

## RISK ASSESSMENT AND RISK MANAGEMENT PLAN (SUMMARY)<sup>1</sup>

### A. Public Financial Management

1. Since 2003, wide-ranging reforms to strengthen public financial management (PFM) and reduce corruption have been implemented. These reforms have been complemented by measures to improve public service efficiency, including a 50% reduction in civil service employees and the provision of higher salaries for retained staff.

2. Recent PFM reforms include (i) introduction of a medium-term expenditure framework (2011), (ii) establishment of a treasury single account (2005), (iii) streamlining of the revenue administration (2011), (iv) establishment of the State Audit Office of Georgia (SAOG 2012), and (v) introduction of program-based budgeting (2012). These reforms have positioned the government to consolidate budget planning, formulation, and execution, and to roll-out complementary reforms to line ministries and sectors. Integrated budget management systems are largely in place, with approximately half of the components operational.

3. Georgia's 2004 Budget System Law codifies the principles for a comprehensive, transparent, and accountable budget system, and outlines the rules and procedures for budget preparation, approval, execution, reporting, and auditing. The 2009 Budget Code (and subsequent amendments) unifies all state financial transactions within the treasury single account and defines divisions of power. In 2012, the first fully programmatic state budget was introduced. However, its efficacy was undermined by the lack of alignment between the project cycle and the budgeting and strategic planning cycles.

4. The Ministry of Regional Development and Infrastructure is designing and implementing the government's decentralization program to improve accountability, participation, and transparency. The newly adopted Local Self-Government Code clearly divides local competencies from central ones. A law defining the proportion of income tax distribution between central and local budgets is being prepared.

5. Expenditure management has been systematized with the expansion of budget coverage to legal entities of public law (LEPLs) and the integration of accounts with the e-budget system. Improved coverage and tracking of LEPL budgets is critical, given LEPL revenues are the equivalent of 9.4% of the total state budget and LEPLs implement most infrastructure projects. Budget execution reports include information on financial flows covering revenues and the economic classification of expenditures. In 2009, the Ministry of Finance's Treasury Service initiated accounting reforms with the adoption of the International Public Sector Accounting Standards Implementation Plan, which was subsequently endorsed. In February 2010, the Georgian Public Sector Accounting Standards Board was established. The 2012 Law of Local Governments, which defines fiscal relations between the central and local governments, may improve the predictability and transparency of intergovernmental transfers.

6. Following the 2011 amendment of the Law on the Chamber of Control of Georgia, the SAOG assumed responsibility for conducting external audits that draw on the auditing standards of the International Organization of Supreme Audit Institutions. All public entities are required to submit their fiscal reports annually, including audited accounts. The implementation of the SAOG's audit report recommendations are monitored by Parliament. The 2010 Law on State

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<sup>1</sup> This summary is based on an assessment of public financial management, procurement, and corruption risks in both country and ADB and donor project systems, specifically in the roads and water and sanitation sectors.

Internal Audit and Inspection (and subsequent amendments) require government agencies and LEPLs to conduct regular internal audits.

7. Weaknesses include poor public investment management, inadequate monitoring and analysis of government contingent liabilities, and the limited capacity of internal audit units. LEPL revenues and expenditures under local governments are not included in budget execution reports. Legislative scrutiny of external audit reports is generally weak.

## **B. Procurement**

8. Georgia's national procurement system is regulated by the 1999 Law on State Procurement (and subsequent amendments). The establishment of Georgia's Competition and State Procurement Agency facilitated procurement reform.<sup>2</sup> However, procurement capacity in line ministries is weakened by limited resources. Recent changes include (i) a strengthened e-procurement system, (ii) mandated disclosure of contract values by procuring entities, and (iii) the inclusion of civil society representatives in dispute resolution procedures. E-procurement has significantly reduced red tape, and allows any person to file an electronic complaint for review by a dispute resolution board. However, the system is currently geared to award tenders to the lowest bidder, without evaluating the quality of the offer. Further, the Law on State Procurement allows state-owned entities to bypass the electronic procurement platform. Data on the value of public contracts is maintained in a public procurement database and Treasury Information system. Spending unit payment schedules allow access to treasury cash request data. Bidders can download public procurement contract data from the electronic tender system.

## **C. Combating Corruption**

9. Georgia's anticorruption regulatory framework is outlined in the 2009 Law of Georgia on the Conflict of Interests and Corruption in Public Service. The Investigative Division of the Prosecution Service is the key anticorruption body. The Anti-Corruption Interagency Council under the Ministry of Justice, including the SAOG, is tasked with coordinating anticorruption efforts. The council comprises high-level officials (supported by a secretariat) along with nongovernment organizations and private sector representatives. Georgia's inaugural National Anti-Corruption Strategy and Action Plan was adopted in 2005. Since 2012, the government has taken steps to restore judicial independence and improve accountability and transparency in public finance, procurement, and private sector oversight. Amendments to the Law on Conflict of Interests and Corruption in Public Service in 2014 seek to improve whistleblower protection, particularly expanding the channels of reporting, and providing for anonymity and protection.

10. Petty corruption is almost eliminated. Conflict of interest rules and codes of ethics govern the conduct of public servants. Government officials are required to publicly disclose their income and assets annually. The prospect of sanctions has significantly affected the extent to which public officials shape policies for their own interests. The need to institutionalize and consolidate Georgia's anticorruption efforts and achievements persists.

## **D. Risk Management Actions**

11. At the country level, the Asian Development Bank (ADB) can build upon existing results and maintain a selective assistance program through demand-driven support for governance. Policy dialogue, donor coordination, and exploring cofinancing and/or technical assistance (TA) on specific activities, will be critical.

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<sup>2</sup> Amendments to Competition Law in 2014 established the Competition Agency as an independent body.

12. ADB is supporting, through a policy-based loan, public sector management reforms to improve domestic resource mobilization by (i) increasing efficiency in taxation and revenue generation; (ii) strengthening PFM; (iii) supporting long-term savings; and (iv) improving the legal, regulatory, and institutional framework for doing business. TA is planned to assist the government in strengthening capital budgeting and public debt management.

13. At the sector level, ADB should support development and implementation of integrated transport and road sector policies and plans, and water supply and sanitation policies. In all sectors, support should be provided to clarify relationships among regulators, policy makers, implementers, utilities, and oversight agencies. ADB should also develop the government's planning, management, and financial capacity to enhance sector oversight.

**Table 1: Summary Governance Risk Management Plan**

Major Risks	Mitigating Actions
<p><b>1. Public Financial Management</b></p> <p><b>1.1</b> Sector policies, regulations, and long-term planning processes could be more comprehensive to ensure more effective and sustainable sector performance.</p> <p><b>1.2</b> In the absence of a clearly defined policy and regulatory framework, compliance with ADB project implementation procedures, procurement, and safeguards may be insufficient, creating reputational and financial risk.</p> <p><b>1.3</b> The absence of long-term (sector) development plans and targets impedes planning and financial oversight.</p> <p><b>1.4</b> While decentralization may improve accountability, participation, and transparency, it could lead to a suboptimal reallocation of functions to regional, municipal, and village levels (and efficiency losses) if implemented too hastily.</p> <p><b>1.5</b> The government's emphasis on road infrastructure has translated into a large project portfolio and high workload for the Roads Department. This risks undermining managerial capacity, monitoring and evaluation, and economic efficiency.</p> <p><b>1.6</b> Given suboptimal regulations, policies, and oversight, the UWSCG and the MDF lack the capacity necessary to set, manage, and maintain service delivery standards and ensure economic efficiency.</p> <p><b>1.7</b> Current water sector tariffs do not cover operation and maintenance, adversely affecting service delivery.</p> <p><b>1.8</b> Analysis and monitoring of contingent liabilities and fiscal risks from LEPLs and local governments is weak.</p> <p><b>1.9</b> The capacity of internal audit units of agencies is weak.</p>	<p><b>1.1</b> ADB will support the development of a more comprehensive policy and regulatory framework in its core sectors of engagement.</p> <p><b>1.2</b> As above.</p> <p><b>1.3</b> ADB will support the MRDI's efforts to prepare a medium-term development plan.</p> <p><b>1.4</b> ADB, alongside other development partners, will engage with the MRDI in policy dialogue and knowledge exchange on fiscal decentralisation.</p> <p><b>1.5</b> ADB will support the MRDI and Roads Department to strengthen institutional capacity for planning and forecasting, results management, cost-benefit analysis, safeguards compliance, and monitoring and reporting.</p> <p><b>1.6</b> ADB will examine corporate governance needs at UWSCG and support necessary reforms, while also providing TA for asset valuation and water quality management.</p> <p><b>1.7</b> ADB will support the UWSCG through policy dialogue, TA, and training to improve tariff-setting processes.</p> <p><b>1.8</b> ADB will provide support through a policy-based loan and TA to strengthen the measurement and evaluation of contingent liabilities and the public debt management framework.</p> <p><b>1.9</b> ADB will discuss this issue in its ongoing policy dialogue with the government. TA may be needed.</p>
<p><b>2. Procurement</b></p> <p><b>2.1</b> Decision-making processes, weak policy and regulatory frameworks, limited managerial capacity, conflicts of interest, and collusion pose significant risks.</p> <p><b>2.2</b> Implementing agencies have limited capacity to manage (international) procurement including for consultancy services.</p>	<p><b>2.1</b> ADB will conduct procurement needs assessments and feasibility studies through qualified consultants.</p> <p><b>2.2</b> ADB will conduct training for executing agencies on procurement and due diligence, and will spot-review proposals for the accuracy of bid evaluation reports.</p>
<p><b>3. Anticorruption</b></p> <p><b>3.1</b> While corruption has been reduced, some concerns regarding corruption remain. Stronger policy and regulatory frameworks and enhanced government capacity are needed.</p>	<p><b>3.1</b> ADB will support the government's anticorruption initiatives relevant to core sectors of assistance.</p>

ADB = Asian Development Bank, LEPLs = legal entities of public law, MDF = Municipal Development Fund, MRDI = Ministry of Regional Development and Infrastructure, TA = technical assistance, UWSCG = United Water Supply Company of Georgia.  
Source: ADB.