, including those received from international collaboration.
- ◆ Other legal sources.

Public medical-sanitary institutions enjoy all the rights given by their legal status. They manage financial funds received from components of the national public budget through the TSA. Other financial resources are managed through their own bank accounts, including foreign currency accounts. They perform non-commercial activities according to self-financing, non-profit principles, in accordance with existing legislation.

Local budgets are managed by local executive authorities. Relations between the state and local budgets are realized through general and special destination transfers.

Spending units may take, on a contract basis, loans which are due and payable in the same budgetary year from the national public budget or from financial institutions for the purpose of covering temporary cash discrepancies.

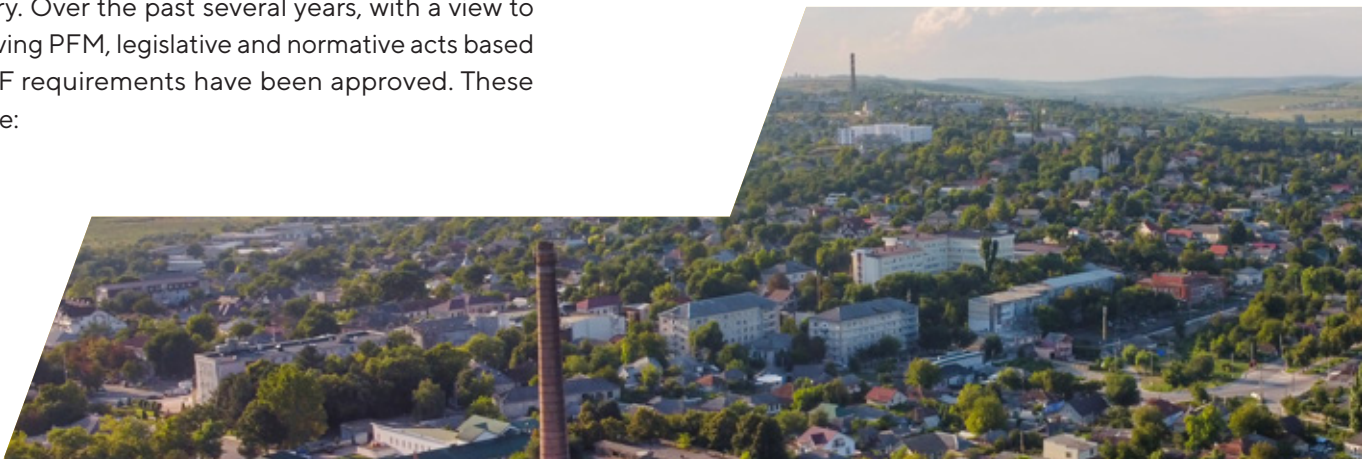
- ◆ The law on public finance and fiscal accountability.
- ◆ Budgetary classifications.
- ◆ Methodological norms on the cash execution of budgets, used for components of the national public budget and of extra budgetary funds through the treasury system of the MoF.
- ◆ A single CoA and the methodological norms on accounting and financial reporting in the budgetary system.
- ◆ The structure of the half-year report on the execution of the national public budget and its components, as well as the composition and format of reporting forms.
- ◆ The development of the PFMS, an integrated system which manages all the processes of budget planning, approval, execution, financial reporting, and the accounting of operations.
- ◆ The amendment of the public procurement system.
- ◆ The establishment of a system of financial management, internal controls, and internal audits in the public sector according to international best practices.

These reforms were supported by the MoF project “PFM,” funded by the World Bank.

2.2 Ongoing PFM reforms

The RoM is in the process of reforming its budgetary system, including the improvement of PFM systems, accounting, and financial reporting.

The purpose of this reform is to strengthen the efficiency and transparency of PFM systems in the country. Over the past several years, with a view to improving PFM, legislative and normative acts based on IMF requirements have been approved. These include:



3

Budgetary system

3.1 Authorities

In accordance with the provisions of the law on public finance and fiscal accountability, roles, and responsibilities in the sphere of public finance are distributed as follows:

- ◆ Parliament approves: (i) the annual budget laws; (ii) laws on the clarification of budgets; and (iii) annual reports on the execution of the state budget, state social insurance budgets and mandatory medical insurance funds.
- ◆ The Government: (i) approves the medium-term budgetary framework; (ii) approves and presents to Parliament the draft annual budget laws and the draft laws on the clarification of budgets; and (iii) presents to Parliament reports on the execution of the national public budget and its components.
- ◆ The MoF: (i) develops the medium-term budgetary framework, the draft annual budget laws, and the draft laws on the clarification of the state budget; (ii) examines the draft annual laws on state social insurance budgets, mandatory medical insurance funds, and the summaries of the draft local budgets; and (iii) ensures the execution of budgets through the treasury system and reports on the execution of the state and national budgets.
- ◆ The Ministry of Health, Labor and Social Protection ensures the development of the laws of the state social insurance budgets and mandatory medical insurance funds and reports on their execution.
- ◆ Budgetary entities and institutions ensure the presentation of budget proposals to the MoF and report on programs in accordance with approved tax and performance indicators.

3.2 Budget basis and approach

Components of the national public budget are developed on a cash basis. In accordance with the law, budgets are developed, approved, and reported on through results-based programs, according to budgetary classifications.

Budgetary classifications include: (i) organizational; (ii) functional; (iii) economic; and (iv) classifications of programs and sources. Performance indicators are a part of the budgetary entities' strategies and are approved within the process of budget proposal development.



4

Accounting system

4.1 Authorities

4.1.1 Standard setters/regulator

The MoF is the central specialized entity of public administration that develops and promotes the single policy of public finance and the application of financial levers in accordance with economic requirements. In its activity, the MoF is guided by the Constitution and laws of the RoM, decrees of the President, decisions of Parliament, and rulings, decisions, and resolutions of the Government.

The MoF is also responsible for the realization of the budgetary process, as well as for the development of the necessary methodological framework for its implementation. One of the main prerogatives of the MoF is the creation of a regulatory framework for accounting in the budgetary and corporate sectors, which will ensure the continuous development of accounting rules and norms and the realization of a better financial reporting process.

4.1.2 Preparer of financial statements

The accounting departments organized within budgetary entities and institutions prepare and present financial statements within the established timeframes. The manager of the budgetary institution ensures the preparation and presentation of financial statements in accordance with the requirements of the MoF, as well as other reports and statements provided by other public authorities.

The centralized accounting departments organized under the mayor's office at the municipal level manage the accounting of local budgets and subsidiary

institutions. The mayor and chief accountant of the centralized accounting department manage the accounting and control of income collection, execution of the budgets of institutions maintained from the local budget, and the preparation of budget execution reports.

4.1.3 Approver of financial statement

The managers of public institutions and other spending units prepare and present financial statements to the central specialized public administration entities, as well as to authorities of the local public administrations.

The central specialized public administration entities, the authorities of local public administrations, and the autonomous institutions prepare and present to the MoF financial statements in accordance with the approved standards. Annual reports on the execution of local budgets for the closed budgetary year are prepared by the local executive authorities and approved by the local councils within the time frame provided by the budgetary calendar.

The MoF establishes the time frame for the presentation of financial reports to the central public authorities, finance directorates of the administrative territorial units, the national social insurance agency, and the national medical insurance company. The MoF also publishes annually, on their official website, the CFS of the central government.

Annual reports on the execution of the state budget, state social insurance budget, and mandatory medical insurance funds are presented to the Government and then to Parliament for approval, after their examination by the court of accounts.

4.2 Accounting basis

Budget revenues are accounted for through the treasury system on a cash basis. The accounting of budgetary revenues and payments through the treasury system is ensured through treasury accounts based on budgetary classifications and the CoA.

The collection of income and other revenue approved in components of the national public budget is ensured by revenue managers and established by normative documents instituting such revenues. In the process of budget execution, budgetary institutions make payments within the limits of approved budgetary allocations and in accordance with liquidity forecasts.

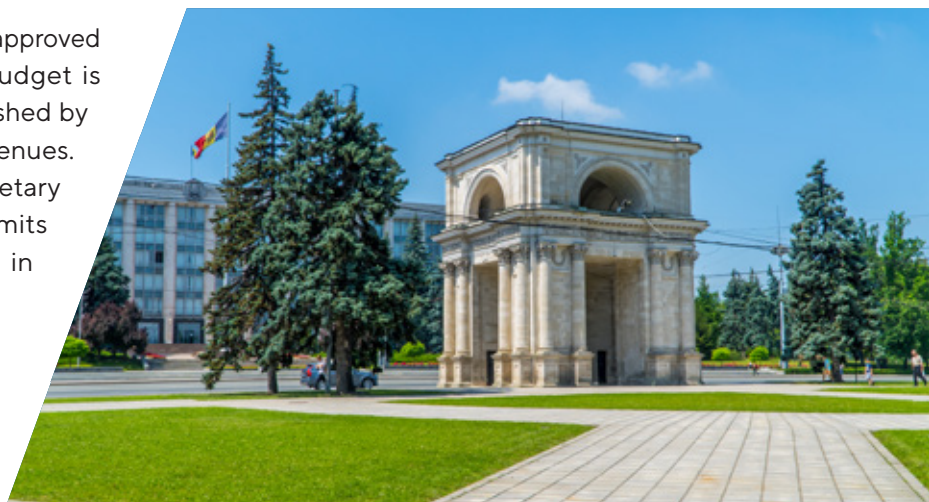
The state treasury and the regional treasuries of the MoF ensure the accounting of the cash execution of the national budget. Budgetary incomes are accounted for at the moment of their receipt in the current accounts. Budgetary expenditures are accounted for at the moment of payment from the current accounts. Operations with non-financial assets, financial assets, and debt are accounted for at the moment of receipt or payment.

The accounting of effective revenues and expenses of budgetary institutions, financial and non-financial assets, debts, and results is performed according to the accrual method.

4.3 Integrated Financial Management Information System

The public institution “Centre of informational technologies in finances” (CITF), integrated with the PFMIS and implemented at the beginning of 2016, ensures the development, approval, execution, and reporting of the budgets. This informational system has been created with the support of the PFM project funded by the World Bank. Authorized users of this informational system are the MoF, central public authorities, local public authorities at the first and second level, and budgetary institutions.

For the purpose of improving accounting and financial reporting, the MoF in collaboration with CITF examines the possibility of developing, testing, piloting, and implementing new unified accounting informational systems which could be subsequently integrated with the PFMIS.



4.4 Asset management

In the RoM, the records of public property are kept in the public property register. The agency of public property, based on its authority provided by law, exercises the function of public property registrar. Public authorities present to the agency of public property annually, before April 15th, the reports on public property and the ways and results of its use as of the start of each year.

The agency of public property:

- ◆ Ensures the processing of information from the presented reports and makes corresponding entries in the public property register, according to the rules for its keeping.
- ◆ Presents to the Government, before May 1st of each year, information on public administration authorities that have not presented within the established term reports on their managed public property.
- ◆ Presents to the Government, before June 15th, the annual balance of public property as of the beginning of each year.

State owned and municipal enterprises, commercial companies with public or public-private stock, and companies that directly hold state public property for economic management present to the central or local authorized authorities AFS and data on their public property and the ways and results of its use.

4.5 Debt reporting

Public sector debt includes: (i) the totality of the state debt; (ii) debt of the administrative territorial units; (iii) debt of the National Bank of Moldova; (iv) debt resulting from internal and foreign loans of state owned and municipal enterprises; and (v) debt from commercial companies with full or majoritarian public capital.

State debt includes: (i) current and due pecuniary contractual obligations of the state; and (ii) unpaid interest arising from the status of debtors or guarantors of the state, which have been contracted on behalf of the RoM by the Government through the MoF.

The Government, represented by the MoF, is authorized to:

- ◆ Take internal and foreign state loans, in national or any foreign currency.
- ◆ Issue internal and foreign state guarantees expressed in national or any foreign currency.
- ◆ Issue state securities for placement on the internal and foreign market.

Foreign state loan contracts and decisions on the issuing of state guarantees are approved by Parliament.

With regard to all direct and conditional liabilities of the RoM, including funds obtained from internal or foreign state loans, the MoF is the only authorized entity which may prepare the following reports:

- ◆ The report on state debt.
- ◆ The report on state guarantees.
- ◆ The report on lending.

State owned and municipal enterprises and commercial companies with full or majoritarian public capital are responsible for the management of debt contracted on their own behalf. The administrative territorial units are responsible for the management of the debt contracted on their own behalf and of issued guarantees.

Financial instruments regulated by the laws of the RoM are used as public sector debt generating instruments. This includes financial instruments applicable to international financial markets, including loans and financial leases, securities, deposits, allocations of special drawing rights, and guarantees.

Spending units may take, on a contract basis, loans from financial institutions to cover temporary cash discrepancies. These loans become due and payable in the same budgetary year.

4.6 Consolidation

In the RoM, the consolidation of budgetary reports, as well as of financial statements of the budgetary entities and institutions, is conducted from the bottom up.

The report on state budget execution is prepared in the informational system by generalizing all the entities and institutions funded from the state budget and excluding transfers between them from revenues and expenditures.

The report on local budget execution is also prepared by generalizing reports at a district level with the exclusion of transfers and loans inside and between districts.

The report on the execution of the national public budget, comprised of the state budget, state social insurance budget, mandatory medical insurance funds, and local budgets, is prepared manually. At this level, transfers and loans between the budgets are consolidated.

According to the normative framework, authorities and institutions prepare and present financial statements to the specialized central entities of public administration and to local public administration authorities, in accordance with the time frame established by the latter. The specialized central entities of public administration, the local public administration authorities, and the autonomous public institutions prepare and present to the MoF CFS according to approved norms and in accordance with the set timeframe. Reports are transmitted through the informational system using a separate module.

If a budgetary institution transfers funds or transmits assets to other budgetary institutions subordinate to the same ministry, the ministry, when preparing the consolidated statement, excludes such amounts manually for both revenues and expenditures. If budgetary institutions are subordinate to different ministries, consolidation is conducted by the MoF during the preparation of the consolidated report on the state budget.

Local public authorities and budgetary institutions funded from second level budgets present their financial statements to the district finance directorate using the same module as above. The finance directorates prepare CFS by manually excluding transfers, loans, and assets transmitted among themselves. These statements are presented to the MoF, which prepares the consolidated financial statement of the local budget.

4.7 Transparency and accountability

The MoF, national social insurance agency, and national medical insurance company publish on their official websites reports on state budget execution, the execution of the state social insurance budget, and the execution of mandatory medical insurance funds. After approval by Parliament, those reports are published in the official gazette.

According to the provisions of the normative framework (the methodological norms on accounting and financial reporting), the ministries, national social insurance agency, national medical insurance company, and the second level local public authorities must have an internal audit subdivision. The same normative framework provides that at least once every three years the internal audit subdivision should audit the high-risk domains, including the financial-accounting processes. Currently there is no specific provision on the obligation to perform the internal audit of financial statements. For 2019, the internal audit subdivisions (51 in total) reported on 26 financial audit missions performed by both the central and local governments.

The court of accounts is the SAI of the RoM, controlling the formation, management, and use of public financial resources and public property by conducting an external public audit according to international standards.

