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ACRONYMS AND ABBREVIATIONS

BDL	Banque du Liban – Central Bank of the Republic of Lebanon
CDR	Council for Development & Reconstruction
CFAA	Country Financial Accountability Assessment
CI	Central Inspection
COA	Court of Accounts
COM	Council of Ministers
DENOS	Dépenses Éxecutées Non-Ordonées
DG	Director General
DMFAS	Debt Management & Financial Analysis System
EBF	Extra Budgetary Fund
EDL	Electricite de Liban
EU	European Union
FAD	Fiscal Affairs Directorate (IMF)
FFI	Foreign-Financed Investments
FMIS	Financial Management Information System
GDP	Gross Domestic Product
GFMIS	Government Financial Management Information System
GFS	Government Financial Statistics
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IIA	Institute of Internal Auditors
IMF	International Monetary Fund
INTOSAI	International Organization of Supreme Audit Institutions
INTOSAI AS	INTOSAI Accounting Standards
IPSAS	International Public Sector Accounting Standards
ISA	International Standards on Auditing
IT	Information Technology
LL	Lebanese Pound (Lira)
MOF	Ministry of Finance
NSSF	National Social Security Fund
OBL	Organic Budget Law
PAL	Public Accounting Law
PEM	Public Expenditure Management
PER	Public Expenditure Review
PFM	Public Financial Management
PIFCS	Public Internal Financial Control Systems
PO	Payment Order
REFM	Revenue Enhancement and Fiscal Management project (MOF)
ROSC	Report on Standards and Codes
SAO	State Audit Office
SAI	Supreme (State) Audit Institution
SOE	State Owned Enterprise
TA	Technical Assistance
TSA	Treasury Single Account
VAT	Value Added Tax
ZBA	Zero Balance Account

Regional Vice-President:	Christiaan Poortman, MNAVP
Country Director:	Joseph P. Saba, MNCMU2
Sector Director:	Hasan Tuluy, MNACS
Country Manager:	Omar Razzaz, MNCMU2
Sector Manager:	Samia Msadek, MNAFM
Task Team Leader:	Robert Bou Jaoude, MNAFM

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Preface

This Financial Accountability Assessment (CFAA) was prepared on the basis of findings from a World Bank (WB) mission that visited Lebanon between September 6 and 17, 2004. The work was carried out by a task team led by Robert Bou Jaoude (Team Leader, Senior Financial Management Specialist) and composed of Pierre Messali (Senior Public Financial Management Specialist, MNAFM), Andy Macdonald (Consultant), Claude Cornuau (Consultant) and Samer Hankeer (Consultant).

At the request of the Government, the Lebanese CFAA mission was conducted jointly with an IMF Fiscal ROSC mission. This joint undertaking by the two donors avoided duplication and created synergies between the WB, the IMF and the Lebanese authorities. The CFAA team reviewed the recommendations of the CFAA and the Fiscal ROSC to ensure that they are consistent in the advice provided to the Government on the scope and pace of future improvements.

The CFAA was also prepared in parallel with the WB Public Expenditure Review (PER). The PER focuses on budget execution issues which directly impact the allocation of resources, and examines how these are linked to the priorities of the Government. It does not cover the CFAA issues of budget preparation, execution, accounting, reporting internal control and audit, external audit, or parliamentary oversight of the Government's fiscal operations.

Objectives and Scope of CFAA

A CFAA is a diagnostic exercise designed to facilitate a common understanding by the borrowing country, the WB, and their development partners of the country's financial accountability framework. Its objective is to assess the design and implementation of this framework and to evaluate its ability to ensure the proper use of the country's own resources and those provided by the WB and other donors. The CFAA assesses the fiduciary risks in the Government's management and execution of its budgets and in the implementation of WB programs using WB funds. The fiduciary risk is the risk of funds not being spent for the purposes for which they have been appropriated. The CFAA then makes recommendations designed to mitigate these risks.

A CFAA has also a developmental objective, which is to understand the capacity-building requirements for improving the country's financial management. The CFAA is also used as a component of the WB's Country Assistance Strategy in order to design better capacity-development activities and WB advisory services, and to improve the dialogue with the client countries on financial accountability issues.

The overall objective of the Republic of Lebanon CFAA is to (i) provide relevant information to the WB and the Government on the public sector financial accountability arrangements in the country; (ii) identify and document the most significant fiduciary risks in the Government's public financial management (PFM) systems; (iii) document the existing program of reforms and capacity building, making additional recommendations, where necessary; and (iv) assist in achieving a pillar of the FY 2005 CAS that relates to building capacity and support for economic management.

The CFAA team used previous donor studies and reviewed the progress made by the Government in reforming its expenditure management processes. It built on the recommendations of previous reports in establishing the current state of affairs and in formulating recommendations for the future.

The CFAA reviewed the three main pillars of the system: the budget formulation and execution process, the accounting and reporting system in place for all public entities, and the internal control system, comprising the executive, internal auditors, and the legislature. The important supporting role of the external auditor was of particular importance. Transparency, completeness, accuracy, and timeliness of financial information to support accountability and decision-making were examined. Revenue generation and collection and private sector accounting and auditing were not addressed, as both had been previously studied separately. Wherever possible, the CFAA employed international standards and best practices in its work. The resultant gaps and priority areas for improvement have formed the basis of the CFAA's recommendations to the Government.

The CFAA is not an audit, and it does not provide assurance that all funds are being used for intended purposes. However, it provides a well-informed and objective assessment of the strengths and weaknesses of financial management systems, a diagnosis of problems and advice on their resolution, and an indication of the level of financial accountability risk in the country concerned.

Relationship to Other Studies

This 2005 CFAA rests on a strong foundation of earlier work, including the 1997 Country Assistance Strategy and the 1997 Public Expenditure Review, both of which are being updated in 2005. Both of these studies identified the need for a well-functioning PFM system to support their overall strategies.

An Accounting and Auditing Report on Standards and Codes (ROSC) was conducted by WB staff in 2003. It noted that international accounting standards, with some variations, had been adopted by the Minister of Finance in 1996. However, there is no compliance mechanism in place for accountants; auditors are similarly unregulated. This has resulted in a wide variation in the quality of accounting and auditing services offered by private sector service providers.

A Country Project Performance Review report issued during the third quarter of 2002 rated two projects as unsatisfactory and listed three others as being projects at risk. The WB has planned a Country Procurement Assessment Review in FY 2005, along with a study on Lebanon's social security and pension reform.

This CFAA was conducted jointly with an IMF team preparing a ROSC – Fiscal Transparency Module. Because many of the areas covered do overlap, a simultaneous, cooperative approach was deemed to be the most effective way to undertake the two studies with the least disruption to the Government. There are some areas covered in this CFAA report that have not been addressed in detail. This reflects the fact that certain areas have been an ongoing priority of the IMF, and the CFAA team did not delve deeply into them. These include the multi-year fiscal planning and budget preparation processes, MOF treasury functions, and central bank operations.

Acknowledgements

The WB team acknowledges the extensive cooperation of officials and staff of the institutions and ministries who provided assistance to the CFAA team in gathering information and follow-

up after the team's visit, including officials and staff of the Lebanese Ministry of Finance. Persons met during the mission are listed in Appendix 1.

Also, the team would like to express its pleasure at having worked and coordinated with the IMF Fiscal ROSC team, headed by Mr. Jésus Seadé and composed of Messrs. Luc Léruth, Jean-Luc Hélis, Stephane Danninger, and Benôit Chevaucher.

Executive Summary

1. The Government of Lebanon has been extensively involved with improving its Public Financial Management (PFM) system for several years. During this period, it has worked closely with the WB, the IMF, the Government of France, and other donors on individual components of its budgeting, accounting, auditing and internal control systems. Much improvement has been made.

2. The Government continues to face challenges in further reforms. The Government's program presented to donors at the Paris II meeting foresaw a significant reduction in the debt-to-GDP ratio, requiring Government action to grow the economy, increase significantly its revenues, and reduce expenditures. One factor that has slowed the pace of reform has been the political reality of coalition government in a highly fractured system of multiple political parties operating in Parliament, and the inevitable accommodations that are required in order to govern. As a result, important legislation, whether new laws or amendments to existing laws, has been stalled in Parliament, in some cases for years, and the Government has been unable to break the stalemate.

3. This CFAA has attempted to propose pragmatic and feasible solutions to problem areas in the current environment. In some cases, the recommendations may be a new approach to resolving an old problem; in others, they may represent new thoughts on an emerging issue. The recommendations are presented in Appendix 8 to this report, and the key recommendations that are designed to address the areas of greatest fiduciary risk for the Government are summarized in this Executive Summary. These key recommendations are designed to assist the Government in improving the Lebanese PFM system and provide the foundation to all the donors to move towards greater use of country system.

4. One of the CFAA's overall themes is that the Government must continue to work to develop a unified budget framework that enables proper management of the finances of the Government, in collaboration with the Bank and the IMF. This would assist the Government to better control public sector debt, revenues and expenditures, maintain its social safety nets, and improve its financial relations with the public utilities.

5. The current budget framework is not unified for the entire public sector; many of its financial activities are still not transparent to the Government itself, to Parliament or to the public. These include transactions of extra-budgetary funds and entities, loans to selected public autonomous agencies that are converted to expenditure at the end of the financial year and unutilized investment authority that is carried forward without additional parliamentary disclosure or for review of actual performance against the budget plans. There is also no formal audit opinion by the Court of Accounts on the fairness of the Government's annual financial report. The CFAA report makes a number of recommendations to address these practices.

Extra-Budgetary Entities and Public Autonomous Agencies

6. The current budget omits important financial activities of the Government, comprising 18.9 percent of total spending in 2004. The activities of extra-budgetary funds and entities operating outside of the budget comprise a significant percentage of the reported budget, and yet they are not fully disclosed to Parliament. Entities that do not submit budget requests to Parliament include the National Social Security Fund's (NSSF) three programs for health

services, family allowances and pensions, and the Independent Municipal Fund that provides the major source of financing to the country's 927 municipalities. The NSSF and the Independent Municipal Fund do not submit financial statements to Parliament to report on their fiscal year performance.

7. Additionally, there is incomplete reporting to Parliament and the public on the operations of a number of the 55 public enterprises. While not part of the core activities of government, they are still part of the general government (public sector) and their activities can have important fiscal implications. In particular, the IMF has identified problems with Eléctricité du Liban, which has been a source of large loans that were subsequently converted to capital and joint ventures of the Banque du Liban with the associated contingent liabilities. There is incomplete financial disclosure of the substance of key transactions between the budget and these public enterprises. An additional concern is the lack of modern oversight of these entities by the Ministry of Finance (MOF) and by the entities' own independent Boards of Directors, and the resulting lack of accountability for performance.(In some cases, this is due to the existing legal framework which does not permit MOF to exact accountability for performance).

8. The CFAA considers that these entities pose a **significant** fiduciary risk to the Government. It recommends inter alia, that:

1. The Government prepare progressively over the next five years a set of audited consolidated financial statements that expands the current financial statements for the budget entities to include extra-budgetary funds and budget entities, municipalities, and public enterprises. These consolidated statements should be prepared in compliance with international accounting and reporting standards and be accompanied by an audit opinion from the Court of Accounts on the fairness of the presentation of the financial statements.

2. The CDR's investment budgets should be fully consolidated into the budget of the Government and its accounting, reporting and governance structures significantly improved.

3. The NSSF's organizational and governance structures should be reviewed by an external, independent reviewer who would make recommendations to ensure its medium-term financial viability. The NSSF should provide Parliament and the public with full disclosure of its planned budget at the same time as the regular budget, and should report its actual financial performance at its fiscal year end, coincident with the Government's final budget report.

4. Similarly, the Independent Municipal Fund should prepare an annual budget for review by Parliament and should submit an annual set of audited financial statements to Parliament at fiscal year end.

5. The Government should prepare a new law on public enterprises that strengthens the governance processes, enforces the use of international standards for accounting, reporting and auditing, and requires the publication of all audited financial statements within six months of the fiscal year end. The Government should also increase its oversight of public enterprises.

Budget Preparation & Execution

9. The Government worked in close coordination with the IMF to reform of the Government's budget planning, preparation and execution processes. There are a number of

reforms that are still in various stages; these are supported by the Government, the IMF and by this CFAA. They are detailed in the main CFAA report.

Preparation

10. The CFAA examined the budget preparation process from the spending ministries' viewpoint. It noted that within the ministries interviewed, the accounting staff simply rolled up the individual, unconstrained, budget submissions from all of its budget entities. This aggregated budget was presented to the minister, who signed it for transmission to MOF. At no time was there any internal "challenge" process to test the robustness of the individual budget submissions. Any challenge occurred only after MOF had examined the budget submissions, and in some cases involved minister-to-minister negotiations to establish the final budget levels. This practice is not surprising, given the absence of hard budget ceilings communicated to line ministries in the budget circular. But once the MOF does implement its multi-year budget framework, and once Council of Minister (COM)-approved ceilings are sent out in the budget circular, then ministers will be accountable for adhering to these ceilings in the budget submission. At that time, an internal challenge process will be essential.

11. The CFAA recommends that individual ministries implement an internal budget challenge function now, in anticipation of the arrival of budget ceilings to which they must adhere .This will require training for the financial staff to perform an analysis of a budget proposal and to interact constructively with the budget's owner during the review process. As greater experience is gained in this function, the quality of challenge and the final budgets will increase. Training will be necessary throughout this transition interval.

Execution

12. The Government's budget execution procedures must be improved. The CFAA notes the concerns previously expressed by the IMF on the lack of coordination between the existing current and investment budgets, the development of a GFS-2001-compliant chart of accounts, the development of the Treasury system, and improvements to debt management, cash management and payment authorization procedures. The CFAA endorses the need for an updated definition of an appropriation that would permit MOF to require cash forecasts on a regular basis and authorize expenditures according to a government-wide cash management plan.

13. The CFAA also endorses the IMF recommendation to remove large carry-forwards from the budget framework. These represent continuing budget authority associated with unexpended funds from the investment budgets and committed amounts from the operating budgets. These previously approved funds are large (an estimated LL2 trillion for commitments (10 percent of GDP) and LL500 billion (2.5 percent of GDP). for uncommitted investments). The resulting freedom of action without the related planning and control creates a high-risk situation for the MOF. The risk magnitude threatens effective expenditure management and sound cash management, making the task of MOF extremely difficult. In addition, Parliament is not fully informed on an ongoing basis of the total commitment authorities outstanding when approving the upcoming investment and operating budgets

14. The CFAA recommends that Parliament be fully advised of all carry-forwards in the budget it is considering and that the Law on Accounting be amended to limit to five years the carry-forward of any individual item. Over the longer term, the Government's implementation of the IMF's recommended multi-year budgeting would be capable of accommodating multi-year capital investments, a better way of handling longer projects that would obviate the need for investment carryovers.

Budgeting Risk Assessment

15. The CFAA believes that the fragmented budget framework represents a **high** fiduciary risk to the Government, because:

- Extra-budgetary entities and public enterprises make major financial transactions outside of the budget framework in an oversight framework that requires significant strengthening;
- There are many outstanding IMF recommendations designed to improve the budget preparation process, and to deal with very large unspent investment budgets that are currently carried forward into the subsequent year's fiscal framework;
- The expenditure control framework is complex, with duplicative functions and overlapping accountabilities.

Accounting and Reporting

16. The Government states that it follows international standards for accounting and reporting; this should be specifically be required by law. The CFAA recommends amending the law on Public Accounting to require that the Government comply with international accounting and reporting standards. The Government has indicated its acceptance of an IMF recommendation to migrate from a cash basis of accounting to an accrual basis over the long term. This will significantly improve information available to them for improved financial management. The CFAA recommends that the Minister of Finance be given the specific authority to determine the pace of this migration.

17. The Government's financial management information system currently meets the majority of its present needs. However, legislative proposals to permit electronic authorizations and electronic transactions will provide the Government with an opportunity to streamline and simplify its expenditure and revenue control processes and reduce the costs of government administration. This is a longer term process. The MOF should begin now to consider the options available to it for its next generation financial system, using expert advice and assistance in formulating and assessing the options.

18. Although the Government's quarterly reports are timely, the final budget reports on its operations for the completed fiscal year are not. The Law on Public Accounting should be amended to require that the final budget execution report, the financial statements, and the auditor's report on these statements all be tabled in Parliament within nine months of the fiscal year end. This is common practice in other countries in the region, and would ensure that Parliament had the relevant information on the Government's performance prior to consideration of the next year's budget.

19. The CFAA considers that the fiduciary risk from the accounting and reporting functions is **moderate**.

Internal Controls and Internal Audit

20. The legislative base for internal controls is weak. Internal controls are an important element of PFM that are established by management to regulate the conduct of its financial activities. The current basis for internal controls is the 1963 Law on Public Accounting. The past 20 years have seen an evolution in modern internal controls for governments, an evolution in

which Lebanon was unable to participate. Now is the time for the Government to take the opportunity to reflect modern internal control standards in its budget law and specifically to assign to the Minister of Finance the responsibility for the development and maintenance of these standards. The Law on Public Accounting requires major amendments, a fact recognized by the Government but, to date, not by Parliament. In 2001, Government proposed a series of very sensible amendments that would, inter alia, have established the accountability for expenditures with the accountable ministry, removing the Court of Accounts and the MOF commitment controller from the process. Unfortunately, Parliament has not seen fit to pass these amendments, nor those relating to the establishment of the MOF Treasury unit. This continuing gap in the legislative framework impairs the Government's ability to make the requisite improvements to its PFM system.

21. The Government is continuing to develop its relationships with the European Union (EU). In time, there will be a need for the Lebanese internal control system to fulfill the functions specified in the EU's Public Internal Financial Control System. Further development of the legal basis for internal controls and the supporting processes should be a priority of the Government. A well-functioning internal audit process, following international standards, is an essential component of all modern internal control processes.

22. The CFAA believes that there is a **significant** fiduciary risk arising from the internal control and audit framework. Several reasons support this assessment:

- The legislative base for internal controls requires significant strengthening beyond that previously recommended by the Government in 2001.

- The existing expenditure control process is lengthy, complex and non-transparent, involving multiple approvals and susceptibility to corruption. In addition, the multiplicity of detailed internal controls results in less overall internal control. Modern internal audit does not exist in the Government of Lebanon. Existing inspection functions are largely concerned with compliance activities, with limited attention paid to assessing risk in control processes and proposing measures to improve them.

- Parliament has refused to pass amendments to the existing Law on Public Accounting to improve the existing controls. There were concerns that a simultaneous removal of the Court of Accounts (COA) and MOF presence from the line ministry ex-ante approval processes would constitute an unreasonable fiduciary risk. Parliament should consider the proposed laws relating to PFM and should reach agreement on acceptable modifications to the Law on Public Accounting, the MOF Treasury reorganization act, and the electronic transaction and authentication bills that were brought before Parliament in the previous session.

23. The CFAA team has recommended a multi-year, phased approach to the establishment of internal audit within the Government. It would begin with a small internal audit unit within the MOF, to meet its own internal audit requirements and to develop the policies, practices and guidelines for internal auditors across Government. Training of new auditors would be performed by the MOF Training Institute. The Law on Public Accounting would be substantially revised to conform to the EU Public Internal Financial Control Systems model and to require the phased implementation of internal audit over a designated number of years. This implementation would be coordinated by the MOF, according to a COM-approved plan, with donor assistance for implementation and training.

The Court of Accounts

24. The external auditor is the Court of Accounts (COA), a judicially competent body that supervises the use of public funds by government entities by ensuring the compliance and legality of transactions. At present, the COA exercises both ex-ante controls (by issuing visas) on expenditures above a defined threshold and ex-post controls, from commitment to recording phase. The COA is administratively linked to the Prime Minister, and consists of 36 judges in seven chambers, 27 auditors, 50 controllers, and 80 administrative staff. Three of the seven chambers are involved exclusively with ex-ante controls.

25. The CFAA reviewed the COA against the relevant INTOSAI auditing standards. It noted that the COA does not meet the criteria for independence (a fact noted by donors and a parliamentary committee chairman) and did not conduct attest audits in a way that would enable the expression of the auditor's opinion on the fairness of the Government's annual financial statements. However, COA determines the correctness and legality of financial transactions. At present, the COA does not undertake performance audits to examine the efficiency and effectiveness of government operations, a role that is common among other external auditors of government.

26. The CFAA considered the COA to present a **significant** fiduciary risk. It endorses the recommendations that the COA be removed from the ex-ante expenditure approval process and that the COA be made independent of the Government by reporting to Parliament. The CFAA recommends that the COA incorporate performance audits into its field audit operations, replacing its previous ex-ante control functions; that it be required by law to monitor and report on the Government's implementation of COA's current and previous recommendations; and that it acquire donor assistance to assist it in the implementation of these changes.

Financial Management Capacity Development

27. The Government has an excellent vehicle for the professional development of its budget, finance and audit personnel. The MOF Training Institute has a number of relevant courses and the capacity to engage external experts for additional courses not presently offered. This training capacity is a valuable resource that can be developed in order to mitigate serious staffing shortages that will soon impair the Government's ability to manage and reform its PFM system. A general staffing freeze has been in effect for three decades. While this freeze has assisted the Government in a reduction in its staff by attrition, it has also created a serious problem: the CFAA team was advised that the average age of the permanent civil service was 58 years, and that mandatory retirement occurred at 64 years of age.

28. Within six years, the Government will therefore lose half of its permanent staff, without significant replacement. This means that, even if MOF has been able to continue to staff for its own internal needs, there will be fewer and fewer permanent staff in the ministries and other agencies that will be available to perform their ongoing tasks, and virtually no one to implement the MOF's reform agenda.[1] The CFAA team encountered instances where an entity's capacity to perform its normal finance activities has already been impaired by staff shortages. Urgent action is required, not only for the MOF communities, but in other professional areas within the Government.

[1] There are a significant number of temporary staff that could be converted to permanent positions; this would require a policy change on the part of the COM.

