Unclassified **GOV/PGC/SBO(2010)10**

Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development **14-Sep-2010**

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PUBLIC GOVERNANCE AND TERRITORIAL DEVELOPMENT DIRECTORATE
PUBLIC GOVERNANCE COMMITTEE

GOV/PGC/SBO(2010)10
Unclassified

Working Party of Senior Budget Officials

BUDGETING IN LITHUANIA

6th Annual Meeting of OECD-CESEE Senior Budget Officials

Budva, Montenegro
23-24 September 2010

For further information, please contact Ian HAWKESWORTH at OECD Headquarters
Tel. +33 1 45 24 16 32 -- Email: ian.hawkesworth@oecd.org

JT03288216

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TABLE OF CONTENTS

PREFACE 3

Chapter 1 -- INTRODUCTION 4
- Summary of recommendations 4
- Overview of fiscal position 7

Chapter 2 -- BUDGET FORMULATION PROCESS 9
- Structure of the budget 9
- Fiscal rules and strategy for adopting the euro 11
- Response to the global financial crisis 11
- Budget formulation cycle and related issues 12
- Budget documentation 19
- Organization of Government and of the Ministry of Finance 19
- Conclusions 20

Chapter 3 -- LEGISLATIVE APPROVAL 23
- The legal framework 23
- The parliamentary process 24
- The impact of parliament 25
- Conclusions 27

Chapter 4. -- BUDGET EXECUTION 29
- Organisation of budget execution 29
- Revenue uncertainty and the reserve fund 29
- Reallocation and carry-overs 30
- Cash and debt management 30
- Procurement 31
- The structure of public administration and service delivery 32
- Fiscal relations across levels of government 33
- Conclusions 35

Chapter 5 -- ACCOUNTABILITY, ACCOUNTING AND AUDIT 36
- Accounting Basis 36
- Reporting 36
- External audit 37
- Internal audit 40
- Relation between internal and external audit 40
- Conclusions 41

PREFACE

This review of the Lithuanian budget procedure was carried out as part of the Work Programme of the Working Party of Senior Budget Officials of the OECD. Budget reviews serve as a basis for the examination of the budget procedures of countries during the annual meetings of the senior budget officials from Central and Eastern Europe and enable the officials to discuss countries' budget procedures in depth. German Technical Cooperation (GTZ) and The United States Treasury are gratefully acknowledged for contributing to the review.

A mission consisting of Mr. Ian Hawkesworth (Lead, OECD Secretariat), Mr. Dick Emery (Consultant), Dr. Joachim Wehner (London School of Economics) and Mr. Jannick Saegert (German Technical Cooperation) visited Lithuania in February 2010 to carry out the review. During its visit the mission met with senior officials from the Prime Minister's office, Parliament, the Ministry of Finance and other line ministries, and the State Control Office.

The mission would like to express its gratitude and appreciation for the cordial reception by the Lithuanian authorities and the frankness and openness that characterised the discussion with all officials. Finally, the mission would like to thank Budget Director Ms. Daiva Kamarauskiene and Deputy Budget Director Mr. Darius Sadeckas of the Ministry of Finance for the excellent organisation of the meetings, unsparing help with the collection of information and the hospitality during the mission's stay in Vilnius.

The views expressed in this report are those of the OECD Secretariat and should not be attributed to any organisation or individuals consulted for this review.

CHAPTER 1
INTRODUCTION

1. This report covers the budget process in Lithuania. It discusses the four phases: budget preparation, legislative approval, budget execution, and accounting and audit in separate chapters. Each chapter ends with a list of recommendations, which are reproduced below. This chapter starts with a summary of recommendations and subsequently provides a brief overview of Lithuania's present and expected fiscal position.

Summary of recommendations

Budget formulation

2. Budget formulation in Lithuania is a modern effective practice. Decisions appear to be made at appropriate levels with increasing focus on programs and performance. The system produces generally transparent information, with quarterly reports on budget implementation. The pending reforms to strengthen strategic planning seem likely to strengthen the policy content and focus of the budget and to provide greater control to the ministers of government. However, care should be taken not to make the system too process-heavy, not to undermine top-down budgeting elements of the current system; the wish to make final decisions regarding the budget in early spring looks optimistic, as discussed further below.

3. Lithuania has responded to the fiscal crisis created by the global economic downturn with apparent success, making necessary but difficult increases in revenues and reductions in public expenditure. There are some areas where change may be appropriate; the following may be worth consideration.

4. *Develop strategic planning in the context of the Medium Term Fiscal Framework* by involving the ministers and the Prime Minister at the beginning of the budget process and integrating a medium-term perspective. The new strategic planning process should strengthen the policy focus of the budget at the level of line ministries. Reaching agreement on the objectives for the line ministries should both strengthen the line minister's role in developing the budget and resolve issues that, under the former procedures, were left unsettled until the very end of the process. However, beginning the process with requests based on "what they need" could result in unconstrained budget requests and a weakened top-down element that make it more difficult to resolve priorities. In addition, the Budget Department may not have enough capacity to support the additional process that is envisaged. Finally, it may be difficult for policy makers to reach conclusions on difficult issues so far in advance of deadlines.

5. Lithuania could consider integrating the new strategic budget process with a more robust Medium-Term Fiscal Framework. Policy targets and expenditure ceilings could be set for each line ministry for the term of government. The Medium-Term Fiscal Framework could be presented to the parliament in a pre-budget report, similar to the Swedish government's approach. By seeking approval from the parliamentarians on a multi-year plan, the policy structure could be more stable. The plan could continue to be adjusted annually to reflect new policy developments or economic realities.

6. *Present consolidated general government budget totals*: The current budget of Lithuania does not *present* a general government consolidated deficit including State deficit, social insurance fund

deficits, and municipal deficits. The Convergence Report does present the consolidated deficit. The consolidated deficit is a more accurate measure of the fiscal impact of government policy on the economy and would thus provide greater transparency and a sound basis for decision making. All government deficits will need to be considered in planning the appropriate government policy. In the future, it may make sense to consolidate government budgets to increase the transparency of the policy choices.

7. *Strengthen budget powers of line ministers*: Lithuania is in the process of consolidating programs and rationalizing budget structures. The strategic planning initiative should enhance the budgetary control of ministers over their ministries. Restructuring and consolidating programmes should increase the flexibility and budget discretion of the ministers in managing the activities under their control. Flexibility in strategic planning and budgeting should be accompanied by increased budget accountability on the part of the ministers.

8. *Simplify budget justification materials to increase transparency*: The Chairman of the parliamentary budget committee observed that budget justification materials focus too much attention on administrative matters. The focus of budget justification materials should be shifted to the purposes and results of programmes, where relevant.

9. *Integrate social insurance funds into the budget*: Social insurance and compulsory health care amount to approximately one-third of the total budget in Lithuania. The transparency of the budget would be enhanced by integrating the social insurance funds in the budget documentation. The State Treasury should be used for cash management, ensuring that the cash and debt management functions of government are fully integrated. Similarly, the social insurance funds should be subjected to the same requirements of budget execution, accounting, and auditing as other government expenditures.

10. *Subject all PPPs to MOF approval*: In particular in a context of fiscal consolidation, PPPs may seem appealing for investments that are difficult to finance by conventional means. However, it is often difficult to ensure value for money in the use of PPPs and the result can be a significant build-up of long-term obligations. This problem is recognised in Lithuania and staff has been devoted to this task. However, given the potential risks, the Government should consider enhancing its analytical capacity before pursuing PPPs at central government level. More worrying is the fact that municipal PPPs are not subject to the review of the Ministry of Finance, while municipal debt is subject to the debt limit established in the budget. Municipalities do not have the expertise to evaluate the complicated financing agreements establishing a PPP. The PPP law should urgently be revised to require municipal PPPs to be reviewed and approved by the Minister of Finance and subject to a volume ceiling.

Legislative approval

11. The Lithuanian Parliament operates a well-designed and orderly review process that allows members the opportunity to scrutinise the budget and to formulate amendment proposals. The committee process follows the principles of top-down budgeting by giving the Budget and Finance Committee (BFC) a strong role in co-ordinating amendment proposals by other committees and parliamentary groups. Overall, amendment activity is very modest, although members can influence some details in the executive budget proposal. The following suggestions may serve to further develop and refocus parliamentary involvement in the budget process.

12. *An extended timeframe*. There is a strong case for lengthening the time available for parliamentary review of the draft budget by one month so that the presentation is required by 15

September. This would bring Lithuania into line with the OECD Best Practices for Budget Transparency. Such a move could enable broader public discussion of the budget, which can be particularly important for building consensus during times of fiscal retrenchment. Moreover, this revised date would allow better co-ordination with the electoral cycle.

13. *Creation of independent analytic capacity*. A number of legislatures in OECD countries have recently strengthened their analytic capacity in budgetary matters in order to support more detailed scrutiny of the budget. Especially if the time allocated to the Seimas is extended, it would be advisable to create a small analytic unit with highly skilled staff to help the BFC in particular to review and consolidate any comments and proposals.

14. *Consultation on the format of the budget*. The Ministry of Finance should consult closely with the BFC about the further development of the budget and supporting documentation, including the programme structure and performance information. Members of the BFC acknowledge the need for more careful scrutiny of the efficiency of spending by the Seimas, and high-quality information presented in an accessible format is an important prerequisite for such a shift.

Budget execution

15. Overall, the execution of the State Budget is based on sound rules and procedures. Since parliamentary approval only binds the Government to the totals for those who manage appropriations, the government has a high degree of discretion in managing the implementation of the budget. However, the execution rules strictly limit the flexibility of appropriation managers. A potential concern is that several features of the budget system may permit local governments to build up significant liabilities that at some point could require central Government intervention. Another concern is the growing interest in PPPs, as discussed above. Based on these observations, consideration of the following proposals is recommended.

16. Enhanced flexibility for appropriation managers: Once the programme structure has been fully developed, it could be complemented with rules that allow appropriation managers to reallocate funds between programmes up to a specified numerical limit, such as 5% of programme expenditure. In addition, carry-overs should be permitted within limits so as to avoid end-of-year spending rushes and resulting inefficiencies.

17. Managing fiscal risks relating to local government: Although municipalities report arrears to the Ministry of Finance on a monthly basis, the central government has no direct authority to limit the accumulation of arrears at the local level. In addition, although municipalities cannot run deficits, this restriction only applies to approved budgets but not actual figures, which encourages unrealistic budgeting. The central Government should closely monitor the build-up of municipal arrears. Finally, the Law on Budget Structure should be amended so that the deficit restriction for municipalities applies ex post as well as ex ante.

18. Further organisational streamlining: The recent reduction in the number of appropriation managers is a positive development. As far as possible, autonomous agencies and other public bodies should be subordinate to central ministries to ensure clear lines of accountability. Further consolidation along these lines may be possible.

Accountability, accounting and audit

19. The Lithuanian system of accounting, internal audit, and financial control, and external audit seems to be working well. Better cooperation and collaboration between internal and external auditors could add value to the audit and control of state activities. However, the role of the internal audit service must be clearly understood and strengthened. As the Lithuanian system of internal audit focuses on the function of providing internal management advice, the external relations should not be overstressed.

20. The shift towards accruals in accounting and financial reporting will enhance the transparency of the government's actions by improving the tracking of commitments and long-term liabilities and thereby strengthening fiscal discipline. A clear understanding of the benefits of the introduction of accrual accounting for each stakeholder should be proactively mainstreamed by the Ministry of Finance. The establishment of central asset management authority would ease the introduction of accrual accounting and also improve the management of state property.

Overview of fiscal position

21. In the coming year, it is expected that the government will concentrate on attempting to narrow the budget deficit. Both the IMF and the government have stated that Lithuania does not need to follow Latvia in asking for an IMF loan. Instead, the government has preferred to tap the international capital markets in 2009 and 2010. The immediate short-term policy focus will be on fostering economic recovery and attempting to put government finances on a more stable footing. An expected budget deficit in excess of the Maastricht limit of 3% of GDP in 2010-11 makes the date for euro adoption uncertain.

22. The budget deficit came in at 8.9% of GDP in 2009. Despite government efforts to restrain the deficit in 2010, the EIU in September 2010 forecast only a moderate contraction, to 8.5% of GDP, as high unemployment and a continued economic downturn place upward pressure on expenditure and depress revenue. Despite efforts to boost revenue, as discussed further in chapter 2, budget revenue has suffered severely from the economic downturn. Revenue is unlikely to recover in 2010, owing to the continued recession.

23. Under the current currency board regime, the monetary base is fully backed by the foreign exchange reserves of the Bank of Lithuania, and the litas has been pegged to the euro at LTL3.45: €1 since February 2002. It is expected that the litas' link to the euro will be maintained.

24. In the second quarter of 2010, GDP grew by 1.1% year on year, according to the first estimate from Statistics Lithuania, marking the first period of year-on-year growth since the third quarter of 2008. In the first quarter of 2010, industrial GVA grew by 0.3% year on year, after five consecutive quarters of decline. According to Statistics Lithuania, the sector recorded its fourth consecutive month of year-on-year growth in June, after 16 months of decline. In June, industrial sales, excluding value-added tax (VAT), increased by 4.8% year on year, and by 0.8% for the first six months of 2010. In the first half of the year, textiles, electronic goods, rubber and plastics, and wood products recorded double-digit growth rates. Sales of food products fell by 3.4% and those of refined petroleum by 0.8%. Clearly signs are hopeful, but much will depend on developments in neighbouring countries and the euro zone as well as the world economy.

Table 1.1. - Forecast summary
(% unless otherwise indicated)

	2008 (actual)	2009 (actual)	2010 (EIU forecasts)	2011 (EIU forecasts)
General government balance (% of GDP)	-3.3	-8.9	-8.5	-6.2
Current-account balance (% of GDP)	-11.9	4.0	3.3	1.4
Real GDP growth	2.8	-14.8	-0.5	2.9
Industrial production growth	5.5	14.6	4.5	-5.0
Gross agricultural production growth	0.5	3.1	1.0	1.2
Unemployment rate	5.8	13.7	16.0	15.3
Consumer price inflation (EU harmonised measure)	11.1	4.2	1.3	1.7
Short-term interbank rate	4.0	0.9	0.5	1.0
Exports of goods fob (US$ bn)	23.8	16.5	19.4	19.9

Source: Economist Intelligence Unit forecasts September 2010.

CHAPTER 2
BUDGET FORMULATION PROCESS

Structure of the budget

25. Lithuania has separate budgets for State (central government), municipal and social insurance funds. The constitution specifies the overall legal framework for the budget, as well as the budget responsibilities of the Parliament (Seimas) and the government. The organic budget law for Lithuania – the Law on Budget Structure – was enacted in July 1990. It defines the contents of the central government and municipal budgets, the legal grounds for raising revenues and the use of appropriations, and the duties of appropriation managers.

26. The State budget and the main financial indicators of municipal budgets are approved in the Law on Approval of the Financial Indicators of the State Budget and Municipal Budgets. The State budget, as approved by Parliament, covers the revenue and expenditures of the ministries of government and other budgetary institutions[1], including State transfers to the municipalities. The municipal budgets are approved by the municipal councils. The municipal budgets cover municipal revenues and funds transferred from the State for delegated functions.

27. The Lithuanian budget has six off-budget funds at the central government level. The municipal privatization funds are also off-budget. The social and health insurance funds have separate budgets; they are not included in the State budget totals, nor does the State budget present consolidated budget totals. The central government Privatization Fund and municipal privatization funds were not included in the budget on the rationale that their revenues come from the sale of assets that are privatized and that their expenditures were used to support privatization costs. The State enterprise Ignalina NPP Decommissioning Fund revenues come from the sale of energy and a grant from the European Bank for Reconstruction and Development, and its expenditures are involved with closing the nuclear power plant. The Guarantee Fund, which provides payments to the employees of undertakings under bankruptcy or bankrupt undertakings, who have terminated employment relationships with such undertakings, as well as to the employees who continue employment relationships with an undertaking under bankruptcy when the undertaking is indebted to them, is also off-budget. It is not clear why the reserve fund is not included in the budget, but it may be that the Government does not assume that the Reserve will be spent. The off-budget funds and their estimated expenditures are described in table 2.1.

1 According to the Law on Budgetary Institutions, a budgetary institution is a limited civil responsibility public entity that performs state or municipal functions and is financed from state, municipal or social insurance fund budgets. A budgetary institution becomes an appropriation manager if it is approved in the budget as a line item.

Table 2.1. - 2010 Expenditures of Lithuania's Off-budget Funds

Name of the Fund	**Expenditures in Millions of Litas**
State Social Insurance Fund	12,600
State Compulsory Health Insurance Fund	4,000
Privatization Fund	112
The Reserve (Stabilization) Fund	350
Ignalina Nuclear Power Plant Decommissioning Fund	139
Guarantee Fund	82

28. The social insurance system is based on the pay-as-you-go principle. Its major source of income is from contributions paid by employers and employees. It consists of two funds: the State Social Insurance Fund, and the State Compulsory Health Insurance Fund. The social insurance system provides for social and health benefits to individuals, including maternity benefits, pensions, unemployment compensation, child and parental benefits, and other subsidies. The finances are based on independent budgets, and are not included in the State or municipal budgets. The social insurance budget is developed according to benefits authorized in the social insurance laws based on demographic assumptions for a period of one year. Both revenues and expenditures continue under substantive law. The combinations of the financial crisis and structural problems have resulted in growing deficits for the social insurance fund. Deficits in the Social insurance fund are financed through borrowing by the fund in the market, through the Treasury or through transfers from the Reserve (Stabilisation) fund. The 2009 Convergence program foresees that social insurance funds will account for 12.4 % of GDP in 2010, with a deficit of 2.9 %

29. Since 2004, EU funds have been fully integrated into the State budget of Lithuania. EU funds are explicitly identified on both the expenditure and revenue sides of the budget in the government decree that breaks down expenditures by function and programme. Funds are allocated among four EU programme areas: human resources, economic growth, cohesion and technical assistance. One-third of the annual Lithuanian budget follows the lead of the EU programmes. Of this third, roughly 85% is from the EU and 15% from local co-financing. Given the weight of EU co-financing in the budget, EU programs have been protected from budget reductions applied to other areas of Lithuania’s budget. EU funding over the past seven years is shown in table 2.2.

Table 2.2. - EU Funds in the Lithuanian budget

	Millions of Litas	
Year	EU Funds in the Lithuanian Budget	Lithuanian Contributions to EU
2004	1.390	0.412
2005	2.003	0.739
2006	2.162	0.835
2007	3.481	0.929
2008	3.481	1.151
2009	5.910	1.083
2010 (est.)	7.892	1.030

30. There are 108 state enterprises; only grants to or payments from these entities are included in the budget.

31. The deficit reported to the EU in the Convergence Program presents the consolidated deficit consisting of deficits of the State, Municipal and Social Insurance budgets (General government). The budget document contains no table presenting the consolidated deficit.

Fiscal rules and strategy for adopting the euro

32. Lithuania has embraced fiscal responsibility since it became an independent republic with a clearly defined goal of transition to full membership of the European Economic and Monetary Union (EMU) and the adoption of the euro currency.

33. Lithuania joined the European Union in May 2004 and has since tried to design its fiscal policy so that accession to the euro zone could occur as soon as possible by meeting the monetary union convergence criteria. These criteria are: the inflation rate must be no higher than 1.5 % above the best performing (lowest inflation) three members of the EU; the deficit must not exceed 3% of GDP; the country must have joined the exchange rate mechanism (ERM II) under the Economic and European Economic and Monetary System; and nominal long-term interest rates must not be more than 2% higher than in the three member states with lowest inflation.

34. Following the National Plan for Adoption of the Euro (2005, new plan from 2007) and in order to meet the euro zone membership criteria, Lithuania enacted the Law on Fiscal Discipline in 2007, establishing fiscal targets for general government that were more restrictive than the EU constraints. The finances of general government are to adhere to the medium-term objective of having the general government sector in surplus or close to balance.

35. The global financial crisis and resulting recession and deficits began in 2008, pre-empting the implementation of the fiscal requirements of the new law on fiscal discipline. The Convergence Programme of Lithuania for 2009 sets deficit targets: for 2010: 8.1% of GDP, for 2011: 5.8% of GDP, and for 2012: 3% of GDP, far above the medium-term objective of an annual general government surplus of about 0.5% of GDP. The Convergence Programme projects general government debt in 2010 at 36.6% of GDP, in 2011: 39.8%, and in 2012: 41%. Lithuania’s goal is to achieve sustainable levels of public debt through constrained fiscal policy and euro adoption in 2014.

Response to the global financial crisis

36. Since the mid-1990s, Lithuania’s economy grew more rapidly than most of Europe. But the global downturn contributed to a dramatic reduction in GDP during 2009, a reduction of 14.8%. The budget for 2009 anticipated the downturn by proposing a corresponding reduction to the deficit by taking action to increase revenues: raising corporate income tax from 15% to 20%, and raising VAT from 18% to 19%.

37. In May 2009 the first of two budget amendments was presented, targeted primarily at the State budget. It took the following actions:

- Cut administrative and capital expenditure (capital expenditure, except for EU financed projects, was cut by roughly 50%),
- Cut top management salaries.

The May reductions resulted in a fiscal consolidation of 3.2 billion litas (3% of GDP) in 2009.

38. In July of the same year, further revisions were proposed including additional cuts in salaries and amendments to the social insurance laws to reduce social spending, as follows:

- 10% cut in the salary bill for each institution, which included reductions of the basis for civil servant salaries from 475 to 450 litas and of the basis for the salaries of employees, (who work under labour contracts), from 128 to 122 litas.
- Smaller cuts for teachers (5%) and for police (2%).
- A further increase in VAT from 19% to 21%
- Reduced social spending:
  - Maternity leave,
  - Old-age pensions above LTL 650 ($270) per month cut by 5%,
  - Widowers' pensions cut by 5%,
  - Health and social care compensation cut by 15%,
  - Pensions of working pensioners cut by 70%,
  - Child and parental benefits reduced,
  - Unemployment benefits reduced (Unemployment rate now 13.8% whereas it has been 5.9% a year earlier), and
  - Transport benefits cut.

39. For 2010, all institutions were cut by 30% in current expenditure and total salaries by another 10%. Debt servicing, EU programmes, and social spending were protected from cuts, increased during 2009, and expanded in 2010. The deficit in the state budget for 2010 is now projected to be 4,9% of GDP, and general government around 8,1% of GDP. Without these extraordinary measures, the deficit was expected to have been 12% of GDP.

Budget formulation cycle and related issues

Budget time table

40. The legal framework for the budget is based on the Constitution, the Law on Budget Structure that predated the constitution, the Law on the Methodology of Determination of Municipal Budgetary Revenues and the Law on Approval of the Financial Indicators of the State Budget and Municipal Budgets. The process is top-down, with guidance developed by the Ministry of Finance and budget allocations resolved through a process of negotiation. Changes to the formulation cycle for the year 2011 will attempt to shift the decision making within the Government to earlier in the year, resulting in more discretion and accountability being assumed by the line ministers as discussed further below (see table 2.3.).

41. The formulation cycle begins with defining the priorities of government. This is done by reviewing the priorities defined in prior years and revising them where appropriate. In February, the Cabinet approves the Plan for Preparation of the Draft Financial Indicators of the State Budget and Municipal Budgets. The plan establishes the time schedule and defines the material that the ministries and appropriation managers are to prepare and submit to the Ministry of Finance.

42. Under the system used over the past few years, in May the Budget Department prepared preliminary allocations for the national budget taking into account the strategic goals, macroeconomic projections, preliminary limits on public investment for three years, general principles for maximum appropriations, and preliminary data about EU fiscal support. In May or June, the Government approved overall ceilings and limits on public investment for the budget year and the two succeeding years. The Ministry of Finance then set individual ministry ceilings and distributed planning guidance to ministries and other appropriation managers. Ministries and other appropriation managers then submitted their budget proposals by early September, followed by negotiations between the Ministry of Finance in order to resolve differences between the ministries' proposals and the approved allocations. This process involved substantial last minute negotiations between the ministries and the Ministry of Finance and last-minute issue resolution by the Prime Minister. The time pressure of resolving budget issues at the end of the process frequently limited line ministers' discretion.

Table 2.3. - 2009 and 2010 schedule for budget preparation

2009 Schedule		**2010 Schedule**	
February	Guidance for preparation of budget.	February	Guidance for preparation of budget.
May	Government approves ceilings	March – April	Unrestricted "what they need" ministerial requests.
August	Ministry Submissions.	April – May	Negotiations among ministers, PM and Minister of Finance on Ministerial ceilings.
September	Negotiations on approved ministry budgets. Budget submitted.	May or June	Approved ministry allocations and priorities.
		September	Budget submitted.

Strategic planning

43. For 2011, Lithuania is modifying the budget formulation procedures to provide for earlier input from the ministries and to involve the Prime Minister in priority setting with the ministries earlier in the process. The new procedure is intended to increase the ministers' role in establishing priorities for their ministries. Ministries are being asked to submit an initial request based on their best judgement of "what they need". How "what they need" will be defined, particularly in the context of stringent budget constraints, is not clear. Will there be room for new initiatives? Will the ministers' priorities be recognized? Will the ministers accept responsibility for proposing necessary cuts?

44. In a process that will be jointly supported by the Ministry of Finance's Budget Department and the Prime Minister's staff, the line ministers will meet with the Prime Minister and the Minister of Finance to discuss their priorities and to identify "results" that they will commit their ministry to achieve for the coming year. The agreements on results to be achieved will be similar to the public service agreements in the United Kingdom. The plan is for the negotiations to be completed during the second quarter, reducing the revisions needed in September.

45. It is not clear how the gap between “what they need” and government-wide constraints, for example a reduction of 30% across the board, will be resolved. The Ministry of Finance will still need to come up with figures for the overall budget, taking into consideration appropriate and necessary adjustments to the base funding: expiring programs, growth in debt service and social insurance programs, and Government priorities. The new procedure will require substantial policy guidance from the Prime Minister earlier in the process. It may be difficult to resolve tough decisions so far in advance of the deadline of the budget submission.

Macro-economic forecasting and assumptions

46. Macro-economic forecasting is the responsibility of the Fiscal Policy Department of the Ministry of Finance. Forecasts are developed in February / March for budget planning, updated in the 3rd quarter for the budget submission to Parliament, and revised at the end of the year for preparation of the Convergence Programme. Some inputs are provided by the European Commission from their standard indicators, for example world GDP, exchange rates and oil prices. The ministry uses an IMF model. The assessment contains a single scenario but provides a discussion of risks to the scenario. The assessment looks at the longer-term budget risks and sustainability of public finance. The ministry does not compare its forecast – at publication or historically – to private sector forecasts or to the IMF, OECD or EU. On the other hand, forecasts of other institutions do provide useful inputs on selected variables.

47. The Fiscal Policy Department uses the macroeconomic forecast as an input for revenue forecasts for the budget, and the Ministry of Economy uses the forecast as an input in developing long-term forecasts for the Lithuanian economy. Until 2002, the Ministry of Economy used to develop the medium-term forecasts in addition to the long-term projections. The Ministry was perceived as having an optimistic bias, an incentive to be overly optimistic, in order to extract more resources for investment. The Central Bank develops its own macroeconomic and budgetary forecast and has released these forecasts to the public since the EU accession process was decided upon. All tax changes are accompanied by forecasts of fiscal impact covering the three upcoming years (when they are submitted to the Government or the Parliament).

Medium-Term frameworks

48. The Constitution and the Law on Budget Structure provide for the budget to be approved for one calendar year and to include estimates for three years – the budget year plus two succeeding years. The budget documents include a parliamentary resolution that presents aggregate numbers for three years, but the budget year appropriations for the 212 line-items are not supplemented with estimates at line item level for the two out-years. The Parliament does, however, make a non-binding resolution concerning the three-year estimates. Investment programs are approved on an annual basis, and the budget documentation includes three-year estimates at project level.

49. Multi-year targets are based on current services recognizing cost changes, as recognizing inflation can be viewed as adding an upward bias to the estimates. The second year of the budget estimates (the first out-year) is not considered as the basis for deciding the budget allocations for a particular line item for the following year in the budget planning process.

50. Some OECD countries have more binding out-year estimates in their medium-term frameworks. For instance, the out-years proposed in Sweden’s MTEF are used as the starting place for subsequent budgets. In the Netherlands, the government coalition agreement covering four years includes binding expenditure ceilings for each line ministry for the entire cabinet period. The US Congressional procedure

for budgeting over the medium term requires that proposals shall be within the out-year constraints set in a prior framework decision. Lithuania should consider giving more emphasis to its out-year estimates, possibly by presenting the MTEF to parliament for approval and / or by using the out-estimates as the ceilings for future ministerial budget allocations.

Top-down budgeting

51. Lithuania structures its budget cycle to allocate budget ceilings by ministry. Under the prior procedures, the Ministry of Finance developed the allocations for approval by Government in the second quarter, with subsequent budget negotiations to resolve policy differences. Under the new strategic planning procedures, policy discussions are expected to precede the approval of top-down ceilings. The numbers of appropriation managers and programs have been reduced substantially over the past few years, to provide more discretion to ministers to allocate funds within their budget allocations. The discretion has been particularly important in the implementation of the budget reductions required by the 2009 budget amendments. Giving ministers flexibility on how to implement cuts is intended to minimize the disruption to programs and ministry operations, and thus make the cuts more efficient.

Performance and results

52. The government submits information on the evaluation criteria presented in appropriation managers' strategic plans together with the submission of the budget. The Parliament does not approve the evaluation criteria. Appropriation managers are to report on the implementation of the budget, providing assessments of performance compared to the indicators for the corresponding budget. The requirements for reporting on program performance apply both to the State budget appropriation managers and to Municipal budget appropriation managers. Appropriation managers report on the use of the funds, excess and unused amounts of payments authorized under the budget, and any amounts carried forward under EU programs or authorized special programs. The Ministry of Finance reports on the implementation of the State budget primarily on the basis of State budget accounting data; municipal administrations report on municipal budgets. The Prime Minister's office reviews programme implementation compared to strategic goals and evaluation criteria. The National Audit Office audits performance of selected programs each year.

The new strategic planning initiative

53. The new strategic planning initiative is intended to increase the attention of the Ministers on program results and to strengthen program review on an on-going basis. At present, there are an estimated 300 strategic plans covering different institutions and policy areas, which are often poorly co-ordinated. The reform initiative is intended to embed annual plans and budgets more consistently within long-term strategic plans and the Government Programme, and to develop a coherent set of performance indicators. Ministers and sub-ordinate appropriation managers will be expected to monitor and assess whether institutions achieve strategic goals and implement programs and whether the employees carry out effectively the tasks delegated to them. The Ministry of Finance will monitor and analyze the performance of the appropriation managers[2] and the use of funds from the State budget.

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[2] According to the Law on the Budget Structure state budget appropriation managers shall be heads of the budgetary establishments indicated in the State budget as approved by the Seimas. In ministries, they are the ministers or the persons authorised by them. In courts, the appropriation managers are the presidents of the courts or the court chancellors authorised by them. Usually ministers delegate the function to Chancellors of the Ministries.

Information on performance is expected to be more transparent, making it easier for the government to attain its short and long-term goals, for the Parliament to oversee government performance, and for the public to assess the quality of public services. This initiative is part of a broader set of public administration reforms co-ordinated by the Office of the Prime Minister which also include civil service reforms, such as the introduction of performance-based pay components which have been piloted in the Ministry of Economy.

Investment budgets

54. The budget of Lithuania includes a State investment program providing information on the acquisition of assets or expenditures of funds to increase the value of current tangible and intangible assets (above 1,000 litas). The investment program includes both projects financed from the State budget and EU funded programs. The program in the budget consists of investment projects describing on-going and proposed individual investment projects necessary for the program objectives of the appropriation managers. The projects are supported by financial, technical and social justifications and specify the funding requirements for a period of no less than three years. The State investment program is organized by appropriation manager and by function. It is reviewed annually and may be revised to reflect changes in the availability of State funds or economic policy. The annex to the budget document includes the starting year, targeted end date, previous year's spending if applicable, the budget year, and two succeeding years. The decree breaks down the investments by project, but only specifies funding for the budget year.

55. Public authorities – institutions, agencies, and municipal authorities and agencies – are responsible for ensuring that the investment funds are used for the intended purpose and that prices are fixed in contractor agreements according to regulations. Responsible authorities are required to report to the Ministry of Finance periodically (no less than every six months), on the efficiency and contractual compliance of the use of State investment funds.

Box 1. - Capital budgeting in OECD countries

Capital budgeting means different things in different countries. Capital budgeting can mean that the government has a divided budget, with one budget for investment and another for current expenditure. It can also mean that the government accounts for investment and current expenditure separately, but then integrates them into a single budget with charges for depreciation and write-offs on capital assets. It also can mean separate decisions, which are then combined into a single budget.

Approximately one-third (12) of OECD countries have separate capital and operating budgets, while half (15) have integrated capital and operating budgets. The three remaining countries, Canada, Denmark and France, noted that neither selection would properly reflect the treatment of capital in their budget system and highlighted multiple means of treating capital in the budget. In Canada, for example, capital votes are presented for appropriation, although no distinction is made in budget documents.

	Number	**Countries**
Capital and operating budgets are integrated	14	Australia, Belgium, Finland, Germany, Hungary, Japan, Netherlands, Norway, Poland, Slovak Republic, Spain, Sweden, Turkey, United States
Other	3	Canada[2], Denmark[3], France[4]
Separate capital and operating budgets	13	Austria, Czech Republic, Greece, Iceland, Ireland, Italy, Korea, Luxembourg, Mexico[5], New Zealand, Portugal, Switzerland[6], United Kingdom

1. Based on Q. 27 "Is the central government budget split into a capital and operating budget?" in the 2007 OECD Budgeting Practices and Procedures Database
2. **Mexico:** Capital and operating budgets are not two different instruments; the capital budget is differentiated from the rest of expenditure.
3. **Switzerland**: The new accounting model introduced separate capital and operating budgets for each agency; however, in the central government budget, capital and operating budgets are distinguished in presentation but integrated in the budget document.
4. **Canada:** *Estimates* are split into separate capital and operating budgets but not the budget.
5. **Denmark:** Mixed, *e.g.* defence and infrastructure have separate budgets.
6. **France**: Investment and operating budgets are merged. There is one presentation of the budget taking into account investment and operating sections.

56. The Investment Division, located in the Budget Department, reviews investment proposals for the State budget appropriation managers and municipalities. Decisions are made on an incremental basis. There is no initial decision to fund a specified level of investment. Projects are reviewed on their merits. EU projects and projects related to NATO membership are given priority, then parliamentary priorities, then urgent repairs. Approximately 90% of the investment budget is "already decided" either to fund on-going projects or as EU initiatives.

Long-term fiscal sustainability – Loans

57. The Law on Approval of the Financial Indicators establishes an aggregate limit on state guarantees and a borrowing limit on municipal debt. No new government loans have been extended since 2003, except where they were needed for the repayment of existing government-guaranteed loans.

As of November 2008, the government loan portfolio accounted for 1.2% of GDP. Financial relations across levels of government are discussed in the following chapter.

Public-Private Partnerships

58. A law requiring central government PPP agreements to be approved by the Ministry of Finance came into effect on 1 January 2010. Given the financial constraints caused by the fiscal crisis, there is substantial pressure to identify alternative financing sources for investment. The Ministry of Finance has established a three-person staff within the Asset Management Department to scrutinize PPP proposals and to oversee the risks of creating such financing vehicles. The Ministry of Finance favours the imposition of strict limits on PPP commitments, for instance bn litas over three years. The Ministry of Economy has a staff group promoting financing of investment programs using PPPs which is appropriately removed from the scrutiny unit. In early 2010, the central government had no PPPs, although feasibility studies were under way for six such projects. There is a longer history of using concessions, which have to be submitted to the Ministry of Finance for review.

59. While interest by the central Government in PPPs is relatively recent, PPPs have been used by local authorities for a number of years. The National Audit Office estimated that 47 PPPs were initiated at the local level by 2007; most of these were concessions. Since 2007 it is likely that there has been a substantial increase in PPPs, but since the *central government does not have the legal authority to oversee and veto sub-national PPPs*, no clear data are available. Given the current fiscal pressures and the lack of central control over local governments entering into PPP agreements, it is likely that PPP agreements are being made at the moment. While the budget law contains a debt limit for municipalities, it does not set a limit on PPPs. The potential liabilities (recognised and contingent) that local governments, and by implication, central government are assuming could be substantial. In addition, there is no reason to expect that local governments in Lithuania have the capacity to understand and negotiate PPP agreements in such a way as to ensure value for money for the public.

Budget formulation within the ministries

60. The Minister of Finance provides top-down ceilings for each appropriation manager. Many ministries have several appropriation managers, organized along the lines of the major program areas. Performance goals are usually tied to program areas. The Ministry of Transport, for example, has five appropriation managers: for the core ministry, for road administration, for the Transport investment directorate (EU funds), for the road inspectorate, and for border crossing units. Budgets are formulated based on the basis of program strategic plans and in the context of the guidance from the Ministry of Finance. The Minister of Transport can shift money among the appropriation managers in his/her ministry. Recent cuts have involved consolidating cuts from the programmes, withdrawing services and applying wages that are set government-wide. The Minister of Transport controls the number of employees. The Ministry has an Economy and Budget Division and a Strategic Planning Division which are responsible for budgeting and planning within the ministry.

61. The Ministry of Education and Science has a single appropriation manager – the Chancellor of the Ministry. For elementary and secondary education, the Ministry prepares the methodology for calculating the student basket used to allocate State funds to the municipalities on the basis of the student population, class size, qualification of teachers, urban versus rural geography, and other factors. The budget law specifies the student basket – cost per pupil, and how the funding can be used. The approximately 1,300 elementary and secondary schools are funded as "autonomous functions" through the municipalities. For higher education, the budget starts with the estimates of the number of students

by institution and subject matter. The budget proposal specifies the number of places by academic field. In developing this proposal, the Ministry interacts with the universities over their strategic plans, but the universities draft their own budgets and the state subsidy is given as a lump sum with a specification for salaries. There are fourteen universities and fourteen scientific institutions, some of which are merging with the universities. Universities can accept both funded students and fee-paying students.

Budget documentation

62. The budget for Lithuania is a well-organized document, legislating significant budget policies, approving budget allocations by ministry and appropriation manager, and providing substantial information on program, financing and investments in appendices to the budget. The “Law on Budget Indicators” has a limited number of articles. Most details of the budget are determined by the Government by decree, not specified in the budget law. The most important legal provisions are:

- total revenues,
- allocation of payments into the State budget, except for EU funds,
- Parliament decree containing whole-of-central government expenditure aggregates for the budget year and two succeeding years (non-binding estimates),
- expenditures for the budget year allocated among 212 line items by appropriation managers, each specifying current expenditures, salaries, acquisition of assets and investment for the budget year,
- aggregate general and targeted grants for the municipalities,
- share of personal income tax (in per cent) for the municipalities,
- funding for student basket and social benefits,
- net borrowing limits,
- guarantee limits,
- In-year execution authority, etc.

The document includes nine annexes providing supplementary information regarding the budget. The annexes for 2010 are:

- Annex 1 – Allocation of revenue by source and expenditure by appropriation manager
- Annex 2 – Allocation of payments into the state budget for special programmes (programs financed by revenue sources other than the State budget) by appropriation manager.
- Annex 3 – Allocation of expenditure, by court
- Annex 4 – State grants to municipal budgets including expenditures for a few municipal functions and investment projects, by municipality
- Annex 5 – General subsidy, by municipality
- Annex 6 – General subsidy repayment by municipality
- Annex 7 - Estimate of the Privatization Fund and Reserve (Stabilization) Fund for 2010
- Annex 8 – State Investment program for 2010 - 2012
- Annex 9 – Estimate of the Fund for Decommissioning the Ignalina Nuclear Power Plant for 2010

The decree is promulgated by the Government, after the parliament approves the budget.

Organization of Government and of the Ministry of Finance

63. Lithuania is a parliamentary republic with a unicameral legislature. The President is the Head of State; the Prime Minister leads the government. In 2010, the government was structured into fourteen ministries with budgetary institutions under their supervision. There are 212 institutions with the status of "appropriation managers" each of which is separately identified in the annual budget. The head of the separately identified entity is the "appropriation manager". There are appropriation managers for ministries, major budget institutions within ministries, courts, parliamentary institutions, and the executive offices of the President and the Prime Minister.

64. Most ministries have four to five appropriation managers, responsible for their larger organizations but with clear accountability to the minister. As noted previously, the Transport Ministry has one core ministry appropriation manager for policy and overhead functions and four programmatic appropriation managers. Some, like the Ministry of Finance have a small number of independent budget institutions, like the State Tax Department and the Customs Department with some independence, while most of the offices of the Ministry are under the central authority of the Minister. Most ministries have a somewhat larger number of programmes than appropriation line items, several of which may be consolidated into the line item for an appropriation manager. In 2009 as part of a streamlining government initiative, 21 formerly independent agencies were subordinated to ministries. Lithuania is in the process of consolidating appropriation managers and programs to provide more flexibility to ministers.

65. The Budget Department of the Ministry of Finance has a total staff of 50 and is organized in seven divisions:

- Budget planning and methodology,
- State funds,
- Regional development and municipal budgets,
- Investment or capital planning
- Three Sectoral divisions:
  - Economy,
  - National Defence and Public Safety Programs,
  - Education, Culture and Social Sectors.

66. The Budget Planning and Methodology Division is responsible for putting the budget together based on inputs from the other divisions. The Investment Division, with a staff of seven, reviews every purchase of more than 1,000 litas, a total of over 1,000 projects a year.

67. Several other offices within the Ministry of Finance have responsibility for related budgeting and public finance functions. The Fiscal Policy Department is responsible for forecasting revenues, preparing macro-economic forecasting, co-ordinating economic policy coordination with the EU, and drafting Lithuania's Convergence Program. The State Treasury is responsible for budget execution and cash management for the State budget, and for debt management. The Financial Control Department prepares internal audit methodology and conducts training for internal auditors. The Accounting Methodology Department promulgates accounting standards and oversees government accounting systems.

Conclusions

68. Budget formulation in Lithuania is a modern effective practice. Decisions appear to be made at appropriate levels with increasing focus on programs and performance. The system produces generally transparent information, with quarterly reports on budget implementation. The pending reforms to strengthen strategic planning seem likely to strengthen the policy content and focus of the budget and to provide greater control to the ministers of government. However, care should be taken not to make the system too process-heavy, not to undermine top-down budgeting elements of the current system; the wish to make final decisions regarding the budget in early spring looks optimistic, as discussed further below.

69. Lithuania has responded to the fiscal crisis created by the global economic downturn with apparent success, making necessary but difficult increases in revenues and reductions in public expenditure. There are some areas where change may be appropriate; the following may be worth consideration.

70. Develop strategic planning in the context of the Medium Term Fiscal Framework by involving the ministers and the Prime Minister at the beginning of the budget process and integrating a medium-term perspective. The new strategic planning process should strengthen the policy focus of the budget at the level of line ministries. Reaching agreement on the objectives for the line ministries should both strengthen the line minister's role in developing the budget and resolve issues that, under the former procedures, were left unsettled until the very end of the process. However, beginning the process with requests based on "what they need" could result in unconstrained budget requests and a weakened top-down element that make it more difficult to resolve priorities. In addition, the Budget Department may not have enough capacity to support the additional process that is envisaged. Finally, it may be difficult for policy makers to reach conclusions on difficult issues so far in advance of deadlines.

71. Lithuania could consider integrating the new strategic budget process with a more robust Medium-Term Fiscal Framework. Policy targets and expenditure ceilings could be set for each line ministry for the term of government. The Medium-Term Fiscal Framework could be presented to the parliament in a pre-budget report, similar to the Swedish government's approach. By seeking approval from the parliamentarians on a multi-year plan, the policy structure could be more stable. The plan could continue to be adjusted annually to reflect new policy developments or economic realities.

72. *Present consolidated general government budget totals*: The current budget of Lithuania does not *present* a general government consolidated deficit including State deficit, social insurance fund deficits, and municipal deficits. The Convergence Report does present the consolidated deficit. The consolidated deficit is a more accurate measure of the fiscal impact of government policy on the economy and would thus provide greater transparency and a sound basis for decision making. All government deficits will need to be considered in planning the appropriate government policy. In the future, it may make sense to consolidate government budgets to increase the transparency of the policy choices.

73. *Strengthen budget powers of line ministers:* Lithuania is in the process of consolidating programs and rationalizing budget structures. The strategic planning initiative should enhance the budgetary control of ministers over their ministries. Restructuring and consolidating programmes should increase the flexibility and budget discretion of the ministers in managing the activities under their control. Flexibility in strategic planning and budgeting should be accompanied by increased budget accountability on the part of the ministers.

74. *Simplify budget justification materials to increase transparency*: The Chairman of the parliamentary budget committee observed that budget justification materials focus too much attention on administrative matters. The focus of budget justification materials should be shifted to the purposes and results of programmes, where relevant.

75. *Integrate social insurance funds into the budget:* Social insurance and compulsory health care amount to approximately one-third of the total budget in Lithuania. The transparency of the budget would be enhanced by integrating the social insurance funds in the budget documentation. The State Treasury should be used for cash management, ensuring that the cash and debt management functions of government are fully integrated. Similarly, the social insurance funds should be subjected to the same requirements of budget execution, accounting, and auditing as other government expenditures.

76. *Subject all PPPs to MOF approval:* In particular in a context of fiscal consolidation, PPPs may seem appealing for investments that are difficult to finance by conventional means. However, it is often difficult to ensure value for money in the use of PPPs and the result can be a significant build-up of long-term obligations. This problem is recognised in Lithuania and staff have been devoted to this task. However, given the potential risks, the Government should consider enhancing its analytical capacity before pursuing PPPs at central government level. More worrying is the fact that municipal PPPs are not subject to the review of the Ministry of Finance, while municipal debt is subject to the debt limit established in the budget. Municipalities do not have the expertise to evaluate the complicated financing agreements when establishing a PPP. The PPP law should urgently be revised to require municipal PPPs to be reviewed and approved by the Minister of Finance and subject to a volume ceiling.

CHAPTER 3
LEGISLATIVE APPROVAL

Box 2. - The Lithuanian Parliament

The *Seimas* of the Republic of Lithuania is a unicameral parliament. It has 141 members who are elected for a four-year term. Seventy-one members are elected in individual constituencies and the remaining 70 are allocated proportionally among political parties in accordance with the results of a nationwide vote. A party must receive at least 5% of the national vote, and a multi-party union at least 7%, in order to be represented in the *Seimas*. In the 2008 elections, ten parties gathered enough votes to achieve parliamentary representation. These parties form parliamentary groups.

The *Seimas* sets up a number of committees to consider draft laws and other issues assigned to it by the Constitution. Committees are formed during the first session of a newly elected *Seimas*. They have to comprise no less than seven and no more than 17 members (with the exception of the Committee on European Affairs) and are constituted according to the principle of proportional representation of parliamentary groups. The *Seimas* decides the exact number of committees. Following the 2008 elections, it constituted 15 committees.

The legal framework

77. The Constitution of the Republic of Lithuania and the Law on the Budget Structure regulate fundamental aspects of the parliamentary budget process. The Constitution (article 130) obliges the government to produce a draft State Budget for the upcoming budget year and to present it to the *Seimas* no later than 75 days before the end of the current budget year, i.e. by 17 October. According to article 31 of the Constitution, the *Seimas* has to consider the draft State Budget and approve it prior to the start of the upcoming budget year. The Law on the Budget Structure (article 20) imposes an additional requirement for the *Seimas* to approve the budget no later than 14 calendar days prior to the start of the new budget year. The combined effect of these provisions is that the Lithuanian Parliament has a minimum of two months in which to consider and approve the draft budget. This is less than the three months recommended by the OECD Best Practices for Budget Transparency.

78. The Law on the Budget Structure spells out specific requirements for the content of the budget and supporting documents. According to article 18, the draft Law on Approval of the Financial Indicators of the State Budget and Municipal Budgets has to establish total revenue (by type of revenue), the allocation of payments into the State Budget for special programmes (by appropriation manager), the allocation of appropriations from the State Budget (by budgetary establishment), the new borrowing limit, a limit of state guarantees issued during the budget year, grants to municipal budgets, borrowing limits for municipalities, and the income tax share allocated to municipalities.

79. The Law on the Budget Structure (article 19) also requires the presentation of explanatory notes, a draft allocation of appropriations according to functions and programmes (which are subject to approval by the government), information on defaulted financial obligations guaranteed by the State, intended borrowing from foreign and domestic creditors, and performance information from the strategic actions plans of appropriation managers.

80. There are restrictions on the powers of the *Seimas* to amend the executive budget proposal. According to article 131 of the Constitution, members may not approve amendments to the budget that increase expenditure unless they specify the sources for any such increase in expenditure. This restriction does not, however, preclude members from funding increases of particular items by reducing the allocation set aside for the Government Reserve, as discussed further below. In addition, members may not reduce the spending authorised in other laws as long as these are not altered.

81. The legal framework establishes clear provisions should parliamentary approval be delayed beyond the beginning of the relevant budget year. In such cases, the Constitution (article 132) allows monthly expenditure not exceeding 1/12 of the State Budget expenditure approved for the previous budget year. The Law on the Budget Structure (article 29) further stipulates that the monthly appropriations of every appropriation manager may not exceed 1/12 of the previously appropriated funds. Moreover, such interim funding cannot be used for new activities but only for "continuous activities", obligations established by laws and debt-servicing obligations. The law explicitly exempts EU financial support and co-funding as well as other financial support from these restrictions. These provisions have been used once since independence, but in recent years timely approval has been the norm.

82. During the budget year, the *Seimas* may approve adjustments to the budget, following the same procedural steps as for the main budget, and it may approve an additional budget if necessary (article 132 of the Constitution).

The parliamentary process

83. There is no formal pre-budget consultation with the *Seimas*, although the Minister of Finance may consult the Chair of the Budget and Finance Committee (BFC) during the drafting process. The main focus of parliamentary scrutiny follows the presentation of the budget in mid-October. The Statute of the *Seimas*, which has the power of law, regulates the procedure for the approval of the State Budget (chapter 27). Following the transmission of the draft budget to the *Seimas*, it is distributed to all committees and parliamentary groups. The Minister of Finance has to address the *Seimas* at its next sitting (see table 3.1.).

Table 3.1. - Timeline of the parliamentary process

17 October	**Presentation of the budget**
10 November	Sectoral committees submit proposals to the BFC
Mid-November	BFC reviews proposals and prepares a report with its decisions
25 November	First reading in the plenary
Mid-December	Second reading and approval of the budget
1 January	Beginning of the budget year

84. Following the address by the Minister of Finance, parliamentary committees and parliamentary groups have time to consider the draft budget. This review is required to last a minimum of 15 days. The BFC announces a date by which comments and proposals by interested persons can be submitted, and forwards any relevant comments to sectoral committees if applicable. A number of inputs are typically given by the private sector, including banks, and independent experts. During this period, the government and other state institutions are obliged by the *Seimas* Statute (article 173) to supply the

committees with any data on which the budget has been formulated. The committees have until 10 November to submit comments and proposals to the BFC. The Auditor General, too, can submit comments, in this case by 15 November.

85. The next step is for the BFC to review the conclusions of other committees as well as the opinions and proposed amendments of parliamentary groups. During these deliberations, representatives from the government, parliamentary groups and other committees join the sessions of the BFC. The Minister of Finance participates in all sittings. The BFC has to either accept or reject each amendment proposal put forward by another committee. If a proposal falls within the sector for which the sponsoring committee has formal responsibility, the BFC has to explain its decision. If an amendment proposal put forward by a committee does not relate to a part of the budget for which it has formal responsibility, the BFC is not obliged to justify its decision. All decisions by the BFC are recorded in a report and published.

86. The first deliberation on the draft budget in the plenary of the *Seimas* is based on the report of the BFC and has to take place by 25 November. The report is made publicly available on the parliamentary website. This first plenary is followed by a second deliberation, during which the government presents a revised draft of the budget that takes into consideration the received proposals and remarks. The *Seimas* Statute stipulates that the second deliberation must take place no later than 23 December (article 177), which is later than the final deadline for approval set in the Law on the Budget Structure (article 20) mentioned above. During the second deliberation, the government has to declare which proposals and amendments it has incorporated and which it has rejected, and explain the decisions. After a discussion, the *Seimas* sets a date for the approval of the State Budget.

87. Prior to the approval session, new proposals and amendments can be submitted to the government. If necessary, the government can be allotted up to 10 days in order to revise the budget. At the final budget session, the *Seimas* votes on each amendment proposal that has not been accepted by the government, as well as the entire State Budget. Amendments require the approval of more than half of all members of the *Seimas*. If the budget is rejected, the government must revise the budget one more time and a further deliberation must be held no sooner than five and no later than 10 days following this rejection.

The impact of parliament

88. Parliamentary review of the budget does not have a substantial impact on the priorities in the budget. During the deliberations, individual members almost always focus on expenditures in particular constituencies. Broader systemic issues mainly emerge in the discussions of the BFC and the Economics Committee. The members of the BFC support an increased focus on performance, but demand that the budget documents should be ‘simple and clear’ and relevant for politicians. A more accessible budget format may also help draw more attention to issues of efficiency in public spending.

Table 3.2. - In all OECD countries, how far in advance of the beginning of the budget year is the budget presented to the Legislature?

7 months before	1
4 months before	4
3 months before	16
2 months before	6
1 month before	2
0 month	0
1 month after	1

Source: Responses of 30 OECD member countries from the Budgeting Practices and Procedures Database (www.oecd.org/gov/budget/database)

89. The BFC would also like to change the legal framework so that the presentation of the budget is required by 15 September. This would give the *Seimas* an additional month to discuss the draft budget. Such a change has potential benefits. First, it might help to get the public more involved in the parliamentary process. Second, elections are usually held in October, so there can be an overlap with the budget process. For instance, in 2008 the government prepared a draft budget and then lost the elections in October. The newly elected government came into office and had very limited time to revise the draft budget. A revision to the timeline as suggested by the BFC would go a long way towards ensuring more orderly revisions following elections (see table 3.2. for practices of OECD countries in this respect).

90. While an extension of the time for parliamentary review seems desirable, it would also put additional demands on committee staff and members. Parliament has no specialised research office or analytic unit that is dedicated to budget analysis. The BFC has 12 staff to support its work, but their analytic capabilities are limited. Some members are very experienced, and two of the current members have a strong economics background. However, the main source of information during the legislative process is the Ministry of Finance. An increase in public involvement and parliamentary deliberation has the potential to decrease this reliance on executive information, but in order to do so the *Seimas* may require additional resources for independent analysis of the draft budget and of any proposals generated during the review process.

91. The increase of analytic capabilities is a key trend across OECD countries, as indicated in Table 3.3. In less than a decade, the number of legislative budget offices has doubled, and their size has increased in a number of cases. In 2000, only six parliaments in OECD countries had a specialised budget research organisation to support their scrutiny of the executive budget proposal. In 2003, this number had increased to seven and to 11 in 2008. Some of these units are very large and sophisticated, such as the Congressional Budget Office in the United States and the National Assembly Budget Office in Korea, while others remain fairly compact. This trend is evidence that legislators in a number of countries value the potential of these institutions as an additional, independent and objective source of information on the budget.

Table 3.3. - Legislative budget offices in OECD countries

Is there a specialised budget research organisation?	Year		
	2000	2003	2008 and number of staff
Yes	Japan, Mexico, Netherlands, Poland, Sweden, United States	Japan, Korea, Mexico, Netherlands, Poland, Sweden, United States	Canada [16], Hungary [16], Italy [50], Japan [21], Korea [96], Mexico [50], Netherlands [140], Poland [15], Portugal [3], Sweden [7], United States [230]
No	Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Korea, New Zealand, Norway, Portugal, Spain, Switzerland, Turkey, United Kingdom	Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, New Zealand, Norway, Portugal, Spain, Switzerland, Turkey, United Kingdom	Australia, Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Luxembourg, New Zealand, Norway, Slovak Republic, Spain, Switzerland, Turkey, United Kingdom

Source: OECD Budgeting Practices and Procedures Database and other data

92. The parliamentary process often generates a large number of amendment proposals. About 300 such proposals were discussed during the approval of the budget for 2010, but only about 15 were ultimately approved. In practice, members typically circumvent the constitutional requirement that any increases have to be financed from specified sources, by tapping into the Government Reserve, a contingency allocation in the budget of the Ministry of Finance. For instance, when the *Seimas* approved the Law on Approval of the Financial Indicators of the State Budget and Municipal Budgets for 2010, it funded several increases by cutting the allocation for this reserve, including increased allocations for the Sign Language Interpreter Centre, for equipment for cultural events in Vilnius, and for the Commission for Preserving Lithuanian Traditions and Heritage.

Conclusions

93. The Lithuanian Parliament operates a well-designed and orderly review process that allows members the opportunity to scrutinise the budget and to formulate amendment proposals. The committee process follows the principles of top-down budgeting by giving the Budget and Finance Committee (BFC) a strong role in co-ordinating amendment proposals by other committees and parliamentary groups. Overall, amendment activity is very modest, although members can influence some details in the executive budget proposal. The following suggestions may serve to further develop and refocus parliamentary involvement in the budget process.

94. An extended timeframe. There is a strong case for lengthening the time available for parliamentary review of the draft budget by one month so that the presentation is required by 15 September. This would bring Lithuania into line with the OECD Best Practices for Budget Transparency. Such a move could enable broader public discussion of the budget, which can be particularly important for building consensus during times of fiscal retrenchment. Moreover, this revised date would allow better co-ordination with the electoral cycle.

95. Creation of independent analytic capacity. A number of legislatures in OECD countries have recently strengthened their analytic capacity in budgetary matters in order to support more detailed scrutiny of the budget. Especially if the time allocated to the *Seimas* is extended, it would be advisable to create a small analytic unit with highly skilled staff to help the BFC in particular to review and consolidate any comments and proposals.

96. Consultation on the format of the budget. The Ministry of Finance should consult closely with the BFC about the further development of the budget and supporting documentation, including the programme structure and performance information. Members of the BFC acknowledge the need for more careful scrutiny of the efficiency of spending by the *Seimas*, and high-quality information presented in an accessible format is an important prerequisite for such a shift.

CHAPTER 4.
BUDGET EXECUTION

Organisation of budget execution

97. Following parliamentary approval of the budget, the Government issues a decree that contains a more detailed breakdown of expenditures. While the Seimas approves totals for appropriation managers, such as ministries, the Government decree breaks spending down to the programme level and by economic category. The government decree also specifies the maximum number of employees by appropriation manager. Ministries can have fewer employees, but they may not exceed the approved total. The decree is also important for the funding of capital projects. The budget law has an annex that provides a breakdown of investment expenditure over the budget year and two further years. The Government decree allocates capital spending by project, but only for the budget year.

98. The system of financial control foresees three major tasks: (1) ex ante financial control, (2) ongoing control and (3) ex-post control "as regards the use of state and municipal assets and liabilities" prescribed by Article 4 of the Law on Internal Control and Internal Audit. The ex ante financial control function is assigned to the chief-accountant or the head of the accounting unit of a public legal entity, including the task of ensuring that financial commitments remain within the approved budget appropriations. However, the system of controlling commitments does not produce centralized information tracking these commitments to be used for in-year apportionments and overall cash management. In addition, out-year liabilities are not tracked and recorded centrally. The shift towards accrual accounting which is currently under way might mitigate some of these problems depending on the actual implementation. It should also enhance the transparency of the government's actions, improve cash management and thereby strengthen fiscal discipline.

Revenue uncertainty and the reserve fund

99. The Law on the Budget Structure deals with revenue received in excess of the approved plan (article 30) as well as shortfalls (article 31). Revenue overruns are to be used to build up cash reserves for the State Budget and "for covering the shortfalls of municipal budget revenue". When the amount of revenue received is less than the planned amount and the accumulated working capital is not sufficient to cover a temporary shortfall, programmes can be financed on the recommendation of the Ministry of Finance. However, allocations involving EU financial support and co-funding as well as other financial support have to be fully implemented and are not subject to such discretion. Amounts of budget appropriations to be transferred to appropriation managers for the funding of special programmes are reduced by the amounts equal to a shortfall (against the plan) in actual payments of revenue by budgetary establishments into the budget.

100. In addition, the Law on the Budget Structure allows the establishment of a reserve fund (article 15). The size of the reserve may not exceed 1% of the total appropriated in the State Budget. The exact amount is voted annually by the Parliament (see previous chapter). During the execution of the

budget, the allocation for the reserve can be used on the basis of a Government resolution. Unlike in some other countries, the reserve is not only for emergencies but also “for other needs according to the priorities established by the Government”. Overspending in excess of the funds approved for the reserve is not allowed without parliamentary approval and requires a supplementary appropriations law. This requirement is applicable for all budget lines set in the Budget Law.

Reallocation and carry-overs

101. Appropriation managers, such as ministers or persons authorised by them, have some authority to shift funds between items in the approved budget. The Law on the Budget Structure distinguishes reallocation within programmes from reallocation between programmes (article 6). Every quarter, appropriation managers can reallocate money between economic categories within a programme as long as they do not exceed the total allocation for that programme. It is prohibited to reallocate funds from current or capital expenditure to the wages/salaries line. Savings within a programme may be used to acquire assets. When reallocating within programmes, appropriation managers have to notify the Ministry of Finance. In contrast, the reallocation of funds between different programmes is “subject to co-ordination with the Ministry of Finance”. Finally, the shifting of funds between different ministries requires parliamentary approval.

102. Carry-overs are not possible for most appropriations. Article 32 of the Law on the Budget Structure requires appropriation managers and subordinate agencies as well as other entities to repay unused funds from the State Budget to the State Treasury account by 10 January following the end of the relevant budget year. The exceptions are unused appropriations for special programmes and construction projects in the completion stage, as well as unused EU financial support and co-funding and other financial support received. Unused funds earmarked for municipalities must also be repaid into the State Treasury account by 10 January, unless the annual budget law stipulates otherwise. Limited carry-over is allowed for balances in accounts opened with foreign credit institutions, for instance by diplomatic missions or by the Ministry of National Defence for the purpose of international operations.

Cash and debt management

103. The State Treasury Department in the Ministry of Finance is charged with administering the Single Treasury Account held within the Bank of Lithuania. The Bank of Lithuania is the central bank of the Republic of Lithuania and acts as a State Treasury agent. The bank is prohibited from lending money to the Government.

104. The Forecasting and Risk Management Division (FRMD) of the State Treasury Department prepares detailed internal revenue forecasts for cash management purposes. Forecasts based on official plans are prepared by the State Tax Inspectorate, Customs Department and State Treasury (for revenues received directly into Treasury accounts). To maximise accuracy, the FRMD co-operates closely with the State Tax Inspectorate and the Customs Department. Value-added tax, excises, and personal and corporate income tax account for about three-quarters of tax revenues. The FRMD prepares separate forecasts for each of these revenue sources.

105. On the expenditure side, quarterly allocations of appropriations by economic classification are complemented with monthly forecasts as well as a day-to-day spending plan based on data received from all spending units and covering the next 20 days. Special attention is paid to forecasting spending for the following three working days, which is the period required to settle payment requests. State debt servicing costs, transfers to municipalities and payments to the EU can be forecast precisely. Forecasts for

salaries and social expenditures are based on information supplied by appropriation managers, and deviations are usually small. It is most difficult to forecast investments and other expenditures.

106. The FRMD ensures that balances are sufficient for the execution of payments by the Financing Division as well as debt management related payments, which are handled by the Debt Liabilities Administration Division. The FRMD submits investment proposals for idle cash and data regarding the State Treasury's demand for borrowed resources to the Borrowing and Cash Management Division, which is responsible for the execution of borrowing and investment operations. Idle cash balances may be invested in time deposits in the Bank of Lithuania, term deposits in Lithuanian and foreign commercial banks, and debt securities and money market instruments issued by governments and financial institutions, among others.

107. Cash management practices for EU funds reflect their multi-annual nature and the fact that financing obligations by the State may be fulfilled after funds for a project are received from the European Commission. EU funds are consolidated in one account. When drafting a revenue and expenditure plan for EU funds, unused EU funds from the previous year are not taken into account, so the actual yearly expenditure does not match the approved plan for that year. However, any mismatch is taken into account for cash management purposes.

108. The Government uses diversified borrowing instruments such as securities (savings notes included) issued in both domestic and foreign markets publicly and to private investors, as well as loans from the European Investment Bank, Nordic Investment Bank and Council of Europe Development Bank. In order to balance cash flows, the Ministry of Finance uses short-term borrowing instruments in the form of Treasury Bills with standard maturities of one, three, six and 12 months, as well as credit lines. The yearly borrowing requirement is reflected in the annual Government Borrowing Strategy. Domestic security auctions are held every week and a three-month auction schedule is announced every quarter. Private placements via domestic banks are issued irregularly.

Procurement

109. The Public Procurement Office is assigned to the economics ministry. It has a staff of 70. The office is responsible for the implementation of procurement legislation, the collection of statistical data on procurement and methodological guidance. The office carries out preventive as well as control functions. It reviews all public procurements, which have to be announced via the Public Procurement Office. The office also carries out controls using a risk-based approach that relies on numerical thresholds other factors, such as whether EU funds are involved or whether the procuring organisation has a record of past violations. This work is supported by the Risk Analysis Division, which was newly created in 2010. The mandate of the Public Procurement Office covers all public bodies, including municipalities.

110. The Government can enter into contracts covering three years. Contracts for longer than this period contain a clause that allow termination should the necessary funds not be available. Most common are annual procurement contracts. The government encourages the use of the Central Project Management Agency, but this is not mandatory.

111. The Public Procurement Office does not deal with dispute settlement, which is a matter strictly for the courts. During 2009, there was a 30% drop in procurement compared with 2008. Due the current crisis, competition is strong, and for that reason there is a spike in disputes and low prices. As a result, there is also a threat that some projects may not be implemented. In the longer term, potential issues

include excessively stringent qualification requirements for suppliers and problems with technical specifications.

The structure of public administration and service delivery

112. The Government consists of Ministers and is headed by the Prime Minister. The 15th Government appointed in 2008 comprises 14 Ministers plus the Prime Minister. The Law on the Government (article 29) lists 14 central government ministries: Environment; Energy; Finance; National Defence; Culture; Social Security and Labour; Transport and Communications; Health; Education and Science; Justice; Foreign Affairs; Economy; Interior; and Agriculture. The President is directly elected and has important powers in foreign policy and defence matters, but does not play a direct role in the budget process.

113. Ministries are typically structured into a small number of departments, which in turn have a set of divisions. A variety of bodies can be assigned to a particular ministry in order to perform regulatory duties or support service delivery. For instance, the Ministry of Finance has 11 subordinate institutions and enterprises in which it performs the functions of founder and owner, implements the rights and duties of the owner, and controls shares owned by the State.[3] The functions, duties and rights of these institutions and enterprises are defined in legal acts governing their activities and also in the founding documents. In an effort to streamline its organisation, the Government made 21 previously more autonomous agencies subordinate to ministries in 2009. This streamlining was intended to establish clearer lines of accountability and reduce the number of appropriation managers to 150. Currently there are 212 appropriation managers.

114. There are about 76,000 employees in 949 public and municipal institutions financed from the state and municipal budgets. Of these, about 27,000 are career civil servants, civil servants of political confidence and heads of institutions. The number of political appointees has doubled in the past five years. There are also 25,000 statutory civil servants (diplomats, police and customs officers, and officers of the national defence system) as well as 24,000 employees with contracts according to the Labour Code.

115. The Civil Service Law, last updated in 2002, regulates the positions, recruitment and remuneration of civil servants, among others. The Civil Service Department under the Ministry of the Interior is in charge of civil service management functions. The department was initially part of the Ministry of Public Administration Reforms and Local Authorities, which was abolished in 2000. The functions of the department include the enforcement of the Civil Service Law, the management of a register and information system, ensuring sound personnel management and career planning in the civil service, and the approval of training programmes and supervision of their delivery. The department also pursues the modernisation of recruitment procedures.

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3 These institutions and enterprises are: State Tax Inspectorate; Customs Department; Service of Technological Security of State Documents; Training Centre of the Ministry of Finance; Public institution Central Project Management Agency; Public institution Audit, Accounting and Property Valuation Institute of the Republic of Lithuania; Authority of Auditing and Accounting; State enterprise Lithuanian Assay Office; State company Deposit and Investment Insurance; Joint-Stock Company Housing Loan Insurance; Joint-Stock Company Turto Bankas.

Fiscal relations across levels of government

116. Lithuania is a unitary state with relatively autonomous local authorities. In 2010, the territorial structure underwent a reorganisation that simplified the local government system. Until then, Lithuania had a two-tier system with 60 municipalities and ten counties. The reforms abolished the county level while maintaining the municipalities, resulting in a single-tier system of local government. Lithuania's municipalities differ greatly in size, and hence also in their economic and political importance. The largest local authority is the municipality of Vilnius, the country's capital, with about half a million inhabitants. The smallest municipality is Neringa, which has about 2700 inhabitants.

117. Lithuania's 60 municipalities have "autonomous functions" as well as "delegated functions". Delegated functions are under the control of line ministries and funded via conditional grants, for instance social expenditures such as heating subsidies and income support. The annual budget law contains an annex for delegated functions. There is also an annex for investments, broken down by municipality, with further details specified by Government decree. Funding for primary and secondary schools is based on the so-called "pupil basket". In 2010, municipalities planned to spend 11.8% of their budgets on delegated functions, 32.9% on the "pupil basket" and 55.3% on autonomous functions.

118. Municipal income consists of grants from the central government, receipts from tax-sharing arrangements and own revenues. Grants made up 48.1% of total planned municipal revenues in 2010 (with 6.8% of planned income from general purpose grants), while tax and non-tax revenues amounted to 51.9%. Income from taxes includes a share of personal income tax (PIT) collected nationally and distributed to municipalities on the basis of origin. The exact size of the municipal PIT share is determined annually in the budget law. In 2010, municipalities received 73% of PIT receipts, slightly more than in previous years.

Table 4.1. - Components of Municipal Finance in Lithuania, 2010

	In millions of Litas	% of Total
Expenditures:		
Autonomous/local functions: (3 -5 largest)		
Education	1549,7	43,2
General government services	825,4	23
Recreation, culture and religion	305,4	8,5
Social protection	279,1	7,8
Sub-total autonomous/local	3583,6	100
Delegated functions: (3 - 5 largest)		
Education	1986,1	73,4
Social protection	580,3	21,4
Public order and safety	48,9	1,8
Economic affairs	39,8	1,5
Sub-total delegated	2705,6	100
Total expenditures	2705,6	100
Revenues: (significant revenue sources)		
Transfers	2901,5	46,1
PIT allocation from federal government	2472,5	39,3
Property taxes	321,3	5,1
Other taxes	593,9	9,5
Total revenues	6289,3	100

119. According to the Law on the Budget Structure, municipal budgets must be approved without a budget deficit (article 21). Municipalities present their approved budgets to the MoF, which then reviews them to make sure they are in line with the indicators for municipalities approved in the annual budget law. Municipalities may borrow for investment expenditure within borrowing limits set in the annual budget law by the central government. Municipal borrowing is subject to a restriction of total debt as a share of planned revenues, set in the annual budget law. Similarly, the size of municipal guarantees is limited to a share of planned revenues. However, municipalities make their own revenue plans, which are sometimes unrealistic in order to accommodate priorities and promises. Over the past years, a growing shortfall of revenues from the State has been allocated to the municipalities, primarily from the PIT being over-estimated in the budget documents. This shortfall results in increasing and substantial budget arrears for the municipalities. Municipal budget managers are meant to ensure that debt remains within the limit and to provide quarterly reports to the Ministry of Finance.

120. As a result of revenue shortfalls as well as the overall fiscal tightening due to the economic crisis, arrears increased in many municipalities. In early 2010, budget officials in Vilnius estimated that municipal arrears (payments due that were delayed by more than 45 days) amounted to 240 million litas, close to a quarter of planned revenues in that financial year. In January 2010, the problem received widespread public attention when, as a result of escalating arrears, the electricity supplier threatened to switch off the city’s streetlights. To stabilise its level of debt to the provider, Vilnius municipality switched off two thirds of its streetlights network.

Conclusions

121. Overall, the execution of the State Budget is based on sound rules and procedures. Since parliamentary approval only binds the Government to the totals for those who manage appropriations, the government has a high degree of discretion in managing the implementation of the budget. However, the execution rules strictly limit the flexibility of appropriation managers. A potential concern is that several features of the budget system may permit local governments to build up significant liabilities that at some point could require central Government intervention. Another concern is the growing interest in PPPs, as discussed above. Based on these observations, consideration of the following proposals is recommended.

122. *Enhanced flexibility for appropriation managers:* Once the programme structure has been fully developed, it could be complemented with rules that allow appropriation managers to reallocate funds between programmes up to a specified numerical limit, such as 5% of programme expenditure. In addition, carry-overs should be permitted within limits so as to avoid end-of-year spending rushes and resulting inefficiencies.

123. *Managing fiscal risks relating to local government:* Although municipalities report arrears to the Ministry of Finance on a monthly basis, the central government has no direct authority to limit the accumulation of arrears at the local level. In addition, although municipalities cannot run deficits, this restriction only applies to approved budgets but not actual figures, which encourages unrealistic budgeting. The central Government should closely monitor the build-up or municipal arrears. Finally, the Law on Budget Structure should be amended so that the deficit restriction for municipalities applies ex post as well as ex ante.

124. *Further organisational streamlining:* The recent reduction in the number of appropriation managers is a positive development. As far as possible, autonomous agencies and other public bodies should be subordinate to central ministries to ensure clear lines of accountability. Further consolidation along these lines may be possible.

CHAPTER 5
ACCOUNTABILITY, ACCOUNTING AND AUDIT

Accounting basis

125. The legal foundation for public accounting is given in the Law on the Public Sector Accountability. Accounts are drawn up in every budgetary institution. The Accounting Methodology Department in the Ministry of Finance promulgates accounting standards, produces consolidated accounting reports, and oversees the government accounting systems. Each budgetary institution has to comply with the government's unitary Chart of Accounts, which complies with ESA 95 standards. Given that each budgetary institution manages its own bookkeeping, end-of-year accounts are first prepared at that level.

126. Accounting of revenues and expenditures is on a modified cash basis. The State Social Insurance Fund and state-owned enterprises apply accrual-based accounting. From 1 January 2010 all public sector entities are obliged to apply the accrual principle for preparing financial statements. Budget execution statements will, however, remain on a modified cash basis.

127. In 2005, the Seimas adopted the *Conceptual Framework of the Public Sector Accounting and Financial Reporting System Reform* which primarily envisioned the introduction of accrual-based accounting for all budgetary institutions, state-owned enterprises, and social and health insurance funds in sequenced steps. The Accounting Methodology Department in the Ministry of Finance provides the methodological framework. In a first step, ten public entities have piloted the introduction of accrual accounting. Currently the roll-out of IT-Systems for accrual accounting is taking place. However, no uniform IT-System has been purchased for all public entities.

128. To make use of the information produced by accrual accounts, a clear understanding of the benefits must be mainstreamed to accountants, financial managers, State Control auditors, Parliamentarians and other stakeholders in the accountability chain. Some training and awareness-raising activities may be considered useful by the Ministry of Finance. A further recommendation to ease the introduction of accrual accounting and to improve the management of state property would be to establish a central asset management agency, which has already been envisaged by the Lithuanian government, as this would centralise the capacity needs for the difficult task of determining the value of state assets.

Reporting

129. The Treasury Department prepares annual and quarterly budget execution reports. The latter have to be submitted within 30 days after the end of the quarter. From July 2010, the MoF website started disclosing quarterly budget expenditure execution reports.

130. The financial statements have to be submitted by the heads of budgetary institutions to the Ministry of Finance. The Treasury Department has to prepare consolidated state financial statements by 15 April; they are subsequently submitted to the State Control. The Head of the State Control must present to the Speaker of the Seimas an audited financial statement by 1 October. The audited financial statement will be primarily scrutinized by the Budget and Finance Committee. The Statute of the Seimas

also spells out that the audited budget execution statement shall be considered at a plenary sitting of the parliament together with the draft of the State Budget for the forthcoming year, before 20 November.

External audit

131. The State Control (National Audit Office of Lithuania) was established in 1990 after independence from the Soviet Union, but its history traces back to 1919. The State Control is a legally independent institution. The independence is granted by Article 134 of the Constitution of the Republic of Lithuania adopted on 25 October 1992. The State Control is by law committed to principles of independence, lawfulness, publicity, neutrality and professionalism. While its legal independence is secure, restrictions apply as to the size of resources available.

132. The institutional setting of the State Control mostly resembles the Westminster model. That is, no legal prosecution rights are designated to the State Control, and it reports and is accountable to the Seimas. The function of Auditor-General is executed by the head of the State Control. This approach to external audit favours an open and independent audit function, as the State Control has its own constitutional position and its head cannot easily be removed from office.

133. The State Control prepares its own budget proposal which is subject to the same procedures and policies as any other governmental organisation included in the Government's budget. But usually the Seimas approves the appropriations for the State Control budget unchanged (see table 5.1.). However, the State Control has also been subject to the overall budget cuts during the financial crisis in 2009 (- 12%). The State Control is audited by a private audit company as appointed by the Seimas Audit Committee.

Table 5.1. - Budgeting for the Supreme Audit Institution in all OECD countries

How is the budget prepared?		Number
	The SAI prepares its budget and the Central Budget Authority includes it in the Government's budget proposal without any changes	12
	The SAI is subject to the same procedures and policies as any other governmental organisation included in the Government's budget	11
	The Supreme Audit Institution prepares its budget and submits it directly to the Legislature for approval	4
	Other	3

Source: OECD Budgeting Practises and Procedures Database 2007 www.oecd.org/gov/budget/database Q30.

134. The Head of the State Control is appointed by the Seimas upon recommendation of the President of Lithuania for a one-time-renewable five-year term, renewable once, which grants the head considerable independence from day-to-day politics. The State Control has eight operational audit departments of which two are exclusively tasked with auditing the use of EU funds and one is assigned to auditing municipalities. The Departments are organized according to thematic/ministerial issues, integrating both financial and performance audits in a specific thematic area in the same Department. The remainder of the Departments – Communication, International Relations, Legal, Audit Development, Finance and Accounting and the Internal Audit Division – are tasked with internal management and external relations.

135. The competencies of the State Control cover a wide range of State funds, including social security funds. The State Control carries out an audit of (1) the implementation of the State budget; (2) the use of State funds; (3) the management, use and disposal of State property; (4) the implementation of the budget of the State Social Insurance Fund; (5) the implementation of the budget of the Compulsory Health Insurance Fund; (6) the fund management institutions and beneficiaries of EU funds; and (7) the use of State budget funds allocated to municipal budgets and use, management and disposal municipal property.

Table 5.2. - Key Performance Indicators of the Supreme Audit Institution

	2009	2008	2007	2006
Staff	355	344	335	316
- off which auditors	66%	59%	n.a.	78%
Financial Audits	162	110	97	n.a.
- of which audit of State Budget appropriations	125 (81,6% of total funds)	72 (82% of total funds)	59 (81% of total funds)	(82% of total funds)
- of which audit of subsidies of State Budget to local level	23 (52% of total funds)	23 (47% of total funds)	24 (57% of total funds)	9
- of which mandatory audits of EU structural assistance	7	6	8	7
Performance Audits	29	28	23	34
Recommendations implemented by audited bodies	87%	79%	91%	86%

Source: compiled from Annual Reports of the State Control 2006-2009, http://www.vkontrole.lt/en/activities_annual.shtml.

136. The annual audit agenda is prepared and confirmed by the Head of the State Control after assessment of recommendations received by the Seimas Audit Committee. Financial audit should cover at least 80% of state budget expenditure and 50% of State budget funds allocated to municipal budgets. In the last four years, according to own sources, the target was met (see table 5.2.). Each ministry and each municipality (State budget funds over 50 million Litas) is subject to the audit programme. Once every five years, subordinate offices need to be audited. Within 30 days after a statement of violation of legal acts has been issued, audited public entities must inform the State Control about the elimination of the violation. Those public legal entities which received a “qualified opinion” will be put on the audit agenda again for the following year.

137. The State Control also carries out performance audits. The number of audits carried out has decreased from 34 in 2006 to 29 in 2009. This decrease was explained by the State Control as an investment in audit quality, increasing both the scope and depth of performance audits.

138. The staffing level has steadily increased in the last years (see table 5.2.) although given the work program, a thorough assessment of whether staffing levels are sufficient may be envisaged. As of 2009, there were about355 staff members, of which roughly two thirds were auditors, distributed among headquarters and two regional offices. A common concern is the qualification of staff. The State Control has its own audit training capacities.

139. The Seimas is the main recipient of information produced by the State Control. There are two Committees in the Seimas of the Republic of Lithuania which have a functional relationship with the State Control – the Budget Committee and the Audit Committee. The latter is the principal body scrutinizing audit reports. According to the Law on the State Control, four reports must be presented to the Seimas by the State Control:

1) opinion on the set of the State budget execution accounts;
2) opinion on the report on public debt and loans given by the funds borrowed on behalf of the State and given State guarantees;
3) opinion on the report of state-owned property; and
4) annual report of the State Control.

140. The Law on the State Control requires the State Control to submit to the Audit Committee within 5 working days all financial and performance audits which entail a qualified or adverse opinion, or disclaimer of opinion in public accounts. All performance audits and a summary of financial audits are presented to the Audit Committee of the Seimas as well as to other Committees concerned. The main reports – the reports on budget execution and debt – are considered in all the committees in the Seimas. The Head of the State Control is further entitled to propose to the Seimas recommendations for improving legal acts and give a separate opinion on government regulations. The main audit report (Annual Audited Financial Statement) is presented to the Seimas approximately 10 months after the end of the financial year.

141. The follow-up mechanisms by the Seimas deserve strengthening. The parliament does not vote on the audited financial statement. However, parliamentary oversight is executed on an ongoing basis by the Audit Committee.[4] Opinions and reports of the State Control are considered at every Audit Committee meeting. The heads of the entities audited are invited to the Audit Committee meetings. The Audit Committee, in individual cases, may oblige public entities to report to the Committee on how the recommendations are implemented. Other Committees as well may consider financial and performance audit reports.[5] A formal process to monitor the implementation of recommendations is being set up this year. From 2010, a summary implementation report will be presented to the Seimas (Audit Committee) and discussed with the press.

142. Compliance is perceived as good. Internal surveys by the State Control find that more than 80% of their recommendations are implemented by the audited public entities. But concerns remain as to whether the most important and effective recommendations were also implemented as eagerly. It is understood that many recommendations require changes to legal acts, which require more time to change.

143. It was reported that recommendations of the State Control received great attention by the government – especially of performance audit findings. In 2009, a performance audit of the State Social Insurance Fund (SoDra) was carried out to identify the reasons for its notoriously huge deficits. The State

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4 In 2009, the Audit Committee considered 26 public audit reports (15 performance audit and 11 financial (regularity) audit reports). The Committee adopted 26 decisions related to public audit reports and other activities of the supreme audit institution (Annual Report of State Control 2009).

5 Other Seimas committees considered 17 public audit reports, mostly the Committee on Social Affairs and Labour, the Committee of the Development of Information Society, and the Committee on Rural Affairs (Annual Report of State Control 2009).

Control's performance audit untangled the mix of benefits entitled by social insurance regulation and universal benefits incurred by other legal entitlements, such as maternity leave benefits, which are not covered by the insurance contributions. As a result of the audit findings, a draft law taking up the major recommendations is going to be considered in the Seimas.

144. The transparency of the audit work is extensive. Audited final accounts are published immediately on the website of the State Control. Going further, all reports produced by the State Control are made publicly available on the website. Committee meetings are open for NGOs and reporters. Critical reports may be promoted by (justifiable) public awareness raising measures.

Internal audit

145. The Law on Internal Control and Internal Audit adopted on 10 December 2002 is the legal basis for the system of internal audit and financial control. Article 6 spells out that an internal audit unit (IAU) "shall be set up in the Office of the President of the Republic, Office of the Seimas of the Republic of Lithuania, Office of the Government of the Republic of Lithuania, all ministries, administrations of county governors and municipalities and in the public legal entities other than those specified in this Article, paragraph 1, if they have at least 200 approved positions […]". As of 2009, approximately 170 IAUs have been set up at the central level, which are supplemented by 50-60 IAU's at municipal level. According to the available data, 374 internal auditors worked in the central government on 1 January 2009.

146. The main tasks of internal audit services are to: (1) assess the legality of the activities of public legal entity; (2) advise the head of a public legal entity on the reduction of risk factors; (3) provide recommendations on the internal control mechanisms; (4) assess strategic action and programme plans as well as the effective, efficient and economic use of State and municipal assets; (5) assess the use of EU funds. Henceforth, the major role of IAUs is to assist the management of the public entity in controlling risks associated with the use of state funds and providing information on programme implementation.

147. Functional independence of each IAU is granted by the Law on Financial Control and Internal Audit. Each IAU is independent in planning and conducting the internal audit and reporting on the internal audit results. The head of the IAU is directly accountable to the head of the respective public entity, who is also empowered to dismiss him/her.

148. The Lithuanian system of internal audit and internal control is a mixed system with mainly decentralized IAUs but also allowing for centralized internal audit bodies exercising tasks for several subordinate public entities. The Internal Audit and Financial Control Methodology Department in the Ministry of Finance serves as the central harmonization unit, reviewing all internal audit reports and compiling an annual internal audit summary report which is presented to the BFC of the Seimas.

149. The organisation and role of the internal audit resembles that found in many former communist countries. This model was based on the notion that the units would be the centre's "eyes and ears". Since this is problematic if the internal auditors are to be integrated and trusted advisors to the head of budgetary institutions on how to manage risks, it is important that the role of the representative of the Ministry of Finance is limited to cases where it is absolutely necessary.

Relation between internal and external audit

150. As envisaged by Article 21 of the Law on the State Control and Article 8 of the Law on Internal Control and Internal Audit, the national audit office shall co-operate with the internal audit services and

exchange information in order to avoid the duplication of work. The Requirements on National Audit of the Republic of Lithuania (State Auditor General Order of 31 February 2002 No. V-26), Paragraph 79, states that an external auditor can use the results of an internal auditor's work in reducing the extent of its audit procedures. This can be done if it is decided that the results of an internal auditor's work can be important in order to achieve the external audit's targets and only after getting assurance that the internal auditor's working methods are proper and that the conclusions are based on sufficient, reliable and proper information.

151. Coordination and collaboration between internal and external auditors clearly is an issue which needs further attention. At the planning stage, coordination seems to be working well. The IAUs share their annual audit programmes with the State Control. Further, the head of an internal audit unit submit an annual internal audit report to the State control within 10 calendar days after co-ordination with the head of the public legal entity and the annual reports.

152. Collaboration during the actual audit work appears to be a bigger issue. To resolve possible tensions between the internal and external audit function a clear understanding of roles and responsibilities must be established and active collaboration triggered.

Conclusions

153. The Lithuanian system of accounting, internal audit, and financial control, and external audit seems to be working well. Better cooperation and collaboration between internal and external auditors could add value to the audit and control of state activities. However, the role of the internal audit service must be clearly understood and strengthened. As the Lithuanian system of internal audit focuses on the function of providing internal management advice, the external relations should not be overstressed.

154. *The shift towards accruals in accounting and financial reporting will enhance the transparency of the government's actions* by improving the tracking of commitments and long-term liabilities and thereby strengthening fiscal discipline. A clear understanding of the benefits of the introduction of accrual accounting for each stakeholder should be proactively mainstreamed by the Ministry of Finance. The establishment of a central asset management authority would ease the introduction of accrual accounting and also improve the management of state property.