The court of account annually performs the financial audit of:

- ◆ The Government's report on state budget execution in the closed budgetary year.
- ◆ The Government's report on the execution of the state social insurance budget in the closed budgetary year.
- ◆ The Government's report on the execution of medical insurance funds in the closed budgetary year.
- ◆ Ministry reports on the budget execution in the closed budgetary year.

These reports are published on the official website of the court of account and in the official gazette.

5

Description of the PSA reform and its implementation status

One of the key elements of PFM reform in the RoM is the alignment of PSA and financial reporting to IPSAS. The improvement of the PSA system is one of the objectives proposed in the PFM development strategy of 2013-2020. This activity was also included in the reform policy matrix as one of the conditions for the improvement of financial controls and reporting based on the financing agreement between the Government of the RoM and the European Commission.

To evaluate the performance of these reforms, in December of 2015 the MoF created a council for national PSA standards – a consultative entity to ensure the development of these standards.

The MoF established that national public sector accounting standards (NPSAS) shall be developed based on IPSAS and implemented in the RoM (using an IPSAS indirect approach), which will take into consideration the specific features of the country and its promoted fiscal policies, and promptly react to changes.

The choice of accounting method is a fundamental issue in the reform of the accounting and reporting system. Accounting and reporting in the budgetary system are performed based on the accrual method with the use of some elements of the cash method. In the treasury system, accounting is performed on a cash basis. In the budgetary entities and institutions, it is performed on an accrual basis. The MoF plans to continue to use the cash method to ensure that the execution of the budgetary process is also applied in the RoM.

The NPSAS will be based on the modified accrual method, except for the recording of some revenues and expenditures which will be kept on a cash basis. These include: (i) tax and customs revenues of the budget; (ii) state social insurance contributions and mandatory medical insurance premiums; and (iii) inter-budgetary transfers. The record of those accounting elements on a cash basis is the most reasonable way to measure such economic operations in the medium term. The NPSAS will cover the budgetary entities and institutions funded from the national public budget.

The overall reform objectives are:

- ◆ The development and approval of the relevant normative framework.
- ◆ The update of the integrated PSA informational system.
- ◆ The strengthening of the capacity for NPSAS implementation.

Identified risks that may affect the implementation of reforms include:

- ◆ Insufficient knowledge of IPSAS application within the MoF.
- ◆ The political risk of non-approval of the normative framework.
- ◆ Delays in the development of the CoA.
- ◆ Delays in the development of the IFMIS.
- ◆ Insufficient capacity to develop PSA methodology.
- ◆ A large number of accountants in the budgetary entities and institutions in need of training.

- ◆ A lack of necessary foreign support for the development of the institutional capacities of the MoF.

30 draft standards had to be developed and approved between 2017-2019. With technical assistance from the EU, 22 of these draft standards were developed between 2017-2018, aligned to IPSAS, and published on the official website of the MoF. These standards are:

1. Presentation of financial statements.
2. Cash flow statements.
3. Accounting policies, changes in accounting estimates, and errors.
4. Borrowing costs.
5. Construction contracts.
6. Inventories.
7. Leases.
8. Property, plants, and equipment.
9. Provisions, contingent liabilities, and contingent assets.
10. Intangible assets.
11. The effects of changes in foreign exchange rates.
12. Revenue from exchange transactions.
13. Events after the reporting date.
14. Investment property.
15. Impairment of non-cash generating assets.
16. Revenue from non-exchange transactions (taxes and transfers).
17. Presentation of budget information in financial statements.
18. Employee benefits.
19. Impairment of cash-generating assets.
20. Agriculture.
21. Financial instruments.
22. Service concession arrangements.

All standards must be further developed, and their approval and implementation will take place gradually in accordance with established priorities, ensuring the development of related informational systems and the training of accountants in the public sector.



6

Impact of PSA reform implementation on other systems

The approval and enforcement of the law on public finance and fiscal accountability no. 181 of July 25, 2014 marked a major step in the promotion, modernization, and strengthening the national PFM system.

The CoA in the budgetary system has been developed in accordance with IMF standards and integrated with the economic budgetary classifications. The PFMIS has been developed, which ensures the formalization of the budget development process and execution and increases the speed and efficiency of transactions.

PSA reform has had an impact on the main directorate of internal public financial control, the subdivision responsible for policies in the field of internal controls and audits, which are perceived as adjacent to the key processes of PFM within the government. The

new strategic development directions specially focus on the integration of internal controls in the processes relating to accounting, budgets, finances, and assets. It will be necessary to revise the approach and managerial attitude on internal controls, as well as the attitude of the internal auditors on the importance of evaluating these processes.

A modern public procurement system has been established in accordance with EU standards.



7

Challenges and lessons learned of the PSA reform implementation

The state treasury directorate, which has the task of developing NPSAS, is facing several challenges:

- ◆ A lack of qualified personnel in the given domain.
- ◆ The ongoing performance of daily tasks, which considerably diminishes the time spent in the development of NPSAS.
- ◆ A lack of technical assistance.
- ◆ A change of the work regime because of the COVID -19 pandemic.
- ◆ A lack of staff training in the application of IPSAS.

Because of the aforementioned challenges and the lack of a foreign technical assistance project, the following eight NPSAS have not been yet developed:

1. Reporting by segments.
2. Presentation of information on related parties.
3. Disclosure of financial information on PSA.
4. Separate financial statements.
5. Consolidated financial statements.
6. Investments in associations and joint ventures.
7. Joint arrangements.
8. Disclosure of interests in other entities.

Problems relating to the low quality and inefficient training of professionals in the accounting field may be solved by the training of trainers with the contribution and support of foreign experts.



8

Next steps in the PSA reform implementation

Accounting and reporting are component parts of the budgetary process, analogous to the budget development, approval, and execution. All the components of the budgetary process are realized through the PFMIS, while accounting in individual budgetary entities and institutions is ensured through various informational systems purchased on a contract basis. To improve financial reporting in the budgetary system as well as alignment with IPSAS, it will be necessary to change the accounting system for budgetary entities and institutions.

A full and coherent accounting system will be needed to support budgetary and financial reporting and to ensure transparency, as well as to provide reliable information for managerial decision making. As such, all budgetary entities and institutions should ensure proper accounting and financial reporting with the mandatory use of the informational systems of the MoF.

The MoF, jointly with the CITF, shall examine the possibility of the creation of a unified budget accounting informational system based on the 1C platform, with unified requirements and rules, which could subsequently be integrated with the PFMIS.

Only after the implementation of this system in all budgetary entities and institutions will the implementation of NPSAS be possible. The CITF is responsible for the maintenance and adjustment of the informational system to changes of the normative framework, including the NPSAS rules.



9

International assistance received

With technical assistance offered by the EU, 22 out of 30 planned standards were developed in 2017-2018

in alignment with IPSAS. These were published on the official website of the MoF.





MONTENEGRO



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1

Introduction

Montenegro is located in southeastern Europe and covers 13,812 square kilometers. It borders Croatia to the west, BiH to the north, Serbia to the east, Albania to the south, and it is separated from Italy by the Adriatic Sea. According to the last census in 2011, there are 620,029 inhabitants in Montenegro.

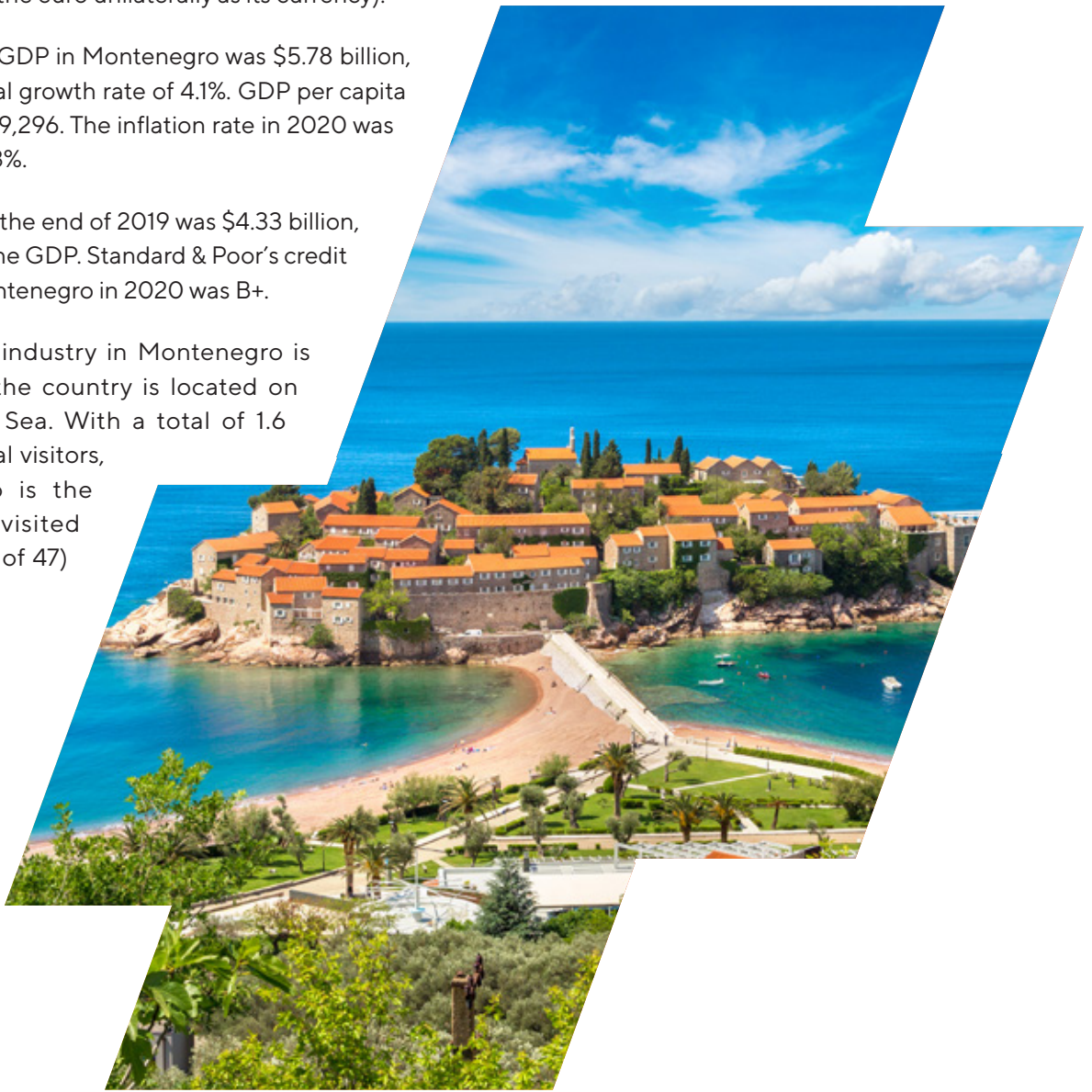
Montenegro is administratively divided into the capital city of Podgorica, the old royal capital Cetinje, and 24 municipalities. Since 2002, the currency used in Montenegro has been the euro (the Central Bank of Montenegro is not part of the euro system, but the country uses the euro unilaterally as its currency).

In 2019, the GDP in Montenegro was \$5.78 billion, with an annual growth rate of 4.1%. GDP per capita in 2019 was \$9,296. The inflation rate in 2020 was negative 0.03%.

State debt at the end of 2019 was \$4.33 billion, or 74.91% of the GDP. Standard & Poor's credit rating for Montenegro in 2020 was B+.

The leading industry in Montenegro is tourism, as the country is located on the Adriatic Sea. With a total of 1.6 million annual visitors, Montenegro is the 36th most visited country (out of 47) in Europe.

Montenegro is a member of the United Nations, the North Atlantic Treaty Organization, the World Trade Organization, the Organization for Security and Co-operation in Europe, the Council of Europe, and the Central European Free Trade Agreement. It is also a founding member of the Union for the Mediterranean and is in the process of joining the EU.



2

Structure and functioning of the public sector

2.1 Political system, territorial, administrative, and fiscal organization

Montenegro is an independent and sovereign state, with a republican form of government. It is a parliamentary democracy founded on the rule of law.

Power is governed by the principle of division of power into legislative, executive, and judicial branches. Legislative power is exercised by the Parliament, executive power by the Government, and judiciary power by the courts. Power is limited by the Constitution and the law and is based on balance and mutual control.

The tasks of state administration are performed by ministries and other administrative bodies. LSG is exercised in the municipalities, the municipality within the Capital, the Old Royal Capital (hereinafter: Municipality), and in LSG units.

The Municipality is independent in performing LSG activities and its rights cannot be denied or limited by acts of state bodies, except in cases determined by law, in accordance with the Constitution. Relations between municipal bodies, state bodies and state administration bodies are based on the principle of mutual cooperation, in accordance with the law. The union of municipalities of Montenegro is a national association of local authorities.

The Municipality is financed from: (i) independent revenue; (ii) revenues assigned by law; (iii) the equalization fund; and (iv) the state budget. It has the right to raise local taxes, which are under its jurisdiction.

Municipalities can take long-term loans and provide guarantees with the prior consent of the Government,

which is given at the proposal of the MoF. Companies and legal entities that are majority owned by the state or municipality can borrow on a long-term basis with the prior consent of the Government.

2.2 Ongoing PFM reforms

Ongoing PFM reforms include:

- ◆ Budgeting (improvement of medium-term planning, creation of an efficient system for measuring the impact of budget programs, improvement of models for macroeconomic projections).
- ◆ Budget execution (improvement of the revenue collection systems at the tax and customs administrations).
- ◆ Public procurement (implementation of an electronic public procurement system).
- ◆ Debt management (upgrade of the system with some new functionalities in the domain of control and reporting).
- ◆ Payroll (implementation of new software for the centralized calculation and control of payrolls in public sector).
- ◆ The development of internal financial controls in the public sector (strengthening management responsibilities at all organizational levels).
- ◆ A transition from cash to accrual accounting in the public sector.
- ◆ Strengthening the state audit institution and the audit authority (strengthening the human capacity of external audits and the body established to audit the management and control system of EU funds).

3

Budgetary system

State budget planning is based on economic and fiscal policy, fiscal policy guidelines, economic growth projections, and macroeconomic stability projections. Budget planning and execution is done in accordance with the following criteria:

- ◆ The general government budget cash deficit will not exceed 3% of GDP at market prices.
- ◆ Public debt will not exceed 60% of GDP at market prices.



The main strategic document is the fiscal strategy adopted by the Government at the beginning of its mandate. This document sets out the main fiscal targets to be achieved in the medium term and provides the basis for planning medium-term and annual policies. Based on the fiscal strategy, the Government, at the proposal of the MoF and social welfare, adopts fiscal policy guidelines by the end of March.³⁴ The guidelines are adopted annually for a period of three years, and contain: (i) medium-term

strategic goals of economic and fiscal policy; (ii) basic macroeconomic and fiscal indicators and projections; and (iii) spending thresholds.

Based on the fiscal policy guidelines, in May of the current fiscal year the MoF issues expert instructions for the preparation of the budget for spending units and the LSG budgets for the next fiscal year. Pursuant to these fiscal policy guidelines and submitted requests, the MoF proposes expenditures for spending units and, if there is a deficit, determines the sources of funds for its financing.

The budget contains the current budget, financing transactions, capital budget, state fund budgets and budget reserves (current and permanent). It shows expenditures and receipts by the sources from which they originate.

3.1 Authorities

The MoF and social welfare prepare the draft law on the state budget and submit it to the Government in October. The draft law on the state budget is determined by the Government and submitted to the Parliament by November 15. If the law on the state budget is not passed by December 31 of the current year, for the next fiscal year the MoF, until its adoption, approves funds for spending units up to one-twelfth of actual expenditures from the previous fiscal year.

The state treasury department oversees budget execution, based on payment requests submitted by budget spending units. Spending units are obliged to use the funds within the limits determined by the

³⁴ The social welfare office is the legal successor of the MoF.

law on the state budget. The budget executor is responsible for the legal use of funds approved to the spending unit. The budget execution system is centralized, and as such the treasury is responsible for the execution of the state budget as a whole. Spending units are also responsible for the execution of their own budgets. The state treasury manages the main treasury account, and budget spending units submit requests for payment from the main account.

3.2 Budget basis and approach

The budget of Montenegro is planned on a cash basis according to economic, functional, program and organizational classifications.

The law on the state budget contains a general and a special part. The general part contains:

- ◆ An estimate of current receipts, expenditures, transfers, and the primary budget cash surplus.
- ◆ An estimate of receipts and expenditures expressed according to economic classification.
- ◆ The normative part of the budget which regulates its execution in detail.
- ◆ The use of budget cash surplus and deficit coverage.
- ◆ The current and permanent budget reserve.

The special part contains expenditures of consumer units by organizational, functional, economic, program, and project classifications.

The estimate of receipts and expenditures expressed by economic classification, as well as the special part of the budget, contain the maximum level of budget spending that is binding on the state budget for the first year and indicative for the second and the third years.

4

Accounting system

4.1 Authorities

4.1.1 Standard setters/regulator

Accounting of public sector entities is prescribed by the MoF. By-laws regulate the CoA and the accounting method, as well as financial reporting.

The law on PSA was adopted on November 22, 2019, and its implementation is planned as of January 1, 2022. Its provisions shall apply until its

implementation, which include accounting and financial reporting as well as by-laws adopted on the basis of the law on budget and fiscal responsibility, which regulates accounting and financial reporting.

4.1.2 Preparer of financial statements

Budget spending units at the central level prepare and submit their financial statements to the MoF and social welfare, which, based on the submitted

reports, prepares the draft law on the final account of the budget of Montenegro and submits it to the Government for adoption. After the Government adopts it, the draft law is submitted to Parliament in the form of a bill, which is adopted as law.

At the local level, the bill of the final account of the municipal budget is determined by the mayor and submitted to the municipal assembly, which then adopts the final account of the municipality. The final account is submitted to the MoF and social welfare for review.

4.1.3 Approver of financial statement

At the central level the law on the final account of Montenegro is adopted by Parliament, while local level final accounts are adopted by the municipal assemblies.

4.2 Accounting basis

Accounting of the budget of Montenegro and of LSG units is based on a modified cash basis, which means that in addition to cash records of receipts and expenditures, records of assets and liabilities are kept. Planning is done by class, category, group, and synthetics, while budget execution is expressed to the level of analytics and sub-analytics, i.e., economic classification. The state of assets and liabilities is expressed by class, category, group, and synthetics.

The state of assets and liabilities can be monitored by analysis and sub-analysis according to the needs of the budget of Montenegro and the municipalities.

4.3 Integrated Financial Management Information System

The FMIS is different at the level of the state budget and at the level of local governments, with no interface between the two. At the central level, it consists of several components:

- ◆ An information system for payroll calculation, which is partly centralized. The full centralization of the system of payroll accounting and its integration with other parts of the FMIS is ongoing.
- ◆ A budget planning information system, which also has an ongoing project to integrate with other components of the FMIS.
- ◆ The accounting information system of the state treasury, which is based on the SAP software solution, and which integrates modules for budget execution, public debt management, and revenue related to information systems of revenue collection institutions (tax administration, customs administration, and the Ministry of Interior).
- ◆ A public procurement information system. The software that is used is the public procurement portal, which enables e-notifications and the electronic publication of tender documents (which contain an invitation to tender) as well as the publication of all other public procurement notices required by law. These include: (i) public procurement plans; (ii) decisions on the selection of the most advantageous bid; (iii)



decisions on the suspension or annulment of the public procurement procedure; and (iv) public procurement contracts. The implementation of the electronic public procurement system in Montenegro is ongoing.

- ◆ The state property register.

4.4 Asset management

The single register of state assets and property in Montenegro for all levels of government are kept by the directorate for cadaster and state property. Because PSA reforms are underway, the state property register is expected to be connected to the accounting information system for accrual basis accounting.

4.5 Debt reporting

Pursuant to the provisions of the law on budget and fiscal responsibility, the MoF manages government and public debt and keeps records of government debt, long-term and short-term loans taken, and issued guarantees.

The MoF prepares and publishes the public debt report by March 31 for the previous fiscal year, while the report on government debt is published quarterly during the year reported.

The public debt report contains information on:

- ◆ Debt balances, trends, and changes in the state of public debt of Montenegro in absolute amounts and as a GDP ratio.
- ◆ The amount of deposits, in an absolute amount and as GDP ratio.
- ◆ The currency and interest rate structure of debt.
- ◆ The ratio of foreign and domestic debt.
- ◆ Concluded arrangements and the balance of undrawn funds under credit arrangements.
- ◆ The debt repayment structure to residents and non-residents.
- ◆ The structure and movement of local government debt.
- ◆ The structure and movement of debt based on issued state guarantees.

The government debt report contains information on:

- ◆ The amount and movement of government debt, in absolute amounts and in relation to GDP.
- ◆ Deposits in absolute amounts and in relation to GDP.
- ◆ The currency and interest rate structure of debt.
- ◆ The ratio of foreign and domestic debt.
- ◆ The debt repayment structure to residents and non-residents.
- ◆ Concluded arrangements in the reporting period.

4.6 Consolidation

The MoF and social welfare, according to the law on the final account of the budget of Montenegro, prepare and publish the consolidated report on public revenues and expenditures, which consolidates the central and local levels of government. SOEs are not included, and consolidation is carried out manually.



4.7 Transparency and accountability

The proposed law on the final account of the budget of Montenegro is available on the websites of the MoF, social welfare, and the Government of Montenegro as of the day of its adoption at Government session. Once adopted in the Parliament, the law is published in the “Official Gazette of Montenegro.” External

audits of the financial statements of Montenegro and of the draft law on the final account of the budget are performed independently by the state audit institution. The audits of the proposed final accounts of municipalities are done by independent auditors. Internal audits are conducted by internal audit units that are established in municipalities and spending units of the budget of Montenegro, in accordance with the law on management and internal control in the public sector.

5

Description of the PSA reform and its implementation status

In March of 2015, the Government of Montenegro adopted the strategy for the transition to accrual accounting in public sector. The strategy defines three key directions of the reform:

1. Staff training.
2. Development of legislation.
3. Development of information systems.

In 2016, in cooperation with the Center of Excellence in Finance, and using CIPFA’s methodology, the MoF began a training and certification efforts for public sector accountants to begin implementing IPSAS. From 2016-2020 three training cycles were organized, with the participation of 120 accountants.

In 2015, the MoF established a working group, which continued its work in the coming years, focused on issues relevant to the localization of the project (e.g., project implementation with domestic resources), so

that the human resources management authority can continue this training in the future. The task of the working group is to create a proposal of institutional responsibilities and legislation related to the localized training of accountants.

In addition to training on the application of standards, the MoF also organized workshops and a conference dedicated to the benefits and challenges of PSA reform.

Based on the strategy for the transition to accrual accounting, the Government has adopted an implementation action plan, which defines activities identified by the strategy in more detail and sets the time frame for their implementation.

One of the key activities identified in the action plan was the adoption of the law on PSA, prepared by the MoF and adopted by the Parliament in November of 2019. The law introduces the accrual principle for PSA.

The Government of Montenegro decided not to adopt IPSAS directly, but to follow an indirect approach by developing its own accounting framework, aligned with the international standards.

Given that all accounting policies, until the adoption of the law on PSA, were defined by the law on budget and fiscal accountability and bylaws adopted on the basis of this law, the MoF has noted that once the law on PSA becomes effective the provisions of the previous law shall cease to apply.

Following the adoption of the law on PSA, in November 2019 the MoF prepared a set of bylaws necessary for the implementation of the law in 2020. These bylaws concern the CoA, new accounting methodologies, a public sector entity register, financial reporting, and the certification of public sector accountants.

The law on PSA, in addition to reforming the recording of business changes, also reforms the creation of the register of public sector entities, defining and recognizing the title and certification of public sector accountants.

The MoF oversees the implementation of PSA reform. It had access to both domestic and international expert assistance during the reform process.

The project is managed by the MoF and social welfare, with the support of the Government. The law on PSA, which officially introduces accrual accounting in the public sector, was adopted in the Parliament.



6

Impact of PSA reform implementation on other systems

PSA reform permeates all spheres of the public sector and effects all aspects of PFM. Budget execution will remain unchanged because the law provides for the continued reporting on budget execution on a cash basis. The reforms will also have a positive impact on GFS, which rely heavily on accounting data. Records

kept by the tax administration and public debt records will also be effected. Challenges related to reform exist in both internal and external audits, and concern complexity, the larger scope of work, and human resource capacities.



7

Challenges and lessons learned of the PSA reform implementation

PSA reform is a complex and demanding process, permeating various aspects of public finances and requiring a special approach. One key element is staff training, and the approach chosen by Montenegro in this regard has proved to be good so far. Currently, training is focused on IPSAS implementation; once

national accounting policies are developed, the accountants will be further trained to implement these as well. Given the complexity of the process, international assistance and the insights of countries that have successfully implemented these reforms are necessary.



8

Next steps in the PSA reform implementation

The focus in next period of accounting reforms will be on improving the accounting information system that will support the implementation of the law on PSA and bylaws to be adopted based on this law. Next steps also include work on the development of the new PSA framework, including developing manuals and instructions.

The development of the information system consists of two phases:

1. The first phase refers to: (i) gap analysis between the functionality of the accounting information system and the functionality required by the new law and bylaws; and (ii) analysis of accounting processes in the public sector and the next process after the entry into force of the new law. The first phase has been completed.
2. The second phase refers to the development of the terms of reference based on analysis, the publication of a public call for proposals, and the implementation of changes in the IT system.

After the improvement of the information system, training will be conducted for accountants in the public sector for the application of new functionalities of the system. This will be developed through workshops for public sector accountants, to be conducted by experts who have worked on the development of the accounting framework and information systems.

The focus in the near future is on training for accountants in the public sector for the implementation of new accounting policies. The MoF planned these activities through an Innovations for Poverty Action project. A special training module will be developed for these purposes, to be conducted by experts who have worked on the development of the accounting framework.



9

International assistance received

During the process of accounting reform in the public sector, the MoF had the support of UNDP, the MoF of Slovakia, the Center of Excellence in Finance from Slovenia, and support through Innovations for Poverty

Action funds for consulting services. In addition, the law on PSA was submitted to the WB and the IMF for opinion and comment before it was adopted.





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**NORTH
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1

Introduction

North Macedonia, officially the Republic of North Macedonia (RoNM) and previously known as the Former Yugoslav Republic of Macedonia, is a country in southeastern Europe. It gained independence in 1991 as one of the successor states of Yugoslavia. North Macedonia is a landlocked country with a total area of 25,713 square kilometers, bordering Kosovo, Serbia, Bulgaria, Greece, and Albania. Skopje, the capital and largest city, is home to a quarter of the country's 2.06 million people.

Macedonia is a small economy with a GDP of \$4.6 billion, representing about 0.01% of the total world output. It is also an open economy, highly integrated into international trade, with a total trade-to-GDP ratio of 79.5%.

RoNM is a developing country, ranking 82nd on the human development index, and provides social security, a universal health care system, and free primary and secondary education to its citizens.

The economy in RoNM has been traditionally based on agriculture. The agricultural sector represents 7.2% of GDP and employs 16% of the active population. Arable agricultural land accounts for half of the

total territory, of which about two-thirds is categorized as pasture with the rest as arable agricultural land. Capital investment as a percentage of GDP reached its highest level of 34.54 percent in 2019.

According to the UN Conference on Trade and Investment 2020 world investment report, net foreign direct investment flows to RoNM decreased significantly to \$365 million in 2019, compared to \$725 million the year before. Total foreign direct investment stock was estimated at \$6.4 billion in 2019.



2

Structure and functioning of the public sector

2.1 Political system, territorial, administrative, and fiscal organization

RoNM is a parliamentary democracy, with a unicameral Parliament. The head of state is the President of the Republic, and the Government is led by a Prime Minister. RoNM is a unitary state comprised of central and municipal levels of governance but was previously decentralized during the Yugoslav period.

Currently, there are 84 municipalities plus the city of Skopje. The latter is recognized as having a special status and encompasses ten municipalities (which are part of the overall number of 84 municipalities). Moreover, there are 8 statistical regions for planning purposes. Within the municipalities, local communities may be established. The main goal of the communities is to enable concerned residents to address issues, take positions, and prepare proposals of an immediate and daily nature to the municipalities.

The principle of LSG is enshrined in the Constitution. Legal control over municipal acts is carried out by the central authorities. Municipalities have the right to appeal to the Constitutional Court if the state authorities encroach on their prerogatives.

Municipalities' revenue is derived from their own revenue sources (including local taxation, fees, charges, and fines), which account for about 40 percent of total revenue, and from grants, which account for about 60 percent. Only 15 percent of their revenue is used for development initiatives, with the remaining 85 percent spent on administrative costs. This data reflects a high degree of centralization and a lack of financial sustainability at the local level. Municipalities may borrow at home and abroad, with the consent of the MoF.

Fiscal decentralization began in July 2005. The law on local government finance created a two-phase process for fiscal decentralization. In the first phase, local government units were made the owners of social sector functions and were given earmarked grants to pay for the costs of maintaining these facilities.

The second phase of fiscal decentralization began on July 1, 2007. Municipalities had to meet certain criteria, such as staffing and strengthening financial capacity, to enter into the second phase, which envisages competencies in culture, social protection, primary and secondary education, and primary health care. All municipalities, except one rural municipality, have entered the second phase.

Compared to 2005, when the process of transferring competencies started and fiscal decentralization was encouraged, the revenues of the municipalities have increased more than six times in nominal value. In the same period, the tax revenues for which municipalities have collection autonomy more than doubled. With these parameters set, RoNM has entered the group of medium-sized decentralized countries.

2.2 Ongoing PFM reforms

The implementation of the PFM reform program for 2018 - 2021 is in progress. The reforms in the PFM reform program are structured within seven priorities aimed at improving the efficiency and effectiveness of public spending through fiscal discipline, debt sustainability, and efficient, transparent, and modern management. These steps are an imperative for stable, sustainable development and the well-being of the citizens of the RoNM:

1. An improved fiscal framework, focused on the introduction of fiscal rules and the strengthened supervision of their implementation and reporting.
2. Revenue mobilization, aimed at improving the country's revenue collection and ensuring the stability of the PFM IT systems in event of a crisis.
3. Planning and budgeting, focused on strengthening the program-based budget approach and medium-term budget planning.
4. Budget execution, aimed at improving the efficiency of budget execution and strengthening financial discipline.
5. Transparent Government Reporting, which main objective is to increase the level of transparency in PFM.
6. Internal controls, focused on strengthening the financial management and control systems.
7. External controls and parliamentary oversight, aimed at enhancing the management of public funds and ensuring accountability and transparency in their use.

In the last two years of program implementation, efforts have been focused on the improvement of legislation in several essential areas: (i) planning and budgeting; (ii) public procurement; (iii) public internal financial control; and (iv) public debt management. In the area of budget execution, the key priority is implementing the IFMIS and improving transparency in the management of public finances. In the area of revenue mobilization, the focus is on the implementation of the new tax system reform strategy for 2021 - 2025.

On the other hand, one of the priorities in the Program of the Government of the RoNM for 2020 - 2024 is continuation of the decentralization process to the end of greater democratization, better public services and intensified local development. The objective is to transfer the competences to a management level most suitable for the citizens. In the coming period, municipal development policies, i.e. fiscal decentralization and equal regional development, will continue to be implemented, to the end of strengthening the municipalities' financial sources, at the same time increasing the accountability and the transparency of their operations.

The three pillars under the fiscal decentralization reform are:

1. Improved fiscal capacity and increased municipal revenues will be implemented through activities which envisage increase of the funds distributed to the municipalities on the basis of collected fees in the central budget, increase of own revenues of the municipalities, and establishment of funds to support the good performance.
2. Strengthened fiscal discipline aims at strengthening the financial discipline of the municipalities, arrears repayment and cost-effective operations.
3. Transparency and accountability seek to strengthen government oversight, in particular by the Department for Public Sector Financial Inspection in terms of the Law on Reporting and Recording Liabilities and reporting non-compliance with the Law on Financial Discipline, through adopting measures with respect to: (i) increased transparency at the municipalities by announcing the financial reports in a transparent and understandable manner; and (ii) strengthening accountability when using budget funds.



3

Budgetary system

3.1 Authorities

The budget of the RoNM consists of the central government budget and budgets of funds (the pension fund, health fund, and employment agency). Together with the budgets of the municipalities, it makes up the consolidated budget.

The budget planning and execution process is regulated through the current budget law. According to the law, the process follows the calendar outlined in Table 5.

The budget is organized under: (i) organizational classifications (first line and second line budget users); (ii) program classifications (budget programs and sub-programs within each budget user); (iii) economic classifications (categories and items of revenues and expenditures); and (iv) classifications of the function of government.

The budget, as a document, consists of three parts: general, specific, and development. Although the development part sets the basis for the medium-term budgetary plan, it is only indicative and focuses on development budget programs and sub-programs.

Authorities in the budget process are:

- ◆ The Government – Adopts the budget and sends it to Parliament.
- ◆ The Parliament – Adopts the budget in the form of a law.
- ◆ Budget users – Set priorities within their respective areas.
- ◆ The MoF – Coordinates the entire budget process and prepares the budget.

Table 5. Budget planning and execution process calendar

Date	Action
April 15	Adoption of strategic priorities by the government.
May 31	Adoption of fiscal strategy.
June 15	Budget circulation.
September 1	Budget requests.
November 1	Draft budget to the Government.
November 15	Draft budget to Parliament.
December 31	Parliamentary debate and budget adoption.
May 31 (the following year)	Final account.

3.2 Budget basis and approach

The budget system in RoNM is regulated through the current budget law from 2005 (with several additional amendments and clarifications), which covers the procedures for preparation, adoption, and execution of the central budget, budgets of LSG units, and the budget of the city of Skopje. It also sets directives for reporting on budget execution. The budget of RoNM is prepared on a cash basis.

Given that the current budget law it is not in line with latest trends, recommendations of international institutions, and directives of the EU, a new budget law has been drafted and is currently in the parliamentary procedure for adoption. The new budget law contains provisions regarding:

- ◆ Fiscal rules.
- ◆ The establishment of a fiscal council.
- ◆ The establishment of a register of public entities.
- ◆ Improvement of the medium-term planning process.
- ◆ Improvement of public investment management.
- ◆ Preparation of a baseline scenario and new initiatives.
- ◆ Regular monitoring of the budget execution.
- ◆ Increased transparency.
- ◆ Establishment of an integrated information system for PFM.



4

Accounting system

4.1 Authorities

The manner of accounting of budgets and budget users in RoNM is prescribed in: (i) the law on accounting of budgets and budget users; (ii) the rulebook for accounting plans for budget and budget users; (iii) the budget law; (iv) the law for the execution of budget; (v) the rulebook for the classification of revenue; and (vi) the rulebook for the classification of expenditures.

The law on accounting of budgets and budget users regulates accounting conduct for:

- ◆ The budget of RoNM.

- ◆ Budgets of LSG units.
- ◆ Budgets funds.
- ◆ Budget users.
- ◆ Other legal entities.

IPSAS have been applied for budgets and budget users, with information published by the MoF in the official gazette of the RoNM if they are not in conflict with laws or other regulations. The MoF prescribes the form and the manner of accounting books for the budgets and budget users. According to the law on accounting for budgets and budget users, final accounts must be submitted to the state audit office and the central registry by the end of February.



overview of spending from the budget reserve and guarantees borrowed in the fiscal year is also prepared.

The final accounts of the budgets of LSG units are approved by the Council of the Municipality no later than March 15 and are submitted to the MoF no later than March 31.

The Government submits the final account for the execution of planned revenues and expenditures of the budget of RoNM to Parliament for adoption, together with the final accounts of the budgets of the LSG units and funds, no later than June 30 of the current year for the previous fiscal year.

According to the law on budgets, the MoF is required to submit to the government the final accounts of the previous year's budget, together with the audit report of the state audit office by May 31. After approval by the Government, the final accounts must be submitted to Parliament no later than June 30th.

Budget entities and budget users are obligated to prepare basic financial statements, including balance sheets and income statements. Financial statements are prepared for the fiscal year beginning on January 1st and ending on December 31 for each calendar year.

The consolidated balance sheet is a complete overview of the revenues and expenditures of the individual users that are part of the budget entity. The consolidated balance sheet is not prepared as a sum of the separate budget accounts of the same user.

Consolidated final accounts are prepared for each fund budget. Each user of the fund prepares a final account and submits it to the manager of the budgetary fund where they are a member, no later than March 1st of the current year for the previous fiscal year. Based on the final accounts of the users, the budget fund manager prepares and submits to the MoF a consolidated annual account, no later than March 31 of the current year for the previous fiscal year.

The final account shall be prepared in accordance with the classification of revenues and expenditures adopted by the MoF. Expenditures on all accounts of the budget of RoNM are compared to the estimates of budget revenues and approved expenditures. An explanation of the main deviations and a detailed

4.2 Accounting basis

In RoNM, budgets and budget users shall maintain accounting and prepare financial statements under the modified cash basis of accounting.

The recognition of revenues and expenditures, which are contained in the general ledger of budgets and budget users, is carried out according to the cash basis. As such, revenues and expenses are recognized in the moment when the real cash inflow and outflow occur.

4.3 Integrated Financial Management Information System

The implementation of IFMIS as a state-of-the-art system is the top priority project for the MoF within the PFM Agenda. IFMIS is regulated in the new organic budget law, which sets the legal base for its implementation. Organic budget law enforcement and IFMIS implementation are expected to significantly improve good governance and the performance of the main functions of the MoF, including: (i) budget planning and execution; (ii) public debt management; (iii) monitoring of public investments; and (iv) data analytics and business intelligence.

Organic budget law will set fiscal mechanisms and ensure prudent management of the taxpayers' money. The law was reviewed and adopted by the Government in January 2021 and has subsequently entered parliamentary procedure.

Currently, multiple IFMIS-related activities are ongoing with steady dynamics. The MoF is conducting extensive arrangements for the drafting of relevant by-laws (both with the EU twinning project and with WB support), updating the functional requirements for IFMIS, and planning the establishment of a dedicated IFMIS unit within the Ministry.

In January 2021, the WB team conducted a pre-identification mission to identify IFMIS-related areas and activities in RoNM. Support is anticipated for this project from WB and EU IPA funds.

According to the PFM reform program, IFMIS will establish the systems needed to evaluate whether budget users have appropriately allocated sufficient resources to service liabilities before their due dates. This will allow for accurate financial planning and the recording of liabilities based on accrual accounting.

4.4 Asset management

At present, there is no unified register of property. Each budget user maintains a separate asset register. Authorized organizations update and reconcile data in their asset registers annually based on an inventory of assets, which is performed by a specially established commission for the inventory of assets at each user level.

According to the law for budgets and budget users, users are required to reconcile their receivables, liabilities, assets, and sources of funds by December 31st.

4.5 Debt reporting

At present, the MoF does not prepare a balance sheet, including information on debt obligations at the national level. The MoF prepares and publishes information formed in accordance with the methodology of IMF special data dissemination standards on internal and external debt obligations of the central government, as well as the amount of debt guaranteed by the central government.

4.6 Consolidation

Consolidated accounting statements are prepared at the level of the budgetary fund managers based on statements from subordinate organizations. The consolidation of these accounting statements is provided automatically using a specialized software product; however, the exclusion of consolidated items is provided manually. The CFS are then transmitted through special software to financial authorities for the subsequent consolidation of individual indicators.

Currently at the national level, only the report on the execution of the consolidated budget of the public administration sector is prepared. This consolidated budget reflects revenues and expenditures on a cash basis, sources of financing of the budget deficit, and directions on the use of the surplus.

The balance sheet, which contains consolidated information on all assets and liabilities of budgetary organizations, as well as assets and liabilities of the Government and local executive and administrative bodies, is not prepared. Information about non-financial assets of all budget organizations is



provided by compiling consolidated reports on the movement of fixed assets, the movement of tangible assets, and receivables and payables.

4.7 Transparency and accountability

Budgets and budget users are required to submit their annual accounts to the register of annual accounts at the central register and to the state audit office by the end of February of the next year (within 60 days of the date of the status change).

Budgets and budget users are obliged to publish final accounts on their website within 15 days from the day of submitting their final accounts to the register of annual accounts.

The Government submits the final account for the execution of planned revenues and expenditures of the budget of RoNM to Parliament for adoption, along with the final accounts of the budgets of LSG units and funds, no later than June 30 of the current year for the previous fiscal year.

5

Description of the PSA reform and its implementation status

There is an ongoing CIPFA program for the certification of public sector accountants, which is implemented by Center of Excellence in Finance from Ljubljana, Slovenia in cooperation with the MoF. The program consists of three modules: (i) financial accounting; (ii) management accounting; and (iii) the national module (which covers the national tax, budgetary, and treasury systems).

Within the twinning project, the goal of which is to strengthen budget planning, execution, and internal control functions, a draft law for the establishment of an academy for public finances was prepared. The purpose of the new academy will be to deliver training in the field of public finance and organize exams for the issuing of certificates/licenses for authorized officials and professionals in the field of public finance. The law is expected to be adopted by the end of the year.



6

Impact of PSA reform implementation on other systems

The impact of PSA reform on other systems is not applicable, as no major PSA-related reform is currently being implemented.



7

Challenges and lessons learned of the PSA reform implementation

Likewise, the challenges of PSA reform are to be determined upon implementation.



8

Next steps in the PSA reform implementation

By the end of 2022, the MoF is planning to start a reform and transition from the existing cash basis accounting to modified accrual accounting in the public sector. According to the “modified accrual accounting”, the expenses will be recorded at the moment of occurrence of the event in the reporting period, and not at the moment of payment, and the income will continue to be recognized at the moment when the funds are actually received. This concept of records will enable more realistic and up-to-date monitoring of outstanding commitments and liabilities of budgets and budget users.

The proposed reform is expected to be implemented through the state Treasury system and implementation of a new FMIS. The PSA reform will be included in the new Public Financial Reform Strategy for the period 2022-2025, which is under preparation and shall be adopted by the end of 2021.

As part of preparation for the reform implementation, the MoF has identified the following risks, which will be timely thoroughly analyzed and mitigated:

- ◆ Adoption of a new Law, bylaws and instructions for application of the modified accrual accounting basis for budgets and budget users.
- ◆ Acceptance of IPSAS.
- ◆ Conducting training on the application of IPSAS by a large number of accountants.
- ◆ Limited human and IT resources.
- ◆ Absence of continuous training for accountants in the public sector through the of Public Finance Academy, which is in the process of establishment.
- ◆ Localization of the Public Accountants Certification Training (PACT) Program and using of international experience and technical assistance.



9

International assistance received

RoNM is part of PULSAR program, and periodically participates in capacity building and knowledge sharing activities organized by that network.





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1

Introduction

The Republic of Serbia (RoS) is located in southeastern Europe, in the southern part of the Pannonian Plain and in the center of the Balkan Peninsula. RoS borders Romania to the northeast, Bulgaria to the east, Northern Macedonia to the south, Albania and Montenegro to the southwest and Croatia and BiH to the west.

RoS has a total population of 8.8 million. Belgrade, the capital, has a population of 1.4 million according to the 2016 census.

RoS is classified as an upper middle-income country, with distinct service, industrial, and agricultural sectors. The country is making significant efforts to build a market economy, although GDP growth has fluctuated since the financial crisis of 2008.

Between 2019 and 2020, GDP fell from 4.5% growth to -1% growth. In 2020, Serbian held \$30.1 billion in public debt, representing about 58% of GDP.



2

Structure and functioning of the public sector

2.1 Political system, territorial, administrative, and fiscal organization

The political system of the RoS is defined by the Constitution of RoS. According to the Constitution, the RoS is a state of the Serbian people and all its citizens, based on the rule of law and social justice, principles of civil democracy, human and minority rights and freedoms, and European principles and values. The policy of the RoS functions within the framework of a parliamentary democracy, or more precisely as a parliamentary republic. The organization of power is based on the division of power into legislative, executive, and judicial branches, with the relationship of all three branches of government based on balance and mutual control. RoS maintains a unique and independent judicial system.

The number of beneficiaries of public funds is regulated by the rulebook on the list of beneficiaries of public funds, within which direct and indirect budget beneficiaries of the RoS include: (i) local government budgets; (ii) users of funds from organizations for mandatory social insurance; (iii) public agencies; (iv) organizations to which public agency regulations apply or that are controlled by the state; (v) other beneficiaries of public funds included in the consolidated treasury account system, based on data from the Business Registers Agency; and (vi) beneficiaries of public funds that are not included in the consolidated treasury account and belong to the public sector.

According to the rulebook on the list of beneficiaries of public funds from December 2016, there are 11,040 beneficiaries, of which 3,769 are central government

beneficiaries and 7,271 are sub-national government beneficiaries (including public companies). Indirect budget beneficiaries do not have the right to borrow, but they do have the right to transfer.

2.2 Ongoing PFM reforms

The PFM Reform Program 2016-2020 with the accompanying action plan for the entire period was adopted by the Government of the RoS on November 28, 2015. The adoption of the program provided the basis for initiating reforms in the field of PFM in a structured manner. Through regular monitoring and reporting on the implementation of the planned results, the greatest challenges in the implementation of reform activities were pointed out in a timely manner. This Program was assessed as an adequate framework for improving PFM.

The main objectives of the program are to achieve a better balanced and sustainable budget, reduce the level of public debt, strengthen financial management and control, and improve the audit control process. The program follows the budget cycle, with the aim of contributing to the implementation of budget execution in the best possible way for the various government policies, thus contributing to increased transparency.

The program revision in 2019 included significant improvement of activities, indicators, and cost estimates of reform activities. The revised program was adopted in September 2019 for the period July 2019 – December 2020 and contains activities that have been carefully formulated with developed indicators and identified sources of verification, as well as a detailed cost analysis.

3

Budgetary system

3.1 Authorities

The budget system consists of the budget of the RoS, local government budgets, and financial plans of organizations for compulsory social insurance.

The National Assembly adopts the law on the budget of the RoS, and local government assemblies decide on local government budgets. The financial plan of the organizations for compulsory social insurance is adopted by the authorized body of the organization in accordance with the law and other regulations, with the approval of the National Assembly.

The Government is responsible to the National Assembly for the execution of the national budget. The authorized local government executive body is accountable to the local government assembly for the execution of local budgets. The organization for compulsory social insurance is responsible to the Government for the execution of the financial plan of the organization for compulsory social insurance.

3.2 Budget basis and approach

The law on the budget system and the regulation on budget accounting prescribe the cash basis for the accounting and preparation of financial statements, according to which transactions and other events are recognized at the time of receipt or payment of funds, as defined by the cash basis of IPSAS.

The rulebook on the standard classification framework and CoA for the budget system prescribes a single classification of budget information, including organizational, economic, functional, and program classifications and the classification of expenditures based on the source of financing.

The Treasury main ledger for the budget of the RoS keeps records of all payments according to organizational, functional, and six-digit economic classifications, as well as by the sources of financing.



4

Accounting system

4.1 Authorities

4.1.1 Standard setters/regulator

The Government regulates budget accounting and the manner of keeping the consolidated treasury account. The MoF regulates the manner of conducting budget accounting and the content and manner of financial reporting for direct and indirect budget beneficiaries, users of funds of organizations of compulsory social insurance, and budget funds of the RoS and local authorities. It may also issue special instructions on financial reporting for certain state administration bodies.

The Minister determines the manner of reporting on total revenues and incomes and total expenditures and expenses for local government treasuries. They also regulate the manner of preparation, compilation, and submission of financial reports of direct and indirect budget beneficiaries, users of funds of organizations of compulsory social insurance, and budget funds of the RoS and local governments.

4.1.2 Preparer of financial statements

Financial statements are prepared for:

- ◆ The budget of the RoS.
- ◆ Budgets of autonomous provinces and LSG units.
- ◆ Direct and indirect budget beneficiaries, including: (i) the Republic Health Insurance Fund and its users; (ii) the Republic Pension and Disability Insurance Fund; (iii) the Social Insurance Fund for Military Insured Persons; and (iv) the National Employment Service.

4.1.3 Approver of financial statements

Direct budget beneficiaries are responsible for the accounting of their own transactions within their power and are also responsible for the accounting of transactions of indirect budget beneficiaries that fall within their authority. In turn, indirect budget beneficiaries and the users of funds of the organizations of compulsory social insurance are responsible for the accounting their own transactions.

The High Court Council and the State Prosecutorial Council are responsible for the accounting of their own transactions, and they are also responsible for the accounting of transactions of judicial bodies under their budget section.

The MoF, on behalf of the Government, is responsible for the accounting of received loans and debts.

4.2 Accounting basis

The law on the budget system and the decree on budget accounting prescribe the cash basis for conducting budget accounting and compiling financial statements, according to which transactions and other events are recorded at the moment when cash receipts are received, or payments are made.

This form of accounting must be in accordance with the annual budget law. Preference is given to cash basis accounting due to its simplicity and greater degree of objectivity, with certain measures being taken to supplement the accounting data with non-cash data.

4.3 Integrated Financial Management Information System

Since 2008, a budget execution information system has been developed in RoS, with further development and improvements introduced every year. This system includes all direct budget beneficiaries and 529 indirect budget beneficiaries, with the number of indirect budget beneficiaries included in the system constantly growing every year. The organizations of compulsory social insurance and local authorities have their own information systems.

4.4 Asset management

The Republic Directorate for Property of the RoS keeps a single record of real estate and a collective record of movable property owned by the RoS. These records are kept based on the received reports on the structure and value of the assets of the beneficiaries of resources owned by the RoS.

budget system regulates economic classifications that facilitate the consolidation process. These are primarily economic classifications of administrative transfers that are intended to identify positions for excluding revenues and expenditures between direct and indirect beneficiaries, as well as classifications and source of funding intended to identify revenues and expenditures of beneficiaries at various levels of government. These items of the CoA facilitate the process, which is still primarily conducted manually.

4.6 Transparency and accountability

Indirect budget beneficiaries are required to submit a quarterly budget execution report to their superior within ten days of the end of the period. The direct budget beneficiary harmonizes these reports with the data in the treasury main ledger and its records, consolidates the data, and submits it to the MoF within 20 days of the end of the quarter. AFS are submitted to the Government and the State Audit Institution in July of the subsequent year.



The minister or local government body responsible for finance is obliged to regularly monitor the budget execution and inform the authorized local executive body at least twice a year, and within fifteen days after the end of the six-month or nine-month period.

The authorized ministers are obliged to regularly monitor the execution of financial plans of organizations for compulsory social insurance and to inform the Government and the Minister at least twice a year, and within fifteen days after the end of the six-month or nine-month period.

4.5 Consolidation

Consolidation in RoS is done at the central and local levels of government, including social security funds. Public companies are not included in the consolidated reports. The rulebook on the standard classification framework and the CoA for the

Within fifteen days after the submission of the report, the authorized executive body of the local government shall adopt and submit the reports to the local and national assemblies. The reports must note discrepancies between the adopted budget and its execution, as well as an explanation for large discrepancies. All adopted financial statements are published in the Official Gazette.

5

Description of the PSA reform and its implementation status

The PFM Reform Program 2016-2020 is an expression of the Government's commitment to implement a comprehensive set of interconnected time-aligned reforms in the field of PFM in the broadest sense, all of which aim to increase accountability, improve financial management, and ensure good governance. This will be achieved through the improved efficiency and effectiveness of public resource management in the RoS, with the goal of ensuring a smooth transition to the public administrative framework of the EU.

The action plan of the PFM reform program from July 2019 to December 2020 included five broad pillars of action:

- ◆ Planning and budgeting of public expenditures.
- ◆ Efficient and effective budget execution.
- ◆ Effective financial control.
- ◆ Public sector accounting.
- ◆ External scrutiny of public finance.

The fourth pillar of the revised PFM reform program is related to PSA under the responsibility of the Treasury.

The scope and quality of budget execution and fiscal reporting have improved. The inclusion of incentive-based budgeting provided comprehensive control over the settlement of obligations, which is one of the key objectives of the PFM Reform Program 2016-2020.

Monitoring and reporting on arrears have also been improved with the expansion of the registry of settlements of the pecuniary commitments system, which includes public sector liabilities.

The Treasury has also established a central invoice registry, which has contributed to more efficient monitoring of commitments and unpaid liabilities within the deadlines defined by the law. This has led to reduction in the number of late payments, better control over the settlement of financial obligations, and improved planning and management of public funds.

The long-term objective of the PSA reform in the RoS is a gradual transition from cash to accrual accounting and financial reporting, as well as the implementation of IPSAS by 2030. One of the activities in this transition process is the preparation of a comparative analysis of the application of IPSAS standards in countries that have transitioned to accrual accounting.

In parallel with the IPSAS implementation plans, the MoF monitors activities related to the development of the European Public Sector Accounting Standards (EPSAS).



6

Impact of PSA reform implementation on other systems

The PFM reform strategy is supported in most sub-areas of PFM by more detailed planning documents prepared by the relevant authorities, which include:

- ◆ The tax administration transformation program.
- ◆ Strategy for payment delays resolution and prevention.
- ◆ National anti-corruption strategy.
- ◆ Strategy for the development of public procurements.
- ◆ Strategy for the development of internal financial controls in the public sector.
- ◆ Strategy for the suppression of irregularities and fraud in the use of EU funds in the RoS for the period 2017-2020.

Due to the importance of external audits in PFM, reforms in this area are included in this document. During the implementation and revision of the PFM Reform Program 2016-2020, special attention was paid to the cross-connection and complementary nature of these strategic documents, but also to the obligations in the process of EU accession.



7

Challenges and lessons learned of the PSA reform implementation

Limited knowledge of IPSAS standards can be an obstacle in the alignment process. Potential long-term challenges are the capacity of employees to comprehend and apply new standards. Therefore, in the coming period, continuous training and improvement of the skill level of state accountants is needed.

To implement PSA reform, it is first necessary to strengthen the capacity and resources of the MoF as well as the users of public funds. The public sector

employs around 14,000 accountants, which indicates that adequate timeframes and human resources need to be provided for capacity building. It is also necessary to select, on a territorial and institutional basis, an adequate number of chief accountants for the training program and certification with the possibility of knowledge transfer. If these preconditions are not met, the lack of qualified professional staff can be a serious obstacle for improvements in PSA.



8

Next steps in the PSA reform implementation

The transition to accrual accounting requires a long-term period of development. For the reform results to be adequate, it is necessary to strengthen the accounting system which is based on the cash basis in accordance with IPSAS standards. In the coming period, it will be necessary to focus on strengthening the existing accounting system based on the cash based IPSAS.

There are no clear and harmonized legal requirements regarding the professional education of accountants, chief accountants, or heads of accounting departments. One of the first activities to strengthen the human resources of public sector accountants will

be the adoption of a national standard of education for professional accountants. This would regulate: (i) professional titles of public sector accountants; (ii) education programs for acquiring professional titles; (iii) qualifications for certification; and (iv) the right and obligation of continuous education.

Participation in an internationally recognized training and certification program would be a desirable step towards sustainable administrative capacity building. Modernization and institutional strengthening of the Treasury are high on the list of priorities for PFM reform.



9

International assistance received

The RoS has benefited from peer-to-peer learning and knowledge exchange initiatives, such as Public Expenditure Management Peer Assisted Learning

(PEMPAL) and PULSAR networks, including a pilot implementation of the first country level public sector accounting reform program.





UKRAINE



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1

Introduction

Ukraine is located in eastern and central Europe, in the southwestern part of the East European Plain. The total area of the country is 603,550 square kilometers. The population of Ukraine in 2019 was 41.9 million people, 18.1 million of whom were economically active. The state language is Ukrainian, and the official currency is the Ukrainian hryvnia.

Ukraine is a state with a developed scientific and industrial base and has been a member of the World Trade Organization since May 16, 2008. It was ranked 64th in the world by the WB for their favorable business environment in 2020.

Nominal GDP for 2019 was \$150 billion, and \$3,556 per capita. Ukraine is an industrial-agrarian country with a predominance of raw material production and an economy based on diverse industrial, agricultural, and service sectors. It is one of the leading exporters of certain agricultural products and foodstuffs. Industries include mining (coal, oil and gas, iron, and manganese ore), some branches of mechanical engineering, and ferrous and non-ferrous metallurgy. Ukraine is a major producer of electricity, and the production of satellites and equipment for space exploration has also been established.

In 2020, with the spread of the global COVID-19 pandemic and the introduction of a strict quarantine regime in Ukraine, there was a drop in economic indicators according to preliminary data from the state statistics committee. Overall, economic activity decreased by 11.4% compared to the corresponding period in the previous year. The spread of COVID-19, as well as the lack of a clear understanding of the duration and depth of the resulting crisis, resulted in a pause among potential investors.

Priority economic reforms are the development of small and medium-sized enterprises, the reform of SOEs, export development, privatization of the public sector of the economy, and labor market reform.



2

Structure and functioning of the public sector

2.1 Political system, territorial, administrative, and fiscal organization

Ukraine is a parliamentary presidential republic unitary state. The system of the administrative-territorial structure of Ukraine consists of 24 regions, cities, districts within cities, and municipalities.

Since 2014 Ukraine has begun decentralization and regional development reform, the goal of which is to give local governments more power to provide public services in areas such as health care, education, agriculture, the environment and natural resources, and local utilities. At the time, the Government and Parliament decided to liquidate the current 490 districts and form new 136 new districts within the current regions. As of October 1, 2020, 907 unified territorial communities have been formed. By the end of 2021 the unification process is scheduled to be completed, creating a total of about 1,450 communities according to the government's plan. United territorial communities are administrative-territorial units that perform the function of municipalities, and can unite several nearby settlements, villages, and cities.

According to the Constitution of Ukraine, state power consists of legislative, executive, and independent judicial branches. The only body of legislative power in Ukraine is the Parliament - the Verkhovna Rada of Ukraine. Municipalities, through their decisions, approve the budgets of the corresponding territorial and administrative units and establish local taxes and fees. Justice in Ukraine is administered exclusively by the courts.

The system of central bodies of executive power consists of ministries and other central bodies. The highest body in the system of executive power is the Cabinet of Ministers of Ukraine. As of October 2020, there are 19 ministries and 62 central executive bodies. Ministries ensure the formation and implementation of state policy in one or more areas, while other central bodies of executive power perform certain functions to implement state policy. The state participates in the formation of local government budgets and financially supports local governments.

Executive power in the regions and districts is exercised by local state administrations. United territorial communities are governed by an executive board, which is elected every five years by the residents of the community and is accountable to them.

Territorial communities of a village, settlement, or city, directly or through LSG bodies: (i) manage property in communal ownership; (ii) approve programs for socioeconomic and cultural development and oversee their implementation; (iii) approve budgets of the respective administrative-territorial units and oversee their implementation; and (iv) establish local taxes and levies in accordance with the law. Community councils have a direct budgetary relationship with the central government, meaning that central government subsidies for health, education, and other expenses are negotiated and allocated directly to the communities rather than being passed through the regional and district levels, as was previously the case.

2.2 Ongoing PFM reforms

In Ukraine, the gradual modernization of PFM systems as part of public administrative reform continues, pursuant to the decisions of the Government. The implementation of this PFM reform is envisaged in the overall strategy of PAR.

The modern stage of reform began with the adoption of the PFM strategy (Order of the Cabinet of Ministers of Ukraine No.142-p of February 8, 2017) and approval of the action plan for its implementation (Order of the Cabinet of Ministers of Ukraine No.415-p of May 24, 2017).

From 2017-2020, the activities of the PFM system bodies were aimed at achieving the goals and priorities identified in the strategy. A legislative basis was created for reforms in the budgetary sphere, which provide for the introduction of medium-term budget planning.

Several important policies have been implemented in the tax and customs spheres. The openness and accessibility of information on the state budget and

other aspects of PFM systems was ensured, and conditions for the effective functioning of the system of state internal financial controls were created. An IT audit was conducted, which became the basis for IT centralization in the PFM system. New electronic services for taxpayers and new IT solutions in the areas of tax administration and control of customs payments were also implemented.

The positive results achieved from 2017-2019 in reforming most components of the PFM system created a solid foundation for the continuation of established tasks and the identification of new priorities.

In 2019 WB experts, supported by the EU and other international partners, assessed the state of PFM, using the public expenditure and financial accountability (PEFA) assessment framework. The accounting chamber of Ukraine audited the implementation of measures to reform the PFM system. Based on their results, and considering the recommendations of the IMF, Support for Improvement in Governance and Management (SIGMA) experts, and stakeholders, an updated PFM strategy for 2020-2024 was released.

3

Budgetary system

3.1 Authorities

The legal basis for the functioning of the budget system of Ukraine and the foundations of the budgetary process are determined by the budget code of Ukraine. The budget code is a part of national legislation approved by Parliament and provides the basis for the budgetary planning, the use of budget funds, and reporting.

Participants in the budgetary process include bodies, institutions, and officials with budgetary authority. As the highest authority in the system of executive bodies, the Cabinet of Ministers of Ukraine prepares a draft law on the state budget, ensures its implementation when approved by Parliament, and submits to Parliament a report on its execution.

The authority of Parliament in the budgetary sphere includes the approval of the state budget and the introduction of amendments, control over its execution, and decision-making on the report on its execution. Control on behalf of Parliament over the receipt of funds to the state budget and their use shall be exercised by the accounting chamber. The President of Ukraine, as head of state, signs the law on the state budget for the relevant year.

According to the budget code of Ukraine, the budgetary system consists of the state budget and local budgets. The list of taxes and fees, which form the basis of the revenues of state and local budgets, are fixed by the budget code. One source of income for local budgets can be transfers from the state budget. Every year, local governments decide on the budget of their corresponding territorial and administrative units.

The preparation and implementation of regional and district budgets in respective territories is ensured by local state administrations. Territorial communities, directly or through their LSG bodies, approve the budgets of the respective administrative-territorial units, control their implementation, and establish local taxes and levies.

3.2 Budget basis and approach

Program-based budgeting is used in the budget process at the state and local levels. Special components of the program-targeted method in the budgetary process include: (i) budget programs; (ii) responsible executors of budget programs; (iii) data sheets; and (iv) performance indicators. The responsible executors of the budget funds are either the main manager of budgetary funds or lower-level fund managers authorized by the main manager.

The program-targeted method provides for the use of medium-term budget planning, which is the framework by which the budget declaration (local budget forecast) is assembled. This budget declaration defines the basis of budgetary policy and indicators of the state budget and is the basis for drawing up the state budget. Medium-term budget planning includes the planned period and the following two budget periods.



The budget is prepared based on the projected macroeconomic and social development indicators of Ukraine for the medium-term period, as well as the analysis of budget implementation in the previous and current budget periods.

When preparing the budget, requests drawn up by the main managers of budgetary funds are considered. Managers of budget funds, in accordance with article 22 of the budget code, are empowered to administer relevant budget allocations. These requests include the scope of long-term obligations and indicators on budget programs, which ensure the implementation of investment projects over several years.

4

Accounting system

4.1 Authorities

4.1.1 Standard setters/regulator

The legal basis of regulation, organization, and maintenance of accounting, as well as the preparation of financial statements in Ukraine is determined by the law "On accounting and financial reporting in Ukraine." Regulation of the methodology of accounting and financial reporting is performed by the MoF, the central body of executive power that implements state accounting policy, approves national accounting standards, and sets other relevant regulatory and legal acts.

4.1.2 Preparer of financial statements

According to the budget code of Ukraine, budget fund administrators are divided into main budget fund administrators and lower-level budget fund administrators. Annually, the main administrators are approved by the law on the state budget, in which budget allocations are established for them.

The responsible executor of budget programs is determined by the main manager of budgetary funds in agreement with the MoF. The implementation of budget programs is ensured by the executor's staff or the manager of budget funds of the lowest

level, which ensures the implementation of budget programs in the system of the main manager

Managers of budgetary funds at all levels, as well as treasury bodies and funds of compulsory state social and pension insurance programs, must prepare financial statements based on accounting data. The treasury and its territorial bodies provide information, compilation, and reporting on the execution of the state and local budgets of Ukraine.

General CFS of public sector entities are prepared by the treasury to obtain information on the overall property status and performance of public sector entities and budgets.

4.1.3 Approver of financial statements

For budgetary funds and funds of compulsory state social and pension insurance, financial statements are approved by the head of the organization. Financial reporting on the execution of local budgets is approved by the head of the relevant territorial body of the treasury.

According to the budget code, treasury divisions are authorized to carry out the accounting, preparation, and approval of financial statements on the execution of local budgets. Quarterly



financial statements on the execution of the state budget are signed by the head of the treasury or their deputy.

AFS on the execution of the state budget are approved by the Minister of Finance and the head of the treasury and submitted to Parliament, the President, and the chamber of accounts. The chamber of accounts prepares and submits to Parliament the conclusion of the annual report on the execution of the state budget, with an assessment of the effectiveness of state budget fund management. They also submit proposals to address violations identified in the reporting period, and on the improvement of the budget process as a whole.

4.2 Accounting basis

Accounting on the execution of state and local budgets is done on a modified cash basis with the application of the accrual method on certain transactions (accounting of the public debt and liabilities of budget funds administrators). Revenue and expenditure transactions are recorded in the accounting records at the time that the corresponding payments are made. Budget financing transactions are recorded at the time of the movement of funds, with the simultaneous recording of active transactions or debt. The treasury bodies' use of the cash method to prepare information on the results of state and local budgets captures the amount of funds received and spent.

Budgetary institutions and obligatory state social and pension insurance funds carry out accounting on an

accrual basis, by which transactions and events are recognized when they occur regardless of the date of receipt or payment of funds.

The transition to the application of national standards and the accrual method of accounting for budgetary institutions has led to an assessment of all obligations undertaken by such institutions. In particular, the modified accrual method has provided an opportunity to objectively assess the financial results of public sector activities, as well as to optimize accounting for the cost of services provided by them.

4.3 Integrated Financial Management Information System

Budget managers (managers who administer funds at the unit level) are using accounting software products from several vendors, exclusively developed in Ukraine. At the lower levels and in local governments, simpler systems are used which provide accounting automation.

Since joining the electronic payment system of the National Bank of Ukraine, the treasury has created and operates the program "AS Treasury," which combines the following systems and subsystems:

- ◆ Transaction day.
- ◆ Income.
- ◆ Expenses.
- ◆ Reporting.
- ◆ Accounting of budget organizations.
- ◆ Formation and submission of tax returns.
- ◆ Processing of utilities and other payments.



The application of AS Treasury will help effectively implement budget management functions within the treasury system. Operations on the execution of the budget are carried out quickly in an automated fashion, eliminating errors in information processing.

The system “AS E-Reporting” was also established for electronic reporting by managers, recipients of budgetary funds, and recipients of state trust funds. AS E-Reporting allows managers to prepare and submit financial or budgetary statements to the treasury at the place of service, and also provides a unified reporting format by clients of the treasury. Its implementation is an important step in modernizing the PSA system. AS E-Reporting includes financial reporting forms approved by the NPSAS report 101: “Presentation of financial statements.”

The open E-data Portal “Unified web portal for the use of public funds” is an official source of state information, provided on the internet with free access. It gives the opportunity for the public to examine the processes of control, formation, distribution, and use of public funds, and provides full transparency of public finances.

4.4 Asset management

The legal basis for the management of state property is defined by the law of Ukraine “On management of state property,” and by the Constitution. In accordance with national legislation, the management of state-owned property is carried out by state agencies or, in cases provided for by law, other budget entities. The right of state property is characterized through a plurality of units due to its multilevel nature.

Local governments are owners of communal property. In accordance with the law, they can approve at plenary sessions of the councils the appropriate procedures and regulations for the alienation, write-off, privatization, and lease of communal property.

The transfer of state property into the communal ownership of villages, settlements, towns, or city districts, as well as transfer of units of communal property rights into state ownership, is regulated by the laws of Ukraine. The alienation and write-off of state property is regulated in the same manner.

Since the introduction of the new conceptual framework and national standards of PSA, information on the availability and value of the property of public sector entities is reflected in financial statements on the accrual basis. Public assets are included in the unified register of state property, which is managed by the state property fund of Ukraine.

4.5 Debt reporting

The application of NPSAS ensures accrual basis accounting, records all financial obligations, and provides a more accurate and up-to-date assessment of public sector assets and liabilities.

Information on liabilities is formed in accordance with the requirements of NPSAS 128: “Liabilities.” However, this standard does not include the reflection of reserves and collateral due to restrictions imposed by budget legislation.

In the financial statements of public sector entities, a liability is recorded if its valuation can be reliably determined and if it is probable that future economic benefits or utility will decrease due to its repayment. The information is broken down by long-term and current liabilities. A liability that does not meet the recognition criteria is classified as an “unpredictable liability” and is not recognized by the public sector entity. Instead, it is recorded in off-balance sheet accounts in the amount of expected repayment.

The government’s annual reporting consists of financial and budget reporting forms. Financial statements on budget execution are prepared in accordance with the NPSAS. Budget reporting, including the debt report, is prepared in the context of the budget classification in line with IMF standards. An annual report on the results of public debt and publicly guaranteed debt management is prepared by the MoF, which implements state budgetary policy in the sphere of public debt management and publishes the report on its official website.

4.6 Consolidation

In the public sector, CFS are drawn up by the main managers of budgetary funds, which include: (i) managers of budgetary funds; (ii) compulsory state social and pension insurance funds; and (iii) the treasury of Ukraine. CFS include financial statements of the controlling entity and its subsidiaries.

Ministries and other executive bodies that manage public sector entities and their property, in addition to their own reporting, prepare and submit CFS for enterprises that fall under their management.

The treasury ensures the consolidation of reporting at the national level through the preparation of CFS on the overall property and performance of public sector entities and budgets. This includes reporting on state and local budgets as well as compulsory social and pension insurance funds.

CFS are drafted in accordance with NPSAS 102: “CFS” through the analysis of financial statements. The AS E-Reporting program automatically consolidates all forms of financial and budgetary reports at each level. Indicators of financial statements of SOEs and municipal sector entities are subject to consolidation in accordance with the specified standard.

CFS for state-owned and municipal enterprises, managed by the controlling entity of the public sector, are compiled separately and submitted as part of the full CFS. In the accounting and financial statements of the controlling entity, contributions to the authorized capital of state-owned or municipal enterprises are reflected as financial investments.

4.7 Transparency and accountability

The budget code of Ukraine enshrines the principle of publicity and transparency, providing for public information on: (i) budget policy; (ii) budget drafting; (iii) the consideration, approval, and execution of the state and local budgets; and (iv) control over the execution of the state and local budgets.

The managers of budgetary funds are required to make available their AFS and CFS by posting them on their webpage. The treasury publishes monthly, quarterly, and annual reports on the implementation of the state budget, as well as annual CFS on the overall status and performance of public sector entities and budgets on its webpage.

The publication of information on local budgets is ensured by the Parliament and Council of Ministers of the Autonomous Republic of Crimea, local state administrations, and LSG bodies. Access to information on budgets and other aspects of the PFM system is regulated by the law “On access to public information.” The public is informed through public websites, social media, presentations, columns, articles, and interviews.

The law “On the audit of financial statements and auditing activities” defines the principles for private sector auditing of financial statements in which the state is a shareholder. In order to carry out internal controls and audits, a structural unit of internal audit is formed independently within each public sector entity.

Functions of control are also realized by state financial control bodies (the state audit service of Ukraine, the accounting chamber of Ukraine), established to carry out an independent assessment of the implementation of the budget and budget expenditures. The state audit service manages: (i) state controls over state financial audits; (ii) audits of public procurements; (iii) the inspection and monitoring of purchases; (iv) the assessment of the management of budgetary funds; (v) savings policies; and (vi) the efficiency and effectiveness of activities performed by controlled institutions.

The accounting chamber of Ukraine, on behalf of Parliament, exercises control over the transfer of funds into the state budget and their use.

5

Description of the PSA reform and its implementation status

The main goal of PSA reform is to improve the quality, reliability, consistency, and comparability of public finance information to ensure its relevance and usefulness.

Political support for the reform and modernization of accounting in Ukraine has been declared by Government directives on PSA reforms, in particular the adoption in 2007 of the PSA strategy for 2007-2015, and in 2018 the PSA strategy for 2018-2025.

As a result of the implementation of the PSA strategy for 2007-2015, several measures were taken to improve the accounting system in the public sector, including:³⁵

- ◆ NPSAS 20, developed on the basis of IPSAS. Separate methodological recommendations for the new standards were implemented.
- ◆ A single CoA for PSA, developed in view of budget classifications, containing sub-accounts reflecting information on the execution of budgets, budget funds managers, and compulsory state social and pension insurance funds. Procedures for its application were also introduced.
- ◆ The introduction of new financial reporting forms for managers of budgetary funds and obligatory state social and pension insurance funds.
- ◆ The implementation of an automated system of electronic reporting by clients of the treasury, “AS E-Reporting.”

PSA reform in Ukraine is based on the indirect adoption of the IPSAS system. Established by the budget legislation, national standards based on IPSAS consider national accounting practices in the public sector and the limitations of financial activities of budgetary institutions. The degree of compliance with the IPSAS is quite high according to international experts; 80% of international standards are fully or partially applied and included in the regulatory framework of Ukraine.

Considering the results achieved through initial PSA reforms, the Government approved an updated PSA strategy for the period until 2025 which aims to create an effective information system for managerial decision making.³⁶

To achieve this goal, it will be necessary to implement a number of tasks in several priority areas, including:

- ◆ Improving the regulatory base of accounting and modernizing the regulatory accounting system in accordance with IPSAS in order to ensure reliability and improve the comparability of financial statements.
- ◆ Improving the accounting system, which will establish a unified methodological framework for accounting systems of budgetary organizations and the execution of budgets at different levels.
- ◆ Increasing the transparency and quality of financial reporting, providing access to high-quality financial reporting for all stakeholders.

³⁵ Resolution of the Cabinet of Ministers of Ukraine No. 34 as of January 16, 2007.

³⁶ Cabinet of Ministers Decree No.437 as of June 20, 2018.

- ◆ Upgrading the qualifications of accountants and auditors in the public sector in order to apply the conceptual framework of NPSAS and ensure an optimal balance between the powers and responsibilities of accountants.
- ◆ Modernizing information systems, which will create a single information space for PSA data in Ukraine.

Implementation of the PSA strategy is based on action plans for the respective years, which include tasks for each area of reform. Achievement of the defined goals is ensured through the implementation of specific activities. Key areas of reform are included in the PFM strategy for 2017-2020, its implementation action plan, and an updated version of the PFM strategy for 2021-2024 which is scheduled for imminent approval.

Steps for monitoring the implementation of the strategy and evaluating its performance include:

- ◆ The preparation of the quarterly report on the implementation of the PFM strategy implementation plan.
- ◆ The preparation of an annual assessment of main achievements and performance evaluation, in accordance with the directions in each area of the PFM system.



6

Impact of PSA reform implementation on other systems

The main goal of PSA reform was to achieve transparency and reliability in financial reporting on public sector entities, as well as the ability to manage the financial resources of the state. The adoption of national standards and application of the conceptual framework, which is based on the accrual principle, made it possible to account for all liabilities, the full number of receivables, and income for all services rendered.

One of the important elements of budget resource management is the ability to determine the projected amount of expenditures and revenues for several subsequent periods. This information allows for medium- and long-term budget planning, as well as ongoing effective control over the targeted use of budgetary funds. Drawing up financial statements using NPSAS, based on IPSAS standards, allows for the formation of statistical information comparable with international public finance metrics.

The accrual method increases the flexibility of the management mechanism in public finance with more reliable and complete information, making it possible to assess the ability of the Government to:

- ◆ Finance its activities and meet its obligations.
- ◆ Facilitate planning processes and the principles of coherence and consistency in public finance decisions.
- ◆ Obtain information on revenues and expenditures, including the impact of paying debts to suppliers and customers.
- ◆ Predict the impact of taxation and other revenues on their fiscal position, as well as the sufficiency of current revenues to cover the costs of current programs and services.
- ◆ Assess the accuracy of calculating the full cost of public services provided, increasing their payback and quality.



7

Challenges and lessons learned of the PSA reform implementation

One important aspect of accounting reform is building political support, which can be achieved with the introduction of accrual accounting, requiring methodological, technological, and personnel assistance.

Accounting reform should include an implementation strategy and roadmap containing key methodological issues. This strategy should include the adoption of a list of standards and a calendar of activities calculating the necessary resources, infrastructure elements, and results to ensure the transition to accrual accounting. In Ukraine, each PSA strategy was supplemented by specific measures to modernize the PSA system. Each action has its own specific result and deadline for implementation with an authorized responsible executive.

Accounting reform requires high quality legal and regulatory support at the state level and by managers of budgetary funds. For the purpose of modernization, a system of regulatory documents including accounting standards, methodological recommendations to the standards, and the CoA was developed.

Integration between the main systems of public administration and PFM is an important step. In Ukraine, the modernization of the accounting system

is part of two higher-order reforms: PAR strategies and PFM strategies, which identify key issues in the development of PSA.

During the implementation of reforms, it is necessary to develop and implement an integrated financial management system to apply uniform principles of planning, budgeting, and budget execution based on revenues received and expenditures incurred. Such an information system must be used by the entire network of budget fund managers for the calculation, preparation, and implementation of budget revenue plans, followed by the preparation of reports. Ukraine has created automated systems through which treasury authorities provide for the cash execution of budgets and consolidation of financial statements. The PSA strategy for the period until 2025 provides for the development of a unified digital accounting product for budgetary fund managers. This will create a unified format for processing accounting data at the managerial level, with subsequent systematization and generalization.

The success of these reforms depends on staff with the proper qualifications and sufficient knowledge of the accrual method and the national, political, and technical peculiarities of its implementation and application. The PSA strategy for the period until 2025 includes measures to improve the qualification of PSA staff to ensure the full application of the new conceptual framework laid down in the NPSAS. In terms of equipment and financial support, international assistance will be needed for the timely, comprehensive implementation of all planned activities.

Reforms are possibly subject to the financial provision of costs associated with the implementation of the above list of activities, including the purchase of technical resources and the creation of software systems that can ensure the implementation of certain tasks.



8

Next steps in the PSA reform implementation

A comprehensive approach to PFM reform provides for the creation of effective information systems for accounting management. Its improvement, in accordance with the demands of users, contributes to the systematic implementation of reforms in public administration, an increase in the effectiveness of control over the use of public resources, and a greater speed of decision-making.

To achieve the goal of updating the accounting system in the public sector, it is necessary to implement tasks in several priority areas, set out in the approved PSA strategy for the period until 2025:

- ◆ Improve the regulatory base of accounting (modernizing the regulatory accounting system in accordance with IPSAS to ensure reliability and improve the comparability of financial statements).
- ◆ Improve the accounting system (which will form a unified methodological framework for the functioning of budget organization accounting systems and the execution of budgets at different levels).
- ◆ Increase the transparency and quality of financial reporting.
- ◆ Upgrade the qualifications of accountants and auditors in the public sector.
- ◆ Modernize information systems (providing for the formation of a single information space for the integration of PSA data).

Over the past 10 years Ukraine has taken significant steps to modernize PSA, but further action is needed to create a reliable methodological basis for financial reporting. This includes consolidated financial reports, the creation of a multilevel automated accounting system with a transparent system of summarizing information, and highly professional staff trained in the accounting process.

The implemented NPSAS are based on IPSAS, approved in 2012. It will be necessary to translate the updated IPSAS and conceptual framework into Ukrainian in order to implement NPSAS updates, as well as to decide on the full list of NPSAS to be developed.

In order to ensure the training of accounting specialists who will have the skills necessary to apply the new conceptual framework, a mechanism of interaction will be established between the MoF and the leading educational institutions of Ukraine. This cooperation will lead to the coordination of curricula for PSA specialist training programs within the responsible departments of the MoF. It will also encourage the faculty of leading specialized educational institutions to conduct training sessions to improve the skills of budgetary institution accounting staff.

9

International assistance received

From 2017-2019, Ukraine received international technical assistance from the EU under the project “Strengthening public resource management” to improve Ukraine’s ability to ensure the effective and transparent management of its resources. The MoF supported the project by developing an updated PSA strategy through 2025.

A diagnosis of the current state of the PSA system was conducted with the involvement of WB experts. In addition, proposals were made to the MoF to develop a strategy for the training and professional development of public sector accountants, as well as the implementation of a draft e-learning program.

From 2017 to 2020, Ukraine also received international technical assistance from the EU to “Strengthen public financial systems of local governments” program. Under this project the progress of reform

at the local level was studied, and the basis for further implementation of NPSAS was prepared by translating the full package of the updated IPSAS standards for 2018. Proposals were made to improve regulatory and legal acts on accounting in the public sector to bring them in line with international standards.





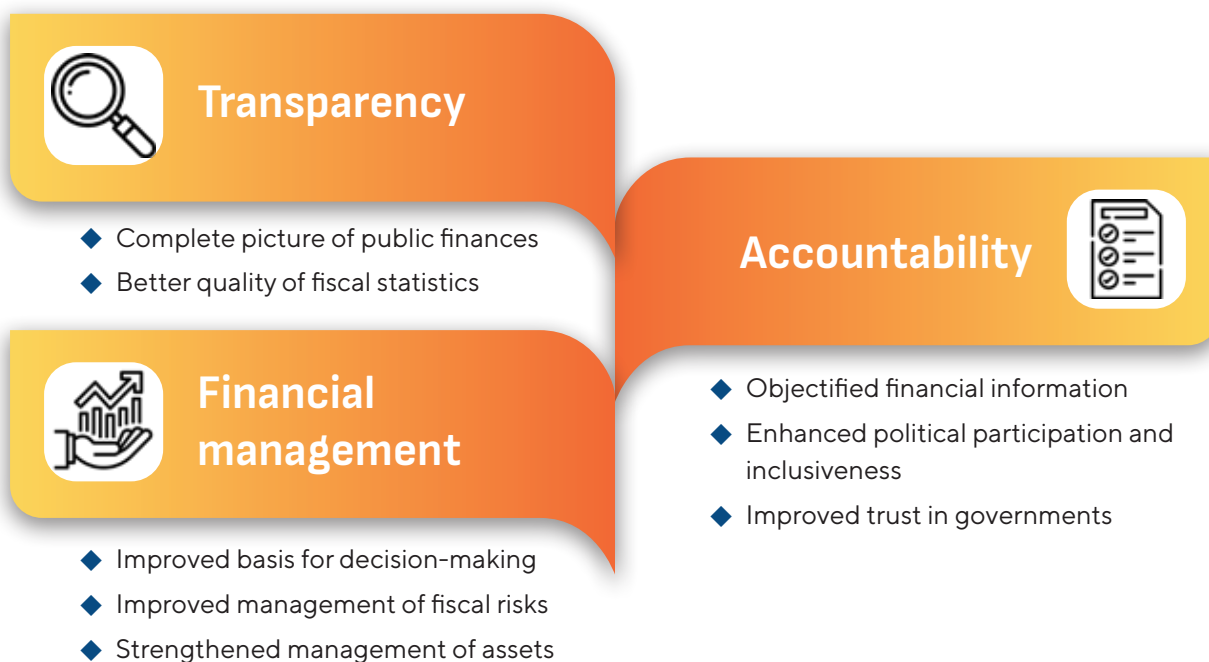
CONCLUSIONS AND RECOMMENDATIONS

Key benefits of implementation of PSA reforms

Efficient and effective PSA systems enable governments to provide information on an entity's overall financial position, the current stock of assets and liabilities, and its revenues and expenditures.

Governments and other users may need this information for various reasons, including, for example, to: (i) demonstrate accountability and transparency; (ii) plan for future funding requirements of asset maintenance and replacement or the repayment of, or satisfaction of, existing liabilities. Various studies confirm different benefits associated with accrual basis PSA systems, particularly in the areas listed in Figure 1.

Figure 1. Benefits associated with accrual basis PSA systems



The implementation of accruals basis PSA systems, based on a robust set of international standards for the public sector and good international practices, such as IPSAS, represents an opportunity for governments to not only improve the transparency, quality, and reliability of their financial information, but also to achieve further indirect benefits, for example:

- ◆ Improving the quality of public services provided.
- ◆ Ensuring fiscal stability and the promotion of national economic growth.
- ◆ Improving the acceptability and credibility of governments.

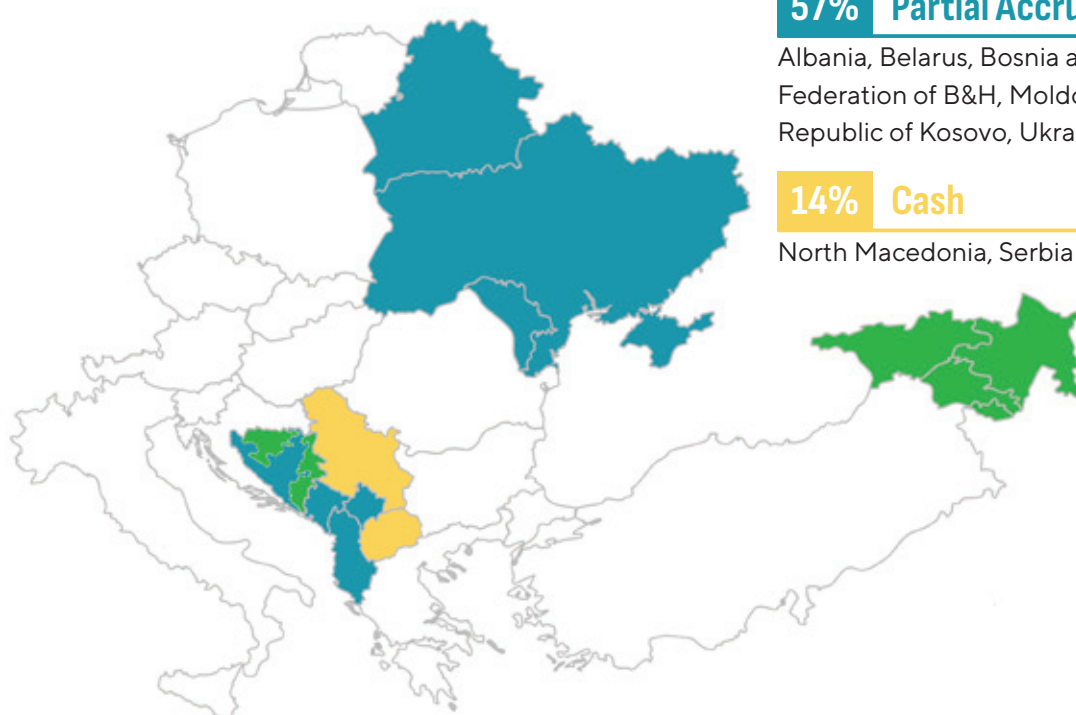
There is agreement that preparation for the transition from cash to accrual accounting and for IPSAS implementation requires an understanding of the gap between national PSA and IPSAS.

Summary of PSA implementation status in PULSAR countries

A look at the PSA reform implementation status highlights certain similarities but also differences across all jurisdictions. The implementation of IPSAS is a central element in each jurisdictions' reform plans and both direct, and indirect approaches can be observed.

The direct approach involves the adoption of IPSAS through changes in the legal framework. This approach has been adopted by Albania, Azerbaijan, RoG, and RS. Conversely, the indirect approach entails the development of national standards in line with IPSAS. This approach has been adopted by RoB, RoM, Montenegro, and Ukraine. While some countries have fully adopted accrual accounting standards, others have adopted a modified or partial accrual (accrual and cash accounting).

Figure 2. Financial reporting basis



29% Accrual

Armenia, Azerbaijan, Georgia, Republika Srpska

57% Partial Accrual

Albania, Belarus, Bosnia and Herzegovina, Federation of B&H, Moldova, Montenegro, Republic of Kosovo, Ukraine

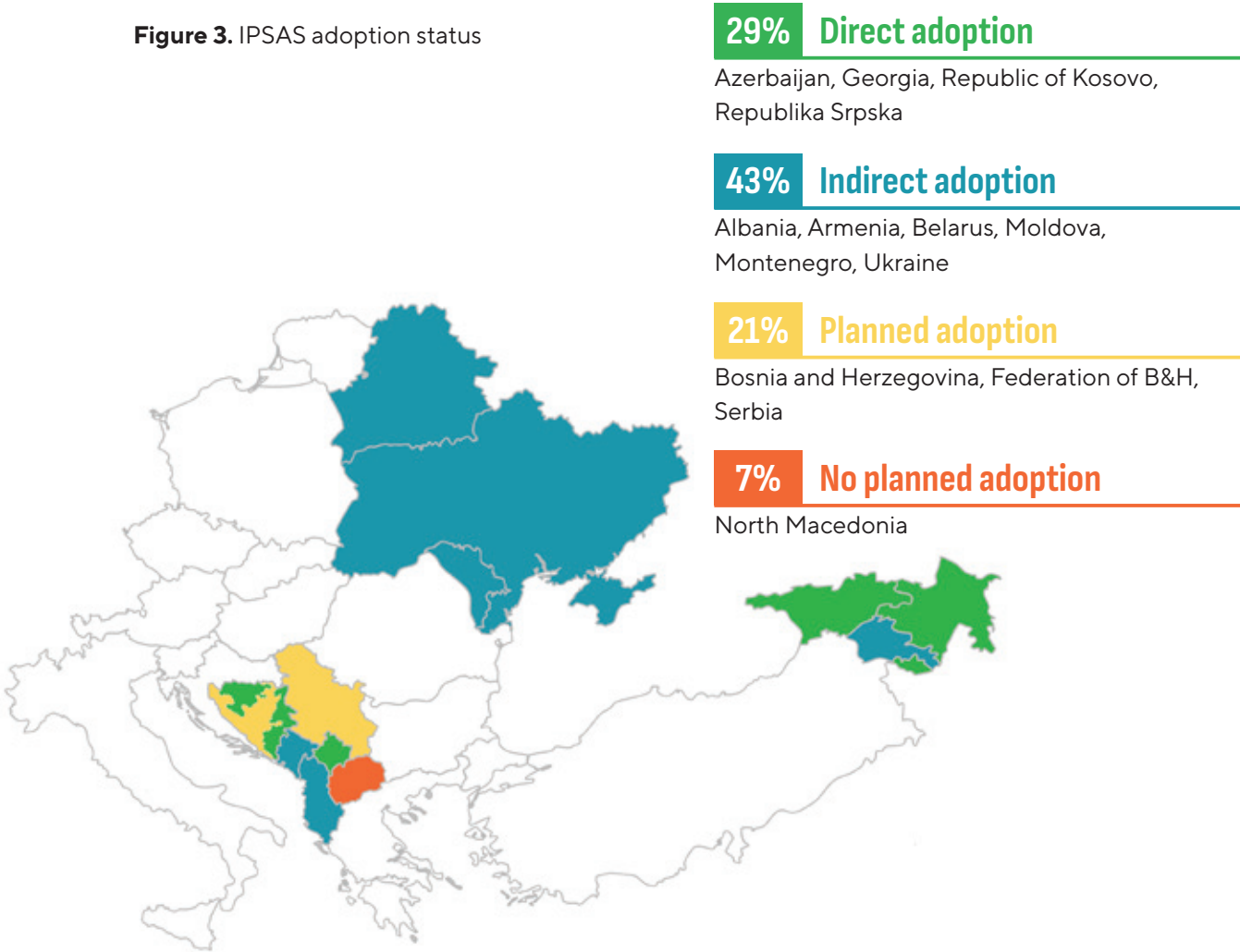
14% Cash

North Macedonia, Serbia

In summary, two stages of implementation status can be identified. The *early stage* group is composed of jurisdictions that are currently developing roadmaps and/or action plans for IPSAS adoption and conducting gap analyses with the goal of transitioning to accrual accounting in the future (BiH, FBiH, RoNM, and RoS). Those roadmaps and action plans include PFM and/or PSA reform schedules with various degrees of detail in planned changes to the national legal framework.

Countries in the *advanced stage* of implementation include those jurisdictions that have either developed a unified CoA and/or are preparing accrual basis financial statements in the public sector based on accrual and partial accrual reporting basis (Albania, Armenia, Azerbaijan, RoB, RoG, RoM, Montenegro, RoK, RS, and Ukraine). Those jurisdictions, based on the data reported by each jurisdiction, have made significant progress in the implementation of PSA reforms, including in some cases the establishment of national accounting standards boards (e.g., in Georgia) or the preparation of a CFS.

Figure 3. IPSAS adoption status



Challenges

The use of either the direct or indirect method presents different challenges. Countries adopting IPSAS *indirectly*, i.e., through national standards, generally face an early challenge in the development of those national standards but tend to find their implementation easier. In contrast, countries adopting IPSAS *directly* find it relatively easy to adopt IPSAS, but challenges are more likely at later stages, i.e., when the standards have to be implemented. In both scenarios, the new standards require a sound legal basis, which, in some cases, needs to be created and in others, at least, updated.

Countries also report other challenges which are not a function of the implementation approach:

- ◆ **Need for capacity building and staff training:** Most jurisdictions emphasize the need for capacity building, including training and retraining of finance and budget officers and professionals on the implementation of IPSAS.
- ◆ **Need for technical assistance:** It was also highlighted the limited availability of financial accounting and reporting professionals in the public sector and how this affects the quality of financial information. Most jurisdictions highlighted the need for technical assistance in the process of IPSAS implementation.
- ◆ **Lack of effective program management:** There is a need for effective program management in the implementation of the reform. Most jurisdictions attribute this challenge to the long-term nature of the program, the interdependency with other public sector programs, and the risk of new developments affecting the implementation of the program.
- ◆ **Lack of adequate IT infrastructure:** All jurisdictions emphasize the lack of adequate IT infrastructure and solutions for collecting and presenting financial information in line with the required standards. There is a need to strengthen IT infrastructure, including software and hardware, to support implementation of IFMIS and the consolidation of financial statements.
- ◆ **High cost of reform implementation:** The high cost of implementing the reform impedes the success of sustainable reform outcome, thus, the jurisdictions also highlighted the need for international financial assistance to support the implementation of PSA reforms.

- ◆ **Conflicts between international standards and local legislation and context:** Potential conflicts arise between local legislation and international standards through harmonization processes. It is therefore crucial to find a middle ground between the use of international best practices and country-specific requirements and needs in the PSA reform process.
- ◆ **Limited availability of financial data:** The lack of reliable financial information for the preparation of financial statements is an obstacle to the reform process and the consolidation of financial statements for central and local governments.
- ◆ **Institutional resistance:** Resistance to change current practices within public sector organizations is a common challenge among the jurisdictions. This fact highlights the need for development of an effective change management strategy which would help to transform the accounting system systematically and strategically within public sector in the PULSAR countries.

Lessons learned and recommendations

From the detailed stories of the fourteen jurisdictions covered in this book and taking into consideration good international practices, it is possible to make some valuable observations, which may be considered key success factors, drivers, and pre-requisites of the reform process. These observations are, at the same time, lessons learned and also recommendations to others who are at varying stages of PSA reform.

1. **Political support and willingness of the key stakeholders to initiate and carry out the reform should be secured and maintained.** Garner visible political support and commitment of key stakeholders at the highest level (such as the MoF and representatives of legislative branch), to ensure political feasibility and offer incentives for changes and successful implementation of PSA reforms.
2. **Reform strategy and feasible implementation timeline should be developed and agreed on.** Due to the long transition time, there is a need for adequate planning and program management that aligns the reform strategy with the specific long-term objective of the reform given the country context, interdependency with other PFM

reform programs, and program risk. Furthermore, a realistic timeline should be set for the achievement of specific reform objectives.

3. **Proper reform coordination and management arrangements should be established.**

Establish different levels and structures for the coordination and implementation of the reform. For instance, establishing project managers at the local government level with coordination and collaboration among them for effective management and consolidation of financial information and data.

4. **Financial and human resources required for the reform should be secured.**

Provide adequate resources, including international financial assistance, technical assistance, capacity building and retraining of public sector accountants and financial professionals as well as adequate investment in IT solutions and infrastructure to support the PSA reform process.

5. **Legal and regulatory frameworks should be timely updated.**

It is necessary to timely align the legal and regulatory framework with international standards and requirements to provide clarity and to build strong institutions for a sustainable reform outcome.

6. **Structure of the new PSA system should be defined.**

A key factor lies in outlining and clarifying the roles of the MoF, National Accounting Standards Board, budget and public sector finance officers, and other key stakeholders. This should also entail agreement on the structure of the accounting function (centralize or decentralize) and the development of respective guidance.

7. **Risk management and mitigation mechanisms should be identified and established.**

Adequate management of risk associated with PSA reforms is essential. For instance, due to the long-term nature of the reform process, it is necessary to effectively monitor new developments as the reform progresses and previously unknown risks arise.

8. **Change management and capacity building strategy should be timely developed and implemented.**

Institutional resistance and difficulty within public sector organizations to adapt to changes is a critical issue in all jurisdictions.

There is a need for development of a strategic and systematic change management strategy to help both public sector officials and organizations in the reform path.

9. **Integration between different PFM functions and upgrading the existing or development of a new IFMIS should be assessed and carried out.**

Since the PSA is a subset of the wider PFM system, there is a need to ensure the PSA reform aligns with other reform initiatives in the PFM system. This interconnection can be achieved by aligning PSA with other PFM systems through an IFMIS as well as updating the IFMIS to incorporate changes in the PSA system in line with the reform.

10. **Reform monitoring and evaluation arrangements should be established.**

Monitoring and evaluation should be incorporated in the PSA reform strategy. This will help ensure continuous learning and improvement in the PSA reform process in accordance with the objectives set out in the reform strategy.

Overall, there is an international consensus that PSA reforms require strong political support and sponsorship. In particular, this support is needed to ensure sufficient resourcing of the reform efforts and to overcome gridlock situations, which are common in public administration.

When deciding on the adoption approach (i.e., direct vs. indirect) of the reform, the experience in the PULSAR region and globally show that both direct and indirect adoption of IPSAS are feasible approaches. Both have advantages and disadvantages which should be addressed in the implementation strategy and action plan. For the indirect method, the process of revising the regulatory framework requires more resources, but in general already addresses some of the implementation issues at an early stage. The direct method, in contrast, is relatively simple at the early stage, but then requires some additional resources for implementation.

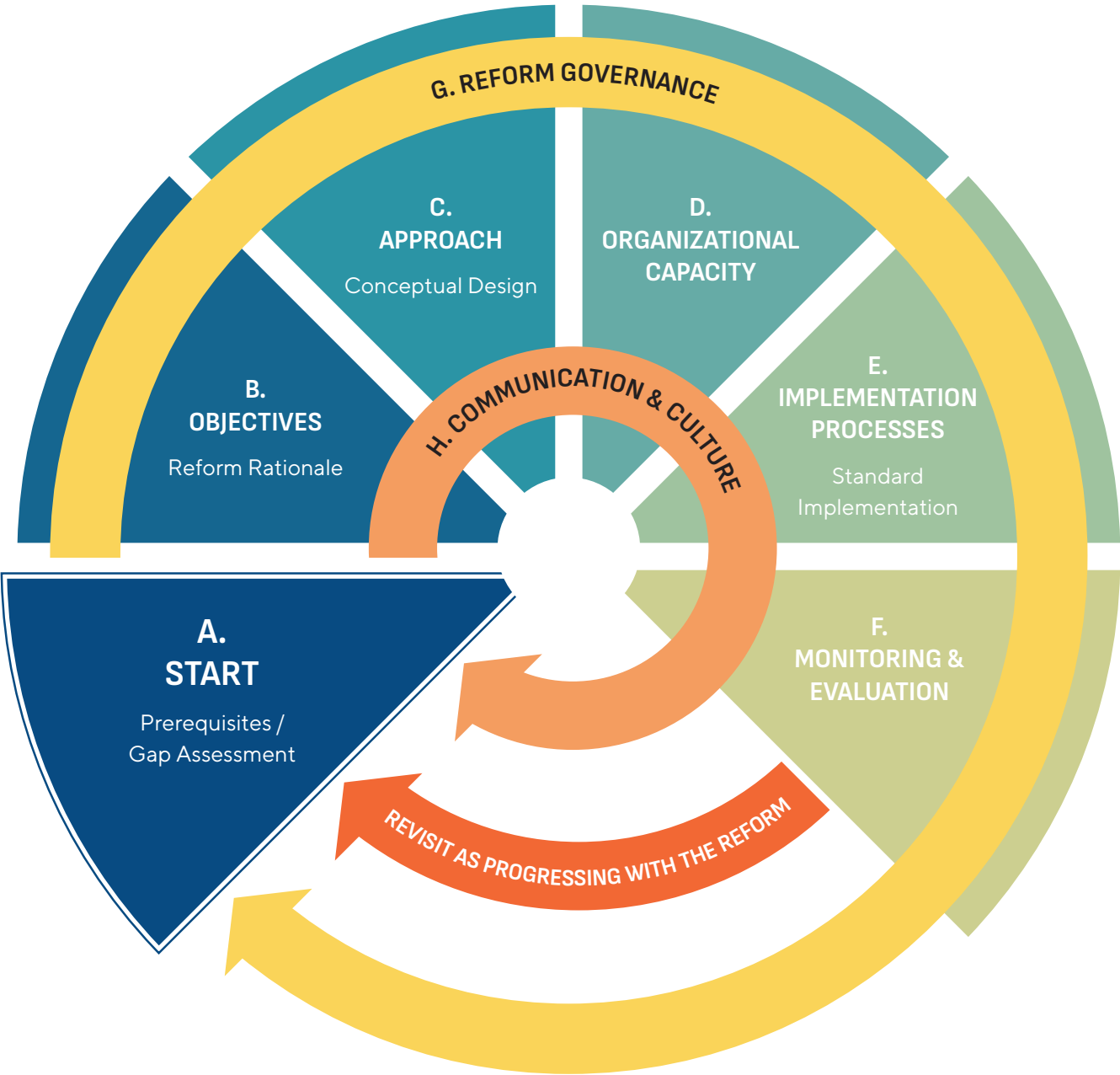
In any case, the integration with other PFM functions, in particular, budgeting, treasury operations and financial statistics, needs to be analyzed and decided. This usually has some implications for the design of the IFMIS, as well as the CoA. In order to mitigate the risk of staff fluctuation, a precise and standard compliant configuration of the IFMIS

should be considered. Finally, the accounting data and information maintained in the IFMIS in almost any country needed to be completed and verified. Often the legacy systems contained some but not all required data. This work usually has to be carried out in the entities but requires some sort of supervision and audit.

Identification of next steps

All jurisdictions covered in this book have embarked on a reform process, however, each is at a different stage. As a general guidance, the following figure illustrates the entire reform process divided into six different steps and two overarching activities, as proposed in one of the first PULSAR publications, “Roadmap to Public Sector Accounting Reform: Good Practice Template.”³⁷

Figure 4. Reform Architecture



³⁷ More information on the reform progress can be found here: <https://cfr.worldbank.org/publications/roadmap-public-sector-accounting-reform-good-practice-template>

The differences in the current reform status of each jurisdiction directly affect the next steps that each jurisdiction could take. The contents of this book, enriched with the most recent local developments, should enable each jurisdiction to identify its location in the reform process and thus recognize the relevant challenges. These placement and identification could be also done using the newly developed by PULSAR team PULSE assessment methodology, which is about to be piloted in 2022.

Based on experience in the PULSAR beneficiary jurisdictions, the best way to deal with the challenges identified earlier in this chapter is through development and preservation of the following four sets of capacities.

- ◆ **Political capacity** is the capacity of a government to secure political support as well as securing the necessary resources (i.e., financial and non-financial) to be consumed and/or invested within the reform process. Political capacity also includes a clear vision and reform objective.
- ◆ **Institutional capacity** is the ability to define institutional arrangements, structures and processes in support of the envisaged PSA and financial reporting reform. It includes proper reform governance and monitoring of the reform process.

- ◆ **Technical capacity** is the ability to set up proper technical infrastructure and other form of capacities (i.e., IFMIS availability and integration of CoA, etc.) to support the reform process.

- ◆ **Human capacity** is the ability to develop a sustainable human-capacity building program, thereby preparing and enabling people to conduct new tasks arising from the envisaged reform.

Addressing, developing, and maintaining all four sets of capacities will build a strong foundation, allowing not only for continuation in the reform process but also to sustain reform progress and outcomes that has been achieved at every step of the way.



THE PULSAR PROGRAM IS

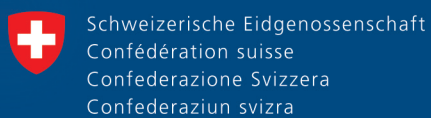
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