



PUBLIC
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ROOT CAUSE ANALYSIS OF PROBLEMS IN THE FINANCIAL MANAGEMENT ON THE LOCAL LEVEL AS DETECTED BY THE STATE AUDIT OFFICE OF GEORGIA

PROJECT:
GOOD GOVERNANCE
FOR LOCAL DEVELOPMENT,
SOUTH CAUCASUS



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Abbreviations

ALGA	Association of Local Government Auditors
AMS	Audit Management System
CHU	Central Harmonization Unit
CAE	Chief Audit Executive
CAO	Chief Administrative Officer
E-	Electronic-
FMC	Financial Management and Control
GIZ	Gesellschaft für Internationale Zusammenarbeit (German Corporation for International Development)
IA	Internal Audit
IIARF	Internal Auditors Research Foundation
IT	Information Technology
LGA	Local Government Association
MoF	Ministry of Finance
MRDI	Ministry of Regional Development and Infrastructure
NALAG	National Association of Local Authorities of Georgia
PEFA	Public Expenditure and Financial Accountability
PIFC	Public Internal and Financial Control
PFM	Public Financial Management
PFMIS	Public Financial Management Information System
SAO	State Audit Office
TSA	Treasury Single Account

Executive Summary

The State Audit Office's main role is to strengthen accountability, transparency and integrity by independently auditing public sector operations and reporting on their findings. To correct identified deficiencies, the SAO issues recommendations that should be implemented by auditees in the predefined timeframe. The review of the last four years' recommendations showed that the implementation rate of SAO's recommendations referring to municipalities, although improved, remains low (38%) and the shortcomings related to the impact and effectiveness of SAO's recommendations persist. Identified deficiencies are repetitive not only across municipalities but also over time for the same municipalities. More precisely, deficiencies related to the Financial Accounting and Reporting and the Management of Public Procurement, Budgetary Resources, and Public Assets are prevalent almost in all municipalities.

The overall goal of this report is to contribute to the improvement of the audit cycle in Georgia by stocktaking and assessing recurrent problems and findings of the SAO reports at the municipal level. In particular, the study enables to identify the root-causes influencing municipalities' ability to efficiently and effectively implement audit recommendations issued by the SAO. The scope of the study was SAO's audit findings and recommendations issued referring to the last five years. The analysis has been performed with the support of the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) within the framework of the program 'Good Governance for Local Development in the South Caucasus'.

The research applied qualitative and quantitative methods to obtain information on the root causes of recurring problems in the municipalities. Specifically, primary and secondary sources were analyzed to obtain information on the performance of individual municipalities and compare them to the world's best practices. Semi-structured interviews were conducted with internal/external auditors and representatives of the central and local governments, international and local NGOs; and data and statistical analysis were conducted for more analytical insights for all municipalities. We have selected 16 municipalities for in-depth analysis of primary information.

The report presents the root causes in three sections as follows:

- System-level root causes - refers to key elements of the local government performance and accountability framework, including the formulation of appropriate institutional and regulatory arrangements. This section identifies the present weaknesses or gaps in the existing arrangements in municipalities where reforms will be required. This will require cooperation and collaboration by all bodies involved in the local governance system, together with clear leadership from the central government.
- Municipal-level root causes - identifies repetitive recommendations in municipal audits, that are related to either absence of proper rules and procedures, or low conformance with certain existing rules. Based on the interview results and the detailed review of audit findings and recommendations, the potential causes of not enacting or implementing recommended rules or guidelines could be authorities' lack of willingness to regulate some municipal activities, shortage of financial or human resources, or the complexity of implementation of the initiative since it requires the involvement of multiple stakeholders.
- SAO-level root causes - as part of our review, we assessed follow-up arrangements and the role played by external audit, and identified the areas and activities where SAO can create more incentives for recommendation implementation.

The research team prepared recommendations that would contribute to the elimination of the root causes of the recurring deficiencies in the municipalities.

1. **Municipalities have not established adequate systems in place to follow up on audit recommendations. We recommend that:**
 - 1.1. **Municipal agencies' should amend their procedural arrangements** (charters/ Internal rules and procedures) accordingly to reflect provisions for:
 - Assuring that, management officials throughout the agency understand the value of the audit process and are responsive to audit recommendations.
 - Setting-up a formal process to ensure all recommendations from SAO are actively tracked and reported.
 - Designating a senior management official to serve as an audit follow-up official to oversee audit follow-up, including resolution and corrective action.
 - The audit follow-up official, among other things, should have responsibility for ensuring that: timely responses are made to all audit reports; disagreements are resolved; actions are actually taken, and Regular progress reports are prepared and sent to the head of the Municipality (Mayor/Gamgebeli) and when necessary, to those charged with governance (Sakrebulo/ Audit Subcommittee).
 - Documenting systems of audit follow-up, resolution, and corrective action;
 - 1.2. **Municipalities' should report periodically on the status of the audit recommendation to Sakrebulos.** As per the good practice example of the central government, this special report can accompany the annual budget execution report.
2. **The municipal financial management system is at an early stage of development.**
 - 2.1. **Legislators should consider an amendment to the Local Self-Government Code that would introduce a new non-political position - City Manager or Chief Administrative Officer (CAO) position in municipalities.** The city manager would be responsible for day-to-day operations and implementing all reforms in municipalities, including FMC. The roles of each key public sector management position, both political and non-political, need to be clarified within the hierarchy of executive organizations. As a result, multiple overlapping responsibility lines will be eliminated, ensuring that everyone in the hierarchy is held accountable for their decisions.
 - 2.2. **Sakrebulos should obligate Municipality heads to acknowledge responsibility for internal control and performance of municipality in their annual reporting -** Municipalities' should present a report of management on the company's internal control over financial reporting to Sakrebulos. This will also provide a basis for SAO to express opinion on internal controls.
 - 2.3. **The Government (MoF) should strengthen the existing PIFC regulatory framework (PIFC Law and PIFC Policy Paper) by preparing FMC methodological documents (including a manual on managerial accountability) that will describe in detail FMC implementation procedures.** This will ensure that clear and comprehensive guidance is available to municipalities.

3. **The Sakrebulo exercise low legislative scrutiny and involvement in the audit process-** Sakrebulo must put more emphasis on audit reports while exercising their oversight power, despite the improvement in the trend of audit hearings. It is recommended that:

3.1. **Sakrebulo strengthen and implement effective municipal oversight mechanisms** designed to ensure:

- Dedicating more time and attention to audit results discussion;
- Inviting both parties (municipality management and audit representatives) to audit report, as well as other relevant persons (sectoral commission member, subject matter experts);
- Implementing a formal discharge procedure regarding audit results;
- Commissioning independent audit annually;
- Continuously developing the technical capabilities of Sakrebulo members and supporting staff who consume audit results and follow-up on audit recommendations;

3.2. **Sakrebulo established a specialized working group/subcommittee** which could play an important role in monitoring the implementation of recommendations. Good practice examples involve:

- development of standard procedures and schedules for Sakrebulo discussion on SAO reports that makes timely conclusions possible;
- requiring action plans from municipalities, and setting deadlines for measures to be taken;
- considering sanctions in cases of serious non-compliance with recommendations from the SAO or Sakrebulo (political, financial and disciplinary);
- requiring reports from the municipality's management on implementation of adequate measures.

4. **The role of internal auditors in follow-up can be strengthened** - strong internal audit functions can increase the implementation rate of SAO recommendations, and facilitate external auditors' engagements because they can rely on controls and use the work of internal auditors. As studies show, many deficiencies exist in the two most important aspects necessary for an effective internal audit function, independence and expertise. These are the factors that SAO also considers when determining to what extent they can use the work of the internal auditor. Therefore, it is recommended that:

4.1. **Sakrebulo should amend the statutes on internal audit functions to increase their independence.** More precisely, an internal audit office should report functionally to the respective Sakrebulo or audit commission/committee and administratively to the mayor. To achieve this goal, the statute should make a Sakrebulo responsible for:

- approving decisions regarding the appointment and removal of the head of internal audit office
- approving the remuneration of the head of internal audit office,
- approving internal audit plan,
- approving the internal audit budget and resource plan
- Receiving annual reports of internal audit office on the internal audit activity's performance relative to its plan and other matters

4.2. **The CHU in collaborating with donors and professional associations should strengthen competencies of Internal Audit functions through Certification and continuous professional development programs by:**

- continue developing an internal auditor certification program that would be tailored to the needs and requirements of Georgia's local government, and would be delivered in Georgian language
- make internal auditor's certification obligatory by law after launching the country-wide localized internal auditors certification program.
- initiate to make it compulsory by law to obtain a certain number of CPE hours related to the subject matter for all internal auditors.
- define the general description of the professional development programs that will be acceptable to meet CPE requirement
- define criteria that should be met by organizations providing CPE program
- initiate to start issuing a special authorization to be a CPE program provider
- encourage and support internal auditors' professional groups to establish an official IIA chapter that would contribute to the capacity development of the local internal auditors, including professional strengthening of CHU.

4.3. **It is recommended that CHU coordinate the implementation of an audit management system (AMS) to technically strengthen municipal internal audits.** This will help ensure compliance with the PIFC law and IIA standards, as well as effectively manage activities.

5. **Policies are needed to promote sustainable development - there are set of factors that can promote the implementation of policies and their sustainability. These include:**

- **Role of IT systems are crucial in sustainable reforms** - IT solutions can be leveraged to improve administrative or service delivery processes in municipalities for achieving sustainable results.
- **Reform coordinators can incentivize institutional reforms** - Key factors that can trigger or facilitate public sector reforms and their sustainability are related to the more specific pressures and institutional reform incentives from reform coordinators from the central government and donors, e.g. conditional budget support instrument is one of those that was recently introduced by central government to municipalities.
- **A comprehensive approach is needed to integrate a wide range of sectoral strategies** - Linking the development of key strategies to the overarching plan of the municipality will increase the chances of them delivering sustainable results. As we have found out during interviews with municipalities, strategic/operational planning is a challenge for most of the municipalities, administrative duties are implemented mainly spontaneously.
- **The role of donors in sustaining reforms is essential** - there is a need for a more institutionalized tool to share created knowledge and technical expertise, especially in the context of municipalities.

Taking into consideration above mentioned factors, it is recommended that:

5.1. **A coordinating agency from the central government /NALAG has to launch the online knowledge sharing platform** - To ensure wide electronic distribution of new knowledge or

insights relevant to municipalities, and create an opportunity to equally and timely distribute the value that donors create with their technical support to particular municipalities. This e-library will serve as the medium of exchange of new knowledge, information and ideas on municipal affairs and support building institutional knowledge, and creating professional information sources in Georgian language.

- 5.2. **Coordinating agency from central government with the involvement of municipalities shall create a performance management tool.** It should align different interdependent domains of a performance management system, including sectoral strategies, municipality strategic planning, performance measurement, evaluation, and program budgeting within municipalities. The system will support municipalities to establish a strong system of financial management and control. Vis a vis improved performance management, this will directly support managing and tracking audit recommendations.
- 5.3. **Relevant coordinating agencies (MoF, MRDI, NALA) to elaborate and deliver onboarding and continuous professional-development program for newly elected officials,** aimed at increasing municipality leaders' understanding of fundamental information regarding municipality governance as well as boosting their soft skills.
- 5.4. **Relevant coordinating agency (NALA) with the support of donors to develop a score-card for sustainable municipalities as a tool to incentivize reforms** - It could be utilized as a regular approach to evaluating and assessing municipal fiscal and operational performance. The results of the assessment could be integrated into larger development projects. For example index results could be used as baselines for assessing municipal progress, for programing guidance, and as indicators of progress; using results to recognize and reward good performing municipalities, and therefore direct their political will.
- 5.5. **Donors to further strengthen National Association of Local Authorities of Georgia's (NALAG's) knowledge-sharing and capacity development role** - considering its goals and similar associations' experiences in other countries, NALAG should play a key role not only in improving the qualifications of appointed and elected officials of LSGs and expanding knowledge sharing activities but also undertake initiatives supporting ongoing reforms in municipalities and incentivizing their sustainability.

6. The State Audit Office can implement a range of activities that will help promote the implementation of recommendations. Namely:

- 6.1. **SAO can further enhance cooperation and the synergy of work with intended Users, such as civil society budget oversight organizations (media, CSOs, and citizens) and with Sakrebulo Members.** The communication between SAO and Sakrebulo should be formalized and it should support the strengthening of relations between the two. This may be achieved by:
 - Actively participating in audit hearings by SAO;
 - Building the technical capacities of Sakrebulo members to monitor/track recommendations implementation status through ARIS;
 - Organizing training and other forums between staff of the SAO and members of Sakrebulo in order to develop a common understanding and approaches to improving governance and internal financial control;
 - Organizing technical level workshops for Sakrebulo administrative staff to train them in understanding and making use of audit reports;
 - Giving access to the members of Sakrebulo to SAO's recommendation follow-up e-system (ARIS) and sharing with Sakrebulo Members, at least annually, information on the progress of their respective municipalities' audit recommendations.

- Adding an analytical section to the SAO's biannual consolidated report on audit results in municipalities about the implementation of the recommendations, comparing different municipalities to their implementation rates, and providing information about the challenges and systemic issues associated with implementing the recommendations.
- 6.2. **SAO shall evaluate the effectiveness of internal controls in municipalities, including internal organizational arrangements for implementing audit recommendations** - it is in SAO's best interest to place greater emphasis on assessing internal controls, including internal organizational arrangements affecting the implementation of recommendations which, in turn, will contribute to realizing the full benefits of audit work. Further, in order to reinforce follow-up of its recommendations, SAO may consider assessing internal organizational arrangements of auditees influencing implementation of audit recommendations in every audit as part of the internal control assessment procedures.
 - 6.3. **SAO can facilitate trainings and knowledge sharing in municipalities** - Based on systemic shortcomings or good management practice examples identified in municipality audits, SAO can prepare better practice guidelines that will help municipalities share others' experience and learn from it. It is also recommended that via different professional forums, thematic coordination groups and trainings, SAO: creates a space to share better practices to overcome challenges in municipality management, and facilitates institutional partnerships in the spirit of mutual learning and targeted co-operation.
 - 6.4. **The cooperation between the SAO and internal auditors needs to be further strengthened** - A memorandum of understanding signed by SAO and CHU is an excellent example of an established cooperation framework. Nevertheless, this opportunity for cooperation was not fully utilized. In order to fulfill the MoU requirements, an Action Plan has to be prepared. A set of actions should be proposed and discussed annually between SAO, CHU and donors to facilitate implementation of the MoU.

Acknowledgments

We are grateful for the cooperation of the many local government representatives who participated in our research and shared their valuable time and insights with us. We thank the State Audit Office for continuous assistance and for providing valuable information for the research. We wish to express our sincere thanks to the representatives of the Ministry of Finance, Ministry of Regional Development and Infrastructure, and all interviewed Donors and Civil Society Organizations for their open and very helpful discussions.

PART I: Introduction

The State Audit Office (SAO) is the supreme audit institution in Georgia. SAO's main objectives are to promote legal, efficient and effective use of public funds and other assets of material value, as well as to protect the national wealth and property of autonomous republics and local self-government units, and to improve public financial management. SAO conducts Financial, Performance and Compliance audits in order to strengthen the accountability, transparency and integrity of government and public sector entities, and to ensure proper spending of public resources.

The audit results of the SAO show similar budgeting issues across various municipalities, including ineffective use of funds, flawed priority determination, irregularities in procurement, an opaque personnel policy, incorrect planning and billing in construction projects, and insufficient internal audit procedures. Therefore, in order to prevent further misuse of public funds, as well as ineffective planning and spending, municipalities should follow SAO's recommendations.

Implementation of the audit recommendations by the municipalities will result in enhanced accountability, improved operations, cost savings and safeguarded assets¹. Audit recommendations provide a valuable means to bridge the gap between standards and agency practices, as well as to provide learning information.

1. The scope and purpose of this report

The overall goal of this report is to contribute to the improvement of the audit cycle in Georgia by stocktaking and assessing recurrent problems and findings of the SAO reports at the municipal level. In particular, the study enables us to identify the root-cause factors influencing municipalities' ability to efficiently and effectively implement audit recommendations issued by the SAO. The study aims to analyze what factors made it difficult for municipalities to take corrective actions on the unresolved and recurring irregularities raised in prior year audits. The analysis of these factors will facilitate the development of appropriate policy responses. Scope of the study was SAO's audit findings and recommendations issued referring to the last five years.

The objective is to find systematic problems that hinder good local governance, their underlying root causes and what needs to be changed or to be newly introduced to overcome these root causes, i.e. propose a range of actions to help address these challenges. In doing so, the difference between treating symptoms and curing the actual underlying problems shall be made clear. One of the possible outcomes of the report is to identify further development areas that donor(s) can support.

1 Aikins, S.K., 2012, 'Determinants of Auditee adoption of audit recommendations: Local government Auditor's perspectives', *Journal of Public Budgeting, Accounting & Financial Management* 24(2), 195–220. <https://doi.org/10.1108/JPBAFM-24-02-2012-B002>

2. Research methodology

The research applied qualitative and quantitative methods to obtain objective and reliable information on the root causes of recurring problems in the municipalities. The project team:

- Conducted a rigorous literature review encompassing external/internal audit reports, PEFA assessments, other reports evaluating LSG performance, and the best practices of municipal governance.
- Defined municipality selection criteria that were used to choose 16 LSGs for in-depth analysis.
- Analyzed correlations between recommendation implementation rate and other chosen municipality selection criteria for all municipalities.
- Interviewed internal/external auditors and representatives of the central and local governments, international and local NGOs to get their insights on potential root causes of the prevailing problems in municipalities.
- Created the list of potential root causes responsible for the low recommendation implementation rate.
- Conducted analytical review of the entire SAO's recommendation database and in-depth analysis of recommendations for the selected municipalities. This analysis aimed to identify which of the root causes might be a reason for low performance.

2.1. Literature review

The literature review covered individual LSG assessment reports, official documents related to the regional development in Georgia, and better practice guidelines on local government. More precisely, to obtain the information on the performance of individual municipalities and to understand the previous and current trends of municipal development in Georgia, the project team reviewed the following primary sources:

- SAO audit reports that cover years 2015 to 2019 -100 reports
- SAO's biannual consolidated report on audit results in municipalities – 3 reports
- PEFA assessment reports conducted from 2018 to 2021 – 47 reports
- Sample of action plans of municipalities related to audit recommendations
- Sample of Internal Audit reports at a municipal level
- Sample of Statutes and rules of procedures of Municipality Mayors and Sakrebulo, and
- Other municipal related documents

To understand better the current regional development trends in Georgia and the world's best practices of municipal government, the team also reviewed the following secondary sources:

- Strategic policy documents related to municipalities (including General, Sectoral, Regional program development, Memorandum of Understanding (MOU) and etc.)
- Evaluation /assessment reports of local and international experts referring to good governance challenges at local level
- Better practice publications, standards, and guidelines relevant to local government with specific reference to audits.

2.2. Selection of Municipalities

One of the most important selection criteria of municipalities was the implementation rate of audit recommendations. The team used the SAO's recommendation follow-up dataset, comprising 818 recommendations. The dataset covers audits performed over the last three years (2018-2020) and refers to fiscal years 2015-2019.

Moreover, the team considered the following two more variables in the selection process: reliance on transfers from the central government (percentage of own budget) and the existence of the Memorandum of Understanding (MOU) between municipalities and the Ministry of Finance. The budget-related data and the list of MOU were obtained from the Ministry of Finance. Georgia has a heterogeneous population distribution across around 55 cities living in different social and geographical conditions. Therefore, characteristics such as the number of inhabitants, rural or metropolitan location, and the share of minority ethnic groups in the regions were used as other selection criteria. These data were obtained from the National Statistics Office of Georgia.