29. The CFAA believes that this imminent staffing crisis represents a **significant** fiduciary risk to the Government. It recommends that the MOF prepare and implement on a priority basis a comprehensive human resources strategy for the hiring and training of new budget, financial and audit staff within the MOF and all government entities. It will also have to provide advanced training for the junior staff not be retiring in the next six years so they will be in a position to assume the responsibilities of those who will have left government service.

Legislative Scrutiny & Public Accountability

30. Parliament plays an important role in the review of the Government's annual budget submission. There is clear evidence of significant changes in the Government's proposals before the final budget is adopted by Parliament. The time allocated to review of the budget submission is sufficient, but not for review of the budget execution report.

31. There are a number of factors that could make Parliament's role more effective and could remedy significant shortcomings in Parliament's review of the Government's performance for the previous fiscal year:

- The Budget Committee should have permanent staff resources that provide them with the expertise required to perform the analysis of the Government's reports tabled in Parliament. This is common in many other countries. Parliament itself is capable of making the necessary changes to implement this recommendation.

- The time available for Parliament's review of the annual final budget execution report (loi de règlements) should be increased significantly to permit Parliament to analyze fully the Government's actual financial performance for the fiscal year. This analysis is the essence of the Government's accountability for its stewardship and the efficient and effective use of the funds granted by Parliament. The law should be changed to establish a more reasonable period of time for Parliament to effectively discharge its responsibilities in this area. The time required will be affected by the level of staff resources allocated to the budget committee.

- The budget committee should require the COA to monitor and report on the Government's implementation of the COA's present and outstanding recommendations, and should hold the Government to account for its progress.

32. The CFAA considers the fiduciary risk from parliamentary oversight to be **significant**, because of the lack of technical capacity available to the budget committee and an extremely short legislative review time to hold the Government accountable for its budget execution performance.

Overall Fiduciary Risk Rating

33. Based on the above assessments, the CFAA concludes that the overall risk assessment of the PFM system in the Government of Lebanon is **significant**. A number of key reforms would enable the Government to reduce its fiduciary risk rating to **moderate**. To achieve this moderate rating the priorities for the next 2-3 years should be focused on:

- Establish a unified budget framework that accounts for the financial activities of the public sector and presents it in a consolidated, audited set of financial statements for the public sector.

- Strengthen internal controls by making the amendments to the Law on Accounting recommended in this report and by previous donor studies. In particular, emphasis should be placed on compliance with requirements of the EU's Public Internal Financial Control system.

- Reform the Court of Accounts to make it independent of the Government, remove it from the Government's internal financial control processes and focus its work on expressing an opinion on the fairness of the Government's annual financial statements and on performance audits of government entities. Address the urgent issue of capacity development of all staff involved in the financial management, budgeting planning, execution and control, and internal audit.

Chapter 1: Budgeting

A. Legislative Basis for the Budget

34. The legislative basis for the budget is the 1963 Public Accounting Law (PAL). It is a non-organic law that can be updated annually in successive budget laws. This law is based on the French system in place in 1963; the Government has to date been unable to get badly needed amendments approved by the Parliament. As a result, the law has not kept pace with the evolution of budget law in France or elsewhere in Europe.

35. The Public Accounting Law (PAL) establishes the budget framework. It sets the rules for the preparation of the annual budget request, specifies the budget preparation calendar, defines the roles of the Minister of Finance and the technical ministers, defines expenditures and revenues, and gives detailed prescriptions for revenue collection and management, sale of assets and collection of state loans. It then defines the four stages of expenditure creation – commitment, liquidation, authorization and payment – and the responsibilities of various parties at each stage of the process. The law sets out the procurement processes and procedures to be used for the acquisition of goods and services, and describes the rules and operation of the Public Treasury.

36. This law has been reviewed by virtually every donor's financial mission in the last decade, and many recommendations for improvement have been made. These may be best summarized by citing the latest IMF report recommendations and observations.

1. Replace the PAL with a modern Organic Budget Law (OBL);
2. Increase the comprehensiveness of the budget by covering all public sector activities and the foreign-financed budget of the Council for Development and Reconstruction (CDR);
3. Require a three-year Council of Ministers (COM)-approved fiscal framework to establish the context for the annual budget, an annual approved global expenditure ceiling, and COM-approved individual ceilings for first-line budget entities prior to the budgets being prepared;
4. Eliminate budget carryovers from one year to the next, which violate the annuality principle of budgeting, and discontinue the use of all treasury advances, which violate the principle of parliamentary control over all government spending;
5. Implement modern commitment controls and redefine the term "appropriation" to mean the maximum authority to spend, subject to cash availability;
6. Define a cash management planning process that links to the debt management strategy;
7. Eliminate the ex-ante control role of the Court of Accounts (COA) in a streamlined expenditure process.

37. The Government has responded to these recommendations. In 2001, it proposed a set of reforms to the PAL that were submitted to the Parliament in Decree 4842/2001. They addressed a number of the issues identified by the IMF and previous studies, including:

- Rationalizing the internal spending controls into two distinct phases:

- by delegating to the responsible ministry the administrative phase (commitment, liquidation, disbursement) of expenditures;

- by assigning to the Ministry of Finance the accounting phase (giving the order to pay an expense and payment of the expense).

This division of responsibilities would have ensured accountability of the spending ministry for all spending decisions and of the MOF for the appropriate accounting.

- Removing the ex-ante control function of the Court of Accounts (COA) and replacing it with the responsibilities to apply ex-post controls over spending, express an audit opinion on the Government's Final Accounts, and undertake a new performance audit of entities relating to cost and efficiency;

- Requiring the Court of Accounts to also make recommendations on how to improve internal controls, and requiring government entities to report to the COA and Parliament on remedial actions they have taken;

- Expanding payment methods from cash to include electronic inter-bank funds transfers and other means to be determined by the Minister of Finance.

38. Parliament has thus far delayed the approval of the law. One reason was their fear that spending controls would be weakened if the COA were to lose its ex-ante approval function at the same time as the MOF commitment controller functions were delegated to the spending ministries. As a result, the MOF considered a two-phase implementation approach, beginning with the removal of the COA ex-ante controls, and then followed subsequently by the rationalization of the internal spending controls. As of the date of the CFAA report, there has been no resolution of the parliamentary impasse.

B. Budget Evolution and Economic Growth

39. The lengthy civil war in Lebanon left the country with the challenge of rebuilding both its infrastructure and all of its government processes. The budgets of the early 1990s reflected this situation, with extremely low revenues and larger expenditures. For example, in 1992, revenues amounted to only 12 percent of GDP, while expenditures were at 23 percent of GDP. The resulting fiscal deficit was 11 percent of GDP. The Government recognized that the fiscal situation had to be improved in order to regain a measure of stability, and made it their priority to enhance revenue, carry out major expenditure reform, and increase capital spending to support the rebuilding of the country.

40. Over the decade of the 1990s, Lebanon made significant progress in creating an open, service-oriented economy. It is now a major banking center and provides educational and health services to the entire region. It also embarked on a massive reconstruction effort to rebuild the country's heavily damaged infrastructure following the end of the lengthy civil war. But at the same time, strains were appearing: growth decelerated; and there was a threatening buildup of public debt, resulting from continuing high deficits and interest rates. Table 1 documents the evolution of economic indicators over the 1997-2004 periods.

Table 1. Selected Economic Variables 1997-2004

	1997	1998	1999	2000	2001	2002	2003	2004
Gross domestic product (LL trillion)	24.0	25.6	25.4	25.0	25.5	27.7	28.8	30.8
Real GDP growth	3.6%	2.3%	-1.2%	1.2%	4.2%	2.9%	2.7%	4.1%
CPI inflation	0.1%	0.4%	-0.5%	-3.1%	4.7%	1.3%	2.5%	2.0%
Gross debt over GDP	98%	110%	132%	151%	167%	171%	175%	170%
Public deficit over GDP	-22.6%	-13.5%	-14.0%	-23.5%	-16.6%	-15.6%	-14.3%	-8.3%
Primary balance over GDP	-8.1%	-0.3%	0.2%	-6.8%	0.3%	1.1%	2.5%	3.6%
Gross foreign reserves (US$ billion)	5.9	6.4	7.7	5.9	4.4	5.1	10.5	10.7

Source: WB staff calculations based on data from MOF, Ministry of Economy and Trade and Banque du Liban (Central Bank).

41. The Government embarked on a number of reforms to help cope with the large budget deficit and a crippling public debt. This included tax reforms (Value Added Tax or VAT was introduced in January 2002 as well as the introduction of the tax on interest income in 2003), expenditure reductions, and planned privatization of public enterprises. In late 2002, the Government managed to convene a donors' meeting (Paris II), during which it presented a program of fiscal and structural policies intended to reduce fiscal imbalances, maintain financial stability and restore growth. By pledging US$3.1 billion (and transferring US$2.5 billion) for debt restructuring, donors provided Lebanon with renewed confidence from local and international investors. Lebanese banks contributed to the effort, through the acquisition of public bonds at zero percent and the write-off of some public debt detained by the Central Bank. Regional developments, through greater tourism inflows, growing oil prices, and the repatriation of Arab funds in the region also contributed to Lebanon's recovery By 2004, these developments, amplified the positive impact of Paris II on market confidence, had stimulated private capital inflows and brought interest rates down.[2].

42. Since that meeting, the deficit has maintained a downward trend, mainly due to lower debt service and greater regional economic activity. Since 2000, the primary surplus has reversed from -7.6% of GDP to +3.4% in 2004. This was due to a major fiscal effort on both the revenue and expenditure fronts, but more specifically, on the revenue front. However its fall has not been sufficient to meet the Paris II targets. In 2004, the budget deficit has approached the 8 percent of GDP figure, down from 14 percent the previous year, but still far higher than anticipated levels, which notably assumed substantial revenues from privatization.[3] Reducing the deficit is the single most important economic priority of the Government, and this imperative

[2] Interest rate declines and capital inflows started as soon as the Paris II conference was announced, in November 2002.

[3] A number of the Government's proposed measures contained in the budget approved by the COM were not accepted by Parliament, adversely affecting both revenues and expenditures.

will have a significant impact on public sector spending plans and revenue-enhancing measures over the foreseeable future.

43. Debt reduction, reforms to improve the investment climate, and greater efficiencies in the management of public expenditures will all continue to be major tools available for the Government to employ in its struggle to create a macroeconomic environment that stimulates and sustains Lebanon’s growth.

C. Budget Coverage

44. Nineteen percent of public spending is outside of the regular budget (see Table 2). There is a need for the Government to continue its work on a unified budget framework that enables proper management of the finances of the Government This would assist the Government to better control public revenues and expenditures, maintain its social safety nets, and improve its financial relations with the public utilities.

45. The current budget framework is not unified for the entire public sector; many of its financial activities are still not transparent to the Government itself, to Parliament, or to the public. The scope of government activities accounted for in the annual budget submitted to Parliament is incomplete in several respects. First, as noted by the IMF, there is a dual budget system in operation.[4] The first budget is the regular one prepared by MOF and approved by Parliament; it covers central government spending as executed by 29 first-line entities and 76 second-line entities. The second budget is the Foreign Financed Investments (FFI) budget, prepared by the CDR and approved by the COM, but neither reviewed nor approved by Parliament. The CFAA recognizes that major effort by MOF were exerted since 2001 in increasing transparency by disclosing all public finance, debt, and trade information on a monthly, quarterly, and yearly basis through regular reports. The information is disclosed as part of the budget statement to Parliament and is posted on MOF's website.

46. Secondly, a number of other public autonomous entities besides the CDR operate outside of the regular budget. These include Éléctricité du Liban (EDL), the National Social Security Fund, municipalities, Banque du Liban (BDL), the National Archives Agency, four consolidated water authorities, public hospitals, and over 60 other entities. A complete listing is given in Appendix 2. The situation is confused because the budget numbers shown in Table 2 exclude the Independent Municipal Fund and Electricité du Liban, while these expenditures are included in the actual figures reported in the final budget report for the fiscal year.

47. Table 2. Public Sector Actual Spending, 2004

Item	**2004** (LL billion)
Regular government budget / of which	8,863
National Social Security Fund	89
Foreign Financed Budget Payments for Debt Service	161

[4] IMF FAD, *Lebanon: Consolidating Public Expenditure Management Reforms*, January 2004, pp 32-4.

Outside regular budget	
Independent Municipal Fund*(a)	461
Foreign Financed Investment Budget (not accurate, included when paid as part of debt service)	234.5
Public autonomous entities	
Transfers to EDL	492
Other Transfers	524
Subtotal, Outside regular budget	1,711..5
Total, regular and Outside regular budgets	**10,574.5**

(a) Independent Municipal Fund is treated as an EBF. It is part of the General Government expenditure, but not part of the central budget. There are no financial statements prepared for this fund. It operates outside of the budget, invisible to Parliament and the public, yet it is responsible for the vast majority of the municipal government revenues. Refer to discussion below on Municipal Budgeting.

Source: WB, MOF Public Finance Q3 Report, 2004, Public Finance Prospects, 2004.

48. Under International Public Sector Accounting and Reporting Standards (IPSAS), enterprises or entities controlled by the Government should be included in consolidated public sector financial statements that are presented to Parliament and the public.[5] Under cash basis accounting, mandatory reporting would be restricted to the cash flows between the Government and the enterprise or entity, with statements of assets and liabilities an optional, but highly desirable, additional disclosure.[6]

Risk Posed by Extra-budgetary Funds

49. The impact of exclusion of a portion of the the Foreign Financed Investment (FFI) budget and the public autonomous agencies from the regular budget impacts more than transparency. Including the balance sheet of extra-budgetary funds (EBFs) in the regular budget is good practice and would aid transparency and integration of the EBF. But being “in the budget document” is not the same as being “in the budget.” Simply including the EBF balance sheet in the Government’s annual budget document would not be sufficient to make the EBF “in-budget,” as it would still not be subject to normal budget scrutiny and procedures.

50. The EBFs operate outside the general budget formulation, budget execution, and reporting system, and they do their banking outside of the TSA, with their own bank accounts that are not subject to Treasury management. The degree to which EBFs are off-budget can vary, with more extreme cases having earmarked revenues (i.e. for social payments, health insurance) and spending set by law, with no reference to MOF. This exclusion of EBFs from MOF budgetary scrutiny results in weaker management incentives and financial controls. Strong and

[5] IFAC, *Handbook of International Public Sector Accounting Prouncements,* 2003 ed, IPSAS 6.

[6] Ibid, IPSAS 2, para 49.

independent governance and oversight arrangements for EBFs may be able to counter this tendency, but this tends to be a rare occurrence, as Supervisory Boards are often composed of civil servants or individuals with little knowledge of governance responsibilities for the business of the fund.

51. It is the EBFs' operations outside the regular budget preparation and execution processes that can create important fiduciary risks. These risks arise due to the inability of MOF to perform its normal management oversight activities. Extra-budgetary funds (EBFs) pose three types of risk to sound public financial management. First, there is a policy risk that Government policies contained in the general budget will be adversely effected by EBF overspending, which draws funds away from the general budget and ultimately must be financed from the same general revenues. Secondly, there is a risk to the performance of the EBFs and to the attainment of their objectives because their efficiency is compromised due to poor oversight, or because excessively rigid laws of incorporation bar them from effectively managing their resources. Thirdly, there are financial risks if the EBFs overspend their budgets and a cash management risk when EBF accounts are not handled through the Single Treasury Account (TSA).

52. Sound public expenditure management minimizes or eliminates extra-budgetary funds. This is a best practice that may not always be possible; however, there are several principles that can be followed to minimize the adverse impact of extra-budgetary funds, presented in Box 1. The general thrust of these principles is to:

- increase the transparency of all EBFs to Parliament for planned and actual performance; and

- ensure that the entities' Boards of Directors actively exercise their oversight function on behalf of the accountable minister and the Government.

BOX 1: GENERAL PRINCIPLES OF CONTROL FOR EXTRA-BUDGETARY FUNDS

1. EBFs provide in annual budget documents the same information as budget entities, with appropriate supplementary disclosure.
2. EBFs are subjected to the same degree of budget scrutiny as budget entities.
3. EBFs meet the same standards for accounting and reporting and internal control and audit.
4. EBFs prepare reports in the same timeframe and frequency as for budget entities.
5. EBFs operate in a transparent manner for reporting and other financial operations (i.e. procurement).
6. EBFs should maintain a balance between expected revenues and expenses to avoid fund deficits.
7. EBF debt issuance, if permitted at all, should always be subject to the review and approval by the Government or MOF.
8. EBFs should be subject to effective oversight authority by an accountable line ministry for sectoral policy issues and by MOF for matters relating to financial accountability. This is in addition to the Board of Directors oversight role. EBFs should be audited annually by the external auditor (Court of Accounts).
9. EBFs should have a modern and independent internal audit unit, reporting to the Board of Directors, to monitor operations for fraud, waste, or abuse; should provide internal management feedback on the effectiveness of their internal controls; and should ensure the integrity of financial management and policy compliance.
10. EBF transactions should be recorded on a gross basis for transparency and accountability. Accrued revenues and expenditures of the funds should also be recorded, as should the source of the accrual.

Source: Bill Dorotinsky, Michael Dybula, and Jos Verbeek. *Poland: Public Expenditure Management Principles for Extra-Budgetary Funds*. World Bank Policy Note. March 7, 2001.

Performance of CDR and NSSF

53. The CFAA reviewed two key EBFs in order to assess their performance and governance relative to the principles identified above.

Council of Development and Reconstruction

54. The CDR was established by Decree No 5, 1977, with subsequent amendments over the years. Its activities became increasingly important following the civil war, when a fast-track approach to reconstruction of national infrastructure became a priority. It administers the foreign-financed loan portfolio on behalf of the Government, preparing all reconstruction and development plans and proposals for economic, social and financial projects for consideration by the Council of Ministers. Once its budget has been approved, CDR selects the executing entity and establishes a contractual relationship for project implementation, acting as the project office on behalf of the Government.

55. ***Financing*****:** The CDR budgets have been established by decrees of the COM.[7] These decrees specified three separate budgets, two of which provide for a very flexible operation:

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[7] COM Decree 19/1980, amended in 1993 by Decree no. 3640.

1. a *regular budget* of revenues and expenses to cover the annual expenses of the Council. This budget is voted annually by Parliament as part of the annual budget process;

2. an Investment *budget* which includes the revenues, made available through loans and grants to the Government, and expenses necessary to implement the projects approved in the General Plan or subsequently authorized by the Council. The operating budgets are not prepared annually, and allocated funds are treated as committed funds, open until the completion of the project;

3. an *ad hoc* budget for Council projects executed by the CDR. The ad hoc budget follows the same procedures as the operating budget.

In addition, the CDR also executes project implementation on behalf of other ministries, administering project budget investments funds as approved by Parliament for individual projects.

56. The decrees also permit forward commitments for the upcoming fiscal year to be entered into on or after October 1st of the preceding period. Exceptionally, funding can be opened in a given year's budget prior to its approval, provided the funding will be recorded. New projects can therefore be proposed and implemented throughout the budget year, subject only to the approval of the MOF and without reference to Parliament. There is no direct link between these capital budgets and the regular budgets of government entities that will be required to cover the new operating and maintenance (O&M) expenses of completed capital projects.

57. ***Governance:*** The governance structures are straightforward. The Board of Directors is appointed by the COM and is charged with oversight of the Council and its management. The board reports to the COM for all items requiring their approval. CDR regular staff are hired as consultants and are not considered public sector staff. Currently, the seven-person board consists of four full-time members, all of whom are executives in the CDR Bureau, plus three part-time members from the banking, legal and industry sectors.

Discussion

58. There are a number of shortcomings in the financial accountability framework of the CDR.

- The Board of Directors is not independent; a majority of its members (and all of the full-time members) are all senior executives of the Council. A non-voting Government Representative also sits on the board. There is no independent oversight of the Council's activities.

- The CDR investment budget is not linked to the central government budget and is not subject to the same oversight and controls. No systematic provision is made for the funding of incremental O&M expenditures that result from completed investment projects.

- The Council's flexibility in creating commitments prior to the beginning of the fiscal year undermines sound expenditure control, as does its ability to fund projects during the fiscal year without prior parliamentary approval.

- The investments involved are large. The CDR 2002 annual report listed LL1.2 trillion in externally financed debt to the public sector[8] and LL49.8 billion to the private sector.[9] The uncommitted FFI carry-forward is estimated at LL660 billion. It is not possible to manage budget execution risk with funds of this magnitude operating outside of the control of MOF.

Fiduciary Risk

59. The CDR operation has a destabilizing impact on the financial framework of the Government. Its use of multi-year commitments unlinked to the annual state budget violates the annuality principle and constitutes a major fiduciary risk. The reported carry-forward of LL660 billion in unexpended project funds could place severe pressures on the budget framework and strain the MOF's ability to effectively manage its cash resources. Parliament should be asked to reconfirm previous commitments granted, but not utilized, as a routine part of the budget approval process.

60. One stated justification for the CDR's extra-budgetary operation at the time of its founding 28 years ago was to permit the implementation of more stringent donor procurement rules. However, other countries have been able to implement these procurement rules for organizations that exist fully within the Government's budget purview. There is no longer any justification for this artificial separation of external financing from normal government budget operations. There is also the view that it is important to keep the flexibility of the CDR's implementation of projects and not to enmesh it in the project control systems used for entities operating within the regular budget. The CFAA was not in a position to investigate this claim in detail. However, if the Government wishes to retain CDR's arms-length relationship with the budgetary entities, then its governance structure should be robust and proactive.

Recommendations

61. The CFAA team recommends that:

- The CDR's investment and ad hoc budgets should be consolidated into the regular budget. The investment and ad hoc budgets would be part of the State budget, subject to the same MOF oversight and monitoring as for any other budget entity; This could be achieved through the treatment of CDR as a ministry for budget purposes or through the allocation of the investment budget through the sector ministries who will be receiving the final asset.

