

Budgeting in Lithuania

by

Ian Hawkesworth, Richard Emery, Joachim Wehner and Jannick Saegert*

This report covers the budget process in Lithuania. It discusses the four phases in separate sections: budget preparation, legislative approval, budget execution, and accounting and audit. Each section ends with a list of recommendations. The new strategic planning process should strengthen the policy focus of the budget at the level of the line ministries and could be accompanied by a more robust medium-term fiscal framework. All public-private partnerships (PPPs) should be subject to approval by the Ministry of Finance, and municipal use of PPPs should be closely monitored. Parliament operates a well-designed and orderly review process but parliamentary involvement can be further developed. Budget execution is based on sound rules and procedures, and the full development of the programme structure could be accompanied by more flexibility. The shift towards accruals in accounting and financial reporting will enhance transparency and should strengthen fiscal discipline.

JEL classification: H610

Keywords: budgeting, Lithuania, performance management, medium-term expenditure framework, MTEF, financial management, budget preparation

* Ian Hawkesworth (lead) is an administrator in the Budgeting and Public Expenditures Division of the Public Governance and Territorial Development Directorate of the OECD. Richard Emery is former Assistant Director for Budget Review, United States Office of Management and Budget. Joachim Wehner is lecturer in public policy at the London School of Economics. Jannick Saegert is an economist at German Technical Cooperation (GTZ).

Preface

This review of the Lithuanian budget procedure was carried out as part of the work programme of the OECD Working Party of Senior Budget Officials. 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, the parliament, the Ministry of Finance and other line ministries, and the State Control Office (the national audit 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 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.

Summary of recommendations

Budget formulation

Budget formulation in Lithuania is a modern effective practice. Decisions appear to be made at appropriate levels with increasing focus on programmes and performance. The system produces generally transparent information, with quarterly reports on budget implementation. The pending reforms seem likely to strengthen the policy content and focus of the budget and to provide greater control to government ministers. However, care should be taken not to make the system too process-heavy and not to undermine top-down budgeting elements of the current system.

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.

It would be beneficial to develop strategic planning in the context of the medium-term fiscal framework. 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 less fixed ministerial ceilings 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.

Lithuania could consider integrating the new strategic planning 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 parliament in a pre-budget report. By seeking approval from the parliamentarians on a multi-year plan, the structure could be more stable. The plan could continue to be adjusted annually to reflect new policy developments or economic realities, but within the agreed overall ceilings.

It would increase transparency to present consolidated general government budget totals. The current budget of Lithuania does not present a general government consolidated deficit including the 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. In addition, the transparency of the budget would be enhanced by integrating the social insurance funds further in the budget documentation.

The budget powers of the line ministers should be increased. Lithuania is in the process of consolidating programmes and rationalising 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.

The budget justification materials could be simplified to increase transparency. The chair 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.

The State Treasury should be used for the cash management of the social insurance funds, and these funds should be subjected to the same requirements of budget execution, accounting and auditing as other government expenditures.

All public-private partnerships (PPPs) should be subject to approval by the Ministry of Finance. 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 resources 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 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

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 Budget and Finance Committee (BFC) has 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 may serve to further develop parliamentary involvement in the budget process.

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” (OECD, 2002). 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.

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. This would be especially relevant if the time allocated to the parliament is extended. 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.

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 parliament, and high-quality information presented in an accessible format is an important prerequisite for such a shift.

Budget execution

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 appropriation managers, the government has a high degree of discretion in managing the implementation of the budget. However, the execution rules limit the flexibility of 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.

Arrears need to be closely scrutinised. 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. The Law on the Budget Structure could thus be amended so that the deficit restriction for municipalities applies *ex post* as well as *ex ante*; alternatively, transparency regarding this issue should be strengthened.

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

The Lithuanian system of accounting, internal audit and financial control, and external audit seems to be working well. Better co-operation 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 unit as risk advisor 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.

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. Importantly, budgeting will remain on a modified cash basis. It is important that the benefits of introducing accrual accounting are made clear for users in order to ensure a successful implementation. The establishment of a central asset management authority would ease the introduction of accrual accounting and also improve the management of state property.

1. Introduction

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

1.1. Basic information on Lithuania

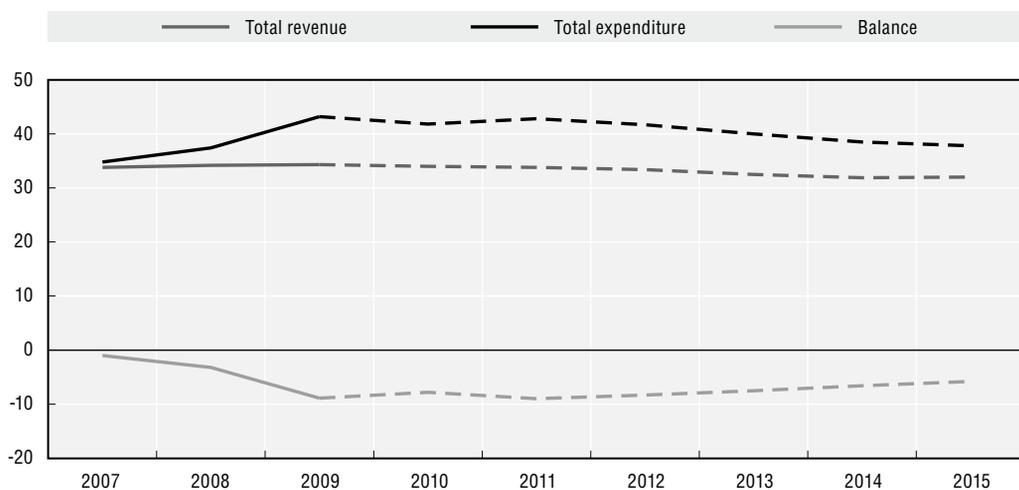
Lithuania is a parliamentary democracy. The Constitution was adopted in October 1992 and last amended on 13 July 2004. The head of state is President Dalia Grybauskaitė (since 12 July 2009) and the head of the government is Prime Minister Andrius Kubilius (since 27 November 2008). The President is elected by popular vote for a five-year term and is eligible for a second term. Presidential elections were last held in May 2009 and are next to be held in May 2014. The Prime Minister is appointed by the President on the approval of the parliament, and the Council of Ministers is appointed by the President on the nomination of the Prime Minister. The parliament (Seimas) is unicameral and has 141 members elected for a four-year term. Parliamentary elections were last held on 12 and 26 October 2008 and are next scheduled for October 2012.

On 11 March 1990, Lithuania became the first of the Soviet republics to declare its independence. Lithuania subsequently restructured its economy for integration into western European institutions; it joined both NATO and the EU in the spring of 2004. Lithuania's territory amounts to 65 300 square kilometres and shares borders with Belarus, Latvia, Poland and Russia (Kaliningrad). The population is majority Lithuanian (84%) but also contains ethnic minorities: Polish (6.1%), Russian (4.9%), Belarusian (1.1%), other (3.9%) (CIA World Fact Book, 2009).

1.2. Overview of fiscal position

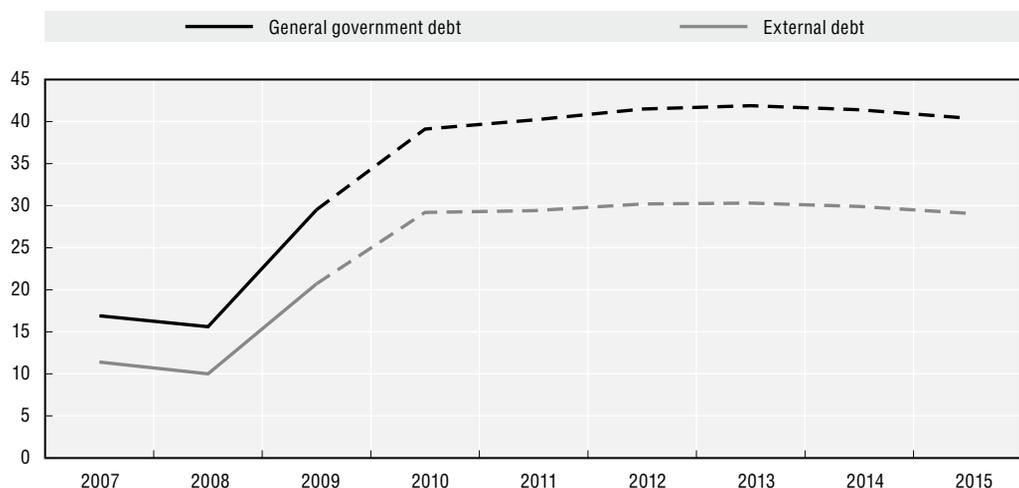
Lithuania, like most of the EU accession countries, experienced strong economic growth and a strengthening of the budgetary position in the period leading up to the global financial crisis in 2008. Thus, in 2007, general government debt stood at 16.9% of GDP and the budget deficit was 1%. However, the crisis hit Lithuania hard: GDP growth slowed from 9.8% in 2007 to 2.8% in 2008, and contracted by 14.8% in 2009. The concomitant effect was a widening of the deficit to -8.9% in 2009 and a jump in general government debt to 29.5% in 2009 (see Figures 1 and 2). Compared to the “old” EU countries (EU15), the Lithuanian financial crisis experience was a contraction in GDP of 14.8% as compared with 4.3% in EU15 (see Table 1). However, growth projections for Lithuania and the EU10/12 accession countries are more positive than for the EU15. The EU accession countries are expected

Figure 1. **Expenditures, revenues and balance of general government (% of GDP)**



Source: IMF (2010), “Republic of Lithuania: 2010 Article IV Consultation – Staff Report”, IMF Country Report No. 10/201, July, International Monetary Fund, Washington DC.