To summarize, for sampling, the team utilized the following criteria:

- High/low implementation rate of recommendations
- Memorandum of Understanding between LSGs and the Ministry of Finance
- Urban cities vs small municipalities
- Financial strength
- Other low priority criteria (population, ethnic minority)

Additionally, we have ensured to choose one representative municipality from each region of Georgia. Out of twelve regions including the capital city, 16 municipalities were selected for detailed analysis and interviews.

2.3. Statistical analysis - Correlations

A statistical analysis was conducted using data that could have an impact on the implementation of the recommendations (Appendix C). The bivariate Pearson Correlation is commonly used to measure the following:

- Correlations among pairs of variables
- Correlations within and between sets of variables

2.4. Interviews

The team conducted semi-structured interviews with 16 internal audit representatives and 5 managers (current or former Mayors) from a sample of 16 municipalities to obtain specific information as well as to facilitate discussions for in-depth answers. Moreover, the team interviewed civil society organizations involved in PFM accountability, SAO auditors, donors, and the representatives of the Central Government's coordinating units such as the Ministry of Infrastructure, the Ministry of Finances, and the Central Harmonization Unit. The respondents provided their perception of the challenges municipalities are facing and shared their opinion on potential root causes of low/high recommendation implementation rates. The detailed information on respondents is presented in appendix A.

2.5. Defining Root causes

Before defining root causes of the recurring recommendations, the research team identified which deficiencies/findings had a repetitive nature over years across municipalities. For this purpose, the team compared the findings described in the SAO's biannual consolidated reports on audit results conducted in municipalities in 2014-2015, 2016-2017, and 2018-2019 and identified repetitive deficiencies. These reports do not analyze explicitly root causes of the recurring deficiencies in the municipalities but since according to the audit standards, the recommendations are aimed to address and fix the causes of the deficiencies, the team based on the information given in the reports defined potential root causes of discovered deficiencies.

In addition to SAO reports, the research team used multiple sources for identifying potential root causes. The interviews were one of the primary sources, especially with the representatives of coordinating central government units and internal and external auditors. Moreover, the team compared the existing recommendation follow-up practice in the municipalities to the international standards and best practices to identify gaps.

3. Limitations of the study

The study summarizes many of the studies conducted in municipalities over the last decade and by its nature focuses largely on challenges and problem areas.

The main limitations of this study were:

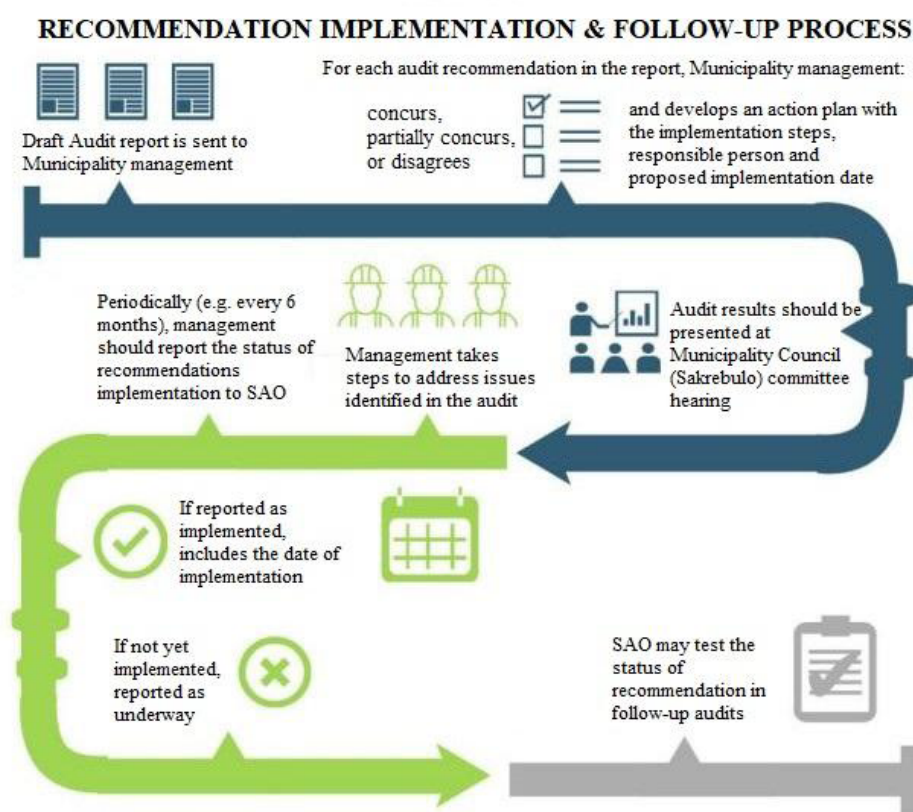
- Representative sample bias - there are 69 municipalities, and the study was limited to the interviews and analysis of primary documents of only 16 selected municipalities. Although the findings are not representative of all the municipalities in the country, the current study could form the basis of understanding systemic issues related to all municipalities in Georgia.
- Quality assessment of SAO's audit recommendations – one notable limitation of the study is that it did not attempt to assess the quality or feasibility of SAO's recommendations.

PART II: Background on the State Audit Office and Municipalities

1. SAO's organizational arrangements to issue and monitor the implementation of recommendations

The SAO's mandate is defined by the Constitution² and the organic law³ of the State Audit Office of Georgia. In addition to the central government entities, the SAO audits municipal self-governments. Namely, two out of nine audit departments in SAO are responsible for auditing municipalities:

Figure 1. Recommendation Implementation & Follow-up process



1. Self-Government Entities Audit Department - carries out audits of local self-government entities as well as enterprises created by 50% or more equity participation by local self-government bodies.
2. The Audit Department in the Autonomous Republic of Adjara – in addition to audits of the legislative and executive branches of the Autonomous Republic, is responsible for auditing local self-government entities within its territory.

Every two years, SAO presents a consolidated report to the Parliament of Georgia about audit results in municipalities⁴.

² The constitutional mandate of the State Audit Office is defined by Article 69 of the Constitution of Georgia

³ Organic law of Georgia on State Audit Office. <https://matsne.gov.ge/document/view/17506?publication=18>

⁴ Law of Georgia on State Audit Office of Georgia, 2008, volume VII, article 31, paragraph 5 <https://matsne.gov.ge/document/view/17506?publication=18>

Audit follow-up is an integral part of good management and is a shared responsibility of municipality management officials and auditors. The benefit of audit work is not in the recommendations made but in their effective implementation. Corrective actions taken by management on resolved findings and recommendations are essential to improving the effectiveness and efficiency of Local Government operations.

According to the law of SAO⁵ audit reports and recommendations shall be presented to the audited agency and to those charged with governance. The auditee should notify the SAO within one month of the measures to be taken with respect to the recommendations.

Measures to resolve audit recommendations should be defined in a corrective action plan - specific form defined by SAO and filled out form should be officially communicated back to SAO. Periodic monitoring is performed by the SAO. It thereafter classifies the recommendations as implemented, partially implemented, not implemented, underway.

According to SAO's performance reports and ongoing Development Strategy⁶ implementation of recommendations issued by SAO still remains a challenge. The existing recommendation follow-up mechanism proved to lack efficiency⁷ and SAO started to revise its follow-up system. SAO has recently developed an electronic monitoring system - ARIS, to monitor the implementation of SAO recommendations elaborated in the mentioned reports. This shall ensure transparent and comprehensive coordination of the process, facilitating a timely and appropriate fulfillment of the recommendations. The system contains all the necessary information and documents related to the process of implementing recommendations. It includes audit reports, deficiencies identified within the audit and recommendations for improving them. All final audit reports issued by the SAO will be monitored by the audit follow-up system and it will establish specific levels of responsibility for review, resolution, and action on audit recommendations.

2. Local Governments and Public Administration Reform

In 2014 Parliament enacted the Law on Local Self-Government (LSG)⁸. By the new law, the own competencies of the municipalities were expanded and the system of internal institutional arrangement of self-governance was changed. Municipalities are independent of the central government but rely on grants and this reliance varies depending on the size of the municipality. Delegated powers from central government to municipalities are assigned along with the applicable material and financial resources.

The Local Self-government Code defines governance structure for the municipalities and self-governing cities. LSGs are governed by a directly elected local legislative body, municipal or city assembly/council (Sakrebulo) and by an executive branch (City Hall) that is headed by a directly elected Mayor. The members of assembly (councilors) and the mayor are elected for a period of four years. The chairman of the municipal or city assembly (Sakrebulo's tarmjdomare) is elected for the same period by the elected councilors. The assembly oversees the activities of the executive branch. It also reviews and approves the local budget, approves local socio-economic development plans and rules how to manage municipal property, introduces taxes and fees as well as any other measures defined by law. The executive branch implements decisions taken by the assembly. The mayor is the supreme official of the city/municipality.

5 Article 24 of the Organic Law of Georgia on the State Audit Office

6 Development Strategy of SAO 2018-2022, SAO-Development-Strategy-2018-2022.pdf

7 Ibid

8 Organic Law of Georgia Local Self-Government Code. <https://matsne.gov.ge/ka/document/view/2244429>

The size of the municipalities varies considerably in terms of population with some as small as 4,000 while Tbilisi has in excess of 1 million. The condition of municipal budgets is yet another factor illustrating economic development capacities and regional disparities across the country.

Figure 2. Municipal Government Structure



PART III: Overview of findings & recommendations

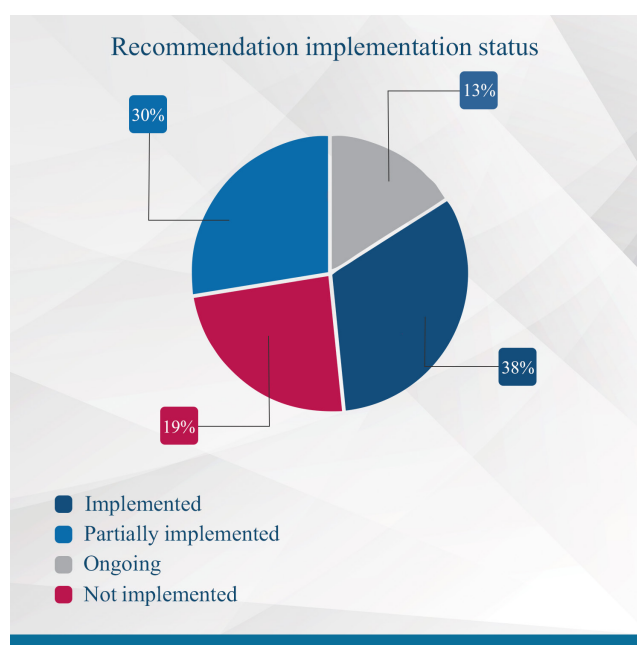
Municipal audit reports revealed that most of the municipalities were not taking corrective action on the issues of irregularities raised in prior years audits; hence, some of the weaknesses and problems remained unresolved or were recurring yearly. **The implementation rate of SAO's recommendations, although improved, remains low and the shortcomings related to the impact and effectiveness of SAO's recommendations persist.** We analyzed a recommendation database of 100 audit reports referring to local government entities. SAO assigns four different implementation statuses to its recommendations: implemented, partially implemented, ongoing, not implemented.

1. Results of Quantitative Analysis

1.1. Recommendation implementation statuses

The SAO's recommendation database contains more than 818 recommendations that were issued to municipalities in the last three years (2018-2020) and refers to the fiscal years of 2015-2019. **The average implementation rate of all of these recommendations is 38%.**

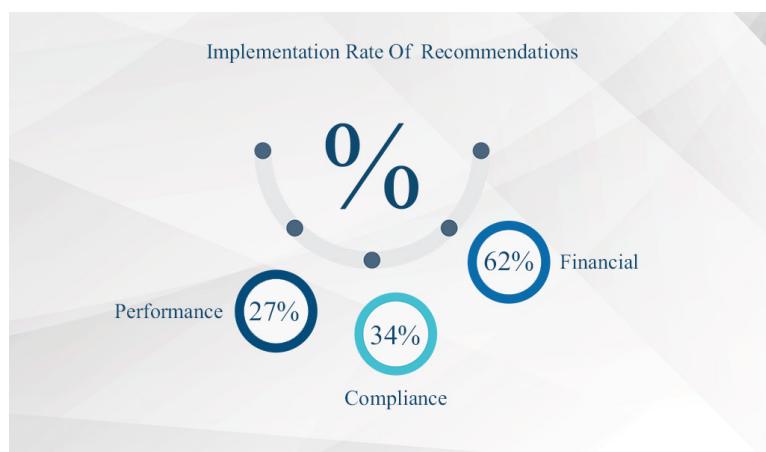
Figure 3. Recommendation implementation status



1.2. Implementation Status by Audit Types

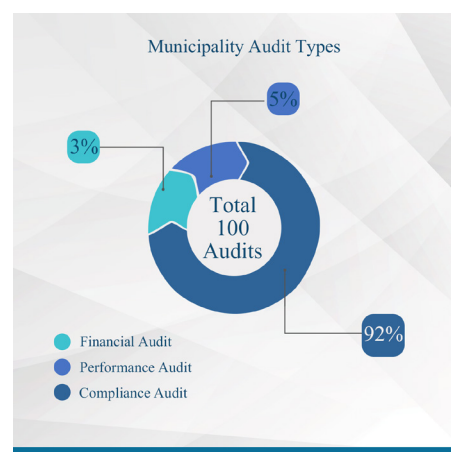
The most common type of audit (92%) conducted in municipalities was compliance audit, and the implementation rate for compliance audits is - 34%. **Financial audits have the highest recommendation implementation rate (62%), while the rate for performance audit was the lowest (27%).** This is easily explained by the fact that performance audit recommendations are more complex by nature, directed to organizational changes or system reformation, while financial audit recommendations are more technical and easy to implement.

Figure 4. Implementation Rate of Recommendations



Source: State Audit Office

Figure 5. Municipality audit types and their share in total

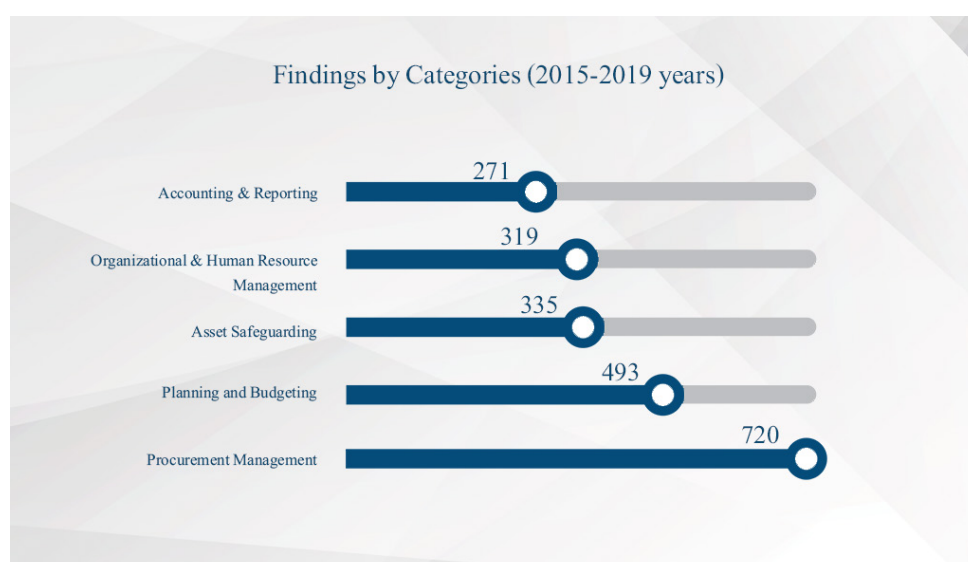


1.3. Audit findings by categories

For audit findings and recommendations SAO utilizes its own classification methodology to identify risk areas, which is mainly used for internal planning and reporting purposes in SAO. Based on this classification structure, there are five broad categories of recommendations: Procurement management, Budgetary management, Organizational and Human Resource Management, Accounting and Reporting, and Safeguarding of Assets. These categories and their frequency in audit results is illustrated below.

The main risk identified by audits are non-compliance with legislation (mostly procurement management), inefficient and wasteful budgetary expenditures (planning and budgeting category), and poor asset management, the cause of which mostly can be traced to weak internal controls within municipal agencies.

Figure 6. Findings by categories (2015-2019 years)



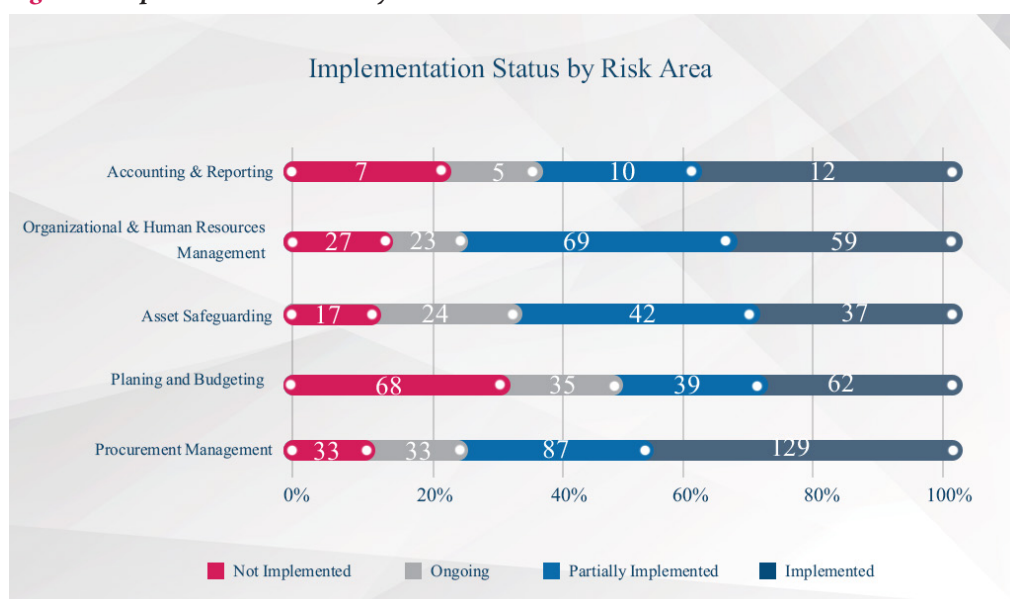
Source: State Audit Office

1.4. Recommendation implementation statuses by risk areas

Figure 7. Recommendations by Risk Area



Figure 8. Implementation Status by Risk Area



Source: State Audit Office

As seen from above charts, the majority of recommendations refers to deficiencies in procurement management. Though it was easiest for municipalities to implement those recommendations: 46% (129 out of 282) of recommendations were already implemented, while only 12% (33 out of 282) were not. However, the same cannot be said for the 'Planning and Budgeting' risk area: 33% (68 out of 204) of recommendations have been noted as not being implemented, indicating that local governments lack strong systems to facilitate more effective fulfillment of audit recommendations.

1.5. Statistical Analysis results

Based on statistical analysis⁹, the bivariate Pearson Correlation coefficient between recommendation implementation rate and the following variables was measured:

- Signed Memorandum of Understanding between select municipalities and Ministry of Finance
- Urban status of municipality
- Financial strength expressed in share of own revenues
- Population
- Budget

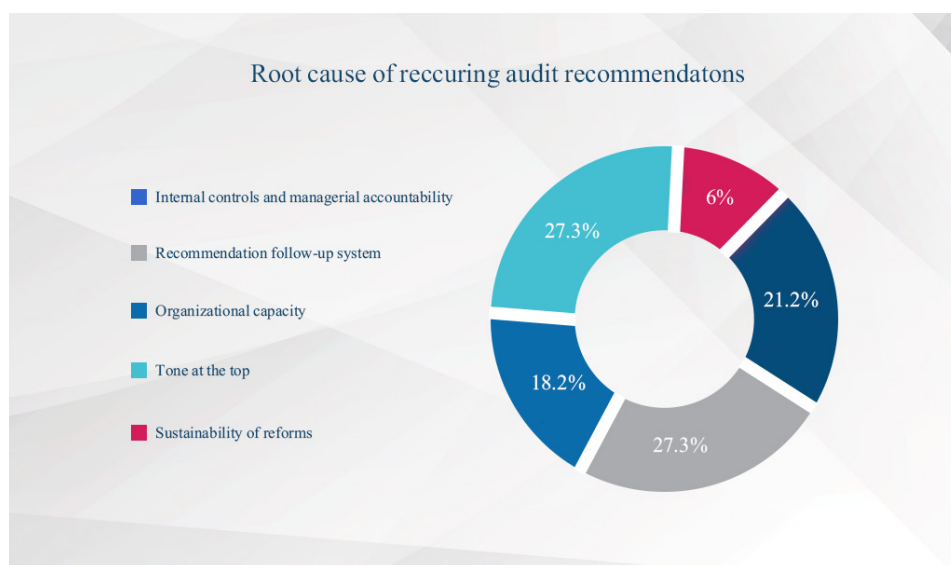
Based on the results of statistical analysis, the selected variables and implementation status of recommendations show no relationship to one another (appendix C).

Due to limited insights from quantitative analysis, qualitative research became increasingly important via semi-structured interviews with the internal auditors of the municipalities, mayors, and various non-governmental organizations, the recommendation implementation processes involved and the circumstances under which municipalities are operating and primary document review in selected municipalities.

2. Results of Qualitative Analysis

2.1. Insights from interviews

Figure 9. Root cause of recurring audit recommendations



During interviews, we discussed the challenges respondents identified as obstacles to implementing audit recommendations and promising strategies or successes they could report. While none of the findings are new and many of them are echoed in other research and analytic reports or the more general policy implementation literature, the comments and examples provided by the respondents offer rich insights that were helpful in defining problems and proposing solutions for improved systems in LSGs.

⁹ IBM SPSS (version 26)

Interview respondents provided insights that fall into five broad categories of root causes for recurring and not implemented audit recommendations:

- **Internal controls and managerial accountability** - during the interviews municipality managers mentioned that **one of the main existing challenges is the lack of proper planning and monitoring of performance at the institutional level**. This was justified by the fact that most of the time, municipalities have to work ad-hoc and in “force majeure mode”. According to other interview participants (donors, CSOs, SAO auditors), different domains of the internal control system is the foundation of municipalities’ inefficiency and probably recurring audit recommendations. Namely, **there is no established accountability and reporting system in place, delegation of duties is mostly informal and is not linked to concrete objectives and achieved results or performance can not be measured by predetermined KPIs. Concerns were raised about independence and quality of Internal Audit functions** as well. They expressed hope that ongoing reforms of Public Internal Financial Control (PIFC), program budgeting and public service reform of the performance appraisal system should contribute to the improvement of the municipalities’ performance in the future.
- **Recommendation follow-up system** - being one of the most commonly named causes of recurring recommendations. According to the respondents, **reasons of low implementation rate should be searched for in the entire process of recommendation follow-up both on part of SAO as well as from other institutions involved in recommendation implementation or oversight (e.g. municipal agencies, audit committees/subcommittees of municipalities)**. Additionally, respondents from the municipalities’ management mentioned that **lack of recommendations’ clarity and straightforwardness as one of the areas of improvement**. As another major root cause found during the interviews, respondents (mostly external and internal auditors) pointed out that the **low implementation level of recommendations is primarily due to the lack of consequences for not implementing them, since SAO can only recommend but not enforce**.
- **Organizational capacity** - amongst the many factors hampering the implementation of SAO’s recommendations could be **unavailability of financial resources and time**. However, this was not named by respondents as one of the major factors affecting the implementation rate. The problem of capacity was concerned mainly with the **issues of inadequate human resources capacity in terms of qualifications, skills and experience**. Some respondents mentioned the **problem of vacant positions that are reportedly filled on the basis of nepotism and political connections rather than fit for purpose**.
- **Tone at the top** - expressed both in **low commitment and high resistance by municipal leaders to implementing reforms and therefore audit recommendations**. Complexities of the local government operations and an increasing need for effective leadership for the management of its resources require the local government to have an effective governance system in place to ensure those audit recommendations are effectively implemented. **As was demonstrated during interviews, most of the municipality managers did not know about the existence of PIFC law, or only had heard about the law from the experience of internal audits. Therefore no knowledge or understanding of internal control and financial management responsibilities assigned by law**.
- **Sustainability of reforms** – (1) **A short duration of political leadership, the change of top managers every four years were cited as one of the main hindrances to reforms and institutional knowledge retention** during interviews with donors and other external stakeholders. They believed that the scale and timing of any reform needed to be aligned with the limited windows of opportunity which exist from election to election. **Municipalities themselves identified turnover of qualified staff as the primary challenge to the successful implementation of reforms and their continuity; In most cases, there are a number of sectoral strategies for municipalities, but no single document that elaborates and sets institutional goals holistically**.

Besides above mentioned, according to municipalities there were also objective reasons hindering their performance in terms of low implementation of recommendations: division of municipalities and the delay caused by novel virus COVID 19.

2.2. Insights from secondary research

i. SAO's biannual *consolidated* report on audit results in municipalities

The SAO once in two years submits a consolidated report to the Parliament of Georgia summarizing the audit findings conducted in previous years. These reports usually cover two to four fiscal years for the majority of the municipalities, but audited municipalities could vary over years. According to the last three consolidated reports¹⁰ available, only results of 8 municipalities were repeatedly presented in all three reports, 37 municipalities were covered by two reports, and the remaining 24 by only one report. **Identified deficiencies are repetitive not only across municipalities but also over time for the same municipalities. More precisely, deficiencies related to Financial Accounting and Reporting and the Management of Public Procurement, Budgetary Resources, and Public Assets are prevalent almost in all municipalities.**

For example, the Consolidated report of two-year (2018-2019) audits, presented the summarized value for the deficiencies related to municipal procurement practices according to which municipalities suffered a financial loss of approximately 45 million GEL almost equaling the nominal annual GDP of Georgia for the respective period. Compared to 2014-2015 audit results, mentioned procurement related losses fell by 67% which could be explained by implementing a nationwide electronic procurement system and continuous training of municipal staff. Like procurement related losses, costs resulting from the mismanagement of budget resources dropped in the same period by 59% which also refers to the improvement in utilizing budget resources. Not surprisingly, findings related to financial accounting and reporting have the largest monetary value that were mostly identified through financial audits. Due to the fact that the SAO was no longer conducting audits of municipalities' financial statements after 2018 (because municipalities are not fully or nearly fully compliant with IPSAS) the last published consolidated report did not present cost estimates of the deficiencies related to Financial Accounting and Reporting.

To evaluate municipalities' overall progress, along with the monetized findings, one should consider non-monetized deficiencies, their impact, and recurrence. According to the discussed reports, the most frequent and repetitive deficiencies are related to:

- The purchase, redistribution and use of municipal fleet vehicles
- Fuel and phone expenses
- Reimbursement of expenses to Council (Sakrebulo) members
- Business hosting and business trip expenses
- The management of the infrastructure projects
- The management of non-profit (non-commercial) legal entities established by municipalities
- The management of municipal property
- Management of financial resources
- Internal audit function

ii. PEFA assessment results

The PEFA Framework provides an agreed set of benchmarks to assess public financial management. PEFA assessments turned out to be very useful in identifying areas of reform. During the last five years (2018-2021) PEFA assessment was conducted in 47 municipalities.

¹⁰ SAO's consolidated reports on audit results in municipalities for 2014-2015, 2016-2017, and 2018-2019 years

The results of the assessment show that the indicators which score high are related to well-standardized, centralized systems. The aspects of PFM which are managed through electronic systems and with built-in control mechanisms function well and the practices in place are in line with the requirements set by the international standard. E.g. Budget Classification, Managing Budget operations, full coverage of all receivables and payables, procurement process and cash control through bank information reconciliation.

Common areas of weakness, as identified by PEFA assessments¹¹, included but were not limited to:

- **Medium Term Planning and Program Budgeting** - None of the municipalities follow closely the templates and guidance defined in the Program-Budget Methodology. The program budget annexes are not in the format required by methodology, and in many cases, they are not publicly available. The budget process needs to set up clear links and roles for different types of short-term and medium-term planning documents (Priority Document, Medium term action plans and program-based budgeting).
- **Accounting and Accountability including Budget Performance Report and Financial Statement** - Outputs/outcomes of Program Budget Annex and their performance measurement indicators are not in line with Program Budget Methodology and Gender-Sensitive Programs. Performance annual reports are rarely made available to the general public. The reports produced are not comprehensive. Reporting on performance is even weaker than program-based budgeting. Financial statements represent the biggest challenge for most of the municipalities.
- **Failure to submit timely annual financial statements for audit to the State Audit Office¹²**, and
- **Inadequate scrutiny by Sakrebulo (local councils) over the implementation of the recommendations of the internal audit and external audit reports.**

PEFA assessment results gave useful insights for the purposes of this report to identify root causes of audit recommendation implementation. **The overall weaknesses in municipalities demonstrate the fact that there is lack of coherence and integration of policy making, planning, and budgeting at municipal level, as well as the absence of adequate accountability arrangements on both the executive and legislative sides.**

iii. Results of other relevant assessments

- **External Quality assessment Internal Audit functions in municipalities¹³** - An external assessment of the quality of internal audit practices was conducted in ten municipalities in 2020, that demonstrated that **many deficiencies exist in the two most important aspects necessary for an effective internal audit function: independence and quality.**
- **GAP analysis of Financial Management System implementation¹⁴** - FMC system evaluation was undertaken in eight municipalities in 2020, revealed that the municipalities do not have a risk management framework in place, and it still remains a less developed element of municipal governance. According to the report of OECD/SIGMA experts¹⁵, which evaluates the FMC system in Georgia, highlighted the difficulty of introducing managerial accountability due to the organizational structure - concentration of political and operational responsibilities within elected heads of municipalities and their deputies.

11 2018 PEFA Municipality Synthesis Report. PEFA.org

12 Based on the 2018 PEFA Municipality Synthesis Report, only three municipalities submitted their financial statements to the State Audit Office for external audit within three months of the end of the fiscal year.

13 CHU (2021). Development of Public Internal Financial Controls: A Consolidated Annual Report of 2020

14 Ibid

15 OECD/SIGMA (2015). Gap analysis: PIFC of the republic of Georgia, With focus on Financial Management and Control

- ***Assessment of Regional Development Program***¹⁶ - a medium-term government document that outlines the main goals for regional development in Georgia and determines priorities and measures for the period 2018-2021, and provides a coherent framework for all stakeholders in line with the national planning documents¹⁷. According to the assessment of Regional Development Program¹⁸: (1) Financial resources at the local level are not sufficient; (2) Many public services for citizens and businesses are organized at the central level; (3) The formula for equalization among local governments needs clarification; (4) The role of municipalities in economic and social development is not well clarified.

16 MRDI/EU (2017). Regional Development Programme of Georgia 2018-2021. <https://policy.asiapacificenergy.org/sites/default/files/Regional%20Development%20Programme%20of%20Georgia%202018-2021%20%28EN%29.pdf>

17 the Social-economic Development Strategy of Georgia ("Georgia 2020), the State Strategy for Regional Development 2010-2017 and the Regional Development Programme 2015-2017

18 Regional program development plan 2018-2021

PART IV: Root causes of repeated audit findings & recommendations referring to municipalities

Based on the insights we gained from interviews, analytical review and secondary research, we attempted to identify and group the root-cause challenges municipalities face in responding to audit recommendations.

The report presents the root-causes in three sections as follows:

1. System-level root-causes - refers to key elements of the local government performance and accountability framework, including the formulation of appropriate institutional and regulatory arrangements. This section identifies the present weaknesses or gaps in the present existing arrangements in municipalities where reforms will be required. This will require cooperation and collaboration by all bodies involved in the local governance system, together with clear leadership from government.
2. Municipal-level root-causes - identifies repetitive recommendations in municipal audits, that are related to either the absence of proper rules and procedures, or low conformance with certain existing rules. A number of audit recommendations tackle complex issues, requiring extensive consultations and negotiations as well as approvals involving a wide range of stakeholders. The identified list of topics can easily be resolved by facilitating subject-matter discussions with relevant stakeholders and providing technical assistance to municipalities.
3. SAO-level root-causes - as part of our review, we assessed follow-up arrangements and the role played by external audit, and identified areas or activities where SAO can create more incentives for recommendation implementation.

Each section has recommended a course of actions which, in our view, is the most appropriate way of introducing reforms to successfully close the identified gaps and among other benefits, resolve the root-causes of recurring audit recommendations.

1. System-level root causes

1.1. Municipalities have not established adequate systems in place to follow up on audit recommendations

Primary responsibility for implementing agreed audit recommendations generally lies with senior managers of the municipality that was subject to the audit. Each agency shall establish systems to assure the prompt resolution and implementation of audit recommendations. These systems shall provide for a complete record of action taken on both monetary and non-monetary findings and recommendations. **Successful implementation of audit recommendations requires strong senior management oversight and implementation planning to set clear responsibilities and timeframes for addressing the required action.**

Management should never blindly accept an audit recommendation – this generally leads to bigger problems later if the recommendation is not fit-for-purpose or the management response does not specifically address the matter to be fixed. Where management officials disagree with an audit recommendation, the municipality should notify SAO officially of their decision, including the reasons for the disagreement.

Based on a review of all municipalities' action plans for implementing recommendations, we found that:

- Before even auditees start resolving audit findings, 44% have never sent action plans to SAO, meaning they have never acknowledged formally their commitment to implement them;
- Even though municipal managers may disagree with audit recommendations, it is not common practice for them to formally acknowledge their disagreement.

The law of SAO¹⁹ **requires audited agencies to respond to SAO's recommendations. The law of SAO is organic law, meaning it has sufficient "supremacy" and takes precedence over other laws of auditees, such as municipal agencies.**

We have analyzed municipality (charters) rules and procedures. Despite the municipalities' obligation to adhere to SAO's law, at the local level, municipalities have not arranged adequate organizational measures, such as acknowledging the importance and responding to audit recommendations, establishing clear responsibilities and reporting arrangements for corrective actions, institutionalizing robust monitoring, implementation, reporting and oversight mechanisms.

From interviews with former or existing municipal heads, we learned that, even though it is not formalized, follow-up coordination for SAO recommendations is most often assigned to Internal Audit functions. As we have found out, internal auditors have weaknesses in practically implementing the follow-up process, which we believe needs further improvement before it can fulfill a coordinator role. This will be further discussed in detail below in Part IV. Section 1.4.

Furthermore, on a technical side of implementation, follow-up and reporting on audit recommendations involves a multitude of actors and a vast amount of information. Common practical challenges in the coordination of follow-up planning and reporting are processing a number of recommendations and interlinked follow-up activities, assigning responsibility and generating ownership for implementation and status tracking. With manual systems, such as Excel spreadsheets and calendar reminders, can provide some level of tracking, but **if the process is not standardized and part of an institutional system, it risks becoming ad hoc, chaotic and unsustainable.**

Good Practice example at central government level in Georgia: Recommendation follow-up mechanism by the executive branch

In order to strengthen accountability, in 2015 **the Government of Georgia established a mechanism²⁰ for follow-up of State Audit Office (SAO) recommendations, establishing legal/formal requirements mandating the Government to monitor the implementation of the Parliament recommendations on SAO findings.** This can serve as a good practice example for municipalities to establish similar instruments.

In the decree the Government committed itself to prepare a special report accompanying the Annual Budget Execution Report in which it explains how it has implemented the audit recommendations. According to the decree the Government should submit a report on progress of implementing recommendations annexed to the annual budget execution report that is submitted to the Parliament.

The decree mandated the Government to:

- prepare an Action Plan to implement those recommendations.
- create a working group, if necessary, consisting of line ministries and agencies which are involved in implementing the Action Plan.

Note: For the last submission to the parliament, Government did not include the report on progress of implementing recommendations annexed to the annual budget execution report of 2020²¹.

¹⁹ Article 24 of the Organic Law of Georgia on the State Audit Office "the auditee shall notify the SAO within one month of the measures to be taken with respect to the recommendations".

²⁰ Government of Georgia decree #144. 30 March 2015. <https://matsne.gov.ge/ka/document/view/2792697?publication=0>

²¹ SAO's report on Budget Execution Report for 2020.

Recommendations:

I. Municipal agencies' procedural arrangements

Municipal agencies should amend their charters/ Internal rules and procedures accordingly to reflect provisions for:

- Assuring that, management officials throughout the agency understand the value of the audit process and are responsive to audit recommendations.
- Setting-up a formal process to ensure all recommendations from SAO are actively tracked and reported.
- Designating a senior management official to serve as an audit follow-up official to oversee audit follow-up, including resolution and corrective action.
- The audit follow-up official, among other things, should have responsibility for ensuring that:
 - Timely responses are made to all audit reports,
 - Disagreements are resolved,
 - Actions are actually taken, and
 - Regular progress reports are prepared and sent to the head of the Municipality (Mayor/Gamgebeli) and when necessary, to those charged with governance (Sakrebulo/ Audit Subcommittee).
- Documenting systems of audit follow-up, resolution, and corrective action.

II. Municipalities' progress reports to Sakrebulos regarding audit recommendations

It is recommended that Municipality heads prepare and submit a report on the status of the audit recommendation to Sakrebulos. As per the good practice example of the central government, this special report can accompany the annual budget execution report.

1.2. The municipal financial management system is at an early stage of development

Analysis of SAO's audit results showed that most of the audit findings' risk categories are due to weak internal controls within the municipal agencies. The weakness of internal controls was also most often cited as the root cause of recurring recommendations during interviews.

Internal controls are processes put into place by management to help an organization operate efficiently and effectively to achieve its objectives. Managers often think of internal controls as the purview and responsibility of accountants and auditors. The fact is that **management at all levels of an organization is responsible for ensuring that internal controls are set up, followed, and reviewed regularly**. The purposes of internal controls are to: Protect assets; Ensure that records are accurate; Promote operational efficiency; Achieve organizational mission and goals; and Ensure compliance with policies, rules, regulations, and laws ²².

22 Office of Inspector General, U.S. Department of Housing and Urban Development (2016), Implementing the Five Key Internal Controls

Overview of PIFC reform in Georgia

In Georgia, the development of internal control systems in public agencies is defined and required by the legislature²³. Under the EU-Georgia Partnership, and particularly after the signing of the Association Agreement²⁴ Public Internal Financial Control (PIFC) has become an important component of the ongoing public financial management reform. The importance of this reform stems not only from Georgia's commitments to the EU, but also from the potential benefits of its implementation:

- Safeguard assets against loss, misuse and damage;
- Ensure that records are accurate;
- Promote operational efficiency;
- Ensure a budget is executed in an orderly, ethical, economical, efficient and effective manner;
- Achieve organizational mission and goals; and
- Ensure compliance with policies, rules, regulations, and laws.

According to the EU Public Internal Financial Control model, the internal control system consists of three main elements, which are: Financial management and control system (FMC), Functionally independent internal audit and Harmonization Center - Coordinating unit.

From the abovementioned elements of Public Internal Financial Control reform, Georgia first started to implement internal audit reform before the Financial management and control (FMC) element of the reform. Consequently, **the current methodological framework, practical implementation or the competencies of staff significantly precedes the implementation of the FMC element. Though It is noteworthy that the success of internal auditing depends on the management culture and ethics in the institution that is formed by the FMC system.**

Since one of the main root causes of the recurring audit recommendations is an absence of the proper internal control system, in the case of strengthening the internal control framework in the municipalities there is high likelihood that the implementation rate of SAO recommendations will rise. To say it differently, by setting up a strong internal control system municipality managers would resolve many issues that are repeatedly raised by audit reports. As interviews with heads of municipalities showed, senior managers are not aware of PIFC law and respective instructions.

For the current state assessment of the internal control environment in municipalities²⁵, it is noteworthy to consider results of FMC system evaluation undertaken in 2020 by the Central Harmonization Unit (CHU) with the support of donors. The assessment revealed that the municipalities do not have a risk management framework in place, and it still remains a less developed element of municipal governance. Other deficiencies that are more or less common across studied municipalities are as follows:

- A person responsible for the implementation of the FMC system has not been designated
- Low awareness of FMC system
- Municipalities do not have a medium-term strategy and annual plan of implementing FMC system
- Monitoring mechanism of current budget execution has not been developed
- Frequent change of annual procurement plan
- Measurable indicators of evaluating the expected and achieved results are not developed

23 Law on Public Internal Financial Control and Inspection, N2839, 2010

24 Association Agreement, Article 279

25 Tskaltubo, Samtredia, Zestafoni, Gurjaani, Sagarejo, Khashuri, Marneuli, and Gardabani

These results reiterate the fact that **FMC reform is at the initial stage of development** and on the other hand without establishing the FMC system, it is hard to successfully implement internal audits or any other ongoing reform.

The analysis²⁶ revealed the following obstacles hindering the proper implementation of the FMC system:

- Insufficient level of political will
- Lack of acceptance and readiness of managers to assume the obligations defined by law
- Low level of awareness of FMC systems
- The law on PIFC does not define what will be a sanction in case of delaying the implementation of the reform and it is not defined to whom the budget organizations are accountable.

Noteworthy that practical instructions for the implementation of the FMC system were approved in 2017 but until 2020 the municipalities were not required to follow it and set up an internal control system and procedures in accordance with the rules of FMC.

For the successful implementation of FMC reform, it is important to have a designated person responsible for the coordination of the process. According to FMC instruction, the role of the Financial Management and Control System Coordinator is to facilitate the implementation of FMC systems within an institution, coordinate its operations, and ensure its proper operation and continuous improvement. According to the instruction the coordinator should be a senior manager, who is the direct supervisor of the financial management unit/ department.

Another prerequisite for the successful implementation of the FMC reforms is managerial accountability. The most common challenges for Georgia's municipalities regarding managerial accountability are

- senior managers face frequent changes in administrative structures;
- unclear reporting and accountability lines;
- the practice of assigning tasks without regard for formal responsibility;
- objectives are not clear or measurable.

According to the report of OECD/SIGMA experts²⁷, which evaluates the FMC system in Georgia, highlighted the difficulty of introducing managerial accountability due to the organizational structure - concentration of political and operational responsibilities within elected heads of municipalities and their deputies. **Since in the municipalities mayors who are political figures are responsible for operational management as well, it creates additional obstacles for better managerial accountability. In order to foster greater managerial accountability on the municipal level, local governing bodies need to implement reforms accordingly, and political figures need to leave operational management to non-political managers.** For proper managerial accountability, besides favorable conditions, it is imperative that concrete instruments and mechanisms are in place, such as objectives and reporting against them, as well as persistent demands from politicians and citizens.

A specific area in which regulatory arrangements affect accountability lines is the distinction made between political figures, such as mayors and councilors, and public managers, who are typically senior

²⁶ Central Harmonization Unit (2019) Consolidated Annual Report on the Development of Public Internal Financial Control System in FY 2018; The State Internal Control Department of the Ministry of Finance of Georgia (Harmonization Center), Policy and Management Consulting Group (PMCG) and Ilia State University. (2018). Retrospective assessment of the law on state internal financial control

²⁷ OECD/SIGMA (2015). Gap analysis: PIFC of the republic of Georgia, With focus on Financial Management and Control

civil servants²⁸. According to ex-post evaluation of PIFC law, in Georgia's municipalities, heads of legislative and executive branches, both are political officials and it is not feasible to delineate accountability lines between political authorities and government bureaucrats/managers. Senior managers should be defined as a special group with specific responsibilities, accountability lines, and employment conditions both to reinforce the boundaries between neutral, professional, senior-level officials and political positions and to safeguard their accountability. **In order to properly oversee and control the work of senior civil servants, clear accountability lines are essential.**

In practice, managerial accountability is highly influenced by the relationship between political leaders and senior civil servants. **Although local government officials and members of Sakrebulo are held politically accountable, other forms of accountability are required within institutions to enforce policy objectives.** The political leadership benefits from managerial accountability, as this essentially supports their political accountability.

Recommendations

I. Introducing City Manager or Chief Administrative Officer (CAO) position in municipalities

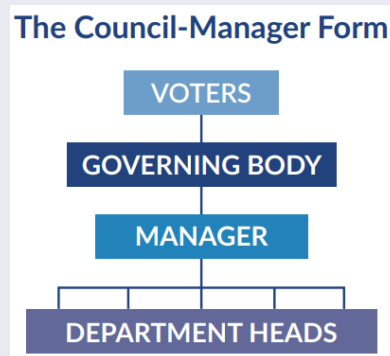
It is recommended to consider an amendment in the Local Self-Government Code that would introduce a new non-political position of the city manager in the municipalities. This position would be politically neutral and hired on professional merit rather than appointed or elected that would not deliver services based on partisan interests. The city manager would be responsible for day-to-day operations and implementing all reforms in municipalities, including FMC. The roles of each key public sector management position, both political and non-political, need to be clarified within the hierarchy of executive organizations. As a result, multiple overlapping responsibility lines will be eliminated, ensuring that everyone in the hierarchy is held accountable for their decisions.

The recommended municipal government structure is known as the Council-Manager Form of Municipal Government. The council-manager form establishes a representative system in which all power rests with the elected council and in which the council hires a professionally trained manager to oversee the delivery of public services. More details about the manager-council structure is provided in the following box.

28 Ministry of Georgia, PMCG Consulting, Ilia State University (2018). Ex-post Evaluation of the Law on Public Internal Financial Control

Why It Might Be Better Idea To Have Council - Manager Form of Municipal Government

Figure 10. The Council-Manager Form



A council-manager government form is the most common form of local government in the United States for municipalities with 2,500 or more residents. Several other countries around the world use this form, including Canada, Australia, the Netherlands, New Zealand, and the United Kingdom. Government in the form of a council-manager combines the strong political leadership of elected officials with the administrative expertise of a manager or administrator that is appointed. Under this form, residents elect a governing body - including a chief elected official, such as a mayor or board chairperson - to adopt legislation and set policy²⁹. Afterward, the governing body hires an administrator or manager to oversee day-to-day operations and carry out the policies.

What's so special about the council-manager form of government?

As part of the council-manager model, elected officials serve as policy makers and map out the long-term vision of the community alongside the policies that govern it. This form identifies the need for a highly qualified individual devoted exclusively to providing services to residents. The key benefit of this system is a clear distinction between the administrative role of the manager and the political and policy roles of the governing body, led by the mayor. As the day-to-day operations of the local government organization are handled by the selected manager, elected officials can devote their time and energy to policy development and evaluation of the effectiveness of those policies in the community. The council-manager form is the system of local government under which professional management is most likely to succeed. Under this system, professional managers can focus on service delivery, policy implementation, and performance management and can align the local government's services with the values, mission, and policy goals defined by the community and elected officials.

II. Obligate Municipality heads to acknowledge responsibility for internal control and performance of municipality in their annual reporting

Based on better practice,³⁰ it is recommended that Municipalities' annual reports to Sakrebulo include a report of management on the company's internal control over financial reporting. The internal control report must include:

²⁹ ICMA. (2019). Council-Manager Form of Government. URL: Council-Manager Form of Government

³⁰ OMB Circular A-123, Management's Responsibility for Enterprise Risk Management and Internal Control, and A-136, internal control over financial reporting

- a statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting for the company;
- management's assessment of the effectiveness of the company's internal control over financial reporting as of the end of the company's most recent fiscal year;
- a statement identifying the framework used by management to evaluate the effectiveness of the company's internal control over financial reporting; and
- a statement that the registered public audit firm that audited the company's financial statements included in the annual report has issued an attestation report on management's assessment of the company's internal control over financial reporting.

This internal control report will also provide a basis for SAO to express opinion on internal controls.

III. Prepare FMC methodological documents that describes in details FMC implementation procedures

The Government (MoF) should strengthen and improve the existing PIFC regulatory framework and guidelines to ensure that clear and comprehensive guidance is available to municipalities. To achieve this objective, the municipalities coordinating agency should develop detailed methodological tools (guidelines, instructions, and manuals) based on the new PIFC Law and PIFC Policy Paper (including a manual on managerial accountability).

This manual is intended for budget users to help further development of financial management and control, primarily aimed at a proactive management approach supported by the development of managerial accountability. Similar manuals were created in Western Balkan countries, that are EU candidate countries, to support PIFC reform required as one of the conditions requested by the EU. The following box will review the FMC manual in Macedonia.

Financial Management and Control (FMC) Manual in Macedonia

The FMC manual is prepared by the Public Internal Financial Control in the Ministry of Finance which is the Central Unit for harmonization of financial management and control³¹. The first time it was issued was in 2010. The manual was intended for the public sector managerial structures and proposed to help them understand what is the financial management and control system and what does it cover, while focusing them towards key areas in which they are expected to get actively involved. The manual covers the following topics:

- Principle of the FMC
- Managerial responsibility of budget user heads and heads of internal audit
- The role of financial affairs units in the financial management and control development
- Methodological framework for financial management and control implementation
- Planning of financial management and control development activities
- Financial management and control reporting
- Budget supervision

³¹ Republic of Macedonia Ministry of Finance. (2016). Financial Management and Control Manual.
URL: <https://finance.gov.mk/wp-content/uploads/2009/07/Manual-for-FMC-Final.pdf>

1.3. The Sakrebulo exercise low legislative scrutiny and involvement in the audit process

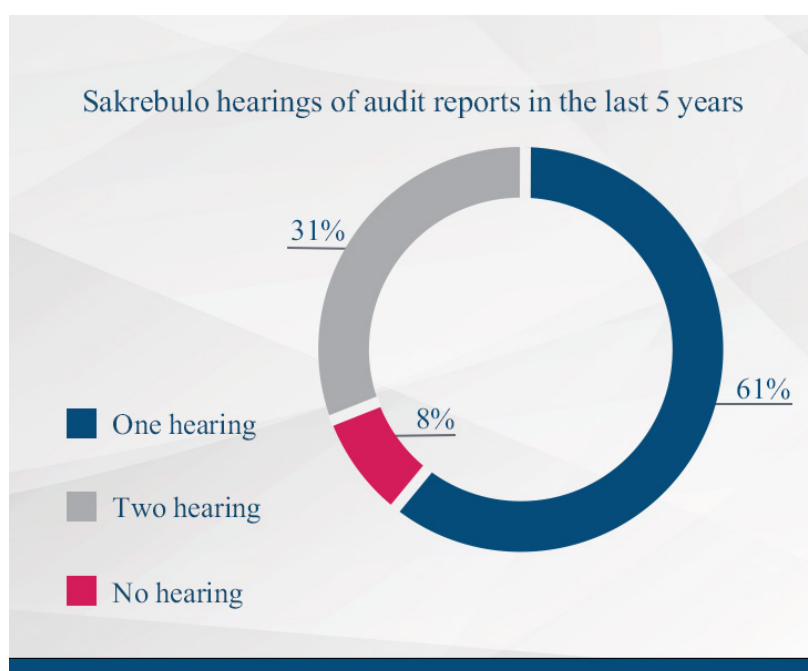
SAO can not enforce its own recommendations; it depends on the good will of the other arms of the government, such as the tone at the top of the executive branch - Municipalities and active involvement of the legislative branch - the Sakrebulo, to enforce their decisions. The external audit work of SAO will gain greater impact if Sakrebulo members would be more involved in follow-up on audit work while exercising their budgetary oversight over the municipality administration. According to the local legislature³² one of the main instruments of Sakrebulo to exercise their oversight function over the executive branch is through audits. There are three types of audits that Sakrebulo are entitled to use:

1. An independent external audit carried out by the State Audit Office, on average every three years.
2. An independent external audit carried out by private audit companies. On a yearly basis, an independent audit of the municipality can be assigned by decision of the Sakrebulo members.
3. An internal audit of a municipality carried out according to the law on Public Internal Financial Control.

Scrutiny of audit reports by Sakrebulo was one of the most common weaknesses identified by PEFA assessment. PEFA indicator (PI-31) referring to Legislative scrutiny of audit reports was evaluated in 28 municipalities. The PEFA methodology scores range from 'A' (highest) to 'D' (lowest). 79% of assessed Sakrebulo got the lowest score - "D" and only three municipalities (Dedoplistkaro, Senaki, Ozurgeti) received "B+". It is noteworthy that the number of audit hearings within municipalities has increased recently. This positive trend in legislative scrutiny is partly due to the Memorandum of Understanding between MoF and municipalities, which was signed at the end of 2019. As part of a condition of the MoU, which is largely based on deficiencies identified by PEFA assessments, Sakrebulo must conduct more audit hearings.

We have surveyed Sakrebulo to find out the status of audit hearings in the last five years. Based on the responses received from 39 Sakrebulo, we have found out that:

Figure 11. Sakrebulo hearings of audit reports in the last 5 years



³² Organic Law of Georgia Local Self-Government Code. Article 139, 140

- **Sakrebulo must put more emphasis on audit reports while exercising their oversight power, despite the improvement in the trend of audit hearings:** the majority of Sakrebulo - 61% - held one audit hearing in the last five years, 8% discussed audit reports twice, and 31% did not hold any audit hearings.
- **Sakrebulo must devote more time and attention to audit results discussion in their agendas, ideally holding a separate meeting solely for audit hearings.** Sakrebulo hearing records indicate that the meeting agendas covered on average eight additional topics along with the audit report discussions. The number of topics discussed in some Sakrebulo (37%) ranged from 17 to 24.
- **Auditors and representatives of relevant municipalities' should attend audit hearings to provide clarification or additional information. The essence of audit hearings by Sakrebulo is to have debate on audit reports, mediate discussion, and enforce recommendations that could not be achieved without the participation of appropriate parties.** Records from audit hearings show that SAO representatives never attended committee meetings and no representatives from the municipality attended 54% of audit hearings.
- **One of the main reasons why municipalities might be reluctant towards implementing SAO's recommendations is because there are no consequences for inactions. Sakrebulo should have a formal discharge procedure in place** to approve its conclusions regarding audit results and request further action from municipalities. We found that only in 31% of cases was a Sakrebulo decree³³ regarding audit results issued (individual administrative-legal act) to be carried out by the Municipality.
- **Sakrebulo should use the possibility of independent private audit firms more often.** Legislator should not let the members of the Sakrebulo decide when a private audit should be commissioned and should define the obligation of the Sakrebulo to convene an independent audit once a year to study the activities of the executive body³⁴. In the past two years, only 23% of the selected 16 municipalities had private independent audits conducted. It is noteworthy that SAO's audit reports³⁵ express concern about the quality of private company audits not conforming to existing regulations and international standards of auditing. SAO auditors who were interviewed also mentioned that they could not rely on private auditors' work.
- **One of the possible reasons as to why Sakrebulo commissions are seemingly ineffective is that there is a shortage of people with financial auditing skills and technical expertise with respect to internal control.** The development of the technical capacities of Sakrebulo members responsible for the oversight of SAO's reports and the follow-up to audit recommendations should be a priority.

It is expected that more than half of the municipalities participating in the MoU with the Ministry of Finance will have their financial statements audited by 2022. Upon audit, the reports will be scrutinized by Sakrebulo, with the goal of holding the local governments accountable for more efficient and transparent operations. Often, Sakrebulo's procedures correctly stipulate that along with the municipality's budget execution report, an independent audit opinion should be submitted to Sakrebulo. Following that, Sakrebulo must hold a hearing of the audit report. The implementation of this will greatly improve Sakrebulo's financial scrutiny.

Better practice examples of effective enforcement mechanisms for implementation of SAO's recommendations can be shared from the Georgian Parliament's experience, which will assist Sakrebulo's decision-makers and administrations to set up proper organizations and procedures.

33 Individual administrative-legal act according to Organic Law of Georgia Local Self-Government Code, Article 61.

34 Menabde V., Papashvili T. (2017) Sakrebulo's oversight function over executive branch in local government of Georgia https://www.researchgate.net/publication/345309126_sakrebulo_zedamkhedveloba_adgilobrivi_ghmasrulebeli_organos_sakmianobaze_sakartveloshi

35 .State Audit Office (2020). Compliance audit of Akhalkalaki Municipality for the years 2018-2019. shorturl.at/cityL

State Audit Office (2019). Compliance audit of Lanchkhuti Municipality programs for the years 2017-2018. shorturl.at/jqwG1;

Good Practice Example: Audit Working Group under Budget & Finance Committee of Georgian Parliament

Starting from 2019, amended Rules of Procedure of the Parliament of Georgia³⁶ envisaged creation of a specialized permanent audit group under the Budget and Finance Committee. The main function of the audit group is to review SAO's audit reports and to present relevant recommendations to the Budget and Finance Committee. Based on these recommendations the Parliament may adopt a relevant decree referring to audited agencies, including the timeframe and terms of its implementation. The Budget and Finance Committee oversees implementation of a decree through the audit group and submits information concerning the status of implementation to the Bureau of the Parliament if necessary. The latter might decide to raise the issue to a plenary sitting of the Parliament.

The charter of the audit group was approved by decision of the Budget and Finance Committee and currently it is composed of five members of the same committee. The audit group is obliged to convene sittings at least once a month during Parliamentary sessions and the meetings are public. Twice a year SAO presents a list of especially important reports. During the existence of the Audit permanent group, 56³⁷ audit reports were discussed. Generally, when SAO reports are debated following stakeholders attend audit group meetings: members of the audit groups, Members of relevant sectoral committees, the Deputy Auditor General (accompanied by other relevant staff), high level officials from audittees and other interested parties.

Recommendations:

I. Sakrebulo's procedural arrangements

Sakrebulo have to strengthen and implement effective municipal oversight mechanisms designed to ensure:

- Dedicating more time and attention to audit results discussion;
- Inviting both parties (municipality management and audit representatives) to audit report, as well as other relevant persons (sectoral commission member, subject matter experts);
- Implementing a formal discharge procedure regarding audit results;
- Commissioning independent audit annually;
- Continuously developing the technical capabilities of Sakrebulo members and supporting staff who consume audit results and follow-up on audit recommendations;

II. Specialized working group/subcommittee

Establishing Sakrebulo's specialised audit commission could play an important role in monitoring the implementation of recommendations. Good practice examples³⁸ involve:

- development of standard procedures and schedules for Sakrebulo discussion on SAO reports that makes timely conclusions possible;
- requiring action plans from municipalities, and setting deadlines for measures to be taken;
- considering sanctions in cases of serious non-compliance with recommendations from the SAO or Sakrebulo (political, financial and disciplinary);
- requiring reports from the municipality's management on implementation of adequate measures.

³⁶ The Rules of Procedure of Parliament of Georgia, Article 165

³⁷ 13 audit reports in 2019, 21 audit reports in 2020, 22 audits in 2021

³⁸ Brétéché, B. and A. Swarbrick (2017), "Developing Effective Working Relationships Between Supreme Audit Institutions and Parliaments", SIGMA Papers, No. 54, OECD Publishing, Paris, <https://doi.org/10.1787/d56ab899-en>.

Why do we need Independent Audit Committees³⁹?

- **Improve government accountability.** Audit committees in the public sector help enhance accountability.
- **Follow best practices.** Audit committees play an important role in ensuring the quality of the annual audits, and ensuring that management implements audit recommendations. They also ensure that the audit function has sufficient resources, competence, and independence from the executive branch to perform audits efficiently and effectively.
- **Ensure independence.** Audit committees ensure that audit functions are empowered to report significant issues to appropriate oversight authorities. The audit committee can prevent management interference with audits or suppression of audit findings.

Audit Committee Best Practices

The IIA developed the characteristics of the well-structured audits committee in the public sector in the Supplemental Guidance: The Role of Auditing in Public Sector Governance⁴⁰. The guide states that an audit committee should strive to:

1. Operate under a formal mandate, preferably legislation, with sufficient authority to complete its mandate.
2. Include independent members who collectively possess sufficient knowledge of audit, finance, risk, and control.
3. Be chaired by a member who is not the individual to whom a CAE reports administratively.
4. Assess the effectiveness of the organization's governance, risk management, and control frameworks and legislative and regulatory compliance.
5. Provide oversight to the organization's internal and external audit activities, including ensuring adequate coverage and resources, approving the internal audit charter and audit plans, reviewing the audit activity's performance, and approving the appointment or termination of internal and external auditors.
6. Oversee the organization's financial reporting and accounting standards.
7. Provide a direct link and regular reporting to the organization's governing board, council, or other authority.

³⁹ Association of Local Government Auditors. Audit Committee Guidance https://cdn.ymaws.com/algaonline.org/resource/resmgr/audit_excellence/support/audit_committee_guidance.pdf

⁴⁰ IIA. 2012. Supplemental Guidance: The Role of Auditing in Public Sector Governance 2nd Edition. URL: https://na.theiia.org/standards-guidance/public%20documents/public_sector_governance1_1_.pdf

1.4. The role of internal auditors in follow-up can be strengthened

Cooperation and coordination between SAO and internal auditors may yield a number of benefits, like **an exchange of ideas and knowledge⁴¹, mutual support on audit recommendations which may enhance the effectiveness of audit services, strengthening their mutual ability to promote⁴² good governance and accountability practices, enhancing management understanding of the importance of internal controls, and etc⁴³**. In an external audit recommendation follow-up process, internal auditors could play a facilitator role by periodically informing management of the implementation status of recommendations. Namely, internal auditors often monitor and track improvement actions suggested by external and internal audits, subject matter experts, ICT reviews, various evaluations and other significant enquiries⁴⁴. Monitoring the implementation status of recommendations is meant to ensure they are properly implemented in a timely manner. In the absence of this internal audit role, the costs and efforts involved in audits, reviews, and evaluations might be wasted if things do not change for the better⁴⁵.

Furthermore, strong and efficient internal audit departments can assist municipalities in resolving one of the most recurring problems, namely an absence or weak internal control environment. The management frequently relies on internal auditors to monitor the design and proper operation of internal control policies and procedures. **By serving as an extra level of control for the government, internal auditors themselves help improve the overall control environment. An improved internal control environment and independent, objective, and qualified internal audit units in the municipalities, on the one hand, will increase the implementation rate of SAO recommendations, and on the other hand, will simplify external auditors' engagements because they can rely on controls and use the work of internal auditors.**

Although there has been significant progress made in the municipalities regarding the internal audit functions, the external quality assessment showed that the overall performance and impact of the internal audit units remains rather low. According to the external assessment of the quality of internal audit practices in 10 municipalities⁴⁶ that were conducted in 2020 by various donor organizations⁴⁷, **many deficiencies exist in the two most important aspects necessary for an effective internal audit function that are independence and the quality of audit work.** Namely:

- The internal audit statute does not safeguard independence of the internal audit office. Their scope, roles, responsibilities and authorities of function needs to be clearer. The statute combines the audit function and inspection under the umbrella of the same service, blurring the distinction between the two functions.
- The statutes of IA give no further specification or clarification of the boundaries of “assurance and consulting” activities. Statute, strategy and annual plan are not well aligned with each other.

41 EUROSAT-ECIA Cooperation. National Cooperation Agreements between SAIs and Internal Auditors in the Public Sector. <https://www.eurosai.org/handle404?exporturi=/export/sites/eurosai/.content/documents/about-us/EUROSAT-ECIA-CC-guide-on-cooperation-agreements-between-SAI-and-IA.pdf>

42 IIA (2021) Getting Audit Actions Implemented

https://iia.org.au/sf_docs/default-source/technical-resources/2018-fact-sheets/factsheet-getting-audit-actions-implemented.pdf?sfvrsn=2

43 Guidance of the International Organization of Supreme Audit Institutions (INTOSAI GOV 9150). https://na.theiia.org/standards-guidance/Public%20Documents/INTOSAI_GOV_9150_E.pdf

44 IIA Australia. 2017. White Paper - Reporting on the Status of Audit Recommendations https://iia.org.au/sf_docs/default-source/quality/white-papers/reporting-on-status-of-audit-recommendations.pdf?sfvrsn=2&submission=267942931

45 IIA (2021) Factsheet: Getting Audit Actions Implemented https://iia.org.au/sf_docs/default-source/technical-resources/2018-fact-sheets/factsheet-getting-audit-actions-implemented.pdf?sfvrsn=2

46 Tskaltubo, Rustavi, Mtskheta, Telavi, Samtredia, Gurjaani, Zugdidi, Lagodekhi, Baghdadi, Tbilisi

47 CHU (2021). Development of Public Internal Financial Controls: A Consolidated Annual Report of 2020. This report summarizes the External Quality Assurance (EQA) of six municipalities by international expert/GIZ, three by OECD/SIGMA and local experts, and one by the Ministry of Finance's Academy of the Kingdom of the Netherlands

- No systemic continuous professional development program for internal auditors; There is no certification program for internal audit aligned with the competence model of internal audits.
- There are no systematic quality assurance and improvement programs (QAIP) established in Internal Audit functions.
- The quality of individual engagement plans, working programs and audit reports should be increased by adding more rich and relevant information
- Analytical review procedures are not documented and therefore not traceable.
- Gap between types of audits mentioned in the statute (for example performance audits) and the actual audits included in the annual plan (compliance), suggests that there might be a gap in internal auditor's skills, that might not be sufficient to deal with broader tasks defined by statute.

Based on interviews with selected municipal internal auditors, **15% reported having limited access to information during the course of internal audits.** According to interviews, we have also found that **internal auditors were not even informed or kept up to date regarding important audit related information of municipalities:** 23% of internal auditors did not know that Sakrebulo had heard SAO's audit results and issued a decision to management, and they were not even informed about an independent audit performed in their municipalities.

Furthermore, **our interviews with selected Internal Audit departments revealed a lack of a robust following-up system, not only external audit, but also for internal audit recommendations.** Just 54% of selected IA units reported receiving formal action plans for resolving internal audit recommendations. In two municipalities (Tbilisi, Batumi), a more advanced system was implemented, and in those cases as well it was more about the design of the process (detailed instructions for followup) than about actual implementation.

In order to address some of the weak points of internal audit function identified during PEFA assessments, **the Memorandum of Understanding between the MoF and eleven municipalities outlined certain requirements that municipalities needed to meet. As of 2020,** these conditions were:

1. Developing a risk-based strategy and an annual plan
2. Developing working files reflecting risk analysis
3. Conducting an audit in accordance with the risk-based plan
4. Holding a hearing by Sakrebulo on internal audit, as evidenced by meeting records

Only two out of eleven (18%) municipalities fully met conditional requirements, six partially, and three could not meet them at all⁴⁸.

I. Strengthening independence of Internal Audit functions

An internal auditor's independence and expertise are important factors for SAO to consider when determining to what extent they can use the work of the internal auditor. Internal audit services are subordinate to the head of the entity within which they have been established. Nevertheless, they shall be functionally and organizationally independent as far as possible within the respective regulatory framework. Internal audit's independence, both real and perceived, is maximized when it reports functionally to the board/council or audit committee of the board/council⁴⁹. The International Professional Practices Framework (IPPF) Practice Advisory 1110-1 states that "the CAE, reporting functionally to the board and

48 CHU (2021). Development of Public Internal Financial Controls: A Consolidated Annual Report of 2020

49 Webster Bruce. (2015) 20 Questions Directors Should Ask about Internal Audit URL: <https://chapters.theiia.org/IIA%20Canada/Documents/20-Questions-Directors-Should-Ask-About-Internal-Audit-March-2016.pdf>

administratively to the organization's chief executive officer, facilitates organizational independence⁵⁰." According to the international reputable IIA's survey⁵¹, 72% of surveyed public and private sector internal auditors worldwide functionally report to the audit committee (or its equivalent) or the board of directors (equivalent legislative body in the public sector). As a result of this type of reporting structure, a Chief audit executive (CAE) - the head of internal audit according to international standards - will have the opportunity to solicit advice, counsel, and support from key stakeholders who won't impose undue pressure on the audit process.

According to the Institute of Internal Auditors Research Foundation (IIARF), organizational independence is one of nine key elements⁵² required to establish an effective internal audit activity. It states that independence is greatly impacted by how a CAE is appointed and can be terminated. Namely, the independence is enhanced further if the audit committee appoints, removes, and fixes compensation for the CAE. CAE also should be protected from management or political interference or retaliation resulting from carrying out legitimate duties in accordance with the Standards⁵³.

Prerequisites for ensuring an independence of internal audit offices

Estonia

In Estonia internal auditors are appointed or removed by an audit committee⁵⁴. The audit committee has at least two members, at least one of whom should be an expert in accounting or auditing. Also, the Auditors Activities Act requires that the committee members as a whole shall have competence relevant to the sector in which the audited entity is operating. Internal auditors are subject to the state oversight by the Ministry of Finance.

Furthermore, an internal auditor must report periodically to senior management and the board. A board is an organization's governing body that includes an audit committee to whom the CAE functionally reports⁵⁵.

In Georgia almost all heads of internal audit offices in the municipalities are appointed by mayor, while in Tbilisi the Sakrebulo elects an internal auditor⁵⁶, which is compliant with the best practice and strengthens the independence of the internal audit office of the capital city. However, like other municipalities, in Tbilisi, the internal auditor reports only to the mayor and not to the council, thus, functionally reports to the head of the executive branch, which is opposite of the best practice.

50 IIA. (2017). International Standards for the Professional Practice of Internal Auditing (Standards). Sec., 1110-01 URL: <https://na.theiia.org/standards-guidance/Public%20Documents/IPPF-Standards-2017.pdf>

51 The IIA Research Foundation. (2015). Global Pulse of Internal Audit URL: <https://dl.theiia.org/AECPublic/2015-Global-Pulse-of-Internal-Audit-Report-Embracing-Opportunities-in-a-Dynamic-Environment.pdf>

52 Organizational Independence, Formal Mandate, Unrestricted Access, Sufficient Funding, Competent Leadership, Objective Staff, Competent Staff, Stakeholder Support, Professional Audit Standards

53 Institute of Internal Auditors Research Foundation. 2014. Nine Elements Required for Internal Audit Effectiveness in the Public Sector. URL: https://www.iiar.nl/SiteFiles/IIA_leden/Nine-Elements-Required-for-Internal-Audit-Effectiveness-in-the-Public-Sector.pdf

54 Auditors Activities Act. § 98.2.2 URL: <https://www.riigiteataja.ee/en/eli/ee/504092017006/consolide/current>

55 Lina R. (2012). Legal Regulation of Internal Audit in Estonia. URL: <http://www.iacmaster.it/iacconference2012/wp-content/uploads/2012/04/Raivo-Linnas.pdf>

56 Statute of the Municipal Internal Audit and Monitoring Service of Tbilisi City Hall. <https://matsne.gov.ge/ka/document/view/4001092?publication=0>

Recommendations:

For strengthening an independence of the internal audit offices in the municipalities, citi/municipal councils (Sakrebulo) should amend an internal audit office's reporting rules in the statute of the Internal Audit Service of the respective municipality. More precisely, an internal audit office should report functionally to the respective Sakrebulo or audit commission/committee and administratively to the mayor. To achieve this goal, the statue should make a Sakrebulo responsible for

- approving decisions regarding the appointment and removal of the head of internal audit office
- approving the remuneration of the head of internal audit office,
- approving internal audit plan,
- approving the internal audit budget and resource plan
- Receiving annual reports of internal audit office on the internal audit activity's performance relative to its plan and other matters

II. Strengthening Competency of Internal Audit functions through Certification and continuous professional development programs

As was mentioned above, competent leadership and staff were two key elements required to have an effective internal audit function in the public sector. The International Standards for the Professional Practice of Internal Auditing (Standards) state that internal auditors must possess the knowledge, skills, and other competencies needed to perform their individual responsibilities. The standard does not obligate, but encourages internal auditors to demonstrate their proficiency by obtaining appropriate professional certifications and qualifications, such as the Certified Internal Auditor designation and other designations offered by The Institute of Internal Auditors (IIA) and other appropriate international or local professional organizations⁵⁷. Although the certification is not explicitly compulsory for all level internal auditors by standard, it is highly advised and expected from Chief Audit Executive (CAE), who is equivalent to head of internal audit office, to have relevant certification. Even more, the IIA's practice guides⁵⁸ that provide mandatory or strongly recommended guidance, require supervisory staff and above to hold relevant audit certification⁵⁹. **Thus, while it is not compulsory for all level internal auditors to become certified auditors by IIA standard, it is highly recommended for heads of internal audit and supervisory staff to have internal audit related certification.**

Like the IIA standard, many countries do not make certification of public sector internal auditors obligatory. Internal audit certifications are often seen as an advantage rather than a requirement to practice internal auditing in the public sector in many countries. However, there are few countries including the Republic of Slovenia⁶⁰ that chose to require public sector internal audit practitioners to be licensed.

57 IIA. (2017). International Standards for the Professional Practice of Internal Auditing (Standards). Sec., 1210 (Interpretation). URL: <https://na.theiia.org/standards-guidance/Public%20Documents/IPPF-Standards-2017.pdf>

58 The IIA. (2015). Practice Guide: Creating an Internal Audit Competency Process for the Public Sector; The IIA (2010) Practice Guide: Chief Audit Executives - Appointment, Performance Evaluation, and Termination. <https://na.theiia.org/standards-guidance/recommended-guidance/practice-guides/Pages/CAEs-Appointment-Performance-Evaluation-and-Termination-Practice-Guide.aspx>

59 According to the IIA Global Survey, 71% of CAE respondents had professional certifications in the internal audit field or equivalent. The Certified Internal Auditor (CIA) was the professional certification held by most of the CAE respondents, followed by the public accountancy certifications and the Certified Government Audit Professional (CGAP) certification respectively.

60 The same approach was used by Macedonia, Montenegro, and Kosovo.

Mandatory Certification of the Public Sector Internal Auditor in Slovenia

The Republic of Slovenia chose to address public sector internal auditors' competency issues by requiring public sector internal auditors to be licensed under the Training of Internal Auditors in the Public Sector (TIAPS) program. The TIAPS is a public-sector-oriented certification program that strives to merge international best practices with localized regulatory concerns and is delivered in the host country's language⁶¹. TIAPS complements the IIA's efforts to build the capabilities of internal auditors working in the public sector. However, there are some crucial differences that make it stand out. Its content is delivered through a more rules-based than principles-based approach, allowing those working in public sector audit to gain a deeper understanding of their country's regulatory framework⁶².

Slovenia's Central Harmonization Unit and the Center of Excellence in Finance (CEF) invested in the creation of TIAPS together with the Chartered Institute of Public Finance and Accounting (CIPFA). In general, TIAPS targets professionals with a bachelor's degree and practical experience in areas such as accounting, financial oversight, and control. The program is composed of seven modules and is divided into two levels, Certificate and Diploma. There are two examinations for every module, and each module takes between 2 and 3 months to complete. Examinations are a combination of test questionnaires and thesis-style assignments. In addition, Slovenian candidates are expected to present and defend a final assignment, to a panel composed of tutors for the modules. Completion of each level normally takes a year. The certificate level requires completing 4 modules such as the Internal Auditing Fundamentals, Public Sector Accounting and Financial Reporting, Governance and Control, and National Legislation and Taxation. The Diploma Level candidates need to take three more modules that are Advanced Internal Audit, Auditing Management Performance, and Managing the Internal Audit Function.

A law similar to the law in Slovenia, requiring certification for state internal audit practitioners, has been passed or is being drafted in Croatia, Macedonia, Kosovo, and Montenegro. While in Slovenia TIAPS has been self-financed by students or their employers, in other listed countries, the program was funded by donor organizations and countries governments, in the first few years of implementation. Among program supporter countries and organizations are the Central European Initiative, the European Commission, Germany, Slovenia, the United States, and the World Bank.

While certification is not compulsory for all level internal auditors across countries by IIA standard, it requires everyone regardless their position to enhance their knowledge, skills, and other competencies through continuing professional development⁶³. This requirement helps ensure that internal auditors remain competent in the growing and dynamic profession of internal auditing. The accumulating CPE hours are required even for those who are IIA certified internal auditors to maintain their certification status. The following box describes CPE requirements for public sector auditors including municipal internal auditors in Estonia and the USA and also, for all IIA certified auditors regardless of the sector.

61 <https://www.adb.org/sites/default/files/publication/190252/training-internal-auditors-ps.pdf>

62 The IIA provides the principles-based guidance, which leaves room for interpretation. The offered rule-based guidance allows applicants to the certification to better understand the public sector internal auditing concepts and processes.

63 IIA. (2017). International Standards for the Professional Practice of Internal Auditing (Standards). Sec., 1230

URL: <https://na.theiia.org/standards-guidance/Public%20Documents/IPPF-Standards-2017.pdf>

Continuing Professional Education (CPE) Requirements for Internal Auditors

Estonia

In Estonia, the Auditors Activities Act defines the legal bases for auditors activities and the requirements for all registered private audit firms or public sector internal or external auditors⁶⁴.

A public sector internal auditor is required to participate in the in-service training for at least 20 academic hours a year.

A certified internal auditor is required to participate in the in-service training for at least 40 academic hours a year.

The in-service training should be organized by the IIA-Estonia, the Association of Auditors, or any organization approved by them.

USA

In the USA, CPE requirements are defined by the Generally Accepted Government Auditing Standards (GAGAS)⁶⁵. All auditors should complete at least 20 hours of CPE in each year of the 2-year periods. Auditors who plan, direct, perform engagement procedures for, or report on an engagement conducted in accordance with GAGAS should develop and maintain their professional competence by completing at least 80 hours of CPE in every 2-year period as follows:

- 24 hours - Subject matter directly related to the government environment, government auditing, or the specific or unique environment in which the audited entity operates
- 56 hours - Subject matter that directly enhances auditors' professional expertise to conduct engagements.

IIA requirements

The IIA requires certified individuals to self-attest annually that they have met the CPE requirements⁶⁶. To maintain an active IIA certification/qualification, both practicing and non practicing certified individuals are required to obtain and attest to

- at least two hours of ethics training annually.
- the completion of the required CPE credit hours annually

Practicing IAs holding CIA require 40 hours CPE

Non Practicing IAs holding CIA require 20 hours CPE

The certification or CPE programs for public sector internal auditors are managed and/or offered mostly by CHUs, the IIA, IIA's local chapters, international and local professional associations, or any IIA or government authorized educational institutions. Like Slovenia, in European countries certification or CPE programs for public sector internal auditors are primarily managed by CHUs and IIA local chapters, while in the USA in addition to the IIA, CPE programs are provided by local professional associations. The following boxes review key bodies organizing Training and Certification Programs (TCP) for public sector internal auditors around the world.

64 Auditors Activities Act. URL: <https://www.riigiteataja.ee/en/eli/ee/504092017006/consolide/current>

65 GAO. (2018) Government Auditing Standards. paragraphs 4.16 - 4.53. URL: <https://www.gao.gov/products/gao-21-368g>

66 The IIA. (2021). Continuing Professional Education Policy: Requirements for Certification and Qualification Programs. URL: <https://na.theiia.org/certification/Public%20Documents/CPE-Policy.pdf>

Professional Bodies Providing Training and Certification Programs for Internal Auditors

The Central Harmonization Unit (CHU)

CHU is a central government agency responsible for developing and promoting an internal control and audit methodology based on international standards and best practices, and for coordinating the implementation of the new government legislation on managerial accountability and internal audit in all government agencies. It is one of the basic objectives of the CHU to improve the quality of staff responsible for financial control and internal audit, and therefore, improve the successful implementation of the PIFC systems. In this regard, the CHU is responsible for coordinating or supervising the establishment of sustainable training facilities. For instance, in Slovenia and Croatia national certifications are managed by the CHU. Besides, CHU closely coordinates and co-operates with the State Audit Offices, professional private organizations (like the local IIA) and academic circles to facilitate training programs.

The Institute of Internal Auditors (IIA) and Its Local Chapters/Institutes

The IIA is a leader in certification, education, and research for internal auditors in the public or private sector. The IIA awards the certified internal auditor (CIA) designation, a globally accepted certification for internal auditors, which is an expert level standard for competency and professionalism throughout the internal audit field. It also offers the Certification in Risk Management Assurance (CRMA), and the Qualification in Internal Audit Leadership (QIAL) certification. The IIA has members worldwide who participate through local IIA chapters or institutes. Chapters are organized in the United States, Canada, and the Caribbean. Institutes are organized internationally in all other remaining countries. The IIA provides various types of training programs that meet CPE requirements.

Good Practice of Knowledge Sharing and Capacity Development of Government Auditors Association of Local Government Auditors (ALGA) in USA

ALGA is a professional association uniting all government auditors in the United States. Its membership includes elected or appointed auditors from cities, counties, utility districts, transit agencies, tribal governments and more. ALGA offers members training that is designed specifically for local government auditors. Training formats include annual conferences, webinars and regional training. participation in ALGA provided training counts toward the GAGAS required CPE.

Aside from training programs, ALGA works to empower local government auditors through excellence in advocacy, communication, and collaboration. It offers the following programs:

Peer review - Member organizations can participate in ALGA's low-cost peer review programs. During peer review evaluators assess the audit office's performance and suggest ways for improvement. Peer review is available for both Red Book (IIA) and Yellow Book(GAGAS) organizations.

Mentorship opportunities - Mentorship is available to all ALGA members, from entry-level auditors interested in developing their skills to newly appointed CAEs navigating the challenges of executive leadership for the first time.

A unified voice - ALGA advocates for independent auditing at the local and state/provincial levels through their Advocacy and Professional Issues Committees.

Knighton Award program - recognizes the best performance audit reports of the year using the Exceptional and Distinguished categories. This award program motivates audit offices to improve the quality of their reports.

Auditor forum - is an online forum where auditors can exchange ideas and find solutions to common challenges.

Certification and CPE are not required by law in Georgia's public sector, however, the law on Public Internal Financial Control in Georgia states that the CHU should ensure the introduction of an internal auditors certification programme⁶⁷. According to the Consolidated Annual report on development of State Internal Financial Control System in 2020, the CHU prepared, translated and adapted to the Georgian context the following exam modules: "Governance and Control" and "the Principle of Internal Audit"⁶⁸.

A conceptual framework for the National Certification Program for Internal Auditors in Georgia is being developed. In 2019, CHU took several steps to create the National Certification Program before COVID-19 pandemics: a "Localization Working Group" was formed; mandatory certification modules were defined; and 10 trainers were selected and trained in their respective modules. A package of legislative changes is also being prepared that will facilitate the successful implementation of the certification program and make its results more tangible.

Recommendations:

To strengthen competencies of Internal Auditor and improve the quality of the internal audit work in the municipalities, the CHU in collaborating with donors and professional associations should

- continue developing an internal auditor certification program that would be tailored to the needs and requirements of Georgia's local government, and would be delivered in Georgian language.
- make internal auditor's certification obligatory by law after launching the countrywide localized internal auditors certification program.
- initiate to make it compulsory by law to obtain a certain number of CPE hours related to the subject matter for all internal auditors.
- define the general description of the professional development programs that will be acceptable to meet CPE requirement
- define criteria that should be met by organizations providing CPE program
- initiate to start issuing a special authorization to be a CPE program provider
- encourage and support internal auditors' professional groups to establish an official IIA chapter that would contribute to the capacity development of the local internal auditors, including professional strengthening of CHU.

III. Technically strengthening municipal internal audits - Implementing audit management system

It is recommended that CHU coordinate the implementation of an audit management system (AMS) for internal auditors that will be available to all internal audit units in municipalities and will help ensure compliance with the PIFC law and IIA standards, as well as effectively manage activities.

The advantages of AMS are increased efficiency, timeliness and quality expressed in:

- high level of standardization among the works of all audit teams completely in line with audit manuals,
- Automation function – there is not possibility to skip procedures
- Establishing a better quality control review and assurance system by supervisors ,
- Facilitating information sharing in a systematic way among auditors
- Producing timely management information to help senior management monitor audits and take necessary decisions.

⁶⁷ Law of Georgia On Public Internal Financial Control. Chapter IV, paragraph k. Consolidated version

⁶⁸ CHU (2021). Development of Public Internal Financial Controls: A Consolidated Annual Report of 2020.

Implementation of Public Internal Audit Software in Turkey

In order to ensure a standardized conduct of internal audit activities and to increase the compliance of internal audit units with the Public Internal Audit Standards, Public Internal Audit Software (İçDen)⁶⁹ has been developed in 2014. The tool was developed by the Internal Audit Coordination Board (IACB) of Turkey, which serves as the Central Harmonization Unit of the country. İçDen is a comprehensive, highly configurable, adaptable and easy to use Audit Management Tool, which enables it to meet all the requirements of the IACB and its member institutions audits. İçDen aims to ensure that the processes of planning, conducting, reporting, and monitoring of internal audit activities are carried out through the software and in compliance with the Public Internal Audit Manual. This software is used in all administrations that have an established internal audit unit. With the usage of İçDen, the aim is to ensure that internal auditors conduct risk-based internal audit and related monitoring activities more effectively.

1.5. Policies are needed to promote sustainable development

No matter how important and necessary some reforms might be, there are set of factors⁷⁰ that threaten the progress in implementation of policies and their sustainability. These factors were echoed in different ways during our interviews with donors, CSOs and municipalities themselves. Namely:

- **the short duration of political leadership, accompanied by turnovers of key decision-makers** - donors mentioned that they had to concentrate more on reform implementation and ‘quick wins’ in municipalities during windows of opportunity that are typically of limited duration.
- **the higher degree of clientelism, favoritism, nepotism** - CSOs⁷¹, SAOs⁷² and others have raised questions in their reports about the optimal size of the bureaucratic apparatus, especially in subordinate legal entities of municipalities (Legal Entities of Public Law (LEPLs) and Non-Entrepreneurial (Non-Commercial) Legal Persons (N(N)LPs)). According to the IDFI’s policy document⁷³ “the number of public servants in state and municipal LEPLs and NNLEs is unreasonably high and keeps increasing”. Besides the fact that favoritism at local government level poses the risk of increased bureaucratic expenses, and is an additional burden to already constrained financial resources, it is directly linked to one of the main root causes of not implementing recommendations: lack of professional capacity in municipalities. Problems of low team spirit, absenteeism, decreasing commitment pose particular challenges at the local level, and favoritism can discourage skilled, motivated and competent candidates from applying for certain positions, and result in the recruitment of unqualified staff, and subsequently dysfunctional governance⁷⁴.
- **lack of a priori expertise of new elected leaders** and top management’s low ability to repackage the issue and maneuver the dynamics of the legal process.
- **lack of project management capacity within municipalities**, both in terms of staff availability and in terms of relevant skills.

69 Kiral H. (2020) Public Internal Audit Reforms in Turkey: Structure, System, and Roles.

70 Bunse, Simone & Fritz, Verena. (2012). Making Public Sector Reforms Work: Political and Economic Contexts, Incentives, and Strategies. 10.1596/1813-9450-6174.

71 Transparency International Georgia (2017), Corruption Risks and Management Practice in State-Founded LEPLs and N(N)LPs. <https://transparency.ge/en/blog/corruption-risks-and-management-practice-state-founded-lepls-and-nnpls>

72 SAO’s Compliance Audit of Gardabani Municipality for the years 2018-2019; SAO’s Compliance Audit of Khoni Municipality for the year 2017.

73 IDFI (2017). Challenges of the Georgian Bureaucratic System (2011-2016). https://idfi.ge/en/challenges_of_the_georgian_bureaucratic_system_2011_2016

74 CoE, Congress of local and regional authorities, Report CG36(2019), Fighting nepotism within local and regional authorities. <https://rm.coe.int/fighting-nepotism-within-local-and-regional-authorities-governance-com/16809312c3>

- ***lack of systematized information sharing of donor-created knowledge*** - there is no centralized repository and knowledge sharing mechanism in Municipalities about the consulting work, evaluation assessments, analytic documents, better practice guidelines or methodologies created with donor support.

To address the above mentioned challenges, we have analyzed different success factors locally in Georgia, or from international better practices to learn what motivates reforms and sustains them. Some of our main considerations include:

a) Role of IT systems are crucial in sustainable reforms

An overriding feature of PFM in Georgia has been the development and good use of Information Technology. The Results of the PEFA assessments⁷⁵ show that the indicators which score high are related to well-standardized, centralized systems that are managed through electronic systems. Based on this successful good practice experience that Georgia has, the research team identified underperforming areas where **IT solutions can be leveraged to improve administrative or service delivery processes in municipalities for achieving sustainable results**. Using technology could enhance innovation in local government, increase interaction between different agencies or units in the municipality and improve citizen responsiveness through redesigned, simplified, and automated procedures.

b) Reform coordinators can incentivize institutional reforms

Key factors that can trigger or facilitate public sector reforms and their sustainability are related to the more specific pressures and institutional reform incentives from reform coordinators from the central government and donors.

This kind of reform-facilitating instrument, a mechanism of conditional financial support, was recently launched by MoF to encourage municipalities to eliminate the weaknesses identified by the PEFA assessments.

Financial support mechanism by Government of Georgia to Municipalities

In order to stimulate PFM reforms at local government level, at the end of 2019 the Government of Georgia introduced a mechanism of financial support^{76 77} conditional upon the municipalities improving identified areas of weakness as per PEFA assessment reports. 27 municipalities signed Memorandums of Understanding (MoU) with MOF to comply with the decree. These MoUs have a set of indicators based on critical PFM areas of weakness identified in PEFA assessments, that the municipalities should achieve by 2022 in order to get more capital grants⁷⁸ for public investments. The objective of the reform is to ensure that municipalities:

- Can plan and prepare more realistic budgets in accordance with the program budget methodology;
- Are subjected to stronger internal and external scrutiny, and
- Are more transparent and engage more with their citizens.

75 Over 2020-22, participating municipalities could receive on average 34 percent of the capital grant transfer they received in 2019, which should be sufficient to incentivize improvements. Transfers are pro-rated to the progress of the municipality on the indicators agreed with the MOF.

76 Government Decree # 2735 of December 30, 2019

77 <https://www.pefa.org/news/pefas-contribution-georgias-pfm-reform-subnational-government-level-stimulated-capital-grants>

78 Over 2020-22, participating municipalities could receive on average 34 percent of the capital grant transfer they received in 2019, which should be sufficient to incentivize improvements. Transfers are pro-rated to the progress of the municipality on the indicators agreed with the MOF.

This kind of mechanism might be a very successful driver for reforms in municipalities; as studies⁷⁹ show political support is often needed for capabilities to develop and be sustained over time and interventions tend to be more successful in areas where task specificity is high, where outputs are measurable and where there are low levels of staff turnover. Therefore the conditional financial support instrument introduced by MoU has a potential for incentivizing tangible results. **Noteworthy, that objectivity in evaluating the implemented conditions is crucial in order not to compromise the instrument's effectiveness. In addition, in order for results to be sustained, the budget support instruments should provide extra incentives or penalties for failure to implement successfully implemented conditions from previous years.**

c) A comprehensive approach is needed to integrate a wide range of sectoral strategies

Linking the development of key strategies to the overarching plan of the municipality will increase the chances of them delivering sustainable results. As we have found out during interviews with municipalities, strategic/operational planning is a challenge for most of the municipalities, administrative duties are implemented mainly spontaneously.

The same problem is echoed in PEFA assessments. Medium term perspective in expenditure budgeting (PI-16), including the alignment of strategic plans and medium-term budgets, was assessed as being at lowest level ('D'/'D+') in 89% of evaluated municipalities.

Strong internal control system (PIFC) vis a vis successfully implemented program budget reform should be an impetus of improved governance in municipalities. The major aim of the program budgeting reform was exactly to address this problem of spontaneity, and the reform was designed to focus on linking plans to day-to-day operations, and ultimately, results (outcomes and outputs), as well as to improve transparency and accountability in the public sector. Even so, the progress of reform is not promising, and the entire process needs to be re-engineered to be efficient and systematic.

PIFC requires strategic/operational plans to be translated into the management organisation⁸⁰, and for them to be realized, they must be incorporated into the performance management system. To accomplish this, performance management is required to establish accountability mechanisms that include performance indicators, performance targets, performance reporting, as well as reward and punishment mechanisms. Measuring performance and using performance data to strategically place resources is key to implementing the results-focused and sustainable governance policies that citizens demand.

d) The role of donors in sustaining reforms is essential

Donor efforts help moving reforms forward, especially if municipality agencies will have a strong incentive to engage. External actors may be able to encourage local actors to find interim solutions to the capability problems confronting them, for example, where there is lack of a priori expertise of new elected leaders and top management's low ability to repackage the issue and maneuver the dynamics of the legal process. Municipalities could be better supported in advertising their incremental progress in their area of competency which could be shown by different scorecards/indices and linked awards for good performance.

Additionally, donor efforts are frequently affected by coordination weaknesses that can limit their impact. In Georgia, thematic Coordination Groups have been set up by the Donor Coordination Unit

79 ODI (2015). Tilley H, Hadley S and others, Sustaining public sector capability in developing countries.

80 OECD/SIGMA (2015). Gap analysis: PIFC of the republic of Georgia, With focus on Financial Management and Control

under the Administration of Georgia (working group on Economic Growth) and a similar structure exists under the State Ministry for European and Euro-Atlantic Integration and Ministry of Regional Development and Infrastructure where donors have opportunity to discuss and agree their support priorities with government representatives and other donors. The existing coordination mechanism acts as a good example of donor coordination, information exchange among donors and continuous policy dialogue with officials and key stakeholders on relevant policies for the action. Nevertheless, **there is a need for a more institutionalized tool to share created knowledge and technical expertise, especially in the context of municipalities.**

Recommendations

I. Developing a knowledge sharing platform

To ensure wide electronic distribution of new knowledge or insights relevant to municipalities, a coordinating agency from the central government has to launch the online platform that will create an opportunity to equally and timely distribute the value that donors create with their technical support to particular municipalities. This e-library will serve as the medium of exchange of new knowledge, information and ideas on municipal affairs and support building institutional knowledge, and creating professional information sources in Georgian language.

II. Implementing a performance management system

Coordinating agency from central government with the involvement of municipalities to create a performance management tool. It should align different interdependent domains of a performance management system, including sectoral strategies, municipality strategic planning, performance measurement, evaluation, and program budgeting within municipalities. This tool should incorporate data collection systems, including a framework for using performance measures (Key Performance Indicators -KPIs) to improve quality, monitoring financial and budgetary status, service delivery, program outcomes, and community conditions. System should be upfront referenced/linked on municipal, regional and sectoral strategic development plans and consistent with the Instruction of Program budgeting developed by the ministry of finance. The system will also support municipalities to establish a strong system of financial management and control to implement the tasks of planning, programming, budgeting, accounting, reporting, and monitoring. Vis a vis improved performance management, this will directly support managing and tracking audit recommendations. Main benefits of the automated system will be:

- Integrating existing planning frameworks, institutional roles and responsibilities and standing procedure information and facilitating coordination in a central place;
- Making the link across mechanisms, plans, institutions;
- Better coordination across the departments/units;
- Documented responsibilities;
- Continuous updating of information and encompassing all sources of assurance in a central repository;
- Facilitated reporting to those charged with governance and external auditors;
- Avoiding loss of institutional memory due to staff turnover.

III. Elaborating and delivering onboarding and continuous professional-development program for newly elected officials

To govern municipalities, locally elected officials need special knowledge and leadership skills. The need for education to improve the governance capacity of elected representatives has been described as great and those who govern competently enhance the lives of their municipalities' present and future generations^{81 82}.

Professional-development program should be aimed at increasing municipality leaders' understanding of fundamental information regarding municipality governance (e.g. fundamentals of financial management, legal framework of municipalities, PIFC law and practical implementation instructions, program-based budgeting and performance management, risk management, overview of ongoing reforms) **as well as boosting their soft skills** (e.g. build and motivate effective teams and cross-sector collaborations, delegate duties, hone public engagement skills, sharpen negotiation skills and much more).

There are different better practice models of arranging this kind of induction program for elected officials. In addition to widely practiced mandatory certification programs for various appointed officials (Municipal Finance Officers, Municipal Internal Auditors, Municipal Clerks and others), requiring elected officials to undergo education to conduct their duties can be seen as undermining their democratic mandate⁸³. Therefore the most appropriate format for elected officials is a voluntary orientation and continuing education program meant to encourage and recognize the efforts of local elected officials to become more effective leaders.

With reference to the Swedish context municipal councilors are mandatorily given an introductory education. Normally, this education takes place over one or two days in connection with the start of a new term in office⁸⁴. While the practice of New York State Conference of Mayors and Municipal Officials (NYCOM)⁸⁵ is entirely voluntary. To encourage participation of elected officials, after successfully completing the education program, they are publicly acknowledged and recognized at two award levels - Education Award and Leadership Award. Another good practice example is the national improvement organization for Local Government in Scotland - The Improvement Service (IS)⁸⁶. It provides elected members with professional and personal development opportunities and generates confidential 360 degree feedback on how they exercise a wide range of important political skills. This framework is voluntary and elected members decide themselves whether they wish to participate.

IV. A scorecard for sustainable municipalities as a tool to incentivize reforms

In order to improve efficiency and competitiveness of municipalities, and reinforce municipalities' commitment to openness and transparency, the municipal reform tracker might be a good solution. **It could be utilized as a regular approach to evaluating and assessing municipal fiscal and operational performance** in order to: continuously gather comprehensive metrics and data on local finance, and focus on developing a system for rewarding municipal financial performance appropriately. These kinds of tools are effective for increasing visibility and therefore pressure of accountability on the executive branch to improve performance.

81 Vogelsang-Coombs, Vera, and Melissa Miller. "Developing the Governance Capacity of Local Elected Officials." *Public Administration Review* 59, no. 3 (1999): 199–217. <https://doi.org/10.2307/3109949>.

82 Battaglio, P. (2008). University-based training programs for local elected officials in the southeast. *State and Local Government Review*, 40(2), 125–131. <https://doi.org/10.1177/0160323X0804000206>

83 Grenier, F., & Mévellec, A. (2016). Training local elected officials: Professionalization amid tensions between democracy and expertise. *Lex Localis*, 14(1), 33.

84 Nordvall, H., Bladh, D., & Malmström, L. (2020). Den lokala politikerns bildningsarenor [Educational arenas for local politicians]. CKS, Linköpings universitet.

85 The Elected Officials Academy (EOA) under The New York State Conference of Mayors and Municipal Officials (NYCOM). <https://www.nycom.org/training/elected-officials-academy>

86 The Improvement Service (IS). CPD Framework for Elected Members. <https://www.improvementservice.org.uk/products-and-services/skills-and-development/cpd-framework-for-elected-members>

Georgia has two good examples of reform assessment tools - Local Self-Government Index and Public Administration Reform Tracker, both of which are funded by donors. Both tools and several other similar benchmark assessments of Georgian municipalities demonstrate that it is possible to gather information and assess different aspects of public management in municipalities based on rigorous methodology. **These tools, on the other hand, also highlight missed opportunities or weaknesses in their sustained application: (a) platforms will no longer be updated if donors cease funding; (2) the results of assessment are not integrated into larger development projects. For example using index results as baselines for assessing municipal progress, for programing guidance, and as indicators of progress. Using results to recognize and reward good performing municipalities, and therefore motivating/directing their political will.**

Local Self-Government Index of Georgia

In Georgia's local government context, a very good example of local government openness and accountability scorecard is the Local Self-Government Index⁸⁷, which is funded and implemented with the support of donor funds and civil society organizations⁸⁸. As part of this local self-government index, the transparency of all self-governing bodies of the country, citizen participation mechanisms, and practices are being evaluated, rated, and a national report will be prepared.

Online Monitoring Platform of the Public Administration Reform of Georgia

PAR Tracker⁸⁹ is an electronic platform for monitoring the implementation of the Georgia's Public Administration Reform Action Plan. The platform combines practical information on Public Administration Reform, such as Policy Planning and Coordination, Civil Service and Human Resource Management, Accountability, Public Service Delivery, Public Finance Management and Local Self-Government.

For implementing the Public Administration Reform, the Government of Georgia, once in every two years approves the Public Administration Reform Action Plan. Within the EU-funded project⁹⁰ Civil society organizations⁹¹ monitors the directions of Policy Planning and Coordination, Accountability, Public Service Delivery and Public Finance Management.

V. Strengthen NALA's knowledge-sharing and capacity development role

The Local Government Association (LGA) has a critical role in encouraging best practice in local government. It is a representative of most municipalities, enjoying their legitimacy and supporting their interests. LGAs are protected by constitution, general law, regulation, or other rules and all of them act in the public interest. If earlier LGAs were mostly focused on its role as an advocate for local government influencing the legislative framework, nowadays, LGAs strengthen own abilities to provide capacity-building services to build up the efficiency and effectiveness of municipalities⁹². **As a result, sharing best practices has become one of the most important services that current LGAs provide**

87 <http://www.lsgindex.org/>

88 Project Donor: Open Society Georgia Foundation (OSGF). Implementing CSOs: Centre for Training and Consultancy (CTC), Institute for Development of Freedom of Information (IDFI) and Management Systems Development Center (MSDC)

89 <https://www.partracker.ge/>

90 "Contributing to PAR through Civic Monitoring and Engagement"

91 the Institute for Development of Freedom of Information (IDFI) in cooperation with the Georgian Young Lawyers' Association (GYLA)

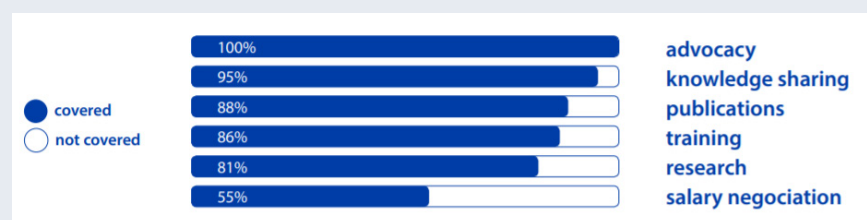
92 Council of Europe. (2015). Best Practice in Local Government. URL: <https://rm.coe.int/bpp-best-practice-programme-for-local-governments/1680746d97>

to their municipalities. Mostly, they partner with the Ministry and/or other organizations in building the capacity of municipalities through sharing the local or international best practices. For example in European countries, in this process, the Ministry responsible for local government usually tries to raise standards in the light of European integration and in the better use of public funding. On the other hand, different national and international organizations may wish to participate by sponsoring an award or managing training, while the LGA decides how to harness such initiatives. The following box reviews some of the key roles of LGAs in European countries.

LGAs Activities in Europe

Most national associations of local and regional governments in Europe are members⁹³ of the Council of European Municipalities and Regions (CEMR). 75% of the CEMR member associations represent only local level municipalities and the remaining ones represent regional governments or are umbrella associations. The CEMR member LGAs' activities mainly cover advocacy, knowledge sharing, publications, training, research, and/or salary negotiations⁹⁴. As the graph shows, for all EU LGAs advocacy is their number one key activity. The second most covered activity is the exchange of good practices and knowledge-sharing. According to the CEMR study, for 60 % of its members, it is a main activity while it is a secondary one for 35%⁹⁵. For instance, for the Swedish, the Bulgarian, the Italian, and two Austrian associations, the English, the Welsh, and the Northern Ireland LGAs, and the Association of Basque Municipalities (EUDEL), the exchange of good practices or knowledge is considered a main activity.

Figure 12. Activities Covered by LGAs



Source: CEMR. 2019

Training and capacity building is also an important topic for the associations, 53% address it as a main activity and 33% as a secondary activity. As an example, the Spanish FEMP, the Slovakian ZMOS, the Austrian STÄDTEBUND and the Croatian HRVZZ have identified training and capacity building as a key activity. For the association of Basque Municipalities (EUDEL), this is a key activity. EUDEL provides specific training for women elected officials (network of mayors and councilors named “Basqueskola”) as well as for all locally elected representatives, regardless of their gender, and for civil servants. In France, the French Association of CEMR (AFCCRE)⁹⁶ has a specific agreement with the French National Centre for Local Public Service (CNFPT) which organizes the training of local civil servants to provide specific training on European policies. AFCCRE is also recognised by the state as a training facility for local and regional elected representatives.

93 CEMR was unites 60 associations in 41 European countries

94 CEMR. (2019). National associations of local and regional governments in Europe. URL: <https://knowledge.uclga.org/IMG/pdf/nationalassociationsoflocalandregionalgovernmentsineurope.pdf>

95 CEMR. (2019). National associations of local and regional governments in Europe. URL: <https://knowledge.uclga.org/IMG/pdf/nationalassociationsoflocalandregionalgovernmentsineurope.pdf>

96 <http://afccre.org/fr/#.YcpdSGjMKUk>

In Georgia LGA equivalent is the National Association of Local Authorities of Georgia (NALAG) that is also a member of the CEMR. NALAG unites all local authorities in Georgia. It is led by the mayor of Tbilisi, but NALAG has a multi-party executive board composed on the basis of regional representation⁹⁷. NALAG representatives actually participate in the committees of the Georgian Parliament with a consultative voice and work with the Government of Georgia on issues that are linked to local governance and local development. NALAG has concluded a Memorandum of Understanding between the Parliamentary Committee on Regional Policy and Self-Government as well as with the Ministry of Regional Development and Infrastructure. This Association is actively involved in the discussions on any matter that has direct influence on local governments. Advocacy, exchange of good practices/ knowledge sharing, and training/ capacity building are NALAG's main activities, while salary negotiation, research and studies, and publications are secondary. For instance, during 2018-2021, NALAG was implementing the EU-funded Networking for Efficiency (N4ED) project that encompassed the best practice program, which involved announcing a competition between municipalities to identify successful cases and then share with peers.

Considering its goals and similar associations' experiences in other countries, NALAG should play a key role in improving the qualifications of appointed and elected officials of LSGs through providing various capacity development activities. Besides, it should continue and expand knowledge and best practice sharing activities to ensure that all municipalities have access to the knowledge pertaining in the local or international network of municipal officials.

NALAG can play a crucial role in implementing those recommendations that we refer to local government's reform coordinators, and more importantly those that are directed towards sustainable results or ongoing reforms.

2. Municipal-level root causes

The SAO biannual consolidated reports⁹⁸ and interviews provided key information about the root causes of recurring deficiencies in municipalities, leading to repetitive recommendations. Based on the SAO reports, the major causes of deficiencies in municipalities can be divided into two groups:

- **The absence of proper rules, strategies, guidelines, control mechanisms on the municipal level.** Municipalities are failing to come up with the best solutions to address issues that are not fully regulated by applicable law. As a result, the decisions made are ineffective.
- **Incompliance with the existing regulations, rules, and recommendations.** The municipalities do not take into account the requirements defined by the current legislation when making a decision.

To get a better understanding which areas need to be regulated and in which areas municipalities avoid requirements of the existing local laws, the research team decided to analyze not implemented recommendations for the selected municipalities. Out of 65 not implemented recommendations in the selected municipalities, 39 recommended to initiate the implementation of the new rule, regulation, strategy, program or control. The research team expanded this analysis to all municipalities to detect what kind of rules were needed across municipalities and identified 27 additional recommendations in other 16 municipalities⁹⁹ with similar suggestions. More precisely, the most frequently issued recommendations across audited municipalities were to develop a rule, strategy or guideline that would:

⁹⁷ <https://nala.ge/leadership>

⁹⁸ SAO's biannual consolidated report on audit results in municipalities

⁹⁹ We should list here these municipalities

- regulate purchase, redistribution, and use of vehicle fleets and set fuel consumption and telephone spending limits on the municipal level.
- regulate business hosting and business trip costs. Namely, the rule would determine the category of guests, the purpose of the visit/meeting, the form of reception, the etiquette of the host, the list of documents to be submitted for payment, and other control mechanisms that will make the costs transparent and result oriented.
- define the prerequisites of issuing construction permits, managing abandoned buildings, and accepting and handing over construction works.
- develop appropriate job descriptions and required qualifications to ensure the employment of competent and capable people in the municipalities.
- enable to minimize negative consequences of the natural disaster.
- establish appropriate control mechanisms over the owned public property.

Having a proper legislature base is a necessary but not a sufficient criterion to build a well-functioning public sector government¹⁰⁰. Along with other requirements, the compliance with legislation, regulations and policies is needed to ensure good governance of the municipalities¹⁰¹. As was mentioned earlier compliance is another recurring issue for municipalities. More precisely, out of the 65 recommendations in the selected municipalities, 26 demonstrated that municipal activities were not compliant with the existing rules. Most of these recommendations could be grouped into the following categories that suggest:

- not to reimburse expenses made by Council members unless they submit a primary document confirming the payment.
- to reimburse the money spent on hidden construction works only in that case when the responsible person submits documentary evidence of work finished.
- to examine properly submitted tender documents of low price bidders to avoid disqualifying applicants due to improper reasons that will make decisions incompatible with procurement law.

Based on the interview results and the detailed review of audit findings and recommendations, **the potential causes of not enacting or implementing recommended rules or guidelines could be authorities' lack of willingness to regulate some municipal activities, shortage of financial or human resources, or the complexity of implementation of the initiative since it requires the involvement of multiple stakeholders.**

- **Lack of political will/absence of authority.** For instance, there is less motivation from municipal authorities to regulate the utilization of work/agency vehicle fleets or to set limits to fuel, mobile or business trip expenses, because one of the incentives to be in the government offices could be to have access to such benefits. As audit findings show municipal authorities are prone to overuse or overspend if the regulation does not restrain them.
- **Lack of expertise of municipal staff in some fields.** The non-availability of staff with the appropriate expertise present additional challenges that need to be met in order to create and implement new specialized rules. For instance, development of a rule defining the calculation method of the actual costs of construction works purchased through a simplified procurement method could be a challenge for those municipalities lacking expertise in this field. Also, development of the natural disaster management strategy requires specialized knowledge that might be missing in some LSGs.

100 Committees, Economic Committee (EC) (2011) Good Practice Guide on Public Sector Governance URL: https://www.apec.org/docs/default-source/publications/2011/3/good-practice-guide-on-public-sector-governance/2011_ec_good-practice-guide-psg.pdf?sfvrsn=7398b3dc_1

101 https://www.bcauditor.com/sites/default/files/imce/OAG%20Public%20Governance%20Bro-FINAL_web.pdf

- **Need for multi-stakeholder enrollment.** A number of audit recommendations tackle complex issues, requiring extensive consultations and negotiations as well as approvals involving a wide range of stakeholders. For example, for implementing procurement, disaster and property management-related rules on the municipal level, municipalities will need to collaborate actively with the central government agencies that also might add additional obstacles to adopting and implementing suggested rules. While the central government's expertise might be very useful for municipalities, it at the same time might delay this process. Thus, multistakeholder enrollment in the initiative could be another root cause of recurring recommendations.

Most of the municipal level root causes are similar across municipalities that's why recommendations issues in the previous section covering systemic root causes would contribute to correcting the discussed problems.

3. SAO-level root causes

Getting action on recommendations depends, to a great extent, on how SAO will extend beyond existing follow-up procedures to engage other stakeholders in the process: the auditee, parliament, the media and the general public. To increase the auditee's response to and actions on the recommendations, we explored different practices that SAO may introduce or reinforce.

3.1. Communication with Intended Users can be further strengthened

Strengthened partnerships between SAO, Sakrebulo Members and Civil Society Organizations can apply pressure on Municipalities to improve the recommendation implementation and realize the benefits of audit work. It is recommended that the SAO plans activities that periodically and consistently remind Sakrebulo Members of the importance of audit recommendations. SAO can strengthen the demand for better financial governance by institutionalizing its communication with intended users in municipalities through implementing a formalized and systemic communication policy and program, where SAO will define its annual and medium-term communication activities:

a) With Sakrebulo Members

Engaging Sakrebulo members to follow up on SAO recommendations at the local level would be a primary mechanism for the enforcement of audit recommendations. The communication between SAO and Sakrebulo should be formalized and it should support the strengthening of relations between the two, and, where appropriate, Sakrebulo's specialized audit working groups or committee/subcommittees. This may be achieved by:

- Actively participating in audit hearings by SAO;
- Building the technical capacities of Sakrebulo members to monitor/track recommendations implementation status through ARIS;
- Organizing training and other forums between staff of the SAO and members of Sakrebulo in order to develop a common understanding and approaches to improving governance and internal financial control;

- Organizing technical level workshops for Sakrebulo administrative staff to train them in understanding and making use of audit reports, and other analytical resources available (e.g. Budget-Monitor) to better scrutinize municipal funds;
- Giving access to the members of Sakrebulo to SAO's recommendation follow-up e-system (ARIS) and sharing with Sakrebulo Members, at least annually, information on the progress of their respective municipalities' audit recommendations, including:
 - If any action plans have not been received;
 - Progress on implementing recommendations where action plans have been received;
 - Any disagreement that the municipality has with implementing a recommendation.
- Adding an analytical section to the SAO's biannual consolidated report on audit results in municipalities about the implementation of the recommendations, comparing different municipalities to their implementation rates, and providing information about the challenges and systemic issues associated with implementing the recommendations.

b) With media, CSOs and citizens

As the ultimate beneficiaries of a better use of public funds, citizens are the most important stakeholders of supreme audit institutions. CSOs and the media can influence the efficiency and transparency of public finances in municipalities, and contribute toward strengthening auditing. For this objective of strengthening the demand for better financial governance, SAO can further enhance cooperation and the synergy of work with civil society budget oversight organizations¹⁰². Although the functions of SAO and CSOs are different in nature, it is evident¹⁰³ that the respective roles of SAIs and CSOs can be mutually complementary. CSOs' distinct characteristics enable them to strengthen the execution of external oversight. These characteristics can be summarized as follows:

- CSOs have greater closeness to citizens who are on the receiving end of public services and, hence, their feedback is most relevant to the risk identification and planning of municipality audits by SAO;
- Citizens and CSOs can help identify areas of possible mismanagement, inefficiency, or corruption, thus expanding SAO's scope.
- Citizens and CSOs can put pressure on legislative and executive agencies to take and enforce corrective actions, as well as help monitor the municipalities' follow-up to audit reports and subsequent decisions taken by Sakrebulo commissions;
- CSOs and other stakeholders, such as the media, can act as both users and replicators of information produced by SAOs, thus increasing the audience of SAO's work.

¹⁰² World bank (2010), Guide to Good Practices, Access to Public Information and Citizen Participation in SAIs, <https://documents1.worldbank.org/curated/en/844431467998826503/pdf/80758-Nino-Citizen-Participation-in-SAI-Box-377336B-PUBLIC.pdf>

¹⁰³ United Nations Department of Economic and Social Affairs. (2013). Citizen Engagement Practices by Supreme Audit Institutions.

Good practice example of SAI's and CSO's cooperation (1)

The Public Service Accountability Monitor (PSAM)'s¹⁰⁴ activities include research, monitoring, advocacy and capacity building in South Africa. PSAM generates and shares knowledge about social accountability and the monitoring and advocacy tools that can build more open, participatory and accountable governments.

PSAM monitored whether recommendations to improve financial controls made to agencies by the Auditor-General and the legislature's oversight committees were being implemented. It utilized a wide variety of means to obtain documents pertaining to financial management, maladministration and corruption including, when necessary, using freedom of information provisions. It publicized its findings on a regular basis, including by producing a weekly column (the "Accountability Monitor") in a provincial newspaper. PSAM produced analyses geared to public understanding and specifically designed to engender and support public involvement in governance processes. It produced and distributed its analyses of public expenditure management in a manner timed to coincide with the budgeting and oversight cycle in order to influence budget and spending priorities and improve service delivery. PSAM has achieved encouraging results.

3.2. SAO shall evaluate the effectiveness of internal controls in municipalities, including internal organizational arrangements for implementing audit recommendations

The SAO's audit findings in various risk areas of municipalities' management, such as effectiveness, efficiency and productivity of operations, the reliability of reporting for internal and external audiences, compliance with applicable laws and regulations, and asset safeguarding are primarily attributable to weaknesses in internal control. By focusing on the effectiveness of internal controls SAO auditors increase the likelihood that they will better diagnose the root causes of audit findings. Moreover, as this report's analysis shows, weak internal controls are one of the main root causes of recurring and unimplemented audit recommendations. As a result, **it is in SAO's best interest to place greater emphasis on assessing internal controls, including internal organizational arrangements affecting implementation of recommendations which, in turn, will contribute to realizing the full benefits of audit work.**

In light of the ongoing PIFC reform, stakeholders as well as the reform implementation status evaluators expect from SAO auditors to report on the effectiveness of internal controls. In accordance with the recommendations of OECD/SIGMA experts¹⁰⁵, which were also echoed in CHU's annual report: "The State Audit Office should review the effectiveness of the PIFC arrangements and should be particularly concerned to satisfy itself that they enhance accountability and transparency and do result in a more efficient and effective delivery of public services."

104 <https://psam.org.za/>

105 OECD/SIGMA (2015). Gap analysis: PIFC of the republic of Georgia, With focus on Financial Management and Control

Good practice example of reporting on internal control effectiveness in municipalities by government auditors based on Generally Accepted Government Auditing Standards (GAGAS) by United States Government Accountability Office (GAO)

The objectives of a financial audit in the public sector are often broader than expressing an opinion as to whether the financial statements have been prepared, in all material respects, in accordance with the applicable financial reporting framework. These additional objectives most often include reporting on the effectiveness of internal control. According to the GAGAS, which is followed by almost all municipal auditors in the United States, reporting on financial statement audits should also include reports on internal control over financial reporting. This standard establishes requirements and applies when an auditor performs an audit of *management's assessment of the effectiveness of internal control* over financial reporting.

Auditors should include in the auditor's report on the financial statements or in a separate report:

1. Significant deficiencies and material weaknesses in internal control over financial reporting,
2. A description of the significant deficiencies and material weaknesses and an explanation of their potential effects, and
3. A description of the scope of the auditor's testing of internal control over financial reporting and whether the tests they performed provided sufficient, appropriate evidence to support an opinion on the effectiveness of internal control over financial reporting.

In the event that no material weaknesses were identified during the audit, the report will state that no deficiencies in internal control were identified that were considered to be material weaknesses during the audit of the financial statements.

Therefore, as part of its municipality audit program, it is recommended that SAO considers increasing emphasis on evaluating and reporting on internal control effectiveness in the course of their audits.

Further, in order to reinforce follow-up of its recommendations, SAO may consider assessing internal organizational arrangements of auditees influencing implementation of audit recommendations in every audit as part of the internal control assessment procedures.

Better practice example of evaluating Audit Recommendations' Implementation arrangements in audited entities by Australian National Audit Office (ANAO)

The Australian National Audit Office (ANAO) regularly publishes audit insights¹⁰⁶ which considers the approaches entities are taking to implement parliamentary and ANAO recommendations to improve public administration practices and outcomes.

Parliamentary committee inquiries and ANAO performance audits identify risks to the successful delivery of outcomes and generally, provide recommendations to address them. To conclude against the audit objective, the ANAO examined whether the audited entity's arrangements for monitoring the implementation of audit recommendations:

- Provided adequate visibility and assurance to departmental management regarding the status of audit recommendations, with appropriate involvement by the Audit Committee and internal audit function; and
- Facilitated appropriate implementation of ANAO, and internal audit, recommendations by agency management in a timely manner.

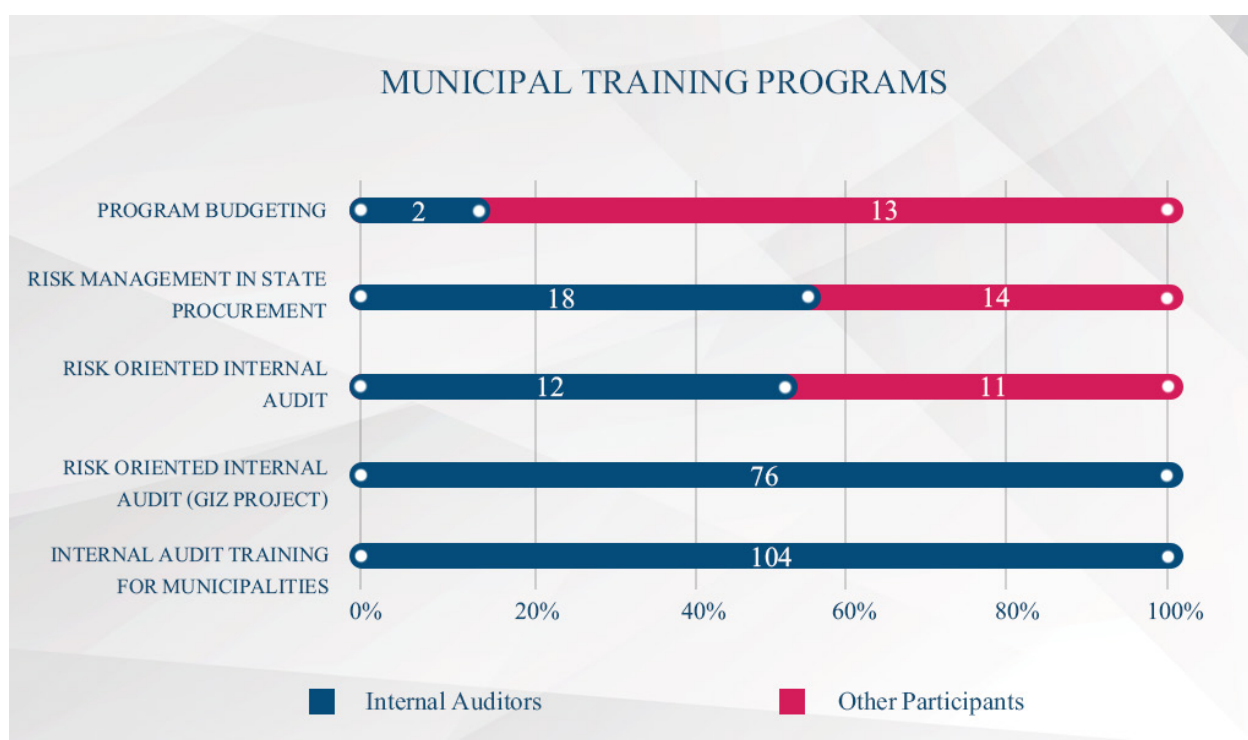
106 ANAO. Audit Insights. <https://www.anao.gov.au/pubs/audit-insights>

3.3. SAO can further facilitate knowledge sharing in municipalities

SAO has in-depth knowledge of the challenges facing municipalities, and their audit work gives them a unique perspective on how these challenges are being met, or they can easily identify innovations or successful ways of working that could be applied more widely. In this sense, SAO is in a position to promote good governance in auditees, among other things to encourage prompt and proper responses from audited entities. At present, this function is partially carried out by the Public Audit Institute (PAI).

PAI is a Legal Entity of Public Law under the State Audit Office. PAI's main mandate is to facilitate knowledge and institutional development of the public sector through capacity building projects and educational training programs. One of the directions of PAI is the Municipal Development Program that was launched in 2019, based on audit results of the State Audit Office. Over the last three years, 250 municipal public officials, including 212 internal auditors, have been trained in municipal development programs such as risk-based internal auditing, state procurement, and program budgeting. It is worth noting that PAI established an online collaboration network of internal auditors to facilitate consultations and knowledge-sharing about financial management in municipalities.

Figure 13. Municipal Training Programs



Additionally, our analysis of other Supreme Audit Institutions' best practices identified some additional relevant activities that SAO may also consider:

1) Based on systemic shortcomings or good management practice examples identified in municipality audits, SAO can prepare better practice guidelines that will help municipalities share others' experience and learn from it.

Better practice example of the Australian National Audit Office (ANAO) (1)

The Australian National Audit Office (ANAO) regularly publishes audit insights¹⁰⁷ which identify and examine common recurring issues, shortcomings and good practice examples, identified through their financial statement and performance audit work. This systemic report outlines a number of key messages from a number of recent ANAO performance audit reports examining prior year recommendations.

The ANAO adopts a range of better practice guides to strengthen the impact of its work and facilitate the sharing of audit insights. Communication practices included the following publications:

- Developing and Managing Contracts
- Administering Regulation
- Implementing Better Practice of Grants Administration
- Fraud Control in Australian Government Entities
- Public Sector Internal Audit
- Human Resource Management Information Systems
- Strategic and Operational Management of Assets by Public Sector Entities

Better practice example of the US Government Accountability Office (GAO) (2)

GAO consistently identifies and documents best practices and leading practices in a number of key agencies and office-management functions¹⁰⁸. These guides assist federal managers in implementing best and leading practice methodologies. Some examples of topics discussed in the guides are:

- A Framework for Managing Fraud Risks in Federal Programs
- Cost Estimating and Assessment Guide: Best Practices for Developing and Managing Program Costs
- Technology Readiness Assessment Guide: Best Practices for Evaluating the Readiness of Technology for Use in Acquisition Programs and Projects
- GAO Schedule Assessment Guide: Best Practices for Project Schedules

Better practice example of the UK National Audit Office (NAO) (3)

UK NAO has a 'Knowledge Sharing' platform¹⁰⁹ where NAO shares insights on important cross-cutting issues, makes it easier for others to understand and apply the lessons from their work. NAO's guidance on the platform contains analysis, case studies and advice for the government to deliver better financial and risk management.

2) SAO experience covers a broad range of essential public administration disciplines and it is uniquely placed in public governance to comment on how well public finances are managed and governed. Because of this, it is recommended that via different professional forums, thematic coordination groups and trainings, SAO may:

- Create a space to share better practices to overcome challenges in municipality management
- Facilitate institutional partnerships in the spirit of mutual learning and targeted co-operation.

107 ANAO. Audit Insights. <https://www.anao.gov.au/pubs/audit-insights>

108 <https://www.gao.gov/about/what-gao-does/audit-role>

109 <https://www.nao.org.uk/knowledge/>

Good Practice example:

The National Intergovernmental Audit Forum (NIAF) led by GAO's

The National Intergovernmental Audit Forum¹¹⁰, created in 1973, is an association of audit executives from federal, state and local governments. This forum provides a means to exchange views and solve common problems, promote audit standards, and coordinate audit guides. It exists to improve coordination, communication, and cooperation among its members, private sector firms, and other accountability organizations to address common challenges, increase public trust, and enhance government performance, accountability, and transparency.

The forums are an excellent example of what can be accomplished through intergovernmental cooperation. One of the forum's major accomplishments is that it has improved working relationships among government auditors by increasing coordination and cooperation and opening lines of communication between member audit organizations and has provided training to members that otherwise might not have been available or affordable.

GAO, in cooperation with the audit forums, has taken the lead in: developing an audit guide for comprehensive financial and compliance audits of multifunded grant recipients; establishing a Task Force for the Prevention of Fraud; and establishing a new foundation to support a State and local government Accounting Standards Board. Moreover, several projects undertaken by GAO and the audit forums have provided substantial improvements in financial accountability and have had far-reaching effects on government auditing. **Thus, intergovernmental communication is of tremendous importance in solving some of the issues that have existed among Federal, State, and local audit organizations.**

3.4. The cooperation between the SAO and internal auditors needs further strengthening

Although SAO and internal auditors in the public sector have differing and clearly defined roles, their collective purpose is to promote good governance through contributions to transparency and accountability for the use of public resources, as well as to promote efficient, effective and economic public administration¹¹¹.

A range of benefits may be obtained from coordination and cooperation between SAO and internal auditors, like **an exchange of ideas and knowledge¹¹², strengthening their mutual ability to promote good governance and accountability practices, and enhancing management understanding of the importance of internal control; Reducing the likelihood of unnecessary duplication of audit work (economy)** and etc. The internal auditor may follow up the implementation and fulfillment of the SAO's audit recommendations, as a means of cooperating with the SAI's audit processes.

SAO may use the results of internal audits' work and are to be in the position to recognize how internal audit could contribute to the overall system of governance in the public sector, if properly resourced; **Successful cooperation will strengthen internal audits professionally as well as organizationally, helping SAO in the future to optimize its performed audit work (save resources).** The auditing standards¹¹³ for both external and internal audit necessitate effective coordination and the sharing of information.

A memorandum of understanding signed by SAO and CHU in April 2018 is an excellent example of an established cooperation framework between the Supreme Audit Institution and Internal Audit Units.

110 <https://auditforum.org/niaf/>

111 Guidance of the International Organization of Supreme Audit Institutions (INTOSAI GOV 9150)

112 EUROSAI-ECIIA Cooperation. National Cooperation Agreements between SAIs and Internal Auditors in the Public Sector. <https://www.eurosai.org/handle404?exporturi=/export/sites/eurosai/.content/documents/about-us/EUROSAI-ECIIA-CC-guide-on-cooperation-agreements-between-SAI-and-IA.pdf>

113 Guidance of the International Organization of Supreme Audit Institutions (INTOSAI GOV 9150)

Nevertheless, this opportunity for cooperation was not fully utilized. This is to be expected, since the implementation of the activities are largely determined by the available financial and human resources. In order to fulfill the MoU requirements, an Action Plan has to be prepared.

MoU between SAO and CHU

The objective of the memorandum was to:

- Increase awareness of internal control among managers at all levels of institutions;
- Reduce the overlap between external and internal audits;
- Establish an effective exchange of information about the risks identified by both functions;
- Implement an effective follow-up system for the audit recommendations issued;
- Improve the efficiency and productivity of both functions by coordinating internal and external evaluations.

Obligations of both parties - SAO and CHU:

- Holding joint working meetings;
- Organizing joint trainings, courses, and sharing of experiences;
- Coordinating joint thematic conferences (both regional and international);
- Information exchange and consultations on legislative initiatives;
- Producing joint publications;
- Reconciliation of strategic and annual plans of the State Audit Office and internal audit agencies.

The State Audit Office has the following obligations:

- To appoint a contact person for internal audit issues in the State Audit Office;
- To provide internal audit entities with information about the weaknesses identified in the course of audit.

Internal Audit entities are required to:

- Support the State Audit Office in follow-up of agreed audit recommendations;
- Ensure timely delivery of the internal audit plans, annual plans and reports upon request;
- Share the risks identified by internal auditors.

The Center of Harmonization Unit must:

- Coordinate the implementation of the Memorandum by engaging the parties;
- Evaluate the implementation of the Memorandum annually and, if necessary, make recommendations.

A set of actions should be proposed and discussed annually between SAO, CHU and donors to facilitate implementation of the MoU. Action plan should outline activities, objectives, and institutions that will be responsible for the implementation of each activity, resources / experts to be involved, and deliverables.

Appendix

A. List of interviewed respondents

List of interviewed respondents			
#	Name/Surname	Position	Organization
1	Badri Janjghava	Chief Auditor, Audit Department of Self-Governing Units	State Audit Office of Georgia
2	Mikheil Chikovani	Chief Auditor, Audit Department of Self-Governing Units	State Audit Office of Georgia
3	Tea Arveladze	Lead Auditor, Local Self-Government Entities Audit Department	State Audit Office of Georgia
4	Giorgi Shurghaia	Chief Auditor, Audit Department of Self-Governing Units	State Audit Office of Georgia
5	Marika Gorgadze; George Jerenashvili	Project Leaders	USAID/Good Governance Initiative (GGI)
6	Nino Kakubava	Project Leader	UNDP
7	Otar Konjaria	Project Coordinator on LED	UNDP
8	Mariam Tkeshelashvili	Project Leader	NDI
9	Zviad Koridze w. his team	Regional Office Manager & Regional Coordinators	Transparency International Georgia
10	Tamar Gureshidze	Project Officer	The Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ)
11	Mzia Giorgobiani	Deputy Minister of Regional Development and Infrastructure of Georgia	MRDI
12	Giuli Chkuaseli	Head of Department, Public Internal Control Department	Ministry of Finance of Georgia
13	Natia Gulua	Head of Budget Policy Division	Ministry of Finance of Georgia
14	Mamuka Darchia	Head of Internal Audit Department	Batumi Municipality
15	Tamar Zurashvili	Head of Internal Audit Department	Gori Municipality
16	Badri Giorgidze	Head of Internal Audit Department	Tbilisi Municipality
17	Vakho Nadiradze	Head of Internal Audit Department	Marneuli Municipality
18	Maia Panozishvili	Head of Internal Audit Department	Sagarejo Municipality
19	Artash Abgarian	Head of Internal Audit Unit	Akhalkalaki Municipality
20	Natruli Tsotsoria	Specialist at Internal Audit Department	Poti Municipality
21	Valeri Bendeliani	Head of Internal Audit Department	Lentekhi Municipality
22	Givi Berberashvili	Head of Internal Audit Unit	Tianeti Municipality
23	Shota Beridze	Head of Internal Audit Unit	Qeda Municipality
24	Giorgi Baghaturia / Tamila Sordia	Head of Internal Audit Unit	Senaki Municipality
25	Mamuka Vadachkoria	Head of Internal Audit Unit	Lanchkhuti Municipality
26	Tamar Adeishvili	Head of Internal Audit Unit	Vani Municipality
27	Inga Getsadze	Head of Internal Audit Unit	Terjola Municipality
28	Kakha Marghishvili	Head of Internal Audit Unit	Tetritskaro Municipality
29	Ekaterine Baghashvili	Head of Internal Audit Unit	Mtskheta Municipality
30	Konstantine Tavzarashvili	Former Mayor of Gori Municipality	Gori Municipality
31	Merab Kupreishvili	Former Mayor of Senaki Municipality	Senaki Municipality
32	Badri Liparteliani	Former Mayor of Lentekhi Municipality	Lentekhi Municipality
33	Aleksandre Sarishvili	Mayor of Lanchkhuti Municipality	Lanchkhuti Municipality
34	Tamaz Metchiauri	Former Mayor of Tianeti Municipality	Tianeti Municipality

B. List of selected municipalities

#	Region	Municipality
1	Achara	Batumi Municipality
2	Achara	Keda Municipality
3	Guria	Lanchkhuti Municipality
4	Imereti	Terjola Municipality
5	Imereti	Vani Municipality
6	Kakheti	Sagarejo Municipality
7	Kvemo Kartli	Marneuli Municipality
8	Kvemo Kartli	Tetritskaro Municipality
9	Mtskheta-Mtianeti	Tianeti Municipality
10	Mtskheta-Mtianeti	Mtskheta Municipality
11	Racha-Letchkhumi and Kvemo Svaneti	Lentekhi Municipality
12	Samegrelo-Zemo Svaneti	Poti Municipality
13	Samegrelo-Zemo Svaneti	Senaki Municipality
14	Samtskhe-javakheti	Akhalkalaki Municipality
15	Shida Kartli	Gori Municipality
16	Tbilisi	Tbilisi Municipality

C. Statistical Analysis results

Correlations		
		Implemented
Budget	Pearson Correlation	-.013
	Sig. (2-tailed)	.921
	N	64
Population	Pearson Correlation	-.018
	Sig. (2-tailed)	.891
	N	64
Revenues	Pearson Correlation	-.035
	Sig. (2-tailed)	.784
	N	64
Memorandum	Pearson Correlation	-.201
	Sig. (2-tailed)	.114
	N	64
Urban	Pearson Correlation	-.097
	Sig. (2-tailed)	.448
	N	64
**. Correlation is significant at the 0.01 level (2-tailed).		

The bivariate Pearson correlation indicates the following:

- Whether a statistically significant linear relationship exists between two continuous variables
- The strength of a linear relationship (i.e., how close the relationship is to being a perfectly straight line)
- The direction of a linear relationship (increasing or decreasing)

Correlation can take on any value in the range $[-1, 1]$. The sign of the correlation coefficient indicates the direction of the relationship, while the magnitude of the correlation (how close it is to -1 or +1) indicates the strength of the relationship. The strength can be assessed by these general guidelines (which may vary by discipline):

- $.1 < |r| < .3$... small / weak correlation
- $.3 < |r| < .5$... medium / moderate correlation
- $.5 < |r|$ large / strong correlation

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