- The financial accounting and reporting processes should be strengthened so that MOF, COM and Parliament would have timely and accurate information on the results of the CDR's operations throughout the year. Accounting and reporting activities should be in full compliance with international accounting and reporting standards. The CDR would

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[8] This relates to rehabilitation projects and equipment for EDL, Port of Beirut and Lebanon Telecom.

[9] Mainly financial support of hospital projects.

be required to meet the six-month deadline for annual reports that the CFAA recommends for other entities.

- The CDR's governance structures must be strengthened. The current Board membership, dominated by CDR senior management, is incapable of providing independent oversight of the CDR's activities. This is a prerequisite for accountability purposes.

National Social Security Fund

62. ***Financial:*** The NSSF operates outside of the Government under its own legislation, separate from the budgetary control processes operated by the MOF. It provides a number of benefits: health care costs, family allowances and indemnities paid on retirement relating to the number of years worked. These benefits are funded by a tax of 23.5 percent of salary levied against employers[10] (employees pay 2.9 percent; the 20.6 percent balance is covered by the employer). These revenues are allocated to three accounts: 9 percent to health insurance, 6 percent to family allowances, and 8.5 percent for the retirement fund. The Government makes contributions on behalf of its civil service contractual employees as an employer; it also contributes on behalf of the approximately 44,000 taxi drivers in the country.

63. The financial situation of the fund is becoming increasingly precarious. Subsequent to the 2001 reduction in contribution rates, surpluses in the health and family allowance funds have been consumed and these funds are now in deficit (see Table 3). The pension fund remains in a surplus situation, on a pay-as you-go basis. Transfers between funds are prohibited by law. Thus, although the fund has an overall cash surplus, two of its three components are in deficit and these deficits will be increasing in 2004 and beyond. Despite this, the NSSF's Treasury Bill Portfolio amounted to LL 1,358 billion as of the end of 2004. Its deposits at commercial banks totales LL 1,837 billion. This shows a reversal of the past trend whereby the majority of cash assets used to be invested in Treasury Bills.

64. The Government was in arrears with respect to its contributions as employer. A COM decision to amortize the outstanding arrears of LL733 billion over 20 years results in an annual charge of LL35B, plus the LL145 billion for its 2004 employer contributions for a total of LL180 billion. As of September, 2004, the Government has paid LL70 billion of the amounts it owes. Parliament has not approved the amounts requested by the Minister of Labor to cover this shortfall; in 2004 only LL50 billion was appropriated and the balance will have to be made up through supplementary budget requests, Treasury advances, or further arrears. However, subsequent to the CFAA draft report, the Government transferred to NSSF a total of LL 290 billion, including a lump-sum transfer of LL 240 billion in June 2005. This was done in accordance with Law # 671 which authorized the opening of additional allocations in Budget 2004 to reimburse the government's contribution in NSSF for 2003 and 2004.

[10] The previous rate was 38.5 percent; this was reduced by the Government in 2001

65. Table 3. NSSF 2003 Receipts and Expenditures

(Billion LL)

Item	Health	Family Allowances	Pensions
Contributions*	242	147	241 + 79
Interest	11	12	367
Total Receipts	253	159	687
Expenditures**	393 +48	215 + 32	194 + 14
Surplus/(Deficit)	**(188)**	**(88)**	479

*Includes LL79 billion in regularization payments made by employers to adjust for shortfalls in contributions when an employee retires.

** Allocated overhead of fund's operation costs under formula established by law.

Source: NSSF

66. The NSSF conducts its own collection activities, and has added 25 auditors to its existing 75 to undertake compliance audits of some 27,000 firms that make regular contributions, plus an estimated 28,000 that contribute irregularly. The natural link between the NSSF declarations and the VAT assessment has not yet been fully developed, although there are clear efficiencies in collection, assessment, and audit operations to be gained from a closer working relationship. The fund has also been receiving technical assistance for the modernization of its benefits delivery system, based on a 2003 consultant's report.

67. The operating budget of the fund is submitted to its board for approval and then to the Minister of Labor. Revenues are determined by the COM. Parliamentary approval of the budget is not sought, nor is any annual report submitted to the Government and Parliament for information and approval, despite the fact that this fund touches the everyday lives of most citizens.

68. ***Governance:*** The composition of the Board of Directors is specified in law. There are 26 members, six appointed from Government by the COM, ten who are salaried syndicate members appointed by the unions, and ten who are elected from the ranks of the employers. The board meets monthly or more often as required, exercising the diligence and oversight activities normally associated with a governing board.

69. There is a parallel three-person technical committee, assisted by some 20 auditors, whose president has the rank of director general. The committee is responsible for internal control and inspection on an ex-ante basis. It reviews all proposed submissions to the COM as well as conducting their own internal control activities.

70. An investment committee consists of the Minister of Finance (chair), the Director General (DG) of Finance, the DG of NSSF, two board members, plus one representative each from the Banque du Liban (BDL) and CDR. There is no external investment expert, despite the

magnitude of the funds being administered by the NSSF. An external, private sector international auditing firm reports to the board on its audits of the fund's financial statements. The Court of Accounts also conducts its own review of operations for 1992-2000; it is now examining the 2000-2003 statements.

Discussion

71. The accountability framework for the NSSF has a number of shortcomings:

- The NSSF's operations are invisible to Parliament and the public. Their budget is not reviewed by Parliament, nor are the results of their operations expressed by their financial statements made known to parliament. The NSSF is unaccountable to the people it serves as citizens.
- The constitution of the board's investment committee does not require an external expert on pension fund investment management.
- Operating costs are allocated against the three funds as an overhead charge. These costs do not receive the benefit of the normal budget scrutiny of MOF that other entities receive, resulting in potential inefficiencies being passed on to the contributors in the form of higher overhead allocations. The basis of allocation of indirect costs has not been re-examined on a periodic basis to ensure that these costs are being fairly allocated to the three funds [11]
- There is no awareness or debate about the growing financial deficits in the health and family allowance accounts or the nature and performance of the investment portfolio administered by the NSSF's investment committee on behalf of the contributors to the retirement fund
- There has thus far been little attempt to increase efficiency by more closely cooperating with other agencies who also interact with the same target populations, perform audits and inspections, and deliver benefits.

Fiduciary Risk

72. The CFAA considered the NSSF to represent a **significant** fiduciary risk to the Government because of the following factors: the lack of transparency in the operations of the NSSF; the increasing deficit positions of two of its three funds; operational constraints on financial management of the individual components of the fund; the lack of oversight of the funds by the Minister of Finance; and the ability of the Minister of Finance to propose changes in contribution rates that can place the funds in deficit without examination of the long-term viability of the NSSF.

Recommendations

73. The NSSF's governance and organizational structures, objectives and operating principles should be subject to an independent review by an external independent expert to establish what changes should be made in law, in operations, and in practices to assure that the funds will be

[11] In Law, the NSSF operates under the authority of the Minister of Labor, who is required to exercise the ministerial oversight responsibilities.

financially viable in the medium and long term . As well, an independent audit of its financial position and results of operations should be undertaken on an annual basis; the audit report should be tabled in Parliament and posted on their web site.

74. The NSSF should provide Parliament and the public with full disclosure of its financial budget and performance, including:

a. preparation of a detailed receipts and expenditure budget for its forthcoming fiscal year by activity, together with a statement of component fund assets and liabilities, submitted to MOF for tabling in Parliament at the same time as the regular State budget;

b. a critical analysis by MOF of the NSSF budget, using the same rigor as the review it provides for all other budget submissions, submitted to Parliament within one week after its budget submission is tabled;

c. preparation of audited financial statements and tabling them in Parliament within six months of the fiscal year end, and posting all of its tabled documents on its website immediately after tabling them in Parliament;

75. The NSSF should conduct an internal efficiency review to ascertain where its processes can be streamlined through internal redesign and cooperation with other agencies of the Government, and should compare its expense ratios with those of other similar government funds in the region.

D. Public Autonomous Agencies

76. The Government owns a large number of public autonomous agencies with varying functions and of widely differing scales of operation. There are two categories: public bodies with commercial activities and public bodies of administration. These agencies range from the Banque du Liban and four water authorities to Eléctricité du Liban (EDL) and Télé Liban. A complete list is given in Appendix 2. With the exception of eight entities, all public bodies are subject to the 1972 Law on Public Enterprises.[12] This law also delegated to the Government the ability to create, amend or delete public enterprises by decree.

77. ***Financial.*** Public enterprises may not be part of the core definition of government. However, they make transactions that can have significant fiscal implications for the Government and therefore warrant attention. These include such items as: the payment of dividends; the receipt of budgetary subsidies to cover losses, debt interest payments or loan payments due; the receipt of government loans or loan guarantees; and the incurring of net liabilities on their balance sheet that could be a source of contingent liability for the Government.

78. The MOF Control of Autonomous Institutions Department, in the Public Accounts Directorate, maintains oversight of the public enterprises on behalf of the Government. At present, 22 financial controllers directly control 41 public enterprises, and another 33 submit

[12] The eight exceptions are the Council for Development & Reconstruction, Banque du Liban, University of Lebanon, Education Centre for R&D, Cooperative of Public Employees, National Council for Scientific Research, National Social Security Fund, Council for Execution of Construction Projects, and the Council for The Execution of Major Projects in the City of Beirut. Each has its own enabling legislation.

their financial data to the directorate for verification and certification of spending. The financial controllers and inspectors examine the books of the enterprise; check that board decisions comply with the law and that procurement complies with the procurement requirements; and verify the legality of revenues and expenditures, the validity of their final accounts, tariffs and revenue collection, and the management of inventories. The Court of Accounts also conducts an external verification of these entities. Follow-up on the results of the directorate work is done by Central Inspection and by the Chamber.

Governance: The Law on Public Enterprises imposed a set of common standards for all enterprises under its jurisdiction. These include a Board of Directors of from three to seven members, appointed by COM decree for a three-year term; the board is responsible for oversight of the public entity's operations, including financial, personnel and operational decisions, annual work plans, budgets and performance reports, compliance with government contract procedures, setting tariffs, requesting treasury advances, and so forth. The executive authority is vested in a director general, appointed by the COM on a proposal from the tutelage minister (responsible minister), whose duties are also specified in the law. All entities under this law are subject to the oversight of the MOF Financial Controller, who exercises ex-ante financial controls over the spending of the entity, and serves as a conduit to the Minister of Finance for all decisions of the board. The law also establishes the entities as being subject to the controls of the Civil Service Council, the Central Inspection, and the ex-post controls of the Court of Account.

Discussion

79. There is an excessive degree of control by the Government over these ostensibly independent entities of public law. The application of the MOF ex-ante financial control over spending, the audit by the Central Inspection unit, and the staffing regulation exercised by the Civil Service Board are not usually associated with public entities, but with ministries. Additionally, the CFAA team noted the use of these entities to incur arrears unrecorded in the core government accounts (e.g. EDL, NSSF) and to conduct commercial activities that are not synonymous with government activities (e.g. a joint venture that owns a casino and an airline).

80. Paradoxically, although the internal controls are in excess of what would normally be expected for a public enterprise, the governance mechanisms are weak and should be strengthened. The CFAA team also believes that the MOF should strengthen its financial oversight activities and should monitor and report on a regular basis the financial position and results of operations for all of its public enterprises. In particular, the actual and contingent liabilities associated with these public entities should be well understood and closely monitored by the MOF on an ongoing basis.

81. The IMF has made a number of previous recommendations in this area that are endorsed by the CFAA, including extending the budget framework to include all non-commercial activities of a government nature, including EBFs and special entities; and discontinuing the practice of Treasury advances to any public entity or SOE.[13] The CFAA endorses these recommendations, and notes that the Government's privatization initiatives and management reforms of those remaining entities will be necessary in order to ensure maximum benefit from the associated public expenditures.

[13] IMF, <u>op cit</u>, pp 29-37, 108-115.

Fiduciary Risk

82. The inability of the Government to monitor the financial operations of all public enterprises and the associated assets and liabilities, combined with the lack of accurate and timely reporting of all such entities, results in a **significant** fiduciary risk for the Government.

Recommendations

83. The operations of these public entities should be more transparent. A number of improvements could be phased in by the Government. First, the Government should prepare a new law for all public enterprises that inter alia:

- strengthens the governance processes for these entities, with the appointment of independent directors as a majority of board members (including appointments from outside the Government) and a chairman who is external to the entity;

- enforces a legal requirement for the use of International Accounting Standards for operations and reporting on the results of the enterprise’s activities in its financial statements;

- strictly enforces the requirement that the financial statements be audited by an external auditor using international standards for auditing;

- requires the annual publication of all audited financial statements of public entities and their distribution to the Government, Parliament and to the public on a timely basis (e.g. within four months of fiscal year end), beginning with the 2006 fiscal year;

- requires that all audited financial statements be permanently posted on a government website (such as that of the tutelage ministry or MOF). The external auditor’s report is an integral part of these financial statements and must be incorporated prior to publication.

84. The Government should further strengthen the governance structures for public enterprises by:

- Requiring the public enterprises to prepare monthly, quarterly and annual financial statements on their financial position and results of operations and submitting them to MOF, COM and Parliament and posting them on the MOF website within 2 weeks of tabling in Parliament;

- tundertaking by MOF of a more proactive monitoring of the financial performance of public enterprises, including monitoring of assets and actual and contingent liabilities, and regular quarterly reporting to the COM;

- requiring MOF to prepare a consolidated annual report of all public enterprises with a statement of assets and liabilities (actual and contingent) and revenues and expenditures, to distribute it within nine months of fiscal year end to Cabinet, Parliament and the public, and to post it on the MOF website.

85. The Government should implement the recommendations of the IMF and discontinue the process of converting loans to budgetary expenditures at the fiscal year end, with no ex-ante reference to Parliament.

E. Budget Preparation

86. Since 1993, the Government of Lebanon has invested considerable effort in rebuilding its budgeting processes, aided by the donor community. The IMF's Fiscal Analysis Division (FAD) has been particularly active in this area, having provided advice on legislation and scope of the budget, fiscal analysis, and budget preparation, execution and reporting.[14] It continues to provide ongoing advice in this area.

87. The Government is implementing a number of these recommendations in the budget preparation area. It has successfully implemented a revised chart of accounts, based on the GFS 1986 classification; computerized the budget preparation, treasury and payroll and pension administration; created a skilled group for fiscal analysis, abolished private bank accounts for government agencies, and moved towards a TSA. The IMF noted that several of the 1993 report recommendations remain to be implemented, including inclusion of foreign financing in the general budget; establishing appropriate commitment control limits, establishing a cash planning function, and a rationalization of the duties of the external auditor to eliminate its present ex-ante control function.

88. The 2004 FAD report acknowledged the considerable progress made by the Government to date. However, it also noted that "there is no clarity as to what the budget is supposed to do or what it achieves... the system is characterized by a lack of transparency and accountability of the spending ministries."[15]

89. It identified a number of short-term improvements in budget planning to address the outstanding issues identified above. These included:

- Commence the conceptual design of a Government financial management information system (GFMIS) that would contain the administrative, functional, program and economic classifications in a GFS 2001-compliant framework. This would enable a more effective top-down budget process that would enforce greater fiscal discipline, respond to government priorities, and reduce bargaining costs.

- Reform the budget preparation process, including a revised budget calendar, a strengthened macro-fiscal planning function to prepare multi-year fiscal plans on a regular basis, a Cabinet-approved aggregate budget expenditure ceiling and a multi-year context for the budget.[16]

90. In the medium term, the FAD also recommended the adoption of performance-based budgeting, following the implementation of the GFMIS and the new COA, compliant with the GFS 2001 standard. The report recommended, and the Government agreed, that the budget system should change to a performance-based budgeting system, with an emphasis on results obtained against objective, rather than only compliance with authorities. This move would assist in improved resource allocation decisions and improved effectiveness of government programs, also contributing to the Government's objective of deficit reduction.

[14] IMF, op cit, pp. 7 - 9.

[15] Ibid, p. 8.

[16] This would be a five-year window: the budget year, the two years beyond the budget year, the forecast for the current year, and the actuals for the most recently completed year.

Recent Developments and Progress

91. To date, Parliament has not approved the Government's amendments to Law on Public Accounting that would have implemented many of the outstanding short-term recommendations. Those changes that do occur are done through the annual budget law. The inability of the Government to prepare reliable macroeconomic data has slowed progress toward constructing a multi-year fiscal framework and improving forecasting. As a result, there is no regular multi-year framework presented to Parliament and the public that yields an expenditure level[17] and no COM-approved hard budget ceilings to launch the budget preparation processes.

92. The absence of a modern budget law has stalled significant reforms. The Government continues to rely on the annual budget law for instructions on the content and structure of the budget submissions; this introduces a high degree of variability and uncertainty into the annual budgeting process. Nor is there is any three-year fiscal framework provided as a regular part of the budget preparation process (although one had been required for the 2003 budget only). A one-time experiment in providing indicative budget ceilings for first-line budget entities received a lukewarm reception by the COM and was not pursued.

93. As a result, line ministry budgets continue to be constructed from the bottom up. There is little senior management involvement in their preparation. The fact that salaries and debt service charges amount to 84 percent of the total budgetary expenditures, and that these expenditures are not easily varied (if at all), exacerbates this problem. The 2005 budget follows the same budget planning process as specified in the Law on Public Accounting, shown in Table 4.

Table 4. Budget Preparation Cycle

	J	F	M	A	M	J	J	A	S	O	N	D
Budget circular sent to ministries				Δ								
Budget entities prepare and submit budget requests				Δ	Δ							
MOF negotiates budget requests with budget entities, refining budget overall						Δ	Δ	Δ	Δ			
Budget to COM by 1st Oct, send to Parliament by 15th Oct									Δ			
MOF submits Budget report (Fazlaka) for Parliament										Δ		
Budget Committee reviews draft budget law, Parliament debates										Δ	Δ	Δ
Parliament passes draft budget law												Δ

Source: Law on Public Accounting

Discussion

94. The CFAA team discussed the ministries' experience to date in the preparation of the 2005 budget. Representatives from the Ministries of Education and Public Works were interviewed to ascertain their experiences with the budgeting preparation processes. They noted that:

[17] The team was advised that MOF prepares medium term fiscal and debt frameworks for internal use only.

- MOF provides insufficient direction in the preparation of the budgets to the [18]there is no multi-year fiscal framework to provide a context for their planning, and the lack of firm budget ceilings means that budgeting is unconstrained and bottom-up, despite the fact that the multi-year framework and firm budget ceilings have been recommended by two successive IMF missions.

- Conditions do not encourage ministry ownership of their budgets. While the system is able to accommodate costed policy initiatives, these are rarely done; the CDR investment budget operates independently of the regular budget process, yet can have significant operating cost implications for ministries; there is little financial room to maneuver in a global budget that is largely pre-determined and is heavily constrained by interest on public debt and salaries. This leaves little room for management innovation in budgeting.

- There is no challenge function to individual budget units' budget proposals during the budget preparation; ministry accounting staff simply total up the budget submissions from the budget entities concerned. The MOF commitment controller is an MOF employee, concerned only with ex-ante controls. This is not to suggest that the MOF budget challenge should be reduced; rather, it should be supplemented by the internal budget challenge process within the ministries as one way of improving the MOF's efficiency when it carries out its traditional budget challenge role.

- In the absence of fixed ceilings and a challenge function within the ministries, individual ministries submit their (unconstrained) budget proposals, based on their previous year's budgets as a reference, to MOF. The MOF examines all of the ministry budget requests to determine the aggregate budget demands, compares this to forecast budgetary revenues, and then returns them to the originating ministry for adjustment to a target budget ceiling. The revised budgets are then returned to MOF, with the tutelage minister regularly involved in higher-level negotiations on budget levels and content.

- The priority for the MOF Budget Department is to challenge the budget assertion made by all budget entities that their resource levels should be at least the same as the previous year. The Government's need to reduce its deficit means that MOF must attempt to shrink the total budget request, an approach that supports a more efficient allocation of resources.

- The MOF Budget Department must develop the analytical capacity to assess the ministerial budget submissions using all relevant information to evaluate their real needs. The traditional bottom-up approach takes last year's budget levels as a baseline for the increases sought in the current submission. Proper scrutiny by MOF would force the ministries to justify the entire base, rather than the incremental increases. This capacity of financial analysis and budget challenge can be developed either by a specific department inside the MOF Budget Directorate, or through a new function to be developed in the MOF Budget Directorate counterparts for every ministry and spending agency.

[18] MOF directions on budget preparation for the next year tend to be administrative (format, data requirements) or general in nature, without hard ceilings or COM-approved spending poriorities

- La Lois des Programmes established a long-term capital program to be set in the context of the annual appropriation cycle. It applies to rehabilitation and small construction works for roads and to CDR's investment projects, both foreign and budget-funded. It provides for a three-year investment horizon, with multi-year commitments disclosed and approved by Parliament as part of the annual budget process. The Public Accounting Law provides for an automatic carry-forward of all unexpended funds in this program.[19] While providing flexibility to line ministry's capital programs, it creates challenges for the MOF's budget monitoring activities.

- Parliamentarians tend to examine detailed line items (projects) in the budgets of ministries with extensive regional operations. There is little interest to date in the strategic aspects of the budget submission; the fact that the accounting unit of the ministry is the main interlocutor between the ministry and Parliament supports this observation. Control is also exercised on a line-item basis, with approval of the minister for transfers within line items; Parliament approves transfers between line items.

Recommendations

95. The Government should continue in its efforts to implement the IMF recommendations on the multi-year fiscal framework, the COM-approved budget ceilings in the budget call letter, and the revised budget preparation framework.

96. Individual ministries should provide an internal budget challenge function to assist in the preparation of a ministry budget submission that reflects the Government's priorities and stays within the established budget ceilings.

97. Parliament should be required to re-authorize all carryovers from the prior fiscal year that are permitted by the Law on Public Accounting; such carryovers should be presented along with the budget requests so that Parliament has full knowledge and control over the authorities available to the entity for the budget year.