Figure 2. **General government public debt (% of GDP)**



Source: IMF (2010), “Republic of Lithuania: 2010 Article IV Consultation – Staff Report”, IMF Country Report No. 10/201, July, International Monetary Fund, Washington DC.

to grow by 2.2% in 2010 and 3.3% in 2011 as a whole, and Lithuania is expected to closely follow this development as compared with 0.9% and 1.6%, respectively, for the EU15. In the longer term, the Lithuanian economy is expected to expand by more than 3%, pointing to a slowing of the catch-up process to achieve EU15 living standards.

In 2009, Lithuania breached the Stability and Growth Pact criteria of a maximum 3% deficit and was placed in the excessive deficit procedure of the SGP. The EU Commission estimates that the Lithuanian deficits in the coming years will be substantially above the benchmark (7.8% of GDP in 2010, falling to 5.8% of GDP in 2015). General government debt is expected to reach 39.1% in 2010 and then hover around 40% in the coming years. Lithuania is planning to remedy the situation of excessive deficit by 2012, as required by the Commission (European Commission, 2010). Lithuania has taken decisive measures to contain the deficit and is planning additional initiatives.

Table 1. Growth of real GDP

Per cent of change on previous year

	2007	2008	2009	2010 ¹	2011 ¹	2012 ¹	2013 ¹	2014 ¹	2015 ¹
EU15 (older) ²	2.8	0.3	-4.3	0.9	1.6				
EU10/12 (accession) ³	5.8	3.0	-3.0	2.2	2.8				
Lithuania	9.8	2.8	-14.8	2.1	3.3	2.6	3.2	3.5	3.6

1. Forecasts.

2. EU15: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom.

3. EU12: Bulgaria, Czech Republic, Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovak Republic, Slovenia.

Source: Eurostat National Accounts Database; IMF (2010), "Republic of Lithuania: 2010 Article IV Consultation – Staff Report", IMF Country Report No. 10/201, July, International Monetary Fund, Washington DC.

1.3. Response to the international financial crisis

The Lithuanian authorities implemented fiscal consolidation in the order of 10% of GDP in the budgets for 2009 and 2010 (IMF, 2010). The effort was primarily expenditure-led with initial focus on broad-based cuts and later more targeted and progressive reductions in public sector wages, pensions and benefits. However, about 40% of the consolidation in the 2009 and 2010 budgets is temporary as the wage cuts are set to expire at the end of 2010 and pension cuts in 2011. Steps to increase VAT and excise rates and broaden their base played a complementary role in the adjustment (see Box 1).

Lithuania is benefiting from the global recovery, with higher exports playing a crucial role in stabilising the economy. However, domestic demand is expected to remain subdued amid high unemployment, falling incomes and weak credit prospects. Confidence in the banking system has been maintained and the sizeable fiscal adjustment has been rewarded with continued market access, providing crucial support to Lithuania's long-standing currency board arrangement. However, the crisis has left three key policy challenges:

- The fiscal deficit remains high.
- Public debt is growing rapidly, leaving Lithuania reliant on external financing.
- There are asset quality challenges for the financial sector.

In their convergence programme, the Lithuanian authorities have emphasised that the adjustment to meet the 3% deficit benchmark by 2012 should be broad-based, that various structural reforms are under way, and that increased EU funds absorption is being

targeted at programmes that create jobs and promote growth. The time frame would seem appropriate, as a more gradual adjustment risks undermining market confidence as well as the objective of euro adoption. More importantly, achieving these targets would substantially lower public debt and financing needs, in addition to saving up to 1.33% of GDP in interest costs over the medium term. Priority reform areas include improving the fiscal framework (as discussed in the following sections), reforming the social security system, restoring the financial viability of the pension system (such as increasing the retirement age and linking it to longevity), exploiting new revenue sources and closing existing tax loopholes, and implementing structural reforms in the education and health sectors (IMF, 2010).

Box 1. Response to the global financial crisis

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 LTL 3.2 billion (Lithuanian litai) in 2009. 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 LTL 475 to LTL 450 and of the basis for the salaries of employees (who work under labour contracts) from LTL 128 to LTL 122;
- 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 (USD 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 had been 5.9% a year earlier)
 - transport benefits cut.

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.

2. Budget formulation process

2.1. Structure of the budget

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

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 government ministries and other budgetary institutions, including state transfers to the municipalities. The municipal budgets are approved by the municipal councils, and cover municipal revenues and funds transferred from the state for delegated functions.

The government is structured into 14 ministries with budgetary institutions under their supervision. There are 212 budgetary institutions. The head of each budgetary institution 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. Most ministries have four to five appropriation managers, responsible for their larger organisations but with clear accountability to the minister. Each appropriation manager is responsible for a number of programmes. Lithuania is in the process of consolidating appropriation managers and programmes to provide more flexibility to ministers and to make lines of responsibility clear so that appropriation managers answer to a minister.

Box 2. Budgetary institution and appropriation manager

A state budgetary institution in Lithuania is a public entity that performs state functions and is financed from state or social insurance fund budgets as approved by the parliament. An appropriation manager is the head of a budgetary institution. In ministries, the appropriation managers are the ministers or the persons authorised by them. In courts, the appropriation managers are the presidents of the courts.

The Lithuanian budget has six off-budget funds at the central government level: State Social Insurance Fund, State Compulsory Health Insurance Fund, Privatisation Fund, Reserve (Stabilisation) Fund, Ignalina Nuclear Power Plant Decommissioning Fund, and Guarantee Fund. The funds' 2010 expenditures are listed in Table 2.

The social insurance system (based on the pay-as-you-go principle) consists of two funds: the State Social Insurance Fund and the State Compulsory Health Insurance Fund. Its major source of income is from contributions paid by employers and employees. 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 two funds have independent budgets that are not included in

the state or municipal budgets, but put to parliament around the time of the presentation of the executive's budget proposal. The social insurance budget is developed according to benefits authorised in the social insurance laws based on demographic assumptions for one year. Both revenues and expenditures continue under substantive law. The combination of the financial crisis and structural problems has 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 programme foresees that the social insurance fund will account for 12.4% of GDP in 2010, with a deficit of 2.9%.

The central government Privatisation Fund and municipal privatisation funds were not included in the budget on the rationale that their revenues come from the sale of assets that were privatised and that their expenditures were used to support privatisation costs. The revenue of the Ignalina Nuclear Power Plant Decommissioning Fund comes from the sale of energy and a grant from the European Bank for Reconstruction and Development, and its expenditures concern the closing of the Ignalina nuclear power plant. The Guarantee Fund, which provides payments to the employees of undertakings under bankruptcy proceedings, is also off-budget. In addition, there is the Reserve (Stabilisation) Fund; it is not clear why this fund is not included in the budget.

Table 2. Expenditures of Lithuania's off-budget funds, 2010

Name of the fund	Expenditures in LTL millions
State Social Insurance Fund	12 600
State Compulsory Health Insurance Fund	4 000
Privatisation Fund	112
Reserve (Stabilisation) Fund	350
Ignalina Nuclear Power Plant Decommissioning Fund	139
Guarantee Fund	82

Source: Lithuanian Ministry of Finance.

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 programmes 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 3.

Table 3. EU funds in the Lithuanian budget (LTL millions)

	EU funds in the Lithuanian budget	Lithuanian contributions to the EU
2004	1 390	412
2005	2 003	739
2006	2 162	835
2007	3 481	929
2008	3 481	1 151
2009	5 910	1 083
2010 (estimate)	7 892	1 030

Source: Lithuanian Ministry of Finance.

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

The deficit reported to the EU in the convergence report 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.

2.2. Fiscal rules and strategy for adopting the euro

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 European Monetary System; and nominal long-term interest rates must not be more than 2% higher than in the three member states with lowest inflation.

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.

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) which are 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 at 39.8%, and in 2012 at 41%. Lithuania's goal is to achieve sustainable levels of public debt through constrained fiscal policy and euro adoption in 2014.

2.3. Budget formulation cycle and related issues

2.3.1. Budget timetable

The legal framework for the budget is based on the Constitution, the Law on the 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 4).

The formulation cycle begins with the definition of government priorities. This is done by reviewing the priorities defined in prior years and revising them where appropriate. In February, the Council of Ministers 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.

Table 4. 2009 and 2010 schedules for budget preparation

2009 schedule		2010 schedule	
February	Guidance for preparation of the budget.	February	Guidance for preparation of the budget.
May	Government approves ceilings.	March-April	Unrestricted “what they need” ministerial requests.
August	Ministry submissions.	April-May	Negotiations among ministers, Prime Minister and Minister of Finance on ministerial ceilings.
September	Finalisation of ministries’ appropriations.	May or June	Ministry allocations and priorities approved.
September	Budget submitted.	September	Budget submitted.

Under the system used over the past few years, in May the Budget Department of the Ministry Finance prepared preliminary allocations for the state budget taking into account the strategic goals, macroeconomic projections, preliminary limits on public investment for three years 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 appropriation managers. Appropriation managers then submitted their budget proposals by early September, followed by negotiations between the Ministry of Finance and appropriation managers in order to resolve differences between their proposals and the approved allocations. In practice, this meant that ceilings for some ministries would be increased compared to the initial ceiling, but at a marginal level. 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.

2.3.2. Strategic planning

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 judgment of “what they need”. How “what they need” will be defined, particularly in the context of stringent budget constraints, is not clear.

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.

It is not clear how the gap between “what they need” and government-wide constraints will be resolved, given that top-down ceilings will not be introduced at an early stage of the process. 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 programmes, growth in debt service and social insurance programmes, 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. It should be noted, however, that many of these issues will be resolved as 2010 unfolds and the new model is concretely implemented.

2.3.3. Macroeconomic forecasting and assumptions

Macroeconomic 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 third 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 its 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 of public finance. The ministry does not compare its forecast to private sector forecasts or to those of the EU, IMF or OECD. On the other hand, forecasts of other institutions do provide useful inputs on selected variables.

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 developed the medium-term forecasts in addition to the long-term projections. The ministry was perceived as being overly optimistic so as to extract more resources for investment. The central bank develops its own macroeconomic and budgetary forecast which is published. When they are submitted to the government or the parliament, all tax changes are accompanied by forecasts of fiscal impact covering the three upcoming years.

2.3.4. Medium-term frameworks

The Constitution and the Law on the Budget Structure provide for the budget to be approved for one calendar year and to include current services 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. Parliament makes a non-binding resolution concerning the three-year estimates. Investment programmes are approved on an annual basis, and the budget documentation includes three-year estimates at project level.

Multi-year estimates are based on current services in nominal terms, as 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.

Some OECD countries have more disciplined medium-term budgeting than Lithuania. In these countries, binding expenditure ceilings, by ministry, are fixed for a certain period. The expenditure estimates, based on current services, are used to investigate whether ministerial programme appropriations have to be cut in order for the ceilings to be

respected. The medium-term budgeting of the Netherlands and Sweden could provide inspiration in this regard.

2.3.5. Top-down budgeting

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 the 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 programmes 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 minimise the disruption to programmes and ministry operations, and thus make the cuts more efficient.

2.3.6. Performance and results

The government submits information on the evaluation criteria presented in appropriation managers' strategic plans together with the submission of the budget. 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 programme 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 authorised under the budget, and any amounts carried forward under EU programmes or authorised special programmes. 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 (State Control Office) audits the performance of selected programmes each year.

2.3.7. The new strategic planning initiative

The new strategic planning initiative is intended to increase the attention of the ministers on programme results and to strengthen programme review on an ongoing 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 subordinate appropriation managers will be expected to monitor and assess whether institutions achieve strategic goals and implement programmes, and whether the employees carry out effectively the tasks delegated to them. The Ministry of Finance will monitor and analyse the performance of the appropriation managers and the use of funds from the state budget. Information on performance is expected to be more transparent, making it easier for the government to attain its short and long-term goals, for 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. This is an ambitious reform that will need to be adjusted in light of experiences.

2.3.8. Investment budgets

The budget of Lithuania includes a state investment programme providing information on the acquisition of assets or expenditures of funds to increase the value of current tangible and intangible assets (above LTL 1 000). The investment programme includes projects financed from both the state budget and EU funds. The programme in the budget consists of investment projects describing ongoing and proposed individual investment projects necessary for the programme 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 programme is organised 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.

Box 3. 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. Capital budgeting can also mean separate decisions which are then combined into a single budget.

Thirteen OECD countries have separate capital and operating budgets, while 14 have integrated capital and operating budgets.¹ 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.

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

1. Based on Question 27: "Is the central government budget split into a capital and operating budget?" in the 2007 *OECD Budget Practices and Procedures Database* (www.oecd.org/gov/budget/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: The 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.

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.

The Investment Division, located in the Budget Department of the Ministry of Finance, 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 ongoing projects or EU initiatives.

2.3.9. Guarantees and loans

The Law on the Approval of the Financial Indicators of the State Budget and Municipal Budgets 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 Section 4.7.

2.3.10. Public-private partnerships (PPPs)

A law requiring central government PPP agreements to be approved by the Ministry of Finance came into effect on 1 January 2010. Given the fiscal constraints caused by the financial 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 scrutinise PPP proposals and to oversee the risks of creating such financing vehicles. The Ministry of Finance favours the imposition of numerical limits on PPP commitments. The Ministry of Economy has a staff group promoting financing of investment programmes using PPPs which is appropriately removed from the scrutiny unit. In early 2010, the central government had no PPPs (excepting concessions), although feasibility studies were under way for six such projects. There is a longer history of using concessions, which must be submitted to the Ministry of Finance for review.

While the interest of the central government in PPPs is relatively recent, PPPs have been used by local authorities for a number of years. The State Control 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 as the central government does not have the legal authority to oversee and veto subnational PPPs, no clear data are available. 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, the 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.

2.3.11. Budget formulation within the ministries

The Ministry of Finance provides top-down ceilings for each appropriation manager. Many ministries have several appropriation managers responsible for a number of programme areas. Performance goals are usually tied to programme 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 on the basis of programme strategic plans. In the budget preparation stage, the minister may shift funds around within his/her area across programmes and appropriation managers. The Minister of Transport controls the number of employees within the wage appropriation. The ministry has an Economy and Budget Division and a Strategic Planning Division which are responsible for budgeting and planning within the ministry.

In the Ministry of Education and Science, the ministry prepares the methodology for calculating the “student basket” used to allocate state funds to the municipalities on the basis of student population, class size, qualification of teachers, urban *versus* rural geography, and other factors. The approximately 1 300 elementary and secondary schools are funded as “autonomous functions” through the municipalities. For higher education, the budget starts with 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 regarding 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 14 universities and 14 scientific institutions, some of which are merging with the universities. Universities can accept both funded students and fee-paying students.

2.4. Budget documentation

The budget for Lithuania is a well-organised document, legislating significant budget policies, approving budget allocations by ministry and appropriation manager, and providing substantial information on programmes, financing and investments in appendices to the budget. 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;
- parliamentary 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 the “student basket” and social benefits;
- net borrowing limits;
- guarantee limits.

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. (programmes 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 Privatisation Fund and Reserve (Stabilisation) Fund for 2010.
- Annex 8: State investment programme for 2010-12.
- Annex 9: Estimate of the Ignalina Nuclear Power Plant Decommissioning Fund for 2010.

The decree is promulgated by the government after parliament has approved the budget.

2.5. Organisation of the Ministry of Finance

The Budget Department of the Ministry of Finance has a total staff of 50 and is organised 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 programmes,
 - education, culture and social sectors.

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 LTL 1 000, a total of over a thousand projects a year.

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 macroeconomic forecasting, co-ordinating economic policy with the EU, and drafting Lithuania's convergence programme. 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.

2.6. Conclusions

Budget formulation in Lithuania is a modern effective practice. Decisions appear to be made at appropriate levels with increasing focus on programmes and performance. The system produces generally transparent information, with quarterly reports on budget implementation. The pending reforms seem likely to strengthen the policy content and focus of the budget and to provide greater control to government ministers. However, care should be taken not to make the system too process-heavy and not to undermine top-down budgeting elements of the current system.

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.

It would be beneficial to develop strategic planning in the context of the medium-term fiscal framework. 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 less fixed ministerial ceilings 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.

Lithuania could consider integrating the new strategic planning 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 parliament in a pre-budget report. By seeking approval from the parliamentarians on a multi-year plan, the structure could be more stable. The plan could continue to be adjusted annually to reflect new policy developments or economic realities, but within the agreed overall ceilings.

It would increase transparency to present consolidated general government budget totals. The current budget of Lithuania does not present a general government consolidated deficit including the 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. In addition, the transparency of the budget would be enhanced by integrating the social insurance funds further in the budget documentation.

The budget powers of the line ministers should be increased. Lithuania is in the process of consolidating programmes and rationalising 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.

The budget justification materials could be simplified to increase transparency. The chair 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.

The State Treasury should be used for the cash management of the social insurance funds, and these funds should be subjected to the same requirements of budget execution, accounting and auditing as other government expenditures.

All public-private partnerships (PPPs) should be subject to approval by the Ministry of Finance. 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 resources 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 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.

3. Legislative approval

Box 4. The Lithuanian parliament

The parliament (*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 parliament. In the 2008 elections, ten parties gathered enough votes to achieve parliamentary representation.

The election results and percentage of the vote by party are: Homeland Union-Lithuanian Christian Democrats (TS-LKD) 19.7%, National Revival (TPP) 15.1%, Order and Justice Party (TT) 12.7%, Social Democratic Party (LSDP) 11.7%, Civil Democracy Party (PDP) 9%, Liberal Movement 5.7%, LCS 5.3%, Electoral Action of Lithuanian Poles (LLRA) 4.8%, Lithuanian Farmers' Union 3.7%, New Union (NS) 3.6%, and other 8.7%. These parties form parliamentary groups.

Parliament 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 parliament. 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. Parliament decides the exact number of committees. Following the 2008 elections, it constituted 15 committees.

3.1. The legal framework

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 parliament 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 parliament 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 parliament 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 period of only 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”.

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 must 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 institution), 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.

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.

There are restrictions on the powers of the parliament 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 without changing those laws.

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 one-twelfth 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 one-twelfth 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.

During the budget year, the parliament 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).

3.2. The parliamentary process

There is no formal pre-budget consultation with the parliament, 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 parliament, 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 parliament, it is distributed to all committees and parliamentary groups. The Minister of Finance has to address the parliament at its next sitting (see Table 5).

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 Statute of parliament (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.

Table 5. Timeline of the parliamentary process

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

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.

The first deliberation on the draft budget in the parliamentary plenary 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 Statute of parliament 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 parliament sets a date for the approval of the state budget.

Prior to the approval session, new proposals and amendments can be submitted to the government. If necessary, the government can be allotted up to ten days to revise the budget. At the final budget session, the parliament 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 parliament. 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 ten days following this rejection.

3.3. The impact of parliament

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.

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 parliament 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 6 for practices of OECD countries in this respect.

Table 6. 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 months	0
1 month after	1

Source: Responses of 30 OECD member countries from the 2007 OECD Budget Practices and Procedures Database (www.oecd.org/gov/budget/database).

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

parliament may require additional resources for independent analysis of the draft budget and of any proposals generated during the review process.

The increase of analytic capabilities is a key trend across OECD countries, as indicated in Table 7. 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.

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 parliament 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.

Table 7. **Legislative budget offices in OECD countries**

Is there a specialised budget research organisation?	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 [10], 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, Luxembourg, New Zealand, Norway, Portugal, Spain, Switzerland, Turkey, United Kingdom.	Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Luxembourg, 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 Budget Practices and Procedures Database and other data.

3.4. Conclusions

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 Budget and Finance Committee (BFC) has 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 may serve to further develop parliamentary involvement in the budget process.

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.

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. This would be especially relevant if the time allocated to the parliament is extended. 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.

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 parliament, and high-quality information presented in an accessible format is an important prerequisite for such a shift.

4. Budget execution

4.1. Organisation of budget execution

Following parliamentary approval of the budget, the government issues a decree that contains a more detailed breakdown of expenditures. While the parliament approves totals for appropriation managers, 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.

The system of financial control foresees three major tasks: i) *ex ante* financial control; ii) ongoing control; and iii) *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 entity, and includes the task of ensuring that financial commitments remain within the approved budget appropriations. However, the system of controlling commitments does not produce centralised 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.

4.2. Revenue uncertainty and the Reserve Fund

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. When cutting expenditures in light of revenue shortfalls is necessary, the funds to the appropriation managers are reduced by the amounts equal to the shortfall.

In addition, the Law on the Budget Structure allows the establishment of a Reserve (Stabilisation) 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 the previous section). 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.

4.3. Reallocation and carry-overs

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 requires government approval. Finally, the shifting of funds between different appropriation managers requires parliamentary approval.

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.

4.4. Cash and debt management

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.

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, the Customs

Department and the 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.

On the expenditure side, quarterly allocations of appropriations by economic classification are complemented with monthly forecasts as well as day-to-day data. 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.

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.

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.

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, the Nordic Investment Bank and the 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. Overall, the cash management practices seem to work in a sufficient manner.

4.5. Procurement

The Public Procurement Office is assigned to the Ministry of Economy. 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 public procurements above a certain threshold. The office also carries out controls using a risk-based approach that relies on numerical thresholds and 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.

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 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 to 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.

4.6. The structure of public administration and service delivery

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.

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.¹ 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, but additional reductions are envisioned.

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. There are 25 000 statutory civil servants with special status (diplomats, police and customs officers, and officers of the national defence system) and 24 000 employees with contracts according to the Labour Code.

The Law on Civil Service, 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 Law on Civil Service, 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.

4.7. Fiscal relations across levels of government

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 10 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 2 700 inhabitants.

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 "student basket". In 2010, municipalities planned to spend 11.8% of their budgets on delegated functions, 32.9% on the "student basket" and 55.3% on autonomous functions.

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 8. Components of municipal finance in Lithuania, 2010

	In LTL millions	Per cent of total
Expenditures: selected autonomous/local functions (3-5 largest)		
Education	1 549.7	43.2
General government services	825.4	23.0
Recreation, culture and religion	305.4	8.5
Social protection	279.1	7.8
Expenditures: selected delegated functions (3-5 largest)		
Education	1 986.1	73.4
Social protection	580.3	21.4
Public order and safety	48.9	1.8
Economic affairs	39.8	1.5
Revenues (significant revenue sources)		
Transfers	2 901.5	46.1
PIT allocation from central government	2 472.5	39.3
Property taxes	321.3	5.1
Other taxes	593.9	9.5
Total revenues	6 289.3	100

Source: Lithuanian Ministry of Finance.

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 Ministry of Finance 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.

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 LTL 240 million, 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.

4.8. Conclusions

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 appropriation managers, the government has a high degree of discretion in managing the implementation of the budget. However, the execution rules limit the flexibility of 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.

Arrears need to be closely scrutinised. 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. The Law on the Budget Structure could thus be amended so that the deficit restriction for municipalities applies *ex post* as well as *ex ante*; alternatively, transparency regarding this issue should be strengthened.

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.

5. Accountability, accounting and audit

5.1. Accounting basis

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 ESA95 standards. Given that each budgetary institution manages its own bookkeeping, end-of-year accounts are first prepared at that level.

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.

In 2005, the parliament 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. It should be emphasised, however, that the budget as presented to parliament and approved will remain on a modified cash basis (i.e. without depreciation for capital).

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.

5.2. Reporting

The State Treasury Department prepares annual and quarterly budget execution reports. The latter must be submitted within 30 days after the end of the quarter. From July 2010, the Ministry of Finance website started disclosing quarterly budget expenditure execution reports.

The financial statements have to be submitted by the heads of budgetary institutions to the Ministry of Finance. The State 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 parliament an audited financial statement by 1 October. The audited financial statement will be primarily scrutinised by the Budget and Finance Committee. The Statute of the parliament also specifies 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.

5.3. External audit

The State Control (the 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.

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 parliament. 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.

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 parliament approves the appropriations for the State Control budget unchanged (see Table 9). However, the State Control was also 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 parliamentary Audit Committee.

The Head of the State Control is appointed by the parliament upon recommendation of the President of Lithuania for a 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 organised 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.

Table 9. **Budgeting for the supreme audit institution (SAI) 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 SAI prepares its budget and submits it directly to the legislature for approval.	4
Other	3

Source: Question 30 in the 2007 OECD *Budget Practices and Procedures Database* (www.oecd.org/gov/budget/database).

The competencies of the State Control cover a wide range of state funds, including social security funds. The State Control carries out an annual audit of: i) the implementation of the state budget; ii) the use of state funds; iii) the management, use and disposal of state property; iv) the implementation of the budget of the State Social Insurance Fund; v) the

implementation of the budget of the State Compulsory Health Insurance Fund; vi) the fund management institutions and beneficiaries of EU funds; and vii) the use of state budget funds allocated to municipal budgets and the use, management and disposal of municipal property.

The annual audit agenda is prepared and decided by the Head of the State Control after assessment of recommendations received by the parliamentary 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 10). Each ministry and each municipality (state budget funds over LTL 50 million) 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.

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.

The staffing level has steadily increased in the last years (see Table 10) although, given the work programme, a thorough assessment of whether staffing levels are sufficient may be envisaged. As of 2009, there were about 355 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.

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

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

Table 10. Key indicators of the supreme audit institution

	2007	2008	2009
Staff	335	344	355
<i>of which</i> auditors	n.a.	59%	66%
Financial audits	97	110	162
<i>of which</i> audit of state budget appropriations	59 (81% of total funds)	72 (82% of total funds)	125 (81.6% of total funds)
<i>of which</i> audit of subsidies from the state budget to the local level	24 (57% of total funds)	23 (47% of total funds)	23 (52% of total funds)
<i>of which</i> mandatory audits of EU structural assistance	8	6	7
Performance audits	23	28	29
Recommendations implemented by audited bodies	91%	79%	87%

Source: Compiled from annual reports of the State Control, 2007-09 (www.vkontrole.lt/en/activities_annual.shtml).

The Law on the State Control requires the State Control to submit to the Audit Committee within five 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 parliament 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 parliament. The Head of the State Control is further entitled to propose to the parliament recommendations for improving legal acts and to give a separate opinion on government regulations. The main audit report (annual audited financial statement) is presented to the parliament approximately ten months after the end of the financial year.

The follow-up mechanisms by the parliament deserve strengthening. The parliament does not vote on the audited financial statement on budget execution. However, parliamentary oversight is executed on an ongoing basis by the Audit Committee.² 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 on how the recommendations are implemented. Other committees as well may consider financial and performance audit reports.³ 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 parliament (Audit Committee) and discussed with the press.

Compliance is perceived as good. Internal surveys by the State Control find that more than 80% of its 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 need more time to change.

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

Audited final accounts are published on the website of the State Control. All reports produced by the State Control are made publicly available on the website. Committee meetings are open to NGOs and the press. Critical reports may be promoted by (justifiable) public awareness-raising measures.

5.4. Internal audit

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 states that an internal audit unit (IAU) “shall be set up in the Office of the President of the Republic, Office of the Parliament 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 IAUs at municipal level. According to the available data, 374 internal auditors worked in the central government on 1 January 2009.

The main tasks of internal audit units are to: i) assess the legality of the activities of a public legal entity; ii) advise the head of a public legal entity on the reduction of risk factors; iii) provide recommendations on the internal control mechanisms; iv) assess strategic action and programme plans as well as the effective, efficient and economic use of State and municipal assets; and v) assess the use of EU funds. Henceforth, the major role of the 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.

Functional independence of each IAU is granted by the Law on Internal 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.

The Lithuanian system of internal audit and internal control is a mixed system with mainly decentralised IAUs but also allowing for centralised 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 harmonisation unit, reviewing all internal audit reports and compiling an annual internal audit summary report which is presented to the Budget and Finance Committee of the parliament.

5.5. Relation between internal and external audit

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 units 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.

Co-ordination and collaboration between internal and external auditors clearly is an issue which needs further attention. The IAUs share their annual audit programmes with the State Control. Further, the head of an internal audit unit submits an annual internal audit report to the State Control within ten calendar days after co-ordination with the head of the public legal entity and the annual reports. However, it would seem difficult for internal auditors to be both the trusted advisors on risks of the top management of budgetary institutions as well as being integrated and co-ordinated with the external auditors. In order to add the most value, it would be most appropriate to emphasise the role as risk advisor to senior management.

5.6. Conclusions

The Lithuanian system of accounting, internal audit and financial control, and external audit seems to be working well. Better co-operation 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 unit as risk advisor 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.

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. Importantly, budgeting will remain on a modified cash basis. It is important that the benefits of introducing accrual accounting are made clear for users in order to ensure a successful implementation. The establishment of a central asset management authority would ease the introduction of accrual accounting and also improve the management of state property.

Notes

1. 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.
2. 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).
3. Other parliamentary 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).

Bibliography

- Central Intelligence Agency (2009), *CIA World Fact Book*, <https://www.cia.gov/library/publications/the-world-factbook/>.
- European Commission (2010), "Public Finances in EMU 2010", *European Economy* No. 4, <http://europa.eu>.
- IMF (2010), "Republic of Lithuania: 2010 Article IV Consultation – Staff Report", *IMF Country Report* No. 10/201, July, International Monetary Fund, Washington DC.
- OECD (2002), "OECD Best Practices for Budget Transparency", *OECD Journal on Budgeting*, Vol. 1, No. 3, pp. 7-14.
- Plikšnys, Arunas et al. (2009), "Transparency in Education in Eastern Europe", Open Society Institute.
- Seimas of the Republic of Lithuania (n.d.), "Legal Acts of the Republic of Lithuania", www3.lrs.lt/dokpaieska/forma_e.htm.
- State Control (2009), *Annual Report*, State Control Office, Vilnius.