

Public
Finance
Management
Reform

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Ministry of Finance of
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Acronyms

GoG	Government of Georgia
MoF	Ministry of Finance of Georgia
CCG	Chamber of Control of Georgia
SWF	Sovereign Wealth Fund
SDF	Stable Development Fund
LEPL	Legal Entity of the Public Law
PFM	Public Finance Management
PFMRPV	Public Finance Management Reform Policy Vision
BDD	Basic Data and Directions
MTEF	Medium-Term Expenditures Framework
GFS	Government Financial Statistics
IPSAS	International Public Sector Accounting Standards
STA	Single Treasury Account
PEFA	Public Expenditure Framework Assessment
VAT	Value-Added Tax

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Introduction

Strengthening public finance remains an important priority of the Government of Georgia. Significant progress has been made since 2004 on improving financial systems and bringing them into conformance with international standards. However, large scale reforms need to be implemented in order to bring Georgian Public Finance Management into full compliance with the best international practices.

In 2007, an independent assessment of the public finance system was conducted by the World Bank and the European Commission through the Public Expenditure Framework Assessment. The assessment report provided guidance for the completion of the Public Finance Management Reform vision document in 2008, the purpose of which was to provide a framework for the coordination of reforms and an integrated approach to improving the public finance system. The vision document identified specific mid-term goals and actions needed to be taken in 2009 in order to achieve the objectives of PFM reform; thus, this report assesses its implementation and progress achieved in 2009.

PFM Components

1. Budgeting

The main goal is to establish a strategic budgeting process that ensures resource allocations are directed towards realizing government policy and strategy priorities and the use of public resources are effective to achieve strategic policy goals.

The new law on the “Budget System” was adopted by the Parliament of Georgia in 2004, fundamentally changing the country’s budget arrangement and budget system. This law abolished all funds that were beyond the budget and established a new budget process and guidelines for inter-relationships between process participants. The law presented a Treasury Single Account, which accumulates all revenues of the State Budget. Additionally, the revised budget preparation and reporting forms make the State Budget more accessible and transparent to the public.

To further enhance the budget system, the MoF began the implementation of MTEF principles in 2005. Based on this, a 4-year Basic Data and Directions document (BDD 2006-2009) was prepared by the GoG. Since then, MTEF is updated and improved annually. Initially, the BDD reflected MTEF of the organizations financed only by the central government; however, from 2007, the BDD document gradually included the MTEF for line ministries, spending agencies, all regions and 5 self-governing cities.

The State Budget Accounting has been in GFSM 2001 classification since January 2008, which makes the public finance management process more transparent. In 2009, the same GFSM 2001 classification was adopted by the autonomous republics and all self-governing cities. In the same period, the budget preparation and reporting format for self-governed units

was changed as well, making information concerning the consolidated State Budget clearer and more understandable for all stakeholders.

1.1. 'Budget Code'

A major step was taken in 2009 to improve the legislation basis for budgeting. Specifically, an entirely new 'Budget Code' was developed, which replaced the existing set of laws and includes internationally recognized best practices.

The following reasons justified the need to develop a new budget code: a) to simplify, improve and unify in one document legislation regulating the budgeting process, b) to further develop MTEF for all budgets (at all levels), c) to unify the budgeting process and budgets at all levels and enhance correlation between them and d) to increase transparency and effectiveness of budget expenditures.

Within the capacity of PSFMRSP, a consulting company was hired to draft a new budget code, and the Dutch Ministry of Finance was also involved in the process. During the first stage, the consultants performed SWOT analyses of existing Georgian and foreign legislation regulating the budgeting process. According to these analyses, a draft of the new budget code was prepared and adoption of the code is scheduled for the end of this year.

When the drafting process was launched, it was decided to strengthen the relationship between MTEF and the State Budget by focusing on improving the budget calendar and reinforcing MTEF and Annual Budget law linkage on a legislative basis. Regarding the proposed budget code, the following changes can be highlighted:

- The terms for the BDD preparation are different. The document is submitted to the Parliament of Georgia along with proposed State Budget Law;
- The BDD defines spending agencies' expenditure ceilings for the next 4 years, giving the document more functions than before;
- If a spending agency's budget request is not in conformity with the priorities stated in BDD, the agency is obliged to give reasonable explanations, and only after that GoG will make a decision about financing the particular priority of the spending agency.
- After approving the budgets at all levels (including local), the MoF is obliged to revise the BDD and present the final version to the Parliament of Georgia,
- Budget reporting will be changed and become more transparent. Particularly, if there will be a significant difference between a spending agency's allocations and actual expenditures for its priorities, the agency will be obliged to give justifications when reporting about its own budget.

- If there is a difference between the confirmed and specified allocations for spending agencies' priorities, the agencies must provide sufficient justifications with the budget report.
- The Full Program budgeting process will be launched from 2012 (medium-term financing of each priority, possible outcome and performance indicators), which will complete the full implementation of MTEF principles.

1.2. Strategic Planning

Apart from the 'Budget Code', the MoF undertook massive reforms in 2009 to improve budgeting. The BDD framework was reviewed, with the aim to improve the linkage between the national and regional strategies and priorities with the strategies and priorities of spending agencies. For the first time, the spending agencies are obliged to develop and approve their own costed strategies and only after they are incorporated within the BDD.

The list of spending agencies that are involved in the 2010-2013 BDD document preparation process was enlarged by the Department of Common Courts, the Constitutional Court, the Supreme Court, the Higher Council of Justice, the Chamber of Control, the Public Defender's Office, the Central Election Commission, the President's representatives in administrative-territorial units -Governors and the 5 self-governing cities: Tbilisi, Batumi, Kutaisi, Poti and Rustavi.

The format of the BDD was modified and updated. Spending agencies' Medium-Term Action Plans are based on the priorities of the Government. Action Plans are categorized by programs and measures of the spending agencies, showing more clearly the purposes of budget expenditures. In order to fully implement MTEF in the Georgian budgeting process, it is necessary to employ MTEF planning for budgets at all levels. The provided information is grouped according to priorities and measures to be realized. Taking this into account, in accordance with the government's initiation, 5 self-governing cities were involved in the BDD preparation process. They presented information about i) their main priorities for the next four years and ii) their financing needs for these priorities. In the future, it is intended to also include in the BDD the priorities of all municipalities.

To develop a comprehensive approach based on medium-term fiscal forecasts and budget policies for setting realistic medium-term ceilings for the spending agencies, the Budget Code introduced the inclusion of the ceilings into the BDD, the BDD will directly determine the following year's budget ceilings for particular spending agencies, which will help to promote the importance of planning.

The existing macro-fiscal framework was audited by an international company with highly satisfactory results, and, thus, the MoF's plan to establish a new framework was dropped. However, the MoF will continue its improvements aiming to finalize necessary changes in 2010.

1.3. Program and Capital Budgeting

Implementing Program and Capital Budgets in the budgeting process is one of the most important issues also relating to MTEF development. As mentioned, program and capital budgets will be an integral part of budgets at all levels. However, with the initiative of the GoG, activities towards this direction have already begun. In 2009, the Parliament received the program budgets as attachments to the proposed 2010 draft budget law, from the Ministry of Justice, the Ministry of Healthcare and Social Assistance and the Ministry of Education, as well as from the Tbilisi municipality and the Adjara autonomous republic.

By ministerial decrees, two working groups were established with a mission to gradually implement capital and program budgeting. The groups include representatives of the MoF, line ministries and foreign experts. The working groups hold intensive consultations with other line ministries and self-governing cities on issues concerning MTEF process. Presented information is analyzed on a permanent basis.

The group also revised budgeting request forms that were submitted to the MoF by spending agencies. Compared to previous years, these forms were simplified and became more informative. At the same time, the relevant attachments were added to the budgeting request forms to prepare capital and program budgets. In these forms, spending agencies provide programs that are financed under the ceilings and justifications to the programs that will be financed above the ceilings.

1.4. Budget Execution Reporting

Within the framework of Public Finance Management together with planning improvement, it is crucial to i) monitor budget execution, ii) modify execution reports and iii) prepare consolidated budget reports. From 1st January 2009, budgets of all self-governing units are in GFSM-2001 classification and categorized organizationally (over the past years, the majority already had functionally classified budgets). New procedures were introduced to municipalities during workshops and seminars organized by the MoF.

From 2009, all self-governing units prepare budget execution reports according to the forms approved by the Minister of Finance. It simplifies the preparation of a consolidated budget report and makes public finance management more open.

In order to increase the level of public accountability and transparency, information concerning the State Budget is constantly posted and updated on the MoF's website. At the same time, Q&A service is always available on the Ministry's website for everyone who is interested in budget issues. Clear answers to questions are prepared and sent to interested individuals immediately.

1.5 LEPL's

One of the major components of public finance management is integrating the budgets of the LEPL's since a large number of their activities are related to the realization of programs and projects defined as priorities of the GoG. Thus, a cohesive database, containing information about all the LEPL's, was created within the MoF. More than 140 LEPL's are reflected in the State Budget and information concerning their budget expenditures is submitted to the Parliament of Georgia quarterly, along with the State Budget execution report. However, in addition to budget resources, some of these LEPL's have their own revenues. Official information about these revenues was not previously available; however, the governmental decree of 6 April 2009 determined that large LEPL's (having high revenues) must provide MoF with semi-annual reports on their budget execution for 2009. The information was submitted to the Parliament of Georgia together with a semi-annual report on State Budget execution. This process proved successful and will be continued.

Furthermore, it should be mentioned that budgeting request include relevant attachments, which should be completed by LEPL's, indicating their budget parameters forecasted for the following year. As a result, budget resources are presented more accurately, are grouped by economic classification and provide significant transparency about LEPL's expenditures.

2. Revenues Mobilization

2.1. Financial Policy

The Georgian tax and customs legislation is undergoing a process of permanent revisions, amendments and changes in order to follow up with international trends in taxation, to encourage investments and to reduce the administrative burden on taxpayers. A new Tax Code came into force on 1 January 2005 and a new Customs Code on 1 January 2007 with the objectives of

- facilitating economic growth – with a minimum number of taxes and low tax rates;
- establishing a stable investment environment – by setting up a solid legal framework and introducing liberal economic principles;
- supporting lawful business – by using strengthened and flexible administration mechanisms to identify and deter dishonest taxpayers;
- increasing culture of taxpaying – by simplifying administrative mechanisms and improvement of taxpayers support.

The new Tax and Customs codes were developed following a fundamental review of tax and customs policies to introduce a more liberal regime. In order to support the implementation of the new rules and major changes to the Tax and Customs codes, considerable effort has been taken to introduce subsequent sub-legislation. From 1 January 2008 to today, 28 regulatory

decrees of the Minister of Finance of Georgia were adopted and up to 500 decrees introduced changes in these 28.

In 2008, the Office of Tax Appeals was established within the Ministry of Finance which serves as a staff for the Council of Tax Appeals. It significantly improved the efficiency of the tax appeals system.

2.1.1. Tax & Customs Sub-Legislation

a) Electronic filing of tax-return declaration - New amendments enable taxpayers, directly or through their representatives, to file tax-return declarations electronically. New forms and rules of filing were developed. On the basis of these forms, tax authorities receive more relevant information with regards to payments in the form of salaries and/or other benefits to employees, range of salaries (highest and lowest amount), payments of dividends and interests, value of goods or services produced in a certain period, etc. At the same time, the rules of filing were simplified, reducing the number of drawbacks. Registration procedures for individuals, legal entities and their branches were simplified and defined in detail.

b) Individuals are not obliged to apply for registration; they could be registered on the basis of submitted declarations. Personal identification numbers coincide with the identification numbers for tax purposes.

c) Introduction of new rules of inventory - The procedures of tax control were not clearly determined, which caused misunderstandings and often became subject to disputes within the Ministry and in courts. New rules of inventory were developed, as one of the important methods of control. To a certain extent, these rules also intend to protect taxpayer rights. As a result, communication between tax officials and taxpayers became more regulated and transparent.

d) Write-offs of valuables and assets destroyed during the war - in order to account for the reality that followed the August 2008 events and to lower the tax burden, certain taxpayers are given the opportunity to write-off valuables and assets destroyed during the war or left behind on the occupied territories. A new form of declaration is introduced for these purposes, indicating the exact information needed for this preferential treatment, thus avoiding uncertainties and enabling the Tax Appeals Board of the Ministry of Finance to decide in favor of the claimants in a given situation.

e) Reduction of the tax burden – The tax burden in some cases proved to be incongruous. In order to lower the tax burden, certain types of activities, by the Minister's decree, are defined as the sale of up to 4 living facilities (a flat or a house) together with attached land in the consecutive 48-months-period are not any more considered as economic activity (which is subject to taxation).

f) Creation of new forms of legal persons - Changes aimed to regulate new international financial institutions within the country, attracting inward investment, encouraging economic growth and sustainable development are of utmost importance. The introduction of free

warehouses and international enterprises into the tax and legal systems will certainly encourage trade and transit within Georgia.

g) Rules are simplified for foreign nationals entering Georgia and traveling for transit reasons by vehicles (without cargo) registered in foreign States. This means simplification of not only the registration of those vehicles, but also control of temporal bringing in or taking out of the vehicles on the territory of Georgia. The filing of a declaration for these reasons is no longer obligatory. The person is only obliged to mark his/her arrival by a sticker in his/her ID document.

h) A one stop-shop principle was introduced for clearance and registration of passenger vehicles. This is an important administrative mechanism that saves time for certain taxpayers as well as for tax authorities. Due to this change, time and cost of compliance is minimized.

i) In order to encourage transit, transporters are no longer obliged to present a guarantee for the transportation of vehicles under customs control. This change allows significant financial savings.

j) The system of risk-based-management ("ASYCUDA") was implemented. Different forms of customs control will be applied by the system. There are 4 channels: green, yellow, red and blue. The risk assessment is performed on the basis of ASYCUDA and its supplementary software, using the price discrepancy and importers/exporters risks analysis. The risk-based checking system significantly reduces not only the time of customs clearance procedures, but also the use of administrative resources. This ensures random, non-human-dependent selection of inspections and, in most cases, minimizes the time and cost of compliance.

k) The practice of specific simplified procedures has been implemented for a certain group of tax payers in the framework of customs-trade cooperation. These payers are eligible to place their goods in their own warehouse instead of the Customs warehouse and to defer payments of import duties up to 30 days. The criteria for selection of the participants eligible for this preferential treatment are also defined in the same decree. These specific criteria, which were defined for inclusion in this cooperation, namely are: experience of foreign economic activity (no less than one year); certain threshold of declared customs value, specific threshold of paid import duties, or quantity of declarations (no less than 100), financial solvency (absence of customs and tax liabilities), no history of serious infringement, registration as VAT payer.

l) By the Decree of the Minister of Finance of Georgia, the International Convention on the Harmonized Commodity Description and Coding System (Harmonized System) was adopted. The adoption of the Harmonized System will further Georgia's compliance with international standards and as well as facilitate the preparatory process for future negotiations on a Deep and Comprehensive Free Trade Agreement (DCFTA) between the EU and Georgia.

m) The golden list program was introduced as a benefit for importers. It offers the possibility to defer payment of customs duties. If the declaration is selected "green" it is considered as accepted and the system automatically assigns a serial number. After the declaration is

assessed, and if import duties will not be paid by declarant, the customs officer will print out the declaration and release goods with the stamp “permissible released against security”. The importer should pay import duties within 30 days.

n) Procedures were defined in order to enable changes in the declaration without further complications. This includes the rules of filing as well as the determination of responsibilities and rights of the declarant and the Tax official. The system of risk-based-management “ASYCUDA” enables the presentation of altered or amended declarations.

o) According to the joint Decree of the Minister of Finance and the Minister of Internal Affairs, phytosanitary and veterinary control was introduced. These procedures are carried out by the Revenue Service. This enables the more efficient use of human resources and ensures better control with regard to safety and quality of products.

p) New instruction for Double Taxation Agreements - Georgia has concluded Double Taxation Agreements with a number of countries. These agreements give additional benefits to residents of contracting states. These benefits include lower withholding tax rates in the country of source or credits for taxes paid in foreign (contracting) states. Existing procedures to claim these benefits are quite complex, time and cost-intensive. The Apostille, regarded as a simplified method of legalization of foreign documents, required by existing regulation is expensive and often impossible to obtain. In order to bring implementing provisions into line with international standards, a new instruction was prepared. The draft instruction on the use of benefits under the treaties abolishes the requirement of any kind of document legalization. New forms will be introduced, which should be filed in order to claim these benefits. The forms are more comprehensive and easier to file.

2.1.2. Tax Disputes Resolution System

a) Amendments of the Tax Code of Georgia to reduce duration of legal proceedings - New amendments introduced to the Tax Code of Georgia will limit time afforded to the respective authoritative bodies to deal with tax appeals. In accordance with the new law, both the Revenue Service (RS) and the Council of Tax Appeals shall have a maximum limit of 65 days (instead of some 125 days) to hear and to deliver a decision on any dispute.

b) Development of Automatic Case-Management System software for tax appeals – In 2009, an electronic system of automatic case-management was developed and introduced within the Ministry of Finance of Georgia, covering both levels of tax appeals system (the RS and Council of Tax Appeals). The purpose for developing this software was to automate legal proceedings and to reduce their duration while simplifying the process for taxpayers and increasing transparency; Furthermore, the software adds a monitoring lever to administrative authorities while providing detailed statistical data and ensuring the involvement of authorities issuing disputed documents. Moreover, the software facilitates the identification of loopholes within the tax system and makes drafting the respective amendments easier for the Government.

- The procedure for making any decision with respect to an appeal is fully automated and does not require submission of draft decisions to various officials.
- The system enables the submission of appeals through different regional centers of the RS as well as online;
- The system automatically informs an applicant about any important decision made with respect to her/his appeal through the SMS telephone service;
- The system automatically generates various statistic tables, including, but not limited to, the amount taxes disputed before different levels of tax appeals system, a list of protracted appeals and time already spent on the case, a list of the most disputed issues (with reference to particular articles of the Tax Code and Custom's Code) and a database with a workload of public officials at agencies reviewing appeals. As soon as a new appeal is registered, the system sends a notice to the respective tax authority, thus avoiding the risk to incorrectly use enforcement (pledge, mortgage, right or sending a collection order) mechanisms against taxpayers.

2.2. Revenues Administration

2.2.1. HR Development

Establish joint training system together with the Ministry of Interior for RS employees –The RS periodically announces recruitment and selection of interns. The purpose of this process is to prepare qualified personnel, further develop and improve recruits' professional skills through trainings and theoretical and practical coaching. Information about the selection process is announced via media advertisements. It is also available on the website of the Academy under Ministry of Internal Affairs. According to the agreement concluded between the RS and the Ministry of Internal Affairs in February 2009, testing, interviewing and theoretical studies of interns are carried out by representatives of the Ministry of Internal Affairs with representatives of the Tbilisi and Rustavi Regional Centers of the Revenue Service.

The course syllabus is designed around Tax, Customs and Audit-related components and are approved and coordinated by both the RS and Ministry of Internal Affairs. Upon completion of the theoretical course, interns must pass examinations and, if successful, are then enrolled into practical studies taking place in the Regional Centers, Tax Inspectorates and other Territorial units. When the probation period is over, interns are interviewed, graded and awarded with the certificates by a special commission.

Overall 545 interns were admitted to the studies:

- 36 finished the full course and were employed in the Batumi Regional Center;
- 167 finished theoretical preparation course;

- 205 are currently participating in the theoretical training course;
- 137 are waiting to begin the theoretical course.

2.2.2 Customs Administration

Gold list becomes functional – The establishment of the “Gold List” began with the creation of the “ASYCUDA World” test server, which includes risk management and risk profile-based, random selection systems. Furthermore, customs staff was trained in “ASYCUDA World.”

In May 2009, the RS received applications from companies who expressed their interest in this project. 4 companies were shortlisted and awarded with this customs-trade participant status.

Currently, 147 customs declarations have been filed by participant companies, of which 124 passed through the “Green Corridor” and the remaining 23 through “Yellow Corridor”.

The “Green Corridor” offers the opportunity to process goods without physical examination and documentary check. Regarding the “Yellow Corridor”, only a documentary check is conducted by customs authorities. “Gold Listed” companies have the advantage of forwarding goods directly to storage premises (bypassing customs terminals) and of paying the relevant customs fees within 30 days from the declaration date.

2.2.3 Tax Audit

Risk assessment tax audit system implemented – A special working group developed risk criteria for tax audit purposes, which are part of the risk management program. Work on this project began one year ago. The reason for establishing this system was induced by following factors:

- In the preceding years, taxpayer selection for an audit was biased and subjective. In particular, taxpayer selection for an audit was determined simply through random viewing of the taxpayer’s information, disregarding the selection list of taxpayers that did not file actual revenues in the returns.
- Increased entrepreneurial activities demanded additional time and human resources for tax audits. Therefore, the development of a strategy for effective resource allocation and result-oriented audit selection methodology was added to the agenda.

Based on these factors, the Revenue Service developed risk criteria that selects high-risk profile taxpayers (according to tax violation) from the database. The selection process is done through an automated analysis of the taxpayer’s registration, returns and other data.

The selection pool were divided into 2 groups – legal entities and individual enterprises – with an adequate risk scoring system. In April 2009, according to the data processed, 24 taxpayers (from both groups) were selected for planned audits, based on their final risk score. New criterias are being developed, and existing ones are evaluated for efficiency, foreseeing changes if necessary. The MoF's Information Technology department provides technical supervision and monitoring of the program.

2.2.5 e-Administration

Establish electronic information exchange system between the commercial banks and the RS – A draft agreement was prepared by the RS and JSC “Procredit Bank” on establishing an electronic information exchange system. Cooperation protocol between RS and this particular bank was justified and brought in conformity with existing legislation. Agreement was signed and is in force from 3rd of April 2009. This mechanism gives RS opportunity to decrease expenses, improve fund administration and simplify procedures for tax payers. RS continues working regarding this issue with other commercial banks too.

2.2.6 Customs Audit

Establish customs audit and fully develop the necessary legislation for risk-based customs control – Amendments made to the customs code in 2008 prepared the legal basis for a customs audit and risk-based customs control system. Since 2008, import control for declared goods has been conducted on the basis of risk management (i.e. after presenting the declaration form to Customs, the automated system assigns a particular form of control). The risk management system was expanded and applies to customs regimes as well.

In January 2009, procedures for post-clearance audit inspection came into force. With the assistance of USAID, several employees were selected for receiving training in customs price valuation and post-clearance inspection. As part of the controlling mechanism, the customs audit is performed based on risk evaluation criteria. Currently, the agenda includes conducting a customs audit of one individual enterprise and one LLC, each selected by the system.

2.2.7. e-Filing

Include all taxes into e-Filing System – The implementation process began in 2007 with the objective to i) simplify declaration and accounting procedures and ii) minimize administrative expenses of the RS. Since then, all taxes were gradually switched to an e-Filing system. On 1 May 2009, the final excise tax was included in the system. The key priorities of this system from the taxpayers' perspective can be characterized as follows: minimize delays while fulfilling tax commitments, no requirement to visit tax authority in person, no requirement to submit a hard version of the documents, each taxpayer can check his own profile online and save taxpayers time and resources.

The result of these changes are very significant, USAID conducted a special study showing that an e-Filing system decreases the time required for processing tax filings by 73%.

The number of declarations e-Filing is expected to reach 10% by the end of 2009.

3. Accounting – Treasury

The Treasury Service is one of the core functional areas in public finance management reform agenda. Substantial reforms have been undertaken by the Treasury in the field of resource management, accounting and reporting since 2004. Significant progress has been achieved in following areas:

- The Treasury took over the management of the Budget Revenues accounting, reporting and settlement from the National Bank of Georgia (April 2004);
- Robust and transparent tax and non-tax refund mechanisms were designed and implemented (April 2004);
- The Treasury Single Account (GEL denominated) became fully functional (January 2006);
- The practice of cash payments was abolished by replacing cash checks with mandatory bank accounts for personnel (January 2006);
- The Treasury became a direct participant of the Inter-Bank Real-Time Gross Settlement (RTGS) System, organized by the National Bank of Georgia (January 2007);
- Cash planning and cash management regulations were prepared and implemented (January 2007);
- As a prerequisite for the accounting reforms, the government financial statistics 2001 manual, which was based on budget classifications, was approved and implemented and the Treasury General Ledger was modified accordingly (January 2008)

In 2009, the Treasury Service continues to focus on public finance management reform implementation, including progress in resource management, improvements in services provided to the budget entities and the public, upgrades in financial management information systems and the implementation of international accounting and reporting standards. Well-defined business process in regulations, coupled with the well-organized information system, ensure the most effective use of the public resources. The Treasury reforms have been implemented based on the Public Finance Management Reform Vision (PFMRV) and as per the PFMRV Action Plan for 2009.

3.1. Deposit Management System

State agencies' deposit management system upgraded to accommodate new functionality requirements - Ready for full exploitation in January 2009, the upgraded deposit management system was implemented before the required March 2009 PFMRV Action Plan deadline.

Since the Budget System law does not allow budget entities to maintain independent bank accounts, these entities hold their deposited funds with the Treasury Service. Practical experience demonstrated the flaws of the previous deposit management system and based on new functionality requirements, a new software application was designed and implemented to address the issue of deposit identification problems and reporting requirements. New coding structures for better identification process and the new deposit management module provide comprehensive information on the total amount of deposits on the Treasury Single Account, the flow of deposits, detailed information on each depositor and the purpose of payments.

3.2. Liquidity Management

Develop draft liquidity management guideline - The Treasury Service is now working on establishing proper mechanisms to deal with excess cash balances on the Treasury Single Account to generate additional revenues for the budget. As per the PFMRV Action Plan for 2009, in the first quarter of 2009, the Liquidity Management Department of the Treasury Service prepared draft liquidity portfolio guidelines. The draft was reviewed internally by the Ministry of Finance and necessary revisions were made. The draft has been shared with the external experts, including the IMF, for their comments. After these experts return their feedback on the document, the Treasury will approve the liquidity management guidelines and implement the liquidity management practices.

3.3. Integrated Public Financial Management Information System

In the PFMRV agenda, one of the largest components is the design and implementation of an Integrated Public Financial Management Information System, including the core-treasury system. The basic structure of the PFMS – including the flow of funds, general reporting requirements, technical specifications and network details – were agreed with the stakeholders and the draft functional and technical design of the system was prepared in July 2009. Preparation of some parts of the system's technical specifications extended past the estimated date; however, currently all major issues are agreed and the draft is being considered within the Ministry of Finance's departments. After the final review of the report from the beneficiaries' side, then it will be revised and approved and, subsequently, procurement will be initiated.

In order to develop the internal understandings of international best practice on PFMS, Treasury personnel conducted a study tour in Ukraine in August and in Slovakia in September 2009 to discuss experiences and issues in implementing their respective PFMS projects.

3.4. National Accounting Standards

Produce national accounting standards and draft necessary amendments to Georgian legislation - MoF has declared its willingness and full support to implementing accounting reform. The accounting reform strategy was formulated and has been approved by ministerial decree #101, 10.02.06. This decree presents the objectives and directions of the reform. The key objectives of the Accounting Reform project are to achieve:

- Direct compliance with International Public Sector Accounting Standards (IPSAS).
- Compliance with the GFS 2001 framework in terms of both its classification system and its accrual recognition basis;

IPSAS contains twenty-eight officially approved standards and additional recommended standards for governments. Compliance with all the required standards requires several years of continuous efforts to achieve. Therefore, an efficient implementation plan is critical for the project's success. The Treasury Service has mobilized technical experts with extensive experience in similar projects to assist the Treasury in designing a detailed action plan for IPSAS implementation. Treasury personnel visited the Slovak Republic's MoF in September to share in their experience in recently adopting IPSAS-based accounting regulations.

In order to make IPSAS materials available for public sector accountants, the Treasury undertook a Georgian translation of the latest version of IPSAS. The expected date for publishing the Georgian IPSAS is the spring 2010. IPSAS 2000 is already translated and published on the MoF website.

3.5. Treasury Single Account

The Treasury's Single Foreign Currency account is fully operational - While the estimated date for the PFMS launching is 2012, the MoF continues upgrading the existing information system and application software to accommodate urgent functional and technical requirements of the public finance management process.

The Treasury Service implemented a considerable project in Q2 2009. The Single Multi-Currency account was established and the necessary software was designed and implemented. Although the PFMRV action plan's deadline for this is the end of 2009, all Treasury accounts denominated in FX were abolished as of July 1, 2009 and all FX transactions are executed straight through the Single Multi-Currency Account. The Treasury runs the new FX information system, which provides precise accounting and more versatile and timely reporting.

3.6. e-Treasury

The electronic Treasury System is fully functional - The Electronic Treasury System software application is completed and tested. The necessary amendments have been prepared and approved that allow for electronic payment document processing. The e-Treasury system eliminates the need for paper document processing and minimizes transaction costs. It is scheduled to be released in January 2010 as per the PFMRPV Action Plan.

4. Internal Audit

In November 2008, the Public Expenditure and Financial Accountability project (PEFA – a joint World Bank & EU Commission for Public Financial Management Assessment) carried out an evaluation of the internal audit functions. The assessment identified that, in most cases, internal audit functions were shared between the General Inspectorates and the Chamber of Control and that there was no legislation or norms for regulation purposes.

The absence of an internal audit unit forced the ministries to request external audit services. Due to the complex nature of internal audits, it was necessary to create a system that could perform necessary functions both in a timely manner and according to specified course of action.

In 2005 and 2006, there was a project to establish an internal financial control system in line with the best international standards. PEFA Report (Indicator 21: Effectiveness of the Internal Audit) states, “A draft Law on State Financial Control suggesting the establishment of a financial control regime that conforms to EU PIFC standards has been withdrawn. A reference is made in Article 44 of the Budget System Law according to which the internal audit would be established in the spending agencies (line ministries and regional authorities) would follow a methodology based on international standards and approved by the MoF and the CoC. To date, such methodology has not been produced.”

The only control mechanism for that period was the “Complex Audit”. Identifying and preventing violations of the law was the General Inspectorates' main task. In most cases, the Inspectorates' auditing capabilities were not of a sufficient quality and level. Furthermore, there was a gap between resources utilized and outcomes realized. For these reasons, the need to develop an internal control system, such as an independent internal audit unit, became increasingly more apparent.

In order to reform the problems and issues inherent to the existing situation while maintaining a proper functioning of internal systems, the MoF established the Risk Assessment and Internal Audit Unit.

The Risk Assessment and Internal Audit Unit of the Ministry of Finance was established on March 2008 in accordance with a 2007 financing agreement between EC and Georgia (“Support to Public Finance Management Reform in Georgia”) with the stated objective of promoting productivity and operational efficiency within all units of the MoF. The Internal Audit Unit, as an independent functional element, assisted the MoF in assessing the specific

existing and future issues related to general management, control and risk management efficiency. The Internal Audit Unit is an instrument that guarantees transparency and independence of the financial management and financial control principles, maintaining and enhancing financial stability of the country.

The establishment of the unit was followed by developing and adopting the “Public Internal Financial Control” (PIFC) document in March 2009. This document is based on the European Union’s PIFC concept and the International Organization of Supreme Audit Institutions’ (INTOSAI) Guidelines for Internal Control Standards for the Public Sector.

PIFC is a strategic document containing plans and activities necessary for the creation of internal control mechanisms in the public sector and minimizing the risk of inefficiency among ministerial bodies. This document also considers the existence of the Harmonization Unit (HU), which was established several months ago. HU guarantees the synchronized function of the internal audit, prevents task duplication and is a control tool for the working process.

In close collaboration with the HU and in line with the best international standards (IFC, IIA), the Risk Assessment and Internal Audit Unit developed internal audit standards, a code of ethics and audit manuals to assist the auditors in preparing the relevant reports (addressing international requirements). Within the scope of this collaboration, training on internal audit issues was conducted for the heads of the General Inspectorates. During the training, participants were familiarized with the internal audit draft law, as well as the internal audit concept and process and also developed a future course of action for internal audit implementation and cooperation.

The Internal Audit Unit is another significant component of the 2009 action plan. The unit has already identified its priorities and highlighted activities for 2010. There are several activities that will be implemented by the end of year, but are not included in the 2009 action plan should also be mentioned. Specifically, these activities include:

- Developing the MoF’s communication strategy;
- Training of internal auditors on managerial accountability and audit procedures;
- Attaining membership in the International Organization for Internal Auditors;
- Developing manual principles for effective audits;
- Conducting pilot audits within 2 ministries and Tbilisi City Hall.

The following activities represent the overall status of the Internal Audit Unit as related to the requirements of the 2009 Action Plan.

4.1. GoG Internal Audit Strategy

According to a 2007 financing agreement between EC and Georgia, “Support to public finance management reform in Georgia”, the Risk Assessment and Internal Audit Unit prepared a document on the “Public Internal Financial Control” (PIFC) in February 2009. A special inter-governmental commission presented the document to the GoG, which approved it in March 2009.

The PIFC document describes detailed plans and activities for the development of the internal financial control system in the public sector. This document is based on the European Union’s PIFC concept and the International Organization of Supreme Audit Institutions’ (INTOSAI) Guidelines for Internal Control Standards for the Public Sector. It is performed by the bodies of legislative, executive and judicial branches of government; the legal entities of public law; local government and self-government bodies and other bodies financed by the State Budget in order to guarantee that Financial Management and Control within the government or government-owned or controlled organizations that spend public funds observe the principles of sound financial management. It aims to give reasonable assurance that transactions comply with the principles of sound financial management, transparency, efficiency, effectiveness and economy, as well as with relevant legislation and budget descriptions. In keeping with standard practice, areas that would normally fall within the scope of PIFC, e.g. government accounting, budgeting, external audit (Chamber of Control) and anti-corruption, are not specifically addressed in the Policy Paper.

PIFC and the Policy Paper reflect the more modern international interpretation of internal control. The view of internal control has been expanded to encompass all internal processes that will help an organization to achieve its goals comprising of human resources, information and communication including written procedures, risk analysis and the ‘control environment’.

The main goal of this strategy is to settle unified internal financial and internal auditing control mechanisms. The complete implementation of the document will guarantee:

- Efficient management of public institutions;
- Proper financial management;
- Managerial accountability;
- Effective and reasonable spending of financial resources.

Admitting the principles of the given strategy obliges public institutions to perform activities in line with appropriate financial management, transparency, efficiency and effectiveness. as well as acting in accordance with the law and the approved budget.

The strategy includes an action plan for the next 2 years, which describes in detail the number and type of activities necessary for the successful fulfillment of the main objectives.

4.2. Internal Audit Harmonization Unit

Approval of the government act on establishing an internal Audit Harmonization Unit - Establishing Audit Harmonization Unit is a significant priority, as determined by the GoG in a PIFC strategy document. The foremost objective of Central Harmonization unit is to:

- Coordinate Audit Divisions' activities;
- Prevent activity duplication;
- Develop and control internal audit process within the country.

At present, Georgia has an active Central Harmonization Unit, which achieves specific measures oriented on internal financial control and internal audit development in the public sector. The unit was established in March 2009 and currently conducts a vast number of activities. Among these activities, it is worthwhile to mention the following: i) legislative basis preparation for internal audit and ii) initial training of the internal auditors. The Harmonization Center is also responsible for the development of i) internal audit methodology and ii) standards, principles, guiding manuals and their implementation into practice. These steps are necessary preconditions for a successful implementation of the Internal Audit institution within the governmental authorities.

Besides the aforementioned, the Harmonization Unit is responsible for conducting and managing trainings and preparing training syllabi. Maintaining the quality of this process at a high level is a guarantee for continuous professional development of the internal auditors.

4.3. Information Protection

Establish a legal request for Information Protection through backup, virus protection, etc. - In order to improve data protection, the Risk Assessment and Internal Audit Unit carried out an inspection within MoF in May 2009. The main goal of this inspection was an assessment of the existing network, operating system and related technical capabilities in the RS. The division developed particular recommendations and an action plan targeted on eradication all problems uncovered during this assessment.

These activities include:

- Developing effective communication system between the IT department and the RS;
- Creating additional vacancies for IT workers in regions,;
- Purchasing expert services and conduct inspections, identifying difference between agreed and actual speed provided by network operators;
- Developing problem solving manuals for regions;
- Implementing an effective system for monitoring problems;

- Assessing the condition and quality of the existing PC's and technical equipment;
- Installing licensed antivirus software;
- Changing workload incompatible software "Citrix";
- Identifying the unit which will be responsible for the proper functioning of technical appliances.

The identified recommendations are mechanisms for protecting data nationwide. They include particular actions in various units of the MoF (including regions and districts) and are aimed at defending the system from malwares and external attacks.

The IT department considered all the recommendations and successfully performed the relevant activities (See IT 3.2).

4.4. Law on Internal Audit and Inspection

Prepare an internal audit-related legal initiative – For institutional development of the internal financial control, managerial accountability and internal auditing strategy, it is necessary to establish a sufficient legal basis and framework.

In June 2009, a draft law on internal auditing and inspection was prepared by the Risk Assessment and Internal Audit Unit in close collaboration with the Central Harmonization Unit and the legal department of MoF. The draft also includes comments and notes proposed by the EU expert. Mainly, this law regulates the scope, requirements, principles, general methodology, standards and other issues with regard to Financial Management and Control and the internal auditing process within the public sector.

Under this law, "public sector entities" refers to the users of the Budget of Georgia, budgets of municipalities, state funds, independent regulatory bodies and other legal entities in which the government or municipalities have a controlling stake. Financial Management and Control is an integral process within the activities of an entity for the purpose of providing a reasonable assurance that the goals of the entity have been achieved through compliance with legislation, regulations, internal policies, contracts and procedures; the provision of reliable, complete and timely financial and operational data and reporting; the economy, efficiency and effectiveness of activities and use of public funds and resources; effective internal communication and the protection of assets, information and other resources against losses.

Financial Management and Control relates to both financial and non-financial processes and activities in the operation of the entity. Financial Management and Control is carried out in all organizational units at all levels of the entity, and covers all resources of the entity.

The main purpose of this law is to promote internal audit principles and practice according to the best international standards.

4.5. HR Development

Internal audit trainings for ministries and other state bodies - One of the key priorities within this reform is to provide executives with initial trainings concerning internal audit issues. This will facilitate a successful implementation of the internal audit process within the public sector. The first training took place in July 2009. The list of participants included representatives from all ministries, the Chamber of Control and Tbilisi City Hall. An intensive 4-day training program was designed around Internal Audit concepts, standards, best international practices, etc. Furthermore, the participants also expressed their comments and suggestions about “Internal audit and inspection” draft law.

The adoption of the internal audit concept should be performed without any mistakes, delays and in full synergy with the financing agreement. Recommendations should be given by well-qualified and professional public auditors. Therefore, it is very important to train and develop those who will be responsible for the internal audit implementation within their institutions.

4.6. Internal Audit Guidelines

Develop internal audit standards, code of ethics and common manuals – The development of these items was carried out in close cooperation with the Central Harmonization Unit, based on the best international practices (IFC, IIA). These standards regulate the principles of internal auditors’ independence, objectivity and impartiality. It also gives a definition to the “Professional Responsibility” principle, quality assurance and management assessment criteria.

Audit Standards is a significant and crucial document designed to help auditors perform professional responsibilities at a high level and follow the aforementioned principles reflected in the relevant audit reports.

In September 2009, a draft code of ethics and common manuals were developed and upon adoption of a law on internal audit, these documents will be released for implementation.

4.7. Internal Audit Regulations

Develop standard regulations for internal audit division, job descriptions with clearly defined responsibilities and accountabilities - A draft charter regulating the responsibilities of the audit divisions was developed in September 2009. It has already been agreed upon with the Ministries and Tbilisi City Hall. The charter outlines in detail the principles related to internal auditors independency, responsibility and proficiency. It also contains details on structural organization, functions and other specific points for the internal audit divisions. The establishment of this charter will have a serious impact on the internal audit development

process. Within this scope, the charter also helps to develop a single concept and the necessary methods for successful implementation of these reforms.

Attachment

As with the MoF, Public Finance Management includes reforms in the Chamber of Control of Georgia (CCG) and the State Procurement Agency (SPA). These independent bodies are currently undergoing a process of institutional and capacity building.

CCG - For the improvement of public accountability and oversight of PFM, the Chamber of Control of Georgia presented its 2009 - 2011 Strategic Development Plan (SDP). The SDP describes in detail the CCG's functions, objectives, core values and key challenges, as well the future actions for its strategic and capacity development, which are:

- Institutional and organizational development of the CCG;
- Introduction of a modern audit methodology;
- Increase transparency;
- Develop IT Infrastructure.

SPA - The reforms in SPA are based on the project activities as planned in accordance with the World Bank grant "Strengthening E-Government Procurement" 2006-2009. The major activities developed under this document can be summarized as follows:

- **Strengthening E-Government Procurement (E-GP) legal framework**
 - Review of the current public procurement law and related legislation;
 - Preparation of amendments compliant with International practices in related to E-GP;
 - Present, Publish and Distribute newly implemented regulations to stakeholders.
- **Strengthen E-GP Institutional Framework and Management Capacity**
 - Increase SPAs authority and build capacity within the Regulation and Supervising Public Procurement System;
 - Assess the strengths and weaknesses of institutions to implement E-GP and provide recommendations on institutional options, organization and management arrangements;
 - Prepare a comprehensive procurement training strategy to develop E-GP experts.
- **Promote public awareness in procurement reforms and E-GP**
 - Increase mass media campaigns and dissemination of information activities.

Chamber of Control of Georgia

The Chamber of Control of Georgia (CCG) is undergoing an institutional and capacity building process. Within the institution, several working groups have been created to carry out the activities envisaged by the various programs, projects, strategy, etc.

Since January 2009, the CCG has initiated several critical initiatives with the objective of institutional development. The CCG has revised its mandate in the public sector according to the international standards, reorganized its institutional structure and updated its SDP, which consists of the range of strategically important activities for 2009-2011. The CCG conducted an open meeting with all existing donors and potential partners in May 2009, where the SDP was presented and discussed. The CCG developed several implementation routes for its SDP and conducted a second open meeting with donors and potential partners on 7th October 2009, where the CCG reported on the progress that has been made since the adoption of the new SDP in May 2009, and any implementation problems related to the SDP were discussed.

Organization and management - As a result of reorganization and reforms, the CCG operates underneath a new organizational structure. This improved organizational structure is built on the principle of the functional differentiation. The functional content and scope of activity has been defined for each structural unit (audit departments). This should ensure a specialized approach to policies subject to audit. Furthermore, this will develop and provide institutional memory and ensure institutional heritage. This will help to i) accumulate information on audit findings, ii) develop methods to resolve uncovered problems, and iii) share knowledge amongst the CCG staff. It also promotes the development of data based on the audit reports, develops a bibliography of institutional memory. It should be noted the reorganization concerns not only the audit departments, but also other units that provide essential assistance to the auditing process and that play an important role in the proper functioning of the CCG.

Legal framework - The new Law on the Chamber of Control of Georgia was adopted on 26 December 2008 and entered into force on 28 January 2009. Based on the new Law, the new edition of “The Rules of Procedure of the CCG” has been prepared and enacted on 13 March 2009 and contains rules on the proper functioning of the CCG in accordance with the Law.

Human Resources & Training - GFPAA Training Information - Over the past 2.5 years from 429 persons initially enrolled in the training (ACCA) program, only 40 remain as current participants. The CCG has observed that the number of trainees is significantly less than originally estimated. Therefore, the CCG and GFPAA agreed to amend the terms and conditions of the Contract in accordance with the Contract rules. The amendment has already been signed and states that the maximum number of students will not exceed 40 (since there are currently 40 people at various stages of the ACCA program). Therefore, the CCG will not send any additional students for ACCA training, and only the current participants will finish the full course. The CCG is willing to cooperate with the GFPAA on drafting the qualification programs for auditors since a combined strategy will couple the ACCA’s expertise on accounting with the CCG’s expertise on auditing.

Recruiting new staff - The CCG started a new project of recruiting new staff, focused on auditor-trainees. The project is envisaged by the new Law that aims at attracting newly graduated, young professionals at the CCG and encouraging their professional development,

both theoretically and practically. 50 auditor-trainees have been selected from a pool of 1,400 candidates. The auditor-trainees have been engaged in a 3-month theoretical course within the professional training program, which is comprised of 4 main components: 1) financial, 2) legal, 3) accounting & auditing, and 4) computer proficiency. Over the next 3 months, they will be involved in practical functional operations of the CCG, particularly within the audit teams to conduct the audit (as direct participants in the process), to write the audit reports and statements and to take part in the various processes of analysis.

Developing new professional training program for all staff – SIGMA, in cooperation with CCG, conducted a workshop on “Developing Training Set-up and Training Program for State Audit”. The workshop was initiated in accordance with the CCG decision to set up a regular training system. The workshop provided the CCG with additional information on what needs to be accomplished to move forward. Now, the CCG is analyzing this information and developing a relevant action plan.

Audit standards and methodology –At the CCG a working group is composed to draft auditing standards that are fully aligned with the international standards. Audit standards draft is comprised of 5 standards that include: Basic principles, General Standards, Code of Ethic, Planning, evaluation of effectiveness of internal controls, testing, and Reporting standards. The Audit standards are already drafted and are being scrutinized. Deriving from the standards, in parallel the same group is working on the Implementing guidelines for audit standards. Next step is drafting audit methodology.

External relations - The CCG is committed to address external relations issues. This component includes 2 main objectives: International and domestic relations. In terms of international relations, the CCG is now establishing links with donor organizations and Supreme Audit Institutions of foreign countries with the objective to receive technical assistance for the institutional and capacity building processes.

As previously mentioned, the CCG is engaged in close cooperation with SIGMA to acquire its assistance. Additionally, the CCG has conducted negotiations with the Swedish SAI to cooperate in TA for capacity building. In fact, the CCG already signed a Letter of Intent (LOI) on 16 September 2009 in Stockholm with the Swedish National Audit Institution. In November 2009, an assessment team will visit the CCG to outline the potential areas of cooperation. After these areas are identified in detail, a general agreement will be signed in the beginning of 2010.

The CCG has revised its cooperation framework with the GTZ. The new Cooperation Memorandum was signed on 24 August 2009, which outlines concrete measures to be taken during the time defined thereof.

The CCG is now developing its Communication Strategy that includes an external/internal communication concept, which is CCG’s institutional development popularization concept. The basic methods for achieving these goals should be developed within the framework of a communications strategy, as should the specific implementation procedures.

State Procurement Agency

State Procurements Agency (SPA) has undergone various stages of evolution since its establishment as a State Procurement Department under the Ministry of Economy in 1999. After legislative changes and amendments were made in 2001, the Procurement Department transformed and became a Legal Entity of Public Law and the supervisory functions remained with the Ministry of Economic Development. Finally in 2007, the supervisory functions were transferred to the Government of Georgia, thus avoiding possible conflict of interests with other state institutions. SPA is an independent body coordinating and monitoring activities in the area of state procurement. The main functions of this agency are to:

- Prepare normative acts and bidding documents and to ensure their harmonization with international standards;
- Analyze the current status of state procurement;
- Organize trainings and seminars for governmental institutions, representatives of media and other stakeholders;
- Provide procurement agencies with recommendations and consultations;
- Establish a unified database and implement new technologies;
- Guarantee transparency and accountability.

In 2007, a working group was established to study and analyze the World Bank's report concerning state procurement, as well as draft changes and amendments to acting legislation. As a result, the team developed a number of recommendations in accordance with the report, which was presented to the supervisory board.

The reforms and structural changes initiated by the SPA significantly improved public credibility towards the state procurement system and procedures. A number of individuals and legal entities participating in tender processes were increased dramatically. Tenders are conducted on a competitive basis, and all participants are treated equally and protected from unfair competition. All information concerning SPA, current or past tenders, successful tender bids and tender award agreements is posted on the public websites www.spa.ge and www.tenders.gov.ge. SPA also established a database containing information about individuals who act inappropriately during the tender process, which is also posted on the websites. To enhance transparency, accountability and public awareness, the SPA developed a series of commercials which are released via television and published media with the assistance of the World Bank.

Presently, the SPA has prepared a package of amendments to the law on "State Procurement", which was presented to the Parliament of Georgia. These amendments will position state procurement on a more technologically advanced level. They will create the opportunity to conduct procurement procedures electronically, manage state resources effectively and, at the same time, minimize expenses. The establishment of a unified procurement system will:

- Simplify the procurement process and results monitoring;
- Reduce state procurement processing time;
- Increase transparency;
- Abolish constraints between purchaser and supplier.

The unified procurement system is also focused on the creation and development of a competitive environment, through information availability to all interested individuals, both domestically and internationally. From a practical perspective, the System is very intuitive and user-friendly, minimizing formalities and paper-based activities.

The state procurement's institutional development created a need for conducting technical capability studies within the larger procurement agencies. Based upon a competitive tender, expert services were selected and a feasibility study was conducted, of which the recommendations have been submitted to the SPA.