Budget Preparation Performance

98. Given current practice, performance measures using budget ceilings cannot be used to assess budget preparation performance. The summary comparison in Table 5 between the budget proposal from the COM and the final budget approved by Parliament does however provide an indication of the influence that Parliament has over the budget process. Details are provided in Appendix 3.

[19] Only committed but unexpended budgetary funds may be carried forward under the Law on Public Accounting; uncommitted budgetary funds lapse.

Table 5. Comparison of Submitted and Approved Budgets, FY 2001-2003

(Billion LL)

Fiscal Year	Budget Submitted to Parliament	Parliament Approved Budget	Variance (percent of submitted)
2003	11,114	10,022	-9.8
2002	11,811	10,452	-11.5
2001	11,768	11,102	-5.66

Source: MOF

Discussion

99. The Parliament has exercised a marked impact on the proposed budget. Appendix 3 shows that, in 2003, it made significant reductions (over 50 percent) in four ministry submissions. Overall, it reduced proposed spending by over 10 percent. In two of these cases (Public Works & Transportation, Environment), the major percentage reductions were in the proposed capital budgets; another (Hydraulic & Electric Resources) had reductions in operating budgets, and one (Labor) had reductions in both the capital and operating budgets.[20] This reflects the balance of power that exists among the various factions in Parliament, and the fact that the governing coalition must work closely with Parliament to obtain a workable budget.

100. As a measure of budget performance, the CFAA team believes that the strong interventionist stance taken by the Parliament on the coalition Government's budget proposals tends to reduce the significance of this measure of budget planning effectiveness. Regardless of what level of budget was proposed, and no matter how sound the justification, Parliament could be expected to alter it in a material fashion.

Municipal Budgeting

101. Municipalities operate outside of the central budget entity. There are 905 individual and 22 united municipalities in Lebanon. They were established under criteria that are no longer appropriate for a modern municipality.[21] Municipal budgets are prepared and controlled under the direction of the Minister of the Interior, who is responsible for their administration and oversight. Municipalities have several revenue sources: 16 different taxes and fees are collected at the local level; 10 percent of utility service invoices (electricity, telephone, water) issued in their region is transferred by the utilities to the municipalities' accounts; and they receive a portion of the income through the Independent Municipal Fund. MOF's role relates to maintaining the individual municipal subaccounts within the Independent Municipal Fund, which is part of the TSA. Because EDL is in deficit, it has not been remitting its deductions to the Independent Municipal Fund, claiming offsets on its legally payable deductions against accounts receivable from the Government in other areas.

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[20] The budgets of these four entities accounted for 6.4 percent of total proposed budgetary spending

[21] The law requires only a minimum of 300 citizens; many municipalities have fewer than 1,000 citizens and are unlikely to be financially viable.

102. The Independent Municipal Fund is treated as an EBF. It is part of the general government budget, but not part of the central budget. There are no financial statements prepared for this fund. It operates outside of the budget, invisible to Parliament and the public, yet it is responsible for the vast majority of the municipal government revenues. Currently, its revenues are determined in law and by decree; they are not under the control of the municipalities, and have not been changed in many years. As a consequence, the fund appears to be in surplus, before the costs of municipal garbage collection are covered; these were estimated by an MOF advisor at LL175 billion annually. However, taking this latter expense into account, the fund is in deficit. The CFAA notes that, as of September 2004, solid waste costs accounted for the majority of the LL334 billion transfers to the municipalities.[22] An audit of the fund would be useful in establishing its current financial condition; conducting such an audit would be the responsibility of the responsible minister.

103. The Independent Municipal Fund disbursements are established as 10 percent to the syndicates, 5 percent for civil defense, and 85 percent to the municipalities (60 percent of which is based on the number of registered inhabitants and 40 percent on a two-year moving average of income). Table 6 provides a measure of the receipts and expenditures of the fund; no other financial information was available.

Table 6. Receipts and Expenditures, Independent Municipal Fund, 1998-2003

(Billion LL)

Year	Receipts	Expenditures*	Surplus/ Deficit (-)
1998	468	199	269
1999	404	167	237
2000	561	434	127
2001	385	110	275
2002	445	345	100
2003	436	180	256

*Excludes annual garbage collection costs of some LL175 billion.

Source: World Bank

104. The CFAA team noted that the financial statements for the Independent Municipal Fund are not transparent to Parliament or the public. It was also advised that the Court of Accounts has not audited the fund's account. It is not clear how the deficit in the fund will be addressed by the Government. Unresolved issues with EDL also compound the problem. The MOF should move immediately to remedy this oversight through a full disclosure of the financial statements of the fund in full conformance with IPSAS standards in its annual budget execution report. The Court of Accounts should also commence an annual audit of this fund.

Recommendations

105. An audited annual financial statement of the Independent Municipal Fund should be prepared by the MOF and reported to Parliament as a schedule to the final budget execution

[22] MOF, *Public Finance Quarterly Report, Q III 2004,* p. 11.

report. The annual audit of these financial statements should be conducted by the Court of Accounts.

Current and Capital Budgets

106. At present, the link between the capital budget of the Government and its operating budget is not well established. The EDL capital budget includes operation & maintenance (O&M) expenditures for those projects contained in the capital budget. This is a mis-classification of capital budgeting, as these O&M expenditures belong in the operating budget. Thus a completed capital project will not automatically generate an approved O&M budget for its maintenance. This undefined link is a direct result of the lack of a multi-year budgeting approach recommended by the IMF, the WB and other experts.

107. The IMF report recommended that steps be taken to more closely integrate the two budgets. This would improve aggregate control of budget expenditures and priorities, link the future budgetary expenditure implications of the investment budget, and improve the flow of information between the MOF and the CDR during the separate budget formulation processes. Specifically, the IMF recommended that: the main budget should include all CDR loans and expenditures: the Government should immediately implement a mechanism to strengthen the coordination of the current and capital expenditures within line ministries, such as a systematic recording of all investments in order to capture the downstream operating budget costs from completed investment projects; and the Government should improve coordination between line ministries and the CDR to lead to the development of comprehensive sectoral investment strategies.

108. The CFAA team did not observe any progress in this area, and endorses fully the IMF mission recommendations.

F. Budget Execution

109. Since 1993, IMF FAD missions have focused on a number of areas that form part of the budget execution processes.[23] These include the development of a Treasury function and organization to perform the functions; of expenditure and cash management processes; of debt management; of improved commitment controls; of payment authorization procedures and processes; and of banking arrangements. The Government has made progress in a number of areas, including a new budget classification system, based on the GFS 1986 standard; computerized budget, treasury, payroll and pension management; elimination of carryovers in 1997; and the elimination of agency accounts in private banks. While progress has been made, much remains to be done. A number of further changes proposed by the Government are stalled in Parliament. Others remain to be addressed.

110. An overarching issue is the definition of what constitutes an appropriation. At present, the appropriation definition permits a budget entity access to its entire appropriation, with no consideration of cash availability. The IMF recommended a redefinition of the term "appropriation" to mean an authority to spend up to the appropriated amount, but subject to an MOF-approved predetermined commitment profile for the given year. In this way, an

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[23] IMF, op. cit, p. 7.

appropriation amount need not necessarily equal the approved level of commitment, and MOF could effectively practice global cash management.

111. A second critical issue is the use of continuing appropriations. Article 114 of the Law on Public Accounting specifies that unused funds in the investment budgets, whether committed or not, may be carried forward into a subsequent fiscal year with a continuing authority. For the operating budgets, committed funds are similarly treated. In effect, this superimposes a multi-year investment budgeting process onto an annual budget appropriation process.

112. The resulting freedom of action without concomitant planning and control creates a high-risk situation for the MOF. These appropriations accumulate and, once approved initially, exist outside of the annual budget approval process. The amounts involved are substantial: MOF advised that the current carry-forward is estimated at LL2 trillion for commitments (10 percent of GDP) and uncommitted amounts carried forward were LL500 billion (2 percent of GDP). Carryovers are not fully financed.[24] Their magnitude threatens effective expenditure management and sound cash management, making the task of MOF extremely difficult. In addition, Parliament is not fully informed on an ongoing basis of the total commitment authorities outstanding when approving the upcoming investment and operating budgets.

113. Parliament should be informed in the budget on the level of carry forward for all proposed individual project (sub-item) level. In that way, they could make more informed decisions on the required levels of spending for the upcoming fiscal year. In addition, the lifetime of these carry-forwards should be restricted to five years, after which the authority would lapse. In the longer term, multi-year budgeting could also help provide more transparency to this process.

The Expenditure Cycle

114. The CFAA and numerous other studies have noted the complex expenditure cycle, its degree of duplication, and the overlap in responsibilities. The result is a non-transparent, lengthy and costly expenditure process that does little to encourage efficiency, contributes to increased non-compliance, and discourages accountability for decisions taken. The expenditure cycle is shown in Appendix 4. MOF staff advised the CFAA team that an average transaction can require approximately 30 signatures to complete the cycle from initiation to payment.

Commitment Phase

115. At present, there are two ex-ante commitment controls in operation:

- Internal ex-ante control is exercised by MOF Commitment Controllers, located in the line ministries.[25] They are MOF staff members, paid for entirely by the MOF budget and rotated annually to avoid capture by the line ministry. The controller's focus is on legal compliance with the appropriation granted by Parliament as well as with all other

[24] While donor components are financed, the department investment budgets dedicated to the CDR are not; these are the threat to the fiscal framework.

[25] There are presently 22 financial controllers, servicing 41 entities on site and 33 other budget entities remotely, including public enterprises acting under the Law on Public Accounting.

applicable legislation affecting the particular transaction.[26] In keeping with the absence of cash profiles for each line ministry and appropriation, the MOF controllers in the line ministries perform no verification for the timing of cash flows. Line ministries can presently commit their entire appropriation at any time of the year, with no regard for whether MOF is able to finance it.

- For commitments that exceed certain thresholds (see Table 7), the request is sent to the Court of Accounts, which has 10 days to review the request and make its recommendation. This is passed back to the controller, who then sends the approved request to the ministry accounting unit for onward processing. Refused requests are returned to the originating unit.

Table 7. Limits of Delegated Authority for Commitment Controllers

Item	Authority Limit < (Million LL)
Competitive Tender	75
Non-tendered Contract	50
Goods & Services	25
Grants & Subsidies	15

Source: Public Accounting Law

116. It is inappropriate for the Court of Accounts to perform ex-ante verification of transactions. INTOSAI standards for external auditors do not support this, as it puts the Court of Accounts in a potential conflict when it performs its ex-post verification of the transaction. As well, the presence of the external auditor in the approval process may result in the commitment controller not exercising his judgment on the transaction. By deferring to the external auditor who may be less informed on the work on the entity, the control framework is weakened.

117. Ex-ante control should be exercised by the accountable entity. It should not be performed by the Court of Accounts or the resident MOF commitment controller. In a modern expenditure control framework, commitment control would be assigned to the responsible and accountable ministry, and the function of commitment controller would be exercised by a ministry financial official. This change had been recommended in the amendments to the Law on Public Accounting, submitted to Parliament in 2000.

118. Parliament has expressed concerns over the simultaneous withdrawal of the Court of Accounts and the MOF financial controller from the ex-ante control process. They feared a loss of internal control should this occur. As a result, other options have been proposed, including retaining COA's ex-ante role, but with higher thresholds before they are implicated in a transaction; or retaining the MOF commitment controller role and eliminating the COA from the process. Neither is attractive in the medium term. Under no circumstances should the Court of Accounts continue to be involved in the ex-ante approval process; this involvement undermines

[26] This is a major challenge for the controllers, who must master all legislation that could potentially impact on any transaction passing through the spending process. The annual rotation of these commitment controllers ensures that this requirement is not effectively enforced, although the interpretation of the controller's signature is that the transaction fully complies with all applicable legislation.

their objectivity and perceived neutrality. Having the MOF financial controller approve ex-ante all expenditure requests also means that accountability for all public sector spending rests with the Minister of Finance.[27] This degree of centralization erodes the accountability of the spending ministry for all decisions made involving its authorized funds.

119. Another option may be worth exploring. It would involve the immediate withdrawal of the Court of Accounts from the ex-ante approval process and a strengthening of its ex-post audit function with the addition of performance audits. The MOF financial controller would be retained in the ministries and other entities until such time as, in the opinion of the COM and on the recommendation of the Minister of Finance, the entity's internal controls are deemed to be sufficiently well-developed that they could assume this MOF-delegated responsibility. Such delegation of authority from the Minister of Finance to the tutelage Minister could be withdrawn if the ministry abused its delegated authority and weakened internal controls. This arrangement would permit a phased implementation of the Government's accountability and control regime, tailored to the individual progress made in each ministry. It could be an incentive for the ministries to achieve those priority PFM reforms that the MOF was promoting (e.g. establishment of effective internal audit, meeting staff training standards, performance budgeting).

120. MOF needs the authority to exercise greater control over commitments. By redefining in law the use of the term "appropriation" and requiring the approval of Parliament for continuing authority, MOF should be able to better manage those carryovers that are approved. Such an approach is consistent with the IMF recommendations for the establishment of clear rules for limiting carryovers and requiring re-appropriation for those commitments that are to be carried forward into the next year. The MOF should also allocate the annual appropriation into expenditure categories, by month and by quarter. These cash limits would serve as the maximum payment profile for each budget entity for its commitments, and the commitment controller would retain the responsibility for ensuring adherence to these limits.

Settlement Phase

121. The expenditure cycle beyond the commitment process involves the originating ministry for acceptance of the expenditure, the MOF disbursement directorate for the issuance of a liquidation document, and the MOF Treasury for payment.

122. Within the ministry, the settlement process is unduly complicated. For example, the schedule of recommended payments is sent to the tutelage minister for approval before forwarding it to the Treasury. This procedure is unnecessary, and presents the risk of bureaucratic influence in the scheduling of the payments. It also makes the minister responsible for cash management within his ministry, not an appropriate role for a minister, nor does it make for effective cash management at the government level. Over the medium term, each ministry should assume all responsibility relating to the commitment of expenditures, liquidation, and the issuance of payment orders once the purchased goods or services have been delivered. This can only be done in the context of a significantly improved internal control framework.

Treasury and Payment Processes

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[27] In fact, the Minister has been called to account by Parliament for expenditures initiated in another ministry, but approved by the MOF commitment controller.

123. In the past, the treasury functions were not consolidated into one organization within MOF. The Government has moved to establish a separate Treasury Directorate, consolidating most of the functions normally found in a modern treasury office into this new unit. At present, the Treasury Directorate is supported by information technology systems and revised budget and expenditure classifications that comply with international standards. Because the Treasury is a relatively new unit, its operations continue to evolve. Additional steps remain to be taken and are being addressed. These include rationalization of the overlapping ex-ante payment controls exercised by the Expenditure Control Directorate and the Treasury's Payment Order Department.

124. In order to move from a system designed to prevent unauthorized expenditure to one that focuses more broadly on effective and efficient financial management and control, other improvements will be necessary. The Fund identified seven future improvement initiatives: (i) implementing financial plans and performing cash management of the Government's cash balances, (ii) eliminating ad hoc treasury advances; (iii) linking controls on commitments to available financial resources; (iv) use of a Treasury Single Account (TSA) to handle all revenue and expenditures transactions of all public sector non-commercial entities; (v) elimination of local office cash transactions to the maximum possible extent along with the practice of netting of transactions; (vi) instituting regular banking charges for TSA transactions in the Banque du Liban; and (vii) increasing the institutional focus on prudent risk management for cash and debt management.[28] The CFAA endorses these recommendations, and notes that the Government is pursuing their implementation.

125. The Government has moved to formally establish this Treasury Directorate. A bill was submitted to Parliament authorizing its creation and staffing; it too has been stalled and the current organization is operating on a temporary ad hoc basis. Parliament has expressed concern over the level of new resources that the bill would authorize for this function. The Government has the opportunity to respond to this concern by eliminating the duplication in the ex-post review function that exists between the Disbursement Directorate and the Payment Order department of the Treasury, and by reallocating some 40 staff positions to the new Treasury directorate, thereby reducing the requirement to hire new staff.

Banking

126. The TSA and its system of accounts are fragmented and incomplete. The IMF noted a number of accounts in the BDL, covering revenues and expenditures (account 36), four Treasury bill accounts, and a number of specific accounts for VAT refunds, interest withholding, and grants. It noted that the Customs Directorate pays its expenditures out of revenues and deposits only net receipts in account 36;[29] other small expenditure categories are still paid in cash at the 24 local accounting offices. All public institutions, including the CDR, have separate local currency sub-accounts in the TSA. There are 40 transit accounts operated by line ministries, mainly for foreign currency; donor accounts for government assistance is kept in commercial banks. The procedures for daily reconciliation of these accounts are not always followed, nor are

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[28] IMF, op. cit, pp. 42-43.

[29] The CFAA understands the reason behind this netting, and urges the Government to move to a gross basis as soon as practicable.

reconciliation reports produced on a regular and complete basis. The Government neither receives, nor is charged[30]), interest on its accounts in the BDL.

127. The IMF report made a series of recommendations for improvement, including: the consolidation of all central government bank accounts (including the CDR and SOE accounts) into the TSA (account 36) or, at a minimum, converting them to a zero balance account (ZBA); convince donors to close their commercial accounts and to use the TSA for donor-financing payments;[31] implement standard market-based interest payments and charges, as well as transaction fees for the TSA and all other government accounts; require competitive bidding by commercial banks to provide banking services for government; implement formal and comprehensive bank reconciliation reports; computerize fully the payment process and eliminate any cash payments, requiring them to be made through bank transfers; and make all cash collections via the commercial banks. The Government is in the process of implementing a number of these recommendations. The CFAA endorses these recommendations, and recognizes the Government's work to implement them over the medium term.

Cash Management

[30] While it is true that the government does not receive any interest payments on its deposits at BDL, it pays BDL market interest on any of its borrowings from it – with the exception of the borrowing performed under Paris II.

[31] One approach, used in Macedonia, is to permit the donors to keep their funds outside the TSA, but to establish a mirror account in the TSA that would be used to finance in Lebanese Livres all transactions funded by donors

128. Proper cash management will increase the efficiency of government. The IMF team estimated that appropriate consolidation of the cash balances of all government accounts (in the TSA, using ZBAs) would reduce the Government's debt by US $500 Million, a significant amount.[32] In its report, the IMF identified a number of issues to be addressed to enable proper cash management of the Government's financial resources. The CFAA strongly supports these recommendations, and provides a synthesis of these recommendations in the form of an approach to implementing effective cash management within the public sector, outlined in Box 2. The legal reforms are prerequisites to the other steps, as they provide the authority and the mandates to perform cash management

BOX 2. STEPS IN IMPLEMENTING EFFECTIVE CASH MANAGEMENT

1. Amend the Law on Public Accounting to:
    a. Redefine an appropriation to be subject to the availability of cash to finance the appropriation, as determined by the MOF.
    b. Require annual, quarterly and monthly cash management plans to be submitted by all budget entities;
    c. Make the Treasury responsible in law for the supervision of all government bank accounts and all financial planning and cash management activities on behalf of the Government. This would be undertaken in consultation with the BDL, major revenue collection entities, and the MOF budget directorate.
    d. Require regular reconciliation of all accounts in the TSA as determined by the MOF.
2. Centralize Cash Balances in the TSA by:
    a. Eliminating all separate central bank accounts of all public institutions by closing or converting them to daily ZBAs in the TSA.
    b. Negotiate with donors to close their commercial bank accounts and use the TSA, as is done in a number of other countries.
    c. Eliminate all cash payments and receipts, except for petty cash and collections, requiring all transfers to be made through a commercial or the central bank.
3. Apply market rates of interest to TSA account balances (both debits and credits) and apply commercial transaction fees to transfers to reflect the cost of money in cash management decisions,
4. Integrate the three Debt Management Financial Information Systems currently in operation in MOF, CDR and BDL into a single system and interconnect it to the existing FMIS in MOF in order to provide timely, complete and accurate information to the Treasury cash management unit. Over the medium term, consider locating all debt management functions in the MOF, with the BDL acting as the Government's agent for debt market transactions.
5. Obtain training for cash management staff through a combination of education and on-the-job training, assisted by a donor-financed technical expert.
6. Conduct cash management activities, accompanied by regular cash management reports to all management in MOF and elsewhere, as determined by MOF.

[32] IMF, *loc cit*, p. 54.

Budget Execution Performance

129. There are a number of measures to assess the performance of the MOF and line ministries in executing the budget approved by Parliament. The WB uses a measure of the deviation of the actual deficit vs. the budgeted deficit as one measure of the ability of the Government to plan and execute its budget. In cases of significant variances between the actual and budget amounts, the CFAA's assessment, detailed in Appendix 7, suggests that the PFM system is not delivering effective fiscal discipline. Good budgetary practice includes continuous budget monitoring and review processes. An important contributing factor is a mid-year review to update the revenue forecast and making corresponding adjustments to expenditure to maintain the deficit target.

Table 8. Actual vs. Budget Deficits as a Percentage of Budget Expenditure, 2001-03

Year	Primary Deficit (-) or Surplus (million LL)			Aggregate Deficit (million LL)		
	Budget	Actual	Deviation (as % Budget)	Budget	Actual	Deviation (as % Budget)
2001	-700	854.3	**222%**	-5000	-3457	**31%**
2002	625	1534	**145%**	-3875	-3088	**20%**
2003	1875	2283	**22%**	-2125	-2591	**22%**

Source: MOF

Table 9. Revenue Collection Effectiveness, 2002-03

(Billion LL)

Revenue		2002	2003	Average Deviation
VAT	Deviation	+24%	+24%	+24%
Customs & Excise	Deviation	-11%	-8%	-10%
Income tax	Deviation	+12%	-12%	-8%
Other taxes	Deviation	-14%	-17%	-16%
TOTAL	DEVIATION	**1.0%**	**5.5%**	

Source: MOF

Discussion

130. The Government's performance in its fiscal deficit budgeting requires serious attention. As shown in Table 8 above, the actual fiscal deficits have exceeded the budgeted level by more than 20 percent for the past three fiscal years, well above the 5 percent threshold suggested in the WB framework . This is due to the fact that the actuale xpenditures include extra budgetary payments such as EDL, municipalities, expenditures on account of previous budgets, etc. This confirms the CFAA's findings regarding the risks involved in carryovers of large investment amounts (primarily in the CDR budgets) and in the conversion of loans to public enterprises to grants at year end. Until these factors have been addressed, the Government's management of its expenditure budget will remain a challenge.

131. In a similar vein, revenue forecasting has been highly variable. Because the revenue forecast is the foundation for the preparation of the aggregate expenditure budget, it is important that it be as accurate as possible. Underestimation can result in large supplementary budget submissions later in the year (or debt reduction); overestimation can lead to cash rationing and

other techniques to slow the rate of expenditure. Although Table 9 shows that the aggregate actual revenue deviation from budget has been minimal (1.0-5.5 percent), this masks wide variations in its components (see Appendix 5 for further details). The Government's inaccurately forecasted two new major fiscal measures: the VAT which impacted consumption patterns in the country and trade patters also (therefore trade revenues), and the Tax Amnesty Law which impacted heavily the income tax revenues. MOF advised that the poor record in forecasting VAT revenue is due to two factors: the newness of the VAT and the resulting lack of experience as to just how it will perform; and the absence of reliable key macroeconomic parameters that are essential to any forecasting model for government revenues[33]. In any case, the MOF should move to increase the accuracy of its VAT and other revenues forecasts.

132. Other than the newly-implemented VAT and tax on interest earned, all other revenue collections have generally fallen significantly short of forecast amounts. In addition to its ongoing efforts to improve macroeconomic forecasting capacity the Government should review its forecasting methodology to adopt a more conservative approach to these revenue estimates. Revenue forecasting is a continuous activity, responding to endogenous factors (such as the approval of new tax and other fiscal measures) and exogenous events (higher than expected euro inflation, higher oil prices, regional political events, etc.) This ongoing updates of projections is essential for cash management throughout the year and is critical for sound public finance management.

Recommendations

133. The Government should amend the Law on Public Accounting to redefine the point at which a commitment is created and to define an appropriation as an authority to expend an amount that is in an MOF-approved annual and MOF-approved monthly expenditure plan;

1. The Law on Public Accounting should be amended to restrict the lifetime of such carry-forwards to five years, after which time they would lapse. Parliament should be informed in the budget of all carryovers from prior fiscal years by project. This would ensure that Parliament has complete knowledge of all spending authorities available to the entity for the budget year.

2. The Government should resubmit the proposed amendment of the Law on Public Accounting to immediately remove the COA from the ex-ante approval process (see also discussion in the chapter on the COA below).

    a. The amendment should retain the MOF commitment controller function until the COM, on the recommendation of the Minister of Finance, agrees that the individual ministry's internal control framework is sufficiently robust to permit

[33] The forecasting macroeconomic aggregates such as inflation, growth, higher oil prices, etc…is not performed by the Ministry of Finance. For its revenue forecast the MOF uses these parameters as forecasted by other agencies, or by the IMF. In Lebanon it is usually the Central Administration of Statistics, the Ministry of Economy who published the 1997-2002 national accounts or the BDL (they implement the INSEE Business Survey), who are responsible for publishing macroeconomic aggregates. Until September 2005, Lebanon had no national accounts, and the overall statistical weakness in the country adversely affected M OF forecasting accuracy.

the delegation of this function to ministry financial staff.[34] Such delegations shall be reported to Parliament in the annual budget submission, and shall be subject to periodic MOF audit. In cases of loss of effective internal control, the delegation shall be withdrawn by the Minister of Finance.

134. The Government should remove from the Law on Public Accounting the unenforceable requirement for the commitment controller to certify that proposed transactions are not in violation of all relevant laws or regulations.

135. The Government should remove the minister from the process of scheduling payments before submission to the Treasury and substitute a strict first-in, first-out (FIFO) rule for processing and payment[35]. All deviations from this FIFO principle must be reported to the COA; material deviations must be reported by the COA in its annual report to Parliament.

136. The Government should adopt more realistic revenue forecasts for all of its component revenue streams to bring forecasts closer to actual revenue collections.

137. The Law on Public Accounting should be amended to require the submission of regular cash management plans by all entities in receipt of budgetary resources to the MOF and to empower the Treasury to undertake cash management activities on behalf of the Government of Lebanon.

G. Budget Risk Assessment

138. The CFAA considers the budgeting process to present a **high** fiduciary risk for the Government for five reasons:

- Major financial transactions occur outside of the central government's reporting entity.

- The existing governance structure for public enterprises requires significant strengthening.

- Key IMF recommendations to improve budget preparation, including a multi-year fiscal framework, Cabinet-approved global and ministry budget ceilings, and a revised budget preparation process, remain outstanding.

- There are extremely high levels of commitment authority for investment budgets that are carried forward into subsequent fiscal years without parliamentary re-affirmation, and large advances to selected public autonomous agencies are converted to budgetary transfers at fiscal year end without prior approval of Parliament.

- The Government's budget execution performance is weak; deviations of budget compared to actual expenditures have exceeded 20 percent for the past three years.

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[34] This is also known as the Hurdle Approach, where each ministry must fulfill a small set of internal control criteria before increased delegation is given. See Geoffrey Dixon and Bill Dorotinsky, *PREM Public Sector Note #73, August 2002*.

[35] MOF advised the team subsequent to the preparation of the report that the procedure has recently changed and is now more in line with paragraph 135.

Chapter 2: Public Sector Accounting & Reporting

A. Legal Basis

139. The Law on Public Accounting provides the legal basis for the accounting procedures to be followed by government entities. It stipulates that an order of the Minister of Finance establishes the general rules for the organization of the public accounts (Article 163), and that there shall be a one-month complementary period in which expenditures liquidated by December 31st can be authorized up to January 31st of the following year (Article 80).[36] The Minister of Finance has adopted the modified cash basis of accounting, cash accounting for revenues and expenditures, plus a 30-day complementary period for expenditures liquidated within the fiscal year but not yet authorized.

140. There is no requirement in law for the Government to follow defined international standards for accounting, reporting or auditing. While the Government states that it does follow international standards,[37] this is not specified by law. It should be. For greater certainty, the applicable international standards to be followed for all government entities, shown in Table 10, should be specified in the Law on Public Accounting or in the appropriate laws on auditing. This prescription should cover budgetary and extra-budgetary entities, as well as the independent entities of public law.

Table 10. International Accounting, Reporting and Auditing Standards and Application

Standards Body	Standard	Applies To
International Accounting Standards Board (IASB)	International Accounting and Financial Reporting Standards (IAS/IFRS)	All entities established under private sector laws
IFAC Public Sector Committee	International Public Sector Accounting Standards (IPSAS)	All public sector entities subject to public sector laws
Institute of Internal Auditors (IIA)	International Standards for Auditing (ISA)	All internal auditors in public and private sector
International Organization of Supreme Audit Institutions (INTOSAI)	Various pronouncements	All Supreme Audit Organizations doing external audits of government spending

Source: World Bank

B. Accounting

141. This report has identified deficiencies in the scope of the reporting entity and the omission of certain revenues and expenditures from parliamentary oversight. The strict application of IPSAS would correct these concerns. At present the Government has a chart of

[36] There have been frequent instances of abuse, where the complementary period has been extended to March under Article 9, which permits clerical errors to be authorized by the Minister of Finance up to March 15th of the following year.

[37] There is a High Accounting Council, chaired by the MOF Director General (and attended by the Minister whenever possible) that deals with issues relating to accounting practices.

accounts with economic, functional and organizational classifications that respond to its needs for the budgetary and the extra-budgetary entities. There is no program classification in place to support the multi-year expenditure planning framework recommended in previous donor studies. While rules are established for budget entities, there are no comparable rules for the municipalities and public entities.

142. The Government currently follows a modified cash basis of accounting for its appropriations. The cash basis is used for revenues; expenditures can be paid in the one-month complementary period. Its chart of accounts complies with the GFS 1986 standard and the Government had indicated a desire to move over time to a GFS-2001-compliant framework. That framework can also support a long-term move (over five to ten years) to performance-based budgeting, and a phased migration from the current modified cash-based accounting to a full accrual basis, as recommended in the IMF report.[38] It also noted that this move would enable the recognition in the accounts of the economic substance of the transactions, would capture new accounts on economic stock and liabilities in the Chart of Accounts, and would provide a basis of accounting that would be common across all government budgets, including those of extra-budgetary entities and public enterprises.

Table 11. Long-term Migration from Cash to Accrual Accounting

Phase	Description	Components
1	Strengthen Cash-based Accounting	• Develop migration strategy from cash to accrual basis of accounting • Implement IPSAS cash-based accounting standards • Develop and disseminate the new GFS 2001-compliant Chart of Accounts
2	Incorporate receivables and payable, financial assets and liabilities into the accounts and reports of the Government	• Compile all financial assets and liabilities, following IPSAS recognition principles • Compile all receivables and payables, following IPSAS recognition principles
3	Incorporate non-financial and contingent assets and liabilities into the accounting and reporting of Government	• Identify and record contingent liabilities and government guarantees (including EBFs and SOEs) • Record new fixed assets purchased and disposed • Identify and record major and other assets and liabilities • Record consumption of fixed assets on annual basis

Source: IMF Consolidating Public Expenditure Management Reforms, January 2004.

[38] IMF op. cit, pp. 60-69.

Discussion

143. The CFAA team believes that the Government should embrace fully the IPSAS and that this should be reflected in the Law on Public Accounting. These standards can be either cash-based or accrual, with mandatory requirements for both bases. In addition, optional accounting and reporting for those items needed for accrual accounting are also contained in the IPSAS standards; these will support a phased migration from cash to accrual accounting, while still complying with IPSAS standards. The Government should also ensure that its charts of accounts for the public sector outside of the budget entities maintain comparability with those of the Government as it evolves towards GFS 2001 compliance.

144. The IMF study recommended that the practice of the three-month complementary period be discontinued, and that the one-month period be strictly enforced. The CFAA concurs. The provision of the three-month period is intended to permit accounting adjustments by MOF in the preparation of the final accounts statement, and is not meant for regular transaction processing. Its use should be restricted to that purpose.

145. The Law on Public Accounting should also be amended to delegate to the Minister of Finance the decisions as to when and how to begin the migration from the pure cash basis of accounting and to establish the accounting policies to be followed by government entities during the transition. These decisions must be disclosed in the notes to the financial statements. Responsibility for establishing these policies should continue to be assigned to the MOF Accounting Bureau; however, its capacity to undertake the development of internationally based accounting policies that support a migration to accrual accounting will require strengthening.

Recommendations

146. The Law on Public Accounting should be amended to require full compliance by the government entities with the IPSAS international standards for accounting and reporting.

147. The Minister of Finance should have the authority to prescribe new accounting policies that reflect a migration from cash-based accounting to full accrual accounting.

148. These migration policies should also comply with IPSAS standards; the accounting standards used by public entities should similarly comply with IPSAS or IASB standards, depending on their public or commercial basis.

149. The staff of the MOF Public Accounting Bureau should receive training and technical assistance in the development and implementation of IPSAS modified cash accounting policies and procedures for government entities; migration strategies towards accrual accounting; and consolidation accounting techniques to prepare the consolidated financial reports that accompany this migration.

C. Financial Management Information Systems

150. The IMF team observed that the MOF had made significant progress in implementing its IT-based financial applications, including budget processing, payroll, treasury and tax management. It confirmed the appropriateness of the development principles underlying IT work, including a focus on improved productivity, public access and service delivery, and

reduced costs. Modern design principles would be used for new applications (such as web-based designs) along with a more integrated approach to financial management systems.

151. The IMF team noted, however, that the reforms appeared to be largely technology driven, with insufficient MOF management involvement and ownership in the development of the new financial management framework and its various components in a fast-changing environment, a common problem faced during IT reforms. The IMF recommended an improved governance process over the IT development process that would include a clear definition of the organizational roles and accountabilities for delivery of the required IT functionality, and the creation of a high-level stakeholder group from MOF, BDL and selected ministries to develop a global strategy to guide future financial systems development. The group could also be useful in advising on risk mitigation approaches in the development of new systems.

152. The CFAA team observed that the current IT systems have been successfully implemented, a notable achievement among countries in the region. IT systems implementation in Lebanon has increased transaction processing accuracy and improved the availability of financial management information for accountability and decision-making. However, the reforms have occurred within the existing financial and budget processes. This has resulted in the continuation of existing paper-based procedures, involving the same flows of supporting documentation as before automation and the maintenance of the overlap and duplication of internal controls over spending and MOF-focused management information. Individual ministries have gone their own way and developed their own financial information systems to meet their operational requirements.

Discussion

153. The existing financial management information system (FMIS) supports the Government's present budgeting and payment processes. It is composed of a number of modules, covering budgeting, payroll, revenue, treasury and debt management. The debt management system, DMFAS, is operated by three entities (Banque du Liban, CDR and MOF) and is not integrated with the other system modules. The FMIS is designed for use by the MOF in Beirut and in its regional offices; a number of individual ministries have their own, free-standing financial systems.

154. A new online enquiry system enables MOF staff to monitor transaction processing at the individual transaction level. This facility has also been offered to the COA to assist in their audit work, but there has been no response to date. The SWIFT system is now being studied to serve as the basis for government funds transfers for supplier payments and staff payrolls, using the banking system rather than cash or check payments. This will require a wide-area network for the system to be rolled out to all major budget entities before the benefits of electronic payment settlements can be fully realized.[39]

155. No consideration is presently being given to the next generation of financial systems, their availability, functionality and costs, although the number of changes in budget accounting and reporting process would seem to warrant a closer look.

[39] The team was advised that problems have arisen in rolling out the system to all budget entities because of network delays occasioned by outstanding arrears owed by the Government to Lebanon Telecom.

156. The IMF expressed concern as to whether the existing FMIS can evolve to meet future budget requirements. The CFAA team noted that the existing system has automated the existing paper-based processes, and in fact the processes are all still paper-based. Authorizations are made on paper, in keeping with the exiting legal requirements. In IT terms, this is known as “paving the cow path” rather than building a new higher speed and greater capacity “highway.” Instead of taking advantage of the new technology to redesign the existing budget processes, the old processes are simply automated. In an evolutionary context, this is an understandable low-risk approach.

157. The CFAA team believes that this approach will not be cost-effective in the future environment, and that the IMF-identified alternative deserves serious consideration. A number of evolutionary changes are creating a new set of conditions that will require the Government to reconsider its future IT systems development strategy.

- There are two bills before Parliament, dealing with electronic transactions and digital signatures. When passed, these laws will permit a total redesign of the FMIS that can radically reduce cost through the elimination of many paper transactions, speed workflow and authorizations, provide a complete audit trail for all transactions, and support continuous external and internal audit throughout the year.[40]

- The evolution of the basis of accounting from pure cash to modified cash and ultimately to accrual accounting will require major system modifications (e.g. accounts receivable and payable, recording of transactions relating to assets and liabilities, inventory valuations, and fixed asset depreciation).

- Systems changes will be necessary to support the multi-year budgeting process, together with a chart of accounts that is GFS 2001 compliant, with functional and program classifications to support results-based management and reporting.

- Payroll management needs to be more closely integrated into the FMIS, given its importance in the composition of total expenditures.

- The needs of individual ministries for financial management information to control their operations will become increasingly important, and greater integration with the central FMIS will be necessary.

- Consolidated reporting of public sector entities, including EBFs and public enterprises controlled by the Government, will require fully integrated, or at least compatible and linked, systems right across the whole public sector.

Recommendations

158. The CFAA recommends that the Government examine the requirements of individual line ministries to interface their financial systems with the central MOF FMIS and take those steps necessary to increase their interoperability.

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[40] This was anticipated in the KPMG report, which devoted significant effort to business process redesign (*Budget Execution and Treasury Management Review and Reform of Procedures and Controls*, November 1998).

159. The MOF should begin now the process of defining the next generation FMIS in terms of the needs of all users and the functionality it will be required to provide.

a. These future processes should take advantage of the electronic transaction and digital signature legislation, when passed by Parliament, to completely modernize and streamline the system of internal controls, maximizing the opportunities for built-in internal control processes and eliminating paper-based transaction to the greatest possible extent.

b. Senior MOF management must lead this process and must not leave it to the technical experts to formulate a recommendation for management approval.

160. A rigorous, formal, cost-benefit analysis must be undertaken by an independent third party, reporting directly to the MOF Director General, on the make-or-buy decision for the next generation FMIS.

E. Reporting

161. The present MOF reporting practice significantly exceeds the legal requirements. The IMF ROSC on Fiscal Transparency, conducted at the same time as this CFAA, dealt extensively with the reporting aspect of government operations. It noted that the Government provides annual and quarterly financial statements, monthly statistical reports, and annual economic and fiscal reports. The revenue agencies also post relevant tax and customs information on policies, practices and statistics on their websites and through other dissemination means. Subsequent to the Paris II agreement, the annual budget report included a section on the aggregate debt levels.[41] The IMF noted that separate systems are used for foreign-financed debt (DMFAS) and for domestic debt; they are not audited by the Court of Accounts, and are maintained by different organizations (BDL for foreign debt, MOF for domestic debt, CDR for investment borrowing). The current reporting practices should be enshrined in the Law on Public Accounting.

162. The annual budget request report submitted to Parliament does not cover all aspects of the Government's financial operations. Information on extra-budgetary funds is limited. For example, the NSSF is essentially invisible to Parliament, despite its major impact on the citizens of Lebanon. Foreign-financed investments carried out by the CDR are similarly missing from the budget, which discloses only CDR's domestic capital spending and its operating budget. The foreign financed capital spending of CDR is not completely absent from the budget as it is reflected indirectly through the principal repayments under debt service expenditure. There is no detail provided on the expenditures of public enterprises, nor on the operations of municipalities beyond budgetary transfers. This occurs despite the fact that the central government would likely bear ultimate financial responsibility for unmet obligations arising in these entities as a moral hazard.[42]

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[41] MOF prepares monthly detailed debt reports that are summarized and reported externally in the quarterly and annual debt reports.

[42] While technically not a central government responsibility, any defaults by a public enterprise, EBF or municipality would be reflected in the financial markets as a failure of the central government, with the associated adverse impact on its market interest rates for future borrowings.

163. Contingent liabilities arising from loan guarantees are reported. However, those associated with future pension entitlements, privatization activities, or outstanding legal actions are not reported. Legislation relating to non-budgetary activities is not assessed for risk to the budget. Tax expenditures are not disclosed to the public, despite the fact that expenditures associated with income tax exemptions can be significant, and the estimated costs of new policy measures are not included in the budget. All such information should be regularly reported in the budget, or as appropriate, in the quarterly and annual financial reports of the Minister of Finance.

164. The annual budget report, the Fazlaka, discloses the spending plans of the central government to a reasonable level of detail. However, the IMF noted that significant unreported loans were made by the Banque du Liban to a number of public enterprises, such as EDL and water distribution entities, to cover their losses arising from public service obligations imposed by the Government. The IMF also noted that the 2003 outlays for EDL to cover losses and debt repayment amounted to 2.5 percent of GDP and that significant arrears still existed for a number of these entities. All are unreported to Parliament, as are financial assets representing equity investments in public enterprises, investments by the NSSF and other insurance schemes.

165. Budget execution reports are not timely. The budget execution report is prepared, audited by the COA, and submitted to Parliament in time for the new budget that is two years after the completion of the fiscal year on which the report is based. This falls short of international best practice, where such statements are available within six to nine months of year end. Moreover, the scope of the report is limited and many activities are not covered

166. A major issue surrounds closing of the financial accounts (comptes de gestion). An inability to agree on a valuation for the opening balances for 1973 has resulted in the provisional acceptance of the annual statement by the COA. It has issued temporary visas, which means that the accounts are subject to restatement after the issue is resolved. The auditor's opinions lag by several years behind the statement period. As of 2003, the last statements to have been prepared were for FY 1996. While these financial accounts are not tabled in Parliament, they are a prerequisite to the COA's certification of the final accounts by means of the Loi des Règlements and should be made available to Parliament and the public.

167. The migration to full accrual accounting and the associated compliance with IPSAS accounting and reporting standards will, in the medium term, assist the Government in extending its scope of reporting for the results of its financial operations. In the meantime, the Government should consider extending its financial statements to provide for a number of different aggregations of government activities:

- the central government budgetary entities;
- the central government budget entities, plus all extra-budgetary funds and extra-budgetary entities;
- the central government, EBFs and extra budgetary entities, plus the municipalities;
- The central government, EBFs and extra-budgetary entities, municipalities, and the Government's equity position in all public enterprises and mixed and joint ventures.

168. The extention of coverage of the financial statements should be progressively implemented, and should be accompanied by a formal audit opinion of the Court of Accounts, following INTOSAI standards, on the fair presentation of these financial statements. The auditor's opinion and the notes to the financial statements constitute an integral part of the financial statements. This will require a major revision of the way in which the external auditor performs the annual audits that should be established in the Law on Public Accounting.

Recommendations

169. The appropriate laws relating to financial reporting for all entities should be revised to reflect, at a minimum, current reporting practices of the MOF.

170. The Government should begin the process of accelerating the preparation of an audited set of financial statements to be tabled in Parliament within nine months of the fiscal year end.

a. The report should be tabled in Parliament and made available on the MOF website.

b. The report should include the central budget entities and the extra-budgetary funds and entities as a first step, after which it should include municipalities and extend to include public enterprises thereafter.

c. The Law on Public Accounting should be amended to require the preparation and tabling of these audited financial statements within nine months of the fiscal year end.

d. The Court of Accounts will also have to modify its procedures in order to prepare an audit opinion on the fairness of the Government's financial statements within nine months of the fiscal year end.

F. Accounting and Reporting Risk Assessment

171. The CFAA believes that the accounting risk is **moderate**. The Government should establish in law full compliance with the international accounting and reporting standards and should strictly enforce its accounting policies. The longer term migration to full accrual accounting can be carefully controlled by the MOF to minimize the accounting risks during transition. Supporting financial systems will require upgrading to accommodate the changes in accounting policy. The Government's current reporting exceeds legal requirements; the law should be changed to require the existing level of disclosure and to expand government reporting progressively to include ultimately all parts of the public sector.

Chapter 3: Internal Controls and Internal Audit

A. Legislative Basis

172. The legal basis for internal control is primarily established in the Law on Public Accounting. Based on EU legislative examples, it establishes the overall framework for the budgeting process and its accounting, and the processes to be followed for the control of revenues, expenditures and assets. It provides statements of the responsibility and authority for key parties in the expenditure management process, including the Minister of Finance, the tutelage minister, the commitment inspector, central inspection, principal accountant, public accountants, authorizing officers, cashiers and tax collectors. Additional details are provided by regulation through decrees of the COM and instructions from the Minister of Finance. The law has not evolved since its original passage and many of the specific provisions currently in the law would normally be expressed in sub-legislative instruments that would permit the Government more flexibility in responding to new innovations in PFM.

B. Internal Controls

173. The Government possesses a sound description of a modern framework for internal controls, including internal audit. It commissioned the 1998 KPMG study that provided an internationally accepted definition of the internal management control environment and went on to describe the role and functions of modern internal audit.[43] The study provided an important caveat in its report.

> The term “audit” in the Government of Lebanon appears to be used to mean tasks that are, in fact, internal management control functions and not audit functions. Internal management control functions are regular and routine activities performed by management and staff to prevent and detect errors in the preparation and recording of financial and operational information.[44]

174. This confusion is based on the fact that a fundamental concept of internal control has yet to be fully understood across government. The KPMG study noted that it is a management responsibility to establish and maintain internal controls; the role of internal audit is to advise management on its activities, the extent to which its internal controls are working, and how they can be improved. In Lebanon today, the perception is still that internal audit is carried out by Central Inspection, and is done to a budget entity, rather than being done for the entity. This perception is reinforced by the ability of the Central Inspection inspectors to levy administrative penalties against offending civil servants.

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[43] KPMG, *Budget Execution and Treasury Management Review and Reform of Procedures and Controls*, November 1998.

[44] Ibid, Internal Audit Function Report, p. 4.

175. International best practice identifies a number of activities in an effective internal control system, outlined in Box 3.

BOX 3. COMPONENTS OF INETERNAL CONTROLS

1. A supportive environment for sound internal control, including such factors as a visible management philosophy supporting internal control, open and continuous communication on the importance of internal control (or to avoid conflict of interests and corruption), and a well-communicated code of ethics;

2. Documented risk assessment approaches to assess the internal control processes, and procedures to ensure the integrity of information collected and to minimize errors;

3. Sound control activities that consist of policies, procedures and practices that include such factors as segregation of duties in financial processes, clear responsibilities for authorization of expenditures and activities, the design and preparation of supporting documentation, physical control of assets and records, and independent verification of these control activities;

4. Information and communication systems providing reliable, timely and accurate financial and operational information and analysis to appropriate levels of management;

5. Continuous monitoring of the quality of the internal controls through internal / external audits, exception reports, and feedback from external clients of the entity.

176. Management faces many potential risks to maintaining sound internal controls. These risks may include the misuse or waste of financial human and technical resources; failure to execute budget and other policy in compliance with their requirements; uneconomic and inefficient administration; failure to maintain complete, accurate, and timely accounting records; fraud and corruption; and failure to provide timely and reliable financial management information.

177. Internal controls can be found in law, decrees, regulations, policies or procedures. The development of financial controls, the most significant component of management controls, is the responsibility of the Minister of Finance, who should also be responsible for the establishment of a modern internal audit function across government.

Discussion

178. Establishing and implementing modern internal control represents a major challenge for the Government of Lebanon. The CFAA team has concluded that much work remains to be done in order to educate both management and future internal auditors on the new and supporting role that internal audit must play to implement the modern internal control model and internal audit. A comprehensive medium-term plan for legislative change, management education, internal auditor training and staff communication is required if internal audit is to be successfully implemented.

Recommendation

179. The legislative base for internal control and audit requires strengthening. The CFAA recommends that the Government follow the EU's Public Internal Financial Control model for future changes to law and sub-legislation. This is supportive of existing arrangements between the EU and the Government of Lebanon, and would facilitate future closer links between the two governments. This would require, for instance, that responsibility for proposing and implementing the component of the internal financial control framework and for internal audit be assigned to the Minister of Finance. The responsibilities and authorities of all the major players in the framework that are now covered in the 1963 Law on Public Accounts would also have to be updated and made consistent with EU standards (Chapter 28 of its acquis communautaire).

Corruption

180. The CFAA is not a survey on corruption. However, in its capacity of assessing internal risks, the CFAA also examines the internal control system for areas of potential weakness that can lead increased fiduciary risk. The 2004 international survey of the perceptions of corruption places Lebanon in the bottom third of the countries surveyed.[45] This suggests that there is a perceived problem in the controls present in Government.

181. INTOSAI has identified a number of potentially high fiduciary risk areas that are particularly susceptible to corruption and an erosion of internal controls. These are presented in Box 4, together with the CFAA team's commentary on their applicability to the Lebanon PFM system.

BOX 4. AREAS OF HIGH SUSCEPTIBILITY TO CORRUPTION

Area	CFAA Comments
Extra-budgetary activities of all types	Large entities operate outside of the budget entity, many subject to weak governance with non-transparent financial reporting to Parliament and the public.
Awarding of government procurement contracts for goods and services.	Not examined. A CPAR will be conducted in early 2005.
Capital expenditure projects including public works	CDR capital budget is not fully integrated into expenditure budget; new projects can be initiated during year without prior approval by Parliament (although the loan for any project has prior approval by Parliament); massive carry-forwards of unutilized spending authority dilute parliamentary control of upcoming budget.
Complex and lengthy approval processes with many approval stages in a non-transparent environment	The internal controls over spending are complex, overlapping and lengthy. Multiple approvals are required. Line ministers should be removed from the process of approval of items for liquidation.
Shared or non-existent accountability within the internal control processes	Multiple stages of approval erode individual accountability for a given action; Court of Accounts ex-ante control weakens government accountability for ensuring that controls are properly applied.
Internal audit effectively operating	No modern internal audit function in place. Existing inspection activities focus primarily on compliance with laws and procedures. Insufficient attention to making recommendations for improving internal controls.

[45] Transparency International, *Corruption Perceptions Index* 2004.

Inadequate reporting and a general lack of transparency	Reporting by some EBFs, extra-budgetary entities and public enterprises is weak and poorly audited, resulting in non-transparency of operations to Parliament and the public.
Recruitment of employees and contracting for services	A hiring freeze has led to many temporary or contract employees (approximately 40% of ministry posts) being hired outside of the control of the Civil Service Board; there is potential risk of abuse of power in hiring. In some cases, contracts are used to hire people with specializations that cannot be hired by the Civil Service Board (e.g. IT specialists) as these jobs are not mentioned in the ministries organization trees.

The performance of the Government in reducing risks of corruption could improve. The CFAA has found that the processes currently in place governing budget execution, reporting and overall governance of non-budget entities are weak and lack transparency, presenting many opportunities for an inappropriate exercise of discretionary power. The Government has no overall approach to combating this potential for corruption. It has, however, implemented a system of payment through bank transfers that reduces the interface with civil servants and the opportunities for rent seeking behavior. Within its current reform program the Government, with the support of the World Bank, is contemplating a number of additional anti-corruption initiatives.

Risk Assessment

182. The CFAA team has rated as **significant** the fiduciary risks from the existing internal control processes. This is because the existing expenditure process is complex; there is a general lack of understanding of modern internal control processes and management responsibilities for internal control; and existing key process controls are susceptible to corruption. Strong ex-post controls help offset these risks.

Recommendations

183. The Public Accounting Law should be amended to reflect the modern internal control standards used by the EU, and the responsibilities of the Minister of Finance for all aspects of this framework should be clearly specified in law.

184. The Government should accelerate its planned revisions to expenditure processing to uniquely specify one person responsible for each step and to establish their specific accountabilities. Attention should also be given to reducing to a minimum the number of approvals required to complete an expenditure transaction.

185. When these standards have been implemented, internal auditors should be tasked to include an assessment of the risk of corruption in the regular audits of existing government processes.

C. Internal Audit

186. At the present time, there is no internal audit function operating in the ministries, budget entities, or extra-budgetary entitles and public enterprises. Nor is there a specific legislative base for internal audit in budget entities. The 2004 IMF FAD report recommended that an internal audit function be established in the MOF Public Accounting Directorate. It would be complementary to the existing duties of Central Inspection, with an efficient interface between the two operations. It noted that it was premature to require internal audit functions in line ministries, as line ministries have a limited financial management role in the foreseeable future, and it would be more appropriate to use Central Inspection to review ministries' internal control systems.

187. While the 2001 budget required all public enterprises to establish an internal audit function and to undergo an external audit, it is early in the process, and the CFAA team encountered two enterprises in the process of contracting for internal audit services. There are, however, existing inspection functions that might serve as the basis for the creation of a new unit to perform internal audit within the budget entities, using international standards. The Minister of Finance stated his intent to have an audit of MOF performed by an independent, private sector auditor, in order to have an assessment of the state of internal controls within the Ministry.

Current Inspection Activities

188. Inspection activities have been carried out at two different levels within the Government. The Central Inspection carries out government-wide inspections, reporting to the COM. Within the MOF, an inspection of autonomous public entities is performed. Within the line ministries, there have been no internal general inspectorates since their abolition in 1959 following the creation of the Central Inspection function at MOF.

Central Inspection

189. The Central Inspection (CI) was established by Legislative Decree 115 (12 June 1959). Administratively linked to the Presidency of the COM, it is the closest approximation to an internal audit function that exist in the Government of Lebanon. Its three main entitles are the Central Inspections Administration (which includes the General Financial Directorate), the research and Guidance Administration, and the Procurement Administration. A number of factors, both positive and negative, would have to be taken into account were these to become the basis for a future internal audit entity.

- The CI duplicates existing internal control functions and does not serve the interests of management; instead, it reports to the executive organs of government.
- Its work planning follows an annual plan, based on its priorities and assessed risks, adjusted for large numbers of complaints received or requests from the CI Head, the Court of Accounts, tutelage Ministers or Directors-General.
- The scope of entities subject to investigation is broad, including the budget and extra-budgetary entities, public autonomous agencies, and municipalities. The judiciary, military and security forces are subject only to financial inspection.

- Although the majority of its investigations examine the administrative and financial compliance of the sector ministries with the applicable laws, regulations and decrees, the CI is capable of reporting on how to improve the systems of internal control.
- International standards for audit planning, audit execution, quality assurance and reporting standards do not exist. Staff knowledge of international standards is limited and no staff have professional auditor certifications.
- Final inspection reports are submitted to the Head of the CI Administration, who then sends copies to the minister or director general concerned and to the Civil Service Board. If the report deals with financial issues, a copy is sent to the Public Prosecutor at the COA for review. The Public Prosecutor returns the report with a legal opinion and recommendations.
- The CI Board may penalize employees, refer them to the Higher Disciplinary Board, or transfer the case to the Public Prosecutor at the Court of Cassation to proceed with judicial action.
- The CI issues an annual report which includes an overview of their inspections, observations and violations uncovered. It details recommendations for the recovery of funds and general recommendations that focus on correcting a particular problem. There are no recommendations that address the underlying controls systems, and how they might be improved.
- The annual report is submitted to the Prime Minister, with copies conveyed to Parliament, the Civil Service Council, and COA, and it is published.

Control of Autonomous Institutions Department

190. Another central inspection body is MOF's Financial Control of Autonomous Institutions Department. Reporting to the Government Accounting Directorate, it audits the accuracy and completeness of the public entity using attest/compliance audits. It has no other responsibilities that could be considered as relevant for a future internal audit unit. It does not conduct formal audits and has no formal audit standards or practices.

Discussion

191. At present, the Government has the capacity to limit the number of incorrect financial transactions through its existing ex-ante controls and ex-post inspections. There is little analysis of the cause of repetitive failures that could lead to correction of the process deficiencies that caused those failures. Consequently, there is no reason to expect a significant decline in the number of incidents of non-compliance, misconduct and corruption.

192. There is a need to improve the efficiency and effectiveness of the Lebanese Government administration. Ideally, every ministry and agency would have fully functioning internal audit units, providing valuable information to the head of the entity and senior management on areas for improvement. But given the constrained resources, this cannot be considered as a short-term goal. It will be necessary to identify an approach for implementation that takes account of the areas of greatest risk, and deals with them first. In the longer term, all significant entities should have access to a modern internal audit function.

193. The CFAA team endorses the KPMG conclusions that there is no unit in Government that performs the functions of a modern internal audit unit. This represents an important gap in a modern internal control framework. The consultants discussed different options for the location of a nascent internal audit unit that could then be grown over time to assume greater internal audit responsibilities. In so doing, it noted several constraints: a general lack of understanding in government of the role, functioning, responsibilities and the benefits of modern internal audit; the need for legislative changes to fully implement internal audit in line ministries; the lack of core financial knowledge and basic and advanced audit skills among all of the staff in inspection organizations. The strategy adopted would have to take this into account.

194. The consultants considered that the Central Inspection was the only entity within government that would be capable of providing a government-wide base from which to build an internal audit function across government. It rejected the MOF location as it "may prove to be insufficient in the long run to cover all government agencies and as such remain restricted to the benefit of the Ministry of Finance."[46] Their report then recommended a direct reporting relationship between the new internal audit unit and the President of the Central Inspectorate.

195. The CFAA team recognizes that this is a practical, short-term feasible option for embedding internal audit into significant budgetary entities. But it has some disadvantages. The short-term solution may not progress beyond a central, government-wide internal audit; this would negate the principle that internal audit is a tool of ministry management and is an aid for it to improve the ministry's internal control framework. The Central Inspection has an embedded culture of control and inspection, with penalties levied for violators. This culture is inconsistent with that of modern internal audit and would be extremely difficult to change.

196. The CFAA team favors another option. It has both short-term and medium-term components. In the short term, a core Internal Audit Directorate should be established within the MOF, and should consist of two bureaus: internal audit operations (for audits of MOF organizations), and audit policy and procedures development. This latter type of bureau is referred to in EU terms as a harmonization unit. There are six reasons that support this recommendation.

- In the EU public financial internal control model, the Minister of Finance is responsible for the development of policies and practices of internal financial control, including internal audit, for use across all government entities. This includes the development of the internal audit policies, procedures, guides, certification standards and training needs. Therefore this work should be performed by an internal audit harmonization unit within MOF.

- There is recognition of the value of modern internal audit and strong support for its development within the senior levels of MOF.

- Because MOF does not have an existing inspection unit reviewing budget entities, it should be relatively easier to implement a modern internal audit function, as there is no

[46] Ibid, Chapter 6, p. 34.

inspection unit and thus there is no cultural orientation to inspecting in order to fine violators.

- The Central Inspection conducts 70 percent of its audits within the MOF; therefore the primary user of internal audit services in the near term will be the MOF.

- MOF is one of the very few ministries that still is able to recruit new civil servants into its ranks, and could therefore hire a number of future internal auditors as part of its regular recruitment activities.

- MOF has a well-developed Training Institute, capable of providing a full range of internal audit training to new hires and redeployed inspectors who are open to learning modern internal audit techniques and practices. Additional new internal auditors for ministries would be provided training through the MOF Training Institute. External financing of this curriculum would, of course, be required.

197. The establishment of the MOF internal audit unit is the first phase in a multi-year implementation plan shown in Box 5. The overall process would be expected to take between four to six years for the initial establishment and training of the new internal auditors; additional training would be ongoing after that point. Close consultation with the COA would be necessary during this implementation phase in order to ensure that their respective audits reinforce each

Short Term

1. Create an Internal Audit Directorate in MOF with two Bureaus – Audit Operations and Harmonization – and pass the necessary act of reorganization.
2. Hire a young and innovative director for the unit who has modern internal audit experience
3. From the annual intake of new recruits into the MOF, assign approximately eight graduates of the introductory training course to the new Internal Audit Directorate.
4. Prepare an internal audit basic training course curriculum in the MOF Training Institute and train the new recruits in modern audit theory, techniques and practices.
5. Repeat steps 3 and 4 as required to assure the needed input of future internal auditors.
6. Undertake internal audits within the MOF to gain experience in internal auditing work. This activity should be overseen by an experienced internal auditor consultant who could provide on-the-job advice and assistance to the new auditors.

Medium Term

7. With donor assistance, undertake the development of any legislation and sub-legislative instruments required to support internal audit, including;
    a. Amendments to the Law on Public Accounting (or provisions in an annual budget law) to require the phased implementation of internal audit units in all line ministries;
    b. Specification of organizational arrangements for internal audit units in ministries;
    c. Development of audit guides covering all aspects of internal audit planning, conducting the audit, reporting, qualifications, and certification procedures for internal auditors in the ministries.

8. Develop for COM approval a multi-year implementation strategy that would use new hires (or redeployed staff) to be trained by the MOF Training Institute and then assign them to newly created internal audit units in the ministries. This would occur over 3 to 5 years, and would focus initially on the higher-risk ministries for early implementation.

9. Original recruits for the MOF internal audit units may become potential heads of the internal audit units in other ministries as they are established.

other and avoid duplication and overlap. As internal audit is established in a given ministry, it would be expected that the COA could progressively shift its audit focus to financial statement attest and performance audit activities.

BOX 5. MULTI-YEAR IMPLEMENTATION PLAN TO ESTABLISH INTERNAL AUDIT IN MINISTRIES

198. As part of the EU model of internal control and audit, the MOF would have the residual responsibility to conduct internal audit in those areas where, in the opinion of the Minister of Finance or the COM, such an audit should be performed. This could be because that ministry does not have an effectively functioning internal audit unit of its own, that specialized knowledge or experience (such as a forensic auditor) is necessary for the audit and is not present in the ministry's internal audit unit, or that the ministry's internal audit unit has been compromised in some manner. Provision for such discretional internal audit would be made in the legislative framework for internal control and audit.

Fiduciary Risk

199. The CFAA assesses the fiduciary risk as **significant**. The total lack of an internal audit function contributes to fiduciary risk. This risk is partially offset by the well-developed Central Inspection unit, the MOF commitment controller in the expenditure approval process, and the controls exercised by the COA.

Recommendations

200. In the short term, the Government should establish an internal audit directorate within the MOF, reporting to the Minister of Finance. The Directorate should consist of two Bureaus: Internal Audit Operations for audits within MOF or as directed by the Minister of Finance and the COM; and Internal Audit Harmonization for the development of the policies and processes required supporting all internal audit units.

201. The Government should amend the Law on Public Accounting (or otherwise provide a supporting COM directive) to require the phased implementation of internal audit units in all significant budget entities in a manner that is consistent with EU requirements for internal audit functions in government. The implementation plan should be approved by the COM and overseen by MOF

202. Staff for the MOF Internal Audit unit should be obtained from the annual graduates of the Training Institute's orientation program for new hires or from redeployments from Central Inspection; all should be provided with internal audit training prior to deployment in the internal audit unit

203. The Government should adopt the strategy of harmonizing all future changes to its internal control and audit systems to conform to the EU public internal financial control standards, amending the Law on Public Accounting to reflect the principles of the EU's internal control framework and its assignment of responsibilities to various defined positions in the financial control process.

204. The Minister of Finance should be assigned the responsibility for proposing all internal controls and audit policies, guidelines, processes and procedures and for overseeing their effective implementation across government.

205. In the medium term, the Government should conduct the phased implementation of internal audit units in budgetary entities according to the COM-approved implementation plan.

Chapter 4: The Court of Accounts

206. Supreme or State Audit Institutions (SAIs) are a crucial component in the balance of power inside democratic institutions. They provide the Parliament with information allowing judicial control of the Executive and provide citizens with basic information on the performance of their elected government. The SAI in Lebanon is the Court of Accounts (COA), an SAI with judicial powers, modeled on the European Court model. It has important specific responsibilities inherited from its past history which are no longer consistent with modern SAI practices. Appendix 6 provides a description of the two different types of SAIs and other supporting material on the COA.

207. As the Government's external auditor, the COA performs a number of important functions. Its audit of public institutions is designed to ensure that their public financial statements give a true and fair view of their financial management performance. The COA also audits for the compliance of transactions with existing laws and regulations. This review relies on checking the validity of internal control through sampling and systems analysis. Most SAIs also undertake performance audits to assess the extent to which the audited institutions' activities promote economy, are conducted efficiently and lead to effective outputs and outcomes. Although it is authorized to carry out performance audits, to date, there has been scant evidence of performance audits conducted by the COA, and the CFAA team concluded that COA is not presently conducting them.

A. Legal Mandate and Powers

208. The enabling act establishes the COA as an administrative tribunal in the financial jurisdiction, similar to its French, Belgian and Spanish equivalents.[47] It exercises ex-ante control over the spending of public funds, audits conformity with laws and regulations and can be inferred to have the authority to conduct performance audits through its ex-post audit mandate. Its main tasks established in law include the supervision of the use of public funds and funds deposited in the Treasury, by:

- controlling the use of funds and ensuring compliance with the laws and regulations;
- determining the correctness and legality of financial transactions and of related accounts;
- prosecuting employees who violate the laws and regulations;
- controlling the administrations of the State, large municipalities and municipalities identified by decrees;
- performing post-audit control of public autonomous agencies.

COA is also required to audit the staffing actions of civil servants on an ex-ante basis for compliance with the applicable regulations.

209. The COA prepares a number of reports based on the results of its administrative ex-post controls. These include compliance statements for each of the financial accounts submitted to it for review, an annual report on the results of the audits conducted throughout the year and the

[47] Government of Lebanon, *Audit Court Organization Act*, Law 82/1983 and amended by law 132/1992.

recommendations for improvement, and special reports, which can be prepared at the discretion of the COA, dealing with specific topics of importance and the associated COA recommendations. Details are presented in Appendix 6.

B. Organization

210. The Court of Accounts consists of a president, 35 judges assigned to seven individual chambers, 30 auditors, 50 controllers and some 80 administrative staff, plus a public prosecutor with three assistants. The COA President and the Public Prosecutor are appointed by a COM decree on a proposal from the Prime Minister. They are selected from the sitting judges of the COA, the judges of the Council of State, and judicial judges. The heads of each of the seven chambers are similarly appointed from the judges of the COA. Judges and Assistant Public Prosecutors are appointed from the pool of graduates of the General Law or Financial Judiciary Section at the Judicial Studies Institute, or from those who have successfully passed a certification examination. Auditors and controllers are appointed from the pool of graduates of designated universities.

211. The President, Public Prosecutor and judges are permanently appointed; they can be transferred to another administration only with the approval of the COA Council. They can be dismissed only on a decision from the Disciplinary Council of the Court of Accounts, an internally struck body that is competent to apply disciplinary sanctions against failing members.

212. By law, the COA is administratively linked to the Prime Minister. It has the judicial power to levy fines for violations of the law. It also has a mandate to review the appointment of civil servants to establish their conformance with the applicable staffing laws and regulations, and the power to prevent the budgeting of salaries of any civil servant whose hiring was found to violate the applicable laws and regulations. While the COA reviews the financial statements of the Government, it is from the compliance perspective only, and the office does not express a formal opinion as to the fairness of the statement in accordance with international standards. The results of the compliance audit absolve the head of the General Accounting Directorate of his personal financial liability for the accuracy and legality of the statements.

213. Within the COA, three of the seven chambers are involved with the ex-ante approval processes of expenditures. The CFAA team recognizes that numerous studies have recommended the removal of this responsibility from the COA on grounds of incompatibility with its functions as the external auditor of government. The CFAA endorses this recommendation.

214. The future organization of the COA would have to change as a result of the new audits for attest in support of an audit opinion on the Government's financial statements and for performance auditing. The CFAA recommends that the three chambers presently committed to ex-ante controls redirect their mandate to performance auditing. There is no legislative restriction that prevents the COA from conducting performance audits immediately. This will require extensive training of all staff involved, including judges, in order to have the required competencies to conduct performance audits and the capacity to understand the implications of the recommendations arising from these audits. Ongoing monitoring and follow-up on the progress of the Government would also be the responsibility of these courts.

C. Compliance with INTOSAI Audit Standards

215. The International Organization of Supreme Audit Institutions (INTOSAI) is the international body responsible for establishing norms, standards and practices for national and

regional SAIs. These norms consist of basic postulates, general standards and field standards. Together they comprise the INTOSAI Auditing Standards (AS). The postulates are agreed by an SAI when joining INTOSAI. The assumption underlying these standards is that the SAI will perform compliance audits (also known as financial audits in some jurisdictions), attest audits to permit the expression of an audit opinion as to the fairness of the presentation of the entity's financial statements, and performance audits to assess the efficiency of the unit under audit and the effectiveness of its outputs and outcomes.

216. These standards are often used by external reviewers to assess the performance of an SAI. The CFAA recommends that the COA adopt these standards internally to monitor its development against international standards as it implements future reforms. Although the CFAA did not conduct the in-depth review of the COA that would be expected from a Peer Review, it has used the INTOSAI auditing standards as a structure to guide its commentary on its operation. Appendix 7 contains the details of the individual assessments by the CFAA using the INTOSAI basic postulates, general standards, field standards and reporting standards. A summary is provided in Box 6.

BOX 6. PRELIMINARY CFAA ASSESSMENT OF COA COMPLIANCE WITH INTOSAI AUDIT STANDARDS

INTOSAI AS Standards Group	CFAA Preliminary Comments
Basic Postulates: Promotion of Public accountability, legal basis for access, conflict of interest	COA promotes public accountability, but it should be specific in the Audit Law. It has unimpeded access to required data. It should have a formal Code of Ethics
General Standards COA should be independent, have competent audit staff, and adequate staff to perform the mandate an active recruitment program with ongoing professional development and training for auditors, appropriate audit guidance for audit staff and an efficiency & effectiveness audit mandate.	The COA's reporting administratively to the Prime Minister is not consistent with the independence requirement. Staff are well qualified and experienced and are predominantly judges and lawyers. This mix of staff will have to change to include a broader range of skills for performance audits. The attest and performance audits do not fully meet international standards or are lacking. The COA lacks a long-term training policy that will enable it to migrate to new types of audits and audit procedures. There is no up to date audit manual. There is no performance auditing.
Field Standards Structured planning process identifies high risk areas; adequate supervision of audits and review of reports and recommendations; review of internal controls regularly conducted; compliance audits conducted; review of government accounts done annually; attest audits to support financial statement audit opinion; formal procedures for collection and retention of audit evidence.	Internal review guidelines should be prepared and promulgated to ensure consistent review processes. Internal audit does not exist and COA can only perform limited audit work to compensate for this deficiency. Audits of government accounts meets standard. Audit evidence not governed by formal procedures. Attest audits should be altered to support expression of audit opinion.

Reporting Standards	
Fair accurate and timely reports from the Government to parliament; expression of statement of assurance on these reports by the auditor;	Problems with opening balances has resulted in only provisional visas being issued by the COA and it has been unable to provide an audit opinion on the fairness of the Government's financial statements.

Discussion

217. The Court of Accounts' structure and functions were modeled on the Belgian and French Cours des Comptes in the early 1960s, when the Lebanese legislative base was established. During the lengthy civil war, there was no opportunity to update the law to take into account developments in the field of external auditors to government, such as INTOSAI, the migration to the non-judicial model, and the dramatic change in internal controls to the modern model described in the previous chapter.

218. Since that time, the European SAIs have evolved in their functions and audit scope. The French Cours des Comptes is quite different today from what it was in 1963; other SAIs have similarly changed. The Spanish model, created in the 1980s, is based on a synthesis between the French judicial model and the British non-judicial model. This could be a useful inspiration for the future evolution of the Lebanese COA. It would be appropriate for the COA and the Government to look at other countries and the evolution of their judicial COAs before adopting a particular organizational form and modernized role. The French and Spanish SAIs are particularly relevant models.

219. The COA has proposed limited amendments to the law governing itself to the Government; additional changes are required. Given that Parliament did not approve the previous proposed amendments and that there is a new Government in place, there is an opportunity to revise and resubmit the requested changes. The proposed amendments are well-known, having been covered by a number of donor and donor-funded studies of the Lebanese PFM over the years.

220. The CFAA team believes that the critical changes necessary to support the modernization of the COA include the elimination of the COA's role in the ex-ante approval of selected expenditures; full COA independence from the executive, reporting instead to Parliament; specific reference to the COA's audit according to INTOSAI standards of the Government's financial statements within six months of their completion; conducting performance audits to assess the economy, efficiency and effectiveness of government spending; and the requirement that the COA monitor and report on the Government's implementation of its recommendations for improvement.

221. The COA performs a valuable service through its compliance audit activities. But it is capable of providing even better value to the Government, Parliament and the citizens of Lebanon through its transformation into a modern SAI, fully utilizing international audit standards for attest and performance audits and for governing its internal procedures.

222. A well-developed SAI has Parliament as its primary client. It reports on the Government's performance over the past fiscal year. This is the same relationship as that for an auditor of a private sector firm who reports to the company's board of directors and not to management. In turn, Parliament can use the results of the audits – compliance, attest and performance – to hold the Government accountable for the effective implementation of its planned spending and for the achievement of the expected results. This is why the independence

of the COA is so important to the development of this relationship of trust and cooperation between the COA and the Parliament that reinforces the Government's accountability to the Parliament and the public. Most EU SAIs report to their Parliament and have standards-based operating modes.

223. Another element of increasing this accountability link is for the Court of Accounts to monitor the Government's implementation of all of its recommendations. This would cover all recommendations, present and past, and the COA would report on the Government's implementation of these recommendations until such time as the COA is satisfied. This extension of the current responsibilities would require the COA to recruit staff with skills that are quite different from the present legal competencies. Performance auditing will require economists, technical specialists of many types, and financial analysts, in order to understand and assess the operations of all entities for which the SAI has audit responsibility.

224. The full adoption and implementation of international auditing standards and processes will profoundly affect SAI operations. For example, the expression of an audit opinion on the fairness of the Government's financial statements and their compliance with IPSAS standards will require a risk-based approach to the section of entities for an attest audit, together with a sampling approach for transaction testing. It will also require ongoing audits to be conducted throughout the year. This is the only way that the COA could complete its audit opinion so it can be an integral part of the Government's financial statements. It will also require a reorganization of the Court of Accounts in order to respond to the new requirements of the attest and the performance audits recommended by this and other studies.

225. The COA should have the opportunity to access donor-funded technical assistance. It can take many forms: technical advisors on the development and application of the international auditing standards and practices; formal training for new and existing auditors on the application of INTOSAI standards to audit operations for attest, compliance and performance audits; the involvement of SAIs from other countries through reciprocal visits, peer group review of the COA and, in the medium term, twinning arrangements. All of these mechanisms will assist the COA in making the necessary transition, which will require several years to be accomplished.

Fiduciary Risk

226. The CFAA considers the fiduciary risk arising from the COA's current activities as significant. It does not meet the INTOSAI independence criterion. While the COA does perform compliance audits in budget units and selected extra-budgetary entities, it does not perform an attest function capable of supporting the expression of an audit opinion on the fairness of the Government's financial statements. Nor does it perform regular performance audits or have an emphasis on identifying internal processes that are susceptible to corruption for priority audit treatment.

Recommendations

227. The CFAA supports previous donor recommendations to remove the COA's ex-ante expenditure approval and ex-ante personnel hiring review roles and assign them to the MOF Treasury and Central Inspection respectively; to make the COA independent of the Government by having it report to the Parliament, consistent with INTOSAI standards; and to incorporate into the COA audit plans performance auditing, to be conducted by its field audit teams.

228. The CFAA recommends that the COA be required by law to monitor the Government's implementation of the COA's current and previous audit recommendations and to report on the Government's progress in its annual report to Parliament.

229. The CFAA recommends that the three COA courts presently committed to ex-ante controls redirect their efforts to reviewing the results of performance audits undertaken by the COA auditors.

230. The CFAA recommends that the COA acquire donor support to assist it in making the transition to a modern SAI, by providing technical assistance to:

- determine the best organizational structure to accommodate the two new audit types and the discontinuance of the ex-ante control function;
- revise the internal processes within the COA to accommodate the attest and performance audit processing and quality assurance requirements;
- update audit guides and procedures that comply fully with the international standards;
- diversify the recruitment to include candidates who are trained in financial accounting, auditing and technical areas necessary for the conduct of performance audits; and
- prepare training course syllabi to provide the basis for training of all auditors and judges on the international standards-based audit principles, processes and procedures.

Chapter 5: Legislative Scrutiny and Public Accountability

231. The Parliament of Lebanon consists of a number of competing political parties. Each of their interests must be weighed in the passage of a budget law or any other proposed legislation. As one parliamentarian remarked, "In Lebanon, a political consensus in Parliament is not 50 percent plus one." Parliament plays an active role in reviewing the budgets and related legislative proposals. There are several instances where important financially related bills have been stalled in Parliament for years, awaiting resolution of difficulties that may, or may not, directly relate to the bill at hand.

232. The Parliamentary Budget Committee, chaired by a Member of Parliament, provides the focal point for the review of the Government's budget proposals and the monitoring of budget execution. It consists of 17 members of Parliament, who meet three times per week when Parliament is sitting. Under the Constitution, Parliament can only propose changes in expenditure if the deficit remains unchanged, necessitating offsetting expenditure reductions or revenue increases for any additional spending recommendations. For a given project, the level of funding can only be changed with the approval of the Government. The committee maintains reasonably good relations with the Government during the budget approval process.

233. As is the case for all parliamentary committees in Lebanon, the Budget committee has no staff support resources. The net result is that the committee is chronically short of time and expertise to perform budget implementation monitoring and other issues surrounding oversight of the Government. While Parliament has, in theory, the right to access any information it wishes that relates to a particular proposal or report before it, in practice it does not. The team was advised that a request for detailed financial information on a particular project from the CDR can take three to four months before a reply is provided But Parliament has only 10 days to review the detailed final budget report.

234. MPs bring a highly regional interest to the budget review process, delving deeply into specifics that affect their regional interests, and forming coalitions of common interest during the review process. As a result, their time horizon is short term, and it is difficult to get a substantive focus on longer term issues. The Committee has identified major concerns with deficits of the EDL, the NSSF and the hospitals; their operations were felt to be insufficiently transparent to Parliament and the public for a proper and informed debate to take place.

Relations with COA and the Public

235. Some parliamentarians view the Court of Accounts as being an instrument of the Government, not of Parliament, and the Budget Committee in the past has requested that the external auditor's independence be strengthened by having it report to Parliament.[48] This recommendation has been made by previous donor missions and by technical advisors. It is also a component of the INTOSAI independence requirement for an effectively functioning SAI. In practice, this would mean that the Parliamentary Budget Committee would become the principal organ of Parliament to deal with the COA for regular aspects of its business.[49] However, the

[48] This was not a universal view. Another committee chairman stated that this should not be an immediate priority, given the coalition-style of governing that characterizes Lebanon.

[49] Other committees would also deal with the COA, particularly with respect to any recommendation that would relate to the work of that committee. Experience in other countries suggests that this is most likely to occur as the result of findings and recommendations of performance audits.

CFAA team was advised that the COA was resistant to any suggestions that its ex-ante role be abolished, fearing a loss of internal control.

236. Parliament does not rigorously follow up on the recommendations of the Court of Accounts, for a variety of reasons. They do not have the staff resources to perform the tracking and reporting; the auditing is not performed by the COA on any systematic basis; and there may be suspicion among some parliamentarians that the lack of independence of the auditor might affect his reporting on implementation progress. As a result, there is little formal and systematic monitoring by Parliament of the effectiveness of the Government's execution of the approved budget, other than the COA's traditional legal compliance reviews.

237. Communicating effectively financial information to the public remains a challenge for the Government. This is a problem faced by all governments, worldwide. Other potential channels for citizens seeking this information include the media, non-government organizations, universities and citizen groups. The CFAA team did not interview members of civil society, such as NGOs, during its mission. However, it did note a vigorous and open media, with public debate on matters of key importance. The high quality of the Government's present reporting contributes to this public dialogue. The MOF advised the team of the difficulty in communicating to the public on its work, and in particular in overcoming the view that the MOF only cuts budgets. The Government should actively seek to establish linkages with additional interlocutors to improve the communication of its key messages to the general public.

Fiduciary Risk

238. The CFAA considers the fiduciary risk from legislative oversight and public accountability to be **significant**. The Budget committee lacks the skilled staff resources necessary for it to analyze the large amounts of financial information provided to it by the Government. Still, Parliament does get actively involved in reviewing the annual budget submission.

239. Where Parliament cannot perform well is in the review of actual performance. Its inability to effectively process all of the information it receives relating to the Government's financial and operational performance for a given fiscal year means that it can not effectively hold the Government to account for its stewardship of public funds or for effective implementation of planned activities. Because this is an essential function of the Parliament-Government relationship, its absence is an important shortcoming. The COA does not report to Parliament, which impairs its usefulness from the viewpoint of some members, who view it more as an instrument of the executive and the ministries.

Recommendations

240. The CFAA recommends that:

- The Parliamentary Budget Committee should remain as the principal point of parliamentary contact when the COA is granted its independence from the Government.
- The Parliamentary Budget Committee should be given sufficient resources to have permanent expert staff support for its mounting workload, and given greater time to review the Government's final budget report. Its review should be carried out coincident with the accelerated tabling of the COA's audit report for the completed year.

- The Budget Committee should require the COA to monitor the Government's implementation of its recommendations and to prepare an annual summary of all new and outstanding recommendations, together with the status of the Government's implementation of each. This summary should be prominently displayed in the annual report of the Court of Accounts and reflected in law.

- The Government should establish relationships with other interlocutors such as NGOs and citizen coalitions in order to improve its effectiveness in communicating the fiscal messages to the public.

Chapter 6: Financial Management Capacity Development

241. The MOF has been engaged for several years in a comprehensive reform program, the Revenue Enhancement and Fiscal Management (REFM), assisted by the UNDP, WB and other donors. This was followed by new project, Capacity Development for Fiscal Reform and Management, begun in 2003.[50] One element of this ambitious reform agenda is the building of staff capacities through economic and financial training programs to support the Government's financial management reforms. This program is being carried out by the MOF Institute of Finance, using a continuous learning approach to the acquisition of the new skills by existing and future staff in government.

242. The MOF has a human resources development strategy. Its purpose is to provide a strategic approach to the development of staff capable of responding to the challenges of the new environment of change within MOF, and to serve as the foundation for the development of an operational plan for implementation. The Institute has a small core of staff, and uses external and internal experts, consultants, and senior civil servants to teach its range of courses.[51] It offers ongoing training to all MOF staff and financial staff in other ministries, in addition to entry-level training for MOF recruits. Subjects offered cover the range of accounting, finance, auditing, information technology and specific software courses, specialized seminars on items of interest, language training, as well as subject-specific needs as they arise.

243. MOF is one ministry that has enjoyed an exemption from the staffing freeze. It has been able to hire more than 100 new recruits annually, and to train them for three to four months before assigning them to an organization within the MOF. None of these recruits are allocated to other ministries.

Discussion

244. While the effective development of the capacities of public servants is always difficult, it is a particular challenge in Lebanon. A general freeze on staffing has been in effect since 1974; any proposed additions to the ministry staff complements must be approved by the COM. This process is tightly controlled and audited. The application of a staffing freeze, over time, is assisting the Government in reducing the wage bill by slowly reducing the number of civil servants as the mandatory retirement age of 62 is reached. This gradualist approach avoids politically difficult decisions but also delays the financial benefits from a more structured program of voluntary and directed workforce reductions.

245. The hiring freeze has an important side effect. The team was advised that the average age of civil servants in Lebanon is now 58 years. This means that in four years, the Government will have lost approximately one-half of its permanent employees, with few or no replacements because of the staffing freeze. While the work of some of these employees can be accommodated by remaining staff, there will be a serious shortage of skilled manpower. Increasing numbers of staff will reach mandatory retirement, and there will be no one recruited and trained to replace

[50] MOF, *Reform Program at The Ministry of Finance*, May 2003.

[51] Staff from the Court of Accounts serve as instructors for some of the courses and attend others as students.

them. This staff shortage will adversely affect the Government's ability to deliver on its ambitious reform agenda across the entire public sector.[52]

246. It may not yet be too late. A government-wide finance and audit HR strategy is necessary if the Government expects the ministries to have the capacity to implement the many reforms planned for the public financial management system. It is not enough to recruit and train new staff for the MOF; all ministries will face serious financial capacity shortfalls in the future. The Government should seek to use some of the resources saved by attrition, or by reductions in the number of internal inspectors or external legal auditors, to support the staffing of new staff in budgeting, finance, internal audit and external audit (for the new skills required for performance auditors).

247. While outside the scope of this study, it is clear that an overall human resources strategy for the entire public sector must be developed before the negative effects of a rapidly shrinking workforce become critical, and while there is still time to rebalance the deficit reduction requirements with the ability to continue to conduct the business of government.

248. On the other hand, the diminution of staff will also present the Government with an opportunity. It will be in a position to augment the competence of its civil service as it begins the process of hiring replacements for those retiring staff that should be replaced. The redefinition of new job responsibilities can permit the combination of the functions of several old positions into one new position, staffed by trained and competent civil servants. The reduced salary budget for the Government will permit an upward revision in salaries to reflect the increased requirements of the new positions, while continuing to contribute to expenditure and deficit reduction targets.

Fiduciary Risk

249. The CFAA considers the fiduciary risk of limitations of financial and audit capacity as **significant**. This reflects the serious depletion of skilled financial officers in the line ministries and other entities, and the apparent lack of an overall capacity development strategy to address the loss of up to 50 percent of the remaining staff in the next four years.

Recommendations

250. The MOF should prepare and implement a comprehensive human resource strategy for the budget, financial and audit staff within the MOF and all government entities on a priority basis.

[52] The CFAA team had encountered evidence that this is already occurring – the CDR is down to one financial officer, who will be retiring in 2005. The CDR is considering outsourcing the financial function to a private sector firm to perform.

Appendix 1: List of People Contacted during the Mission

Family Name	Given Name	Title/Function/department	Institution
Siniora	Fuad	Minister of Finance	MOF
Bifani	Alan	Director General	MOF
Azour	Jihad	Advisor to the Minister	MOF
Baltagi	Awni	Advisor to the Minister	MOF
Rizk	Rola	MOF Macroeconomic Unit	MOF
Abou Khaled	Nadine	MOF Macroeconomic Unit	MOF
Kassem	Zena	MOF Macroeconomic Unit	MOF
Yamout	Nabil	Advisor to the Minister	MOF
Khoury	Moni	Head	MOF
Shebano	Amal	Treasury Department	MOF
Soubra	Abed	Treasury Department	MOF
Daher	George	Director of the IT	MOF
Charbel	Elias	Director	MOF
Taki	Joumana	Budget Directorate	MOF
Moubayed	Lamia	Director	Finance Institute
Darwish	Roula		Finance Institute
Hamad	Chawki	VAT Project Director	MOF
Balaa	Salim	Customs Component Manager	MOF
Abbas	Alia	Head of Disbursement	MOF
Marini	Rabah	Director of Accounting	MOF
Azar	Samir	Chaiman of the Budget Committee	Member of Parliament

Family Name	Given Name	Title/Function/department	Institution
Fuleihan	Basil	Chairman of the Economic Committee of the Parliament of Lebanon	Member of Parliament
El-Khalil	Youssef		Banque du Liban
Tibrawy Rached	Josette	Deputy President	Cours des Comptes
El-Hajj	Ramzi	Director of Finance	CDR
Hayek	Kamal	Director General	EDL
Samaha	Elie	Director of Elementary Education	Ministry of Education
Awad	Bahaa	Budget Officer	Ministry of Education
Hilal	Malek	Director of Financial Inspection	Central Inspection
Nammar	Fadi	Director General	Public Work and Transport
Karaki	Mohammed	President	Council of National Social security
Alameh	Fouad	Accounting Director	Ministry of Health
Jabbour	Nakhoul	Senior Financial Officer	OMSAR
Merhi	Atef	Senior Policy Analyst	OMSAR
Hakim	Yahya	Advisor to the Minister	OMSAR

Appendix 2 : Lebanon's 72 Public Enterprises

No.	Name of the Agency	The Tutelage Authority
1	The Investment Development Authority of Lebanon	Presidency of the COM
2	The Public Agency for Consumption Markets	Presidency of the COM
3	The Public Agency for Securing Investments	Presidency of the COM
4	Cooperative of Government Employees	Presidency of the COM
5	The National Archives Agency	Presidency of the COM
6	Elissar Agency	Presidency of the COM
7	The Council for Development and Reconstruction	Presidency of the COM
8	The Council of the South	Presidency of the COM
9	The National Institute of Administration (ENA)	Presidency of the COM
10	The Litani River National Authority	Ministry of Energy and Water
11	The Electricity Authority of Lebanon (EDL)	Ministry of Energy and Water
12	The Barouk Water Authority	Ministry of Energy and Water
13	The Batroun Drinking and Irrigation Water Authority	Ministry of Energy and Water
14	The Dinnieh Drinking and Irrigation Water Authority	Ministry of Energy and Water
15	The Kbayyat Water Authority	Ministry of Energy and Water
16	The Koura Drinking and Irrigation Water Authority	Ministry of Energy and Water
17	The Matten Water Authority	Ministry of Energy and Water
18	The Bsharri Drinking and Irrigation Water Authority	Ministry of Energy and Water
19	The Baalbek & Hermel Drinking and Irrigation Water Authority	Ministry of Energy and Water
20	The Beirut Water Authority	Ministry of Energy and Water
21	Mount Amel Water Authority	Ministry of Energy and Water
22	Byblos Drinking and Irrigation Water Authority	Ministry of Energy and Water
23	Zahle and Neighborhood Water Authority	Ministry of Energy and Water
24	Zghorta Drinking and Irrigation Water Authority	Ministry of Energy and Water
25	Shamsin Water Authority	Ministry of Energy and Water

26	Tyr Water Authority	Ministry of Energy and Water
27	Sidon Water Authority	Ministry of Energy and Water
28	Tripoli Water Authority	Ministry of Energy and Water
29	Akkar Drinking and Irrigation Water Authority	Ministry of Energy and Water
30	Ain el-Dilbeh Water Authority	Ministry of Energy and Water
31	Kisirwan and Ftouh Water Authority	Ministry of Energy and Water
32	Nabeh el-Tasseh Water Authority	Ministry of Energy and Water
33	The Lebanese University	Ministry of Education
34	The Internal Fund for Vocational and Technical Education	Ministry of Education
35	The National Council for Scientific Research	Ministry of Education
36	The Educational Center for Research and Development	Ministry of Education
37	The Solidarity Fund for the Lebanese University Teachers	Ministry of Education
38	The National Higher Institute of Music	Ministry of Culture
39	The Center for Civil Aviation Safety	Ministry of Public Works and Transportation
40	The Agency for Investment in the Port of Tyr	Ministry of Public Works and Transportation
41	The Agency for Investment in the Port of Sidon	Ministry of Public Works and Transportation
42	The Agency for Investment in the Port of Tripoli	Ministry of Public Works and Transportation
43	The Railways and Public Transportation Agency	Ministry of Public Works and Transportation
44	Public Agency for the Management of Nabatieh Public Hospital	Ministry of Public Health
45	Public Agency for the Management of Baabda Public Hospital	Ministry of Public Health
46	Public Agency for the Management of Beirut University Hospital	Ministry of Public Health
47	Public Agency for the Management of Beirut Public Hospital	Ministry of Public Health
48	Public Agency for the Management of Rashaya el-Wadi Hospital	Ministry of Public Health
49	Public Agency for the Management of Dahr el-Bashik Hospital	Ministry of Public Health
50	Public Agency for the Management of Kartaba Public Hospital	Ministry of Public Health
51	Public Agency for the Management of Margeyoun Hospital	Ministry of Public Health

52	Public Agency for the Management of Tannourin Hospital	Ministry of Public Health
53	Public Agency for the Management of Halba Public Hospital	Ministry of Public Health
54	Public Agency for the Management of Rahbeh Public Hospital	Ministry of Public Health
55	Public Agency for the Management of Seer el-Dinnieh Public Hospital	Ministry of Public Health
56	The National Office of Medicine	Ministry of Public Health
57	The Public Agency for Housing	Ministry of Social Affaires
58	The National Social Security Fund	Ministry of Labor
59	The National Employment Agency	Ministry of Labor
60	The Sports City Agency	Ministry of Youth and Sports
61	The Agency for Lebanese Standards and Specifications	Ministry of Industry
62	The Authority for Construction and Management of Industrial Centers	Ministry of Industry
63	The International Exhibition of Rashid Karameh	Ministry of Economy and Trade
64	The Committee of Control on Insurance Companies	Ministry of Economy and Trade
65	Télé Liban	Ministry of Information
66	The National Fund For the Displaced	Ministry of the Displaced
67	OGERO	Ministry of Telecommunications
68	The Project of Activating Animal Products	Ministry of Agriculture
69	The Scientific Agricultural Research Agency	Ministry of Agriculture
70	The Office of Execution of the Green Project	Ministry of Agriculture
71	The Tobacco Administration (Regie)	Ministry of Finance
72	The Central Bank (Banque du Liban)	Ministry of Finance

Note: The 21 water authorities were merged into four authorities under Law No. 221, issued on May 29, 2000, “Organization of the Water Sector.” The four water authorities are: (1) Beirut and Mount Lebanon Water Authority (located in Beirut); (2) North Lebanon Water Authority (located in Tripoli); (3) The Bekaa Water Authority (located in Zahle); (4) South Lebanon Water Authority (located in Sidon). The Litani River National Authority was not merged with the other water authorities.

Appendix 3: Details of Proposed Budget & Approved Expenditures, 2000-2003

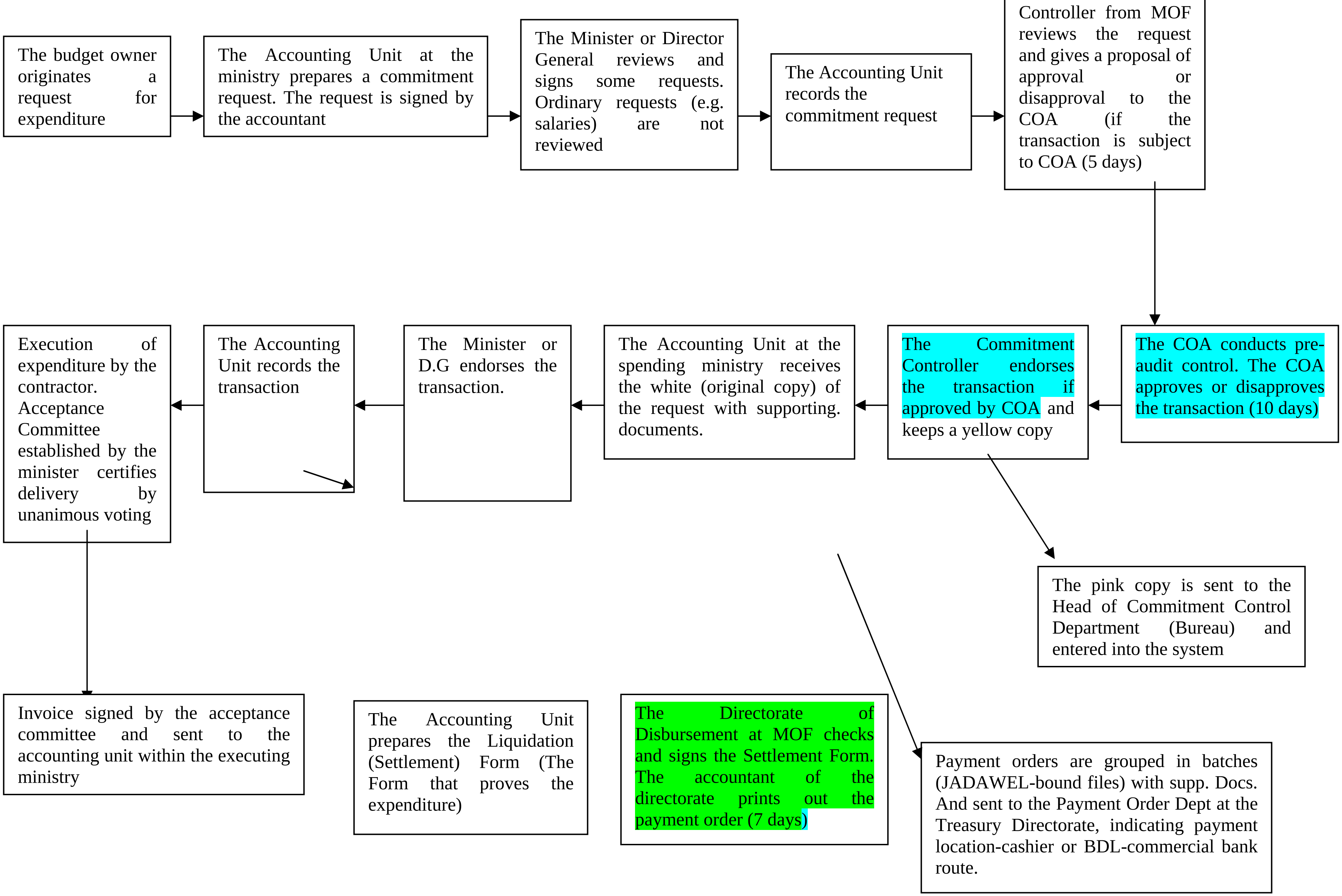
(Million LL)

Ministry	Budget Submitted to Parliament	Parliament Approved Budget	Variance (percent of submitted)
Presidency	4,125	3,355	-19.1
Parliament	41,220	41,220	0.0
Council of Ministers	573,121	388,834	-32.5
Constitutional Council	2,239	2,221	-7.6
Justice	43,714	43,619	--
Foreign Affairs	103,270	92,497	-9.0
Interior, Municipal & Rural Affairs	520,782	386,602	-8.0
Finance	96,070	79,737	-17.0
Public Works & Transportation	414,595	144,304	**-65.2**
National Defense	860,830	795,169	-7.6
Education & Fine Arts	808,266	750,174	-7.2
Public Health	366,756	262,096	-28.5
Economy & Trade	6,094	5,896	-3.2
Agriculture	51,875	33,772	-34.9
Post & Telecommunications	13,122	12,490	-4.8
Labour	109,165	26,156	**-76.0**
Information	21,578	20,363	-5.6
Hydraulic & Electric resources	170,487	66,291	**-61.1**
Tourism	9,508	8,534	-10.2
Culture & Higher Education	23,385	16,215	-31.0

Environment	5,845	2,799	**-52.1**
Displaced Affairs	6,903	5,971	-16.1
Youth & Sports	20,007	12,974	-36.1
Social Affairs	110,748	94,096	-15.0
Debt Servicing	4,500,000	4,500,000	0.0
End of Service Indemnities	1,000,000	1,000,000	0.0
Budget Reserves	99,393	99,393	0.0
SUBTOTAL	**9,991,946**	**8,899,000**	**-10.9**
National Lottery	81,808	81,808	0.0
Grain & Sugar Beet Office	42,383	42,383	0.0
Telecommunications	998337	998337	0.0
ANNEX BUDGET SUBTOTAL	**1,122,528**	**1,122,520**	0.0
GRAND TOTAL 2003	**11,114,474**	**10,021,520**	**-9.8**

Source: MOF

Appendix 4: The Expenditure Cycle



Copies of P.O. and supp. Docs sent quarterly to Directorate of Public Accounting (MOF) for review and filing, pending the COA audit

Actual Payment at Cashiers (MUHTASSEB) or through BDL-commercial bank route

Payment order (AMER BIL-DAFEH) signed by the Head of P.O. Dept. or by Director of Treasury

Blue and green shaded areas indicate duplication of function

Appendix 5: Revenue Budget vs. Actual Performance, 2001-2003 (billion LL)

Revenue Source		2002	2003	Average Deviation
VAT	**Budget**	800	1100	
	Actual	993	1361	
	Deviation	+24%	+24%	**+24%**
Customs/Excise	**Budget**	2019	1976	
	Actual	1787	1819	
	Deviation	-11%	-8%	**-10%**
Income tax	**Budget**	650	1000	
	Actual	727	783	
	Deviation	+12%	-12%	**-8%**
Other taxes	**Budget**	567	650	
	Actual	489	538	
	Deviation	-14%	-17%	**-16%**
TOTAL	**DEVIATION**	**1.0%**	**5.5%**	

Source: MOF

Appendix 6: Supporting Material on the Court of Accounts

Models for State (Supreme) Audit Institutions

1. The Court of Accounts in Lebanon is the Supreme Audit Institution (SAI) that fulfills the external audit function for the Government of Lebanon's financial operations and reports. SAIs are a crucial component in the balance of power inside democratic institutions. They provide the Parliament with information allowing a legal control of the Executive and provide citizens with basic information on the performance of their elected government. They may be considered as being in two categories:

- *SAIs without judicial power:* operate independently, perform their audits and make recommendations to the parliaments or, in the case of criminal acts, to judicial courts. They do not have the ability to pass judgment and impose legal sentences. The prototype of this organization is the National Audit Office of the United Kingdom; a majority of Commonwealth countries also have adopted this model.

- *SAIs with judicial competency*: are legal jurisdictions. In addition to the prerogatives and competencies of the other category, they have the authority to judge instances of violations and impose legal penalties. The prototype of this organization is the French Court of Accounts; many other European jurisdictions also have similar structures.

Functions of the Lebanese Court of Accounts

2. The Court of Accounts in Lebanon has judicial competency. To discharge these responsibilities, the COA exercises administrative controls and judicial competencies. The administrative controls and the associated reporting include:

- *Administrative <u>ex-ante</u> visas*: to verify the correctness of the transaction and its compliance with the budget, laws and regulations. Transactions subject to administrative *<u>ex-ante</u>* visa from the COA are transactions exceeding thresholds fixed by law.[53] The decision of the COA must be respected, unless overturned by the Council of Ministers. This exercise of *<u>ex ante</u>* control is a highly unusual role for a SAI to perform, as it is an integral component of the internal financial control process of the Government, and is a responsibility of management;

- *Administrative <u>ex-post</u> controls:* assess the financial transactions from the time the expenditure was committed until the end of execution and recording of accounts. The findings of administrative *<u>ex-post</u>* control and the proposals of the COA are recorded in its annual and special reports:

- *Compliance Statements*: Every year the COA is required to issue a compliance statement related to each of the accounts submitted. These statements are submitted to the House

[53] Article 25 of Law 286 (February 12, 1994) and article 42 of Law 622 (March 7, 1997).

Speaker and members of Parliament, and separately to the Minister of Finance for the accounts of the general budget and other budgets subject to the endorsement of the legislature. Those compliance statements that are related to the accounts of budgets that are not subject to the endorsement of Parliament are submitted to the Minister of Finance, the Tutelage Minister and the authority in charge of endorsing the budget execution report.

- *Annual report:* The President of the COA submits an annual report to the President of the Republic, with copies of the report to Parliament, the Civil Service Board and Central Inspection. The report is published in the Official Gazette. It includes official responses from the auditees on the reports observations and recommendations.

- *Special reports*: The preparation of special reports is left to the discretion of the Court of Accounts. Special reports are submitted to the President of the Republic, or House Speaker, or Prime Minister, or the administrations concerned. These reports deal with specific topics and include the COA's recommendations relating to the issue.

3. The COA's judicial competencies are exercised by its seven chambers, headed by a judge, and staffed by 38 judges with support from auditors, controllers and administrative staff.

INTOSAI Standards Governing Supreme Audit Institutions

4. The International Organization of Supreme Audit Institutions (INTOSAI) is the international body responsible for establishing norms, standards and practices for national and regional SAIs. These norms consist of basic postulates, general, field and reporting standards. Together they comprise the INTOSAI Auditing Standards (AS). The postulates are agreed by an SAI when joining INTOSAI. The assumption underlying these standards is that the SAI will perform compliance audits, attest audits to permit the expression of an audit opinion as to the fairness of the presentation of the entity's financial statements and performance audits to assess the efficiency of the unit under audit and the effectiveness of its outputs and outcomes. These standards are often used by external reviewers to assess the performance of an SAI and served as a guide for the preliminary review conducted by the CFAA team.

Practice in Lebanon

INTOSAI Basic Postulates

5. ***Promotion of public accountability.*** The SAI should require, promote and facilitate public accountability in the management of public resources. This includes applying accounting standards and internal controls, along with transparency, accessibility to data, and fair presentation.

> This function does not appear to be assigned in law. It should be added to the duties of the COA when the Law is next amended.

6. ***Legal Basis for access.*** The SAO has the mandate to audit all State government bodies, State legal entities and other State bodies. It can also audit local government bodies and legal entities. Currently it does not have a legal mandate to audit EU and other foreign grants.

Representatives from the COA declared there were no restrictions or practical difficulties to get requested information, confirming the principle of free and unrestricted access to relevant information.

7. ***Conflicts of interest.*** INTOSAI requires that SAIs avoid conflicts of interest between the auditor and entity being audited. This issue is appropriately addressed in the SAA's article 6 which prohibits auditors from auditing entities and/or activities to which they have a budget unit, political or family affiliation.

The Court of Accounts does not have a Code of Ethics, other than a general prohibition for judges and auditors to refrain from any external activity except teaching. The COA should resolve this gap by preparing an acceptable Code of Ethics for its auditors and judges.

INTOSAI General Standards

8. ***Independence.*** The Court of Accounts reports administratively to the Prime Minister. Concern was expressed by some members of Parliament that this compromised the audit office's independence. The INTOSAI standard recommends that the SAI report to the Parliament, for maximum independence from its auditee, the Government. Existing legislation assigns staff appointments and dismissals to the SAI, either directly or with their consent in the case of transfers of senior staff to another administration. The President has the same administrative and financial powers as a minister, with the exception of constitutional prerogatives.

Future legislative amendments should clarify the COA's independence and require it to report to Parliament.

9. ***Competence.*** The SAI auditors should meet international standards for competency in auditing.

The COA recruits extensively from the legal profession, reflecting its judicial orientation. Its present staff does not have the requisite knowledge to perform the kinds of audits that would be done in a modern SAI organization; additional audit training would be necessary for performance and attest audits to support the financial statements of the Government.

10. ***Applying standards.*** There are certain INTOSAI-defined audits that the COA does not perform. This includes performance audits and attestation audits that meet international standards. The latter is not sufficient to support an expression of opinion on the fairness of the Government's financial statements that complies with international standards.

While the Court of Accounts voluntarily complies with the INTOSAI standards, it is not required by law. This should be so specified in the law when next amended.

11. ***Recruitment.*** All of the SAO professional staff has backgrounds in law, administration or economics. Staff is hired via public announcements of vacancies and recruitments are done following formalized procedures where the key criteria are work experience and formal education. The conditions for recruitment of the Chairman, of the public prosecutor and of the judges are compatible with independence.

In terms of competence, current practice emphasizes legal background rather than accounting skills: this should be more balanced in the future, particularly as the office moves towards performance audits.

12. ***Training & development.*** Many young auditors attend high quality training sessions, organized by the MOF Training Institute, on a voluntary basis. But the Court of Accounts as an institution does not have a long term training policy to link its future audit needs to its existing capacities. There are no regular staff appraisals or other methods of measuring staff competency, training needs and ability to perform certain types of audits, which would adversely affect the ability to build staff competencies in a structured manner. The team was advised that there was no training budget for in-depth training, despite a recognized lack of accounting skills in many judges and auditors. This could adversely impact on the move to international-standards-based attest audits to support audit opinions of financial statements and performance audits.

The COA should develop and implement a major training effort to support attest and performance audits of the Lebanese PFM system.

13. ***Audit guidance.*** The team was advised that there was no updated audit manual or technical written guidelines available to staff.

The COA's audit manual and related guides should be updated to reflect the new mandate once it has been approved by the Parliament.

14. ***Staff composition & adequacy.*** Under the judicial model followed by the Court of Accounts, recruitment focuses on the legal skills of potential applicants, given the compliance focus of the judicial model of operation. As a result, accounting and technical skills are deeply underrepresented among its staff. The lack of formal assessment mechanisms identified above will complicate any transition to new audit methodologies.

In the light of the two new audit methodologies that must be implemented, the CFAA recommends a review of the underlying criteria used to select and promote all staff within the Court of Accounts.

15. ***Monitoring efficiency and effectiveness***. There is no formal review of efficiency and effective carried out by the Court of Accounts on any entity of government.

The COA should implement performance auditing into its audit practice and, over time, devote an increasing percentage of its total audit resources to the conduct of performance audits.

16. The COA is the only Lebanese public body not to be audited by an external auditor. It should be subject to an external audit by a professional auditing firm, approved by the COM on the recommendation of the Minister of Finance, appointed for a three-year term. The SAI makes little use of information-technology-based solutions, despite having on-line access to the MOF Treasury transaction data base. Their adoption of computer-based auditing techniques, using standard audit packages such as IDEA or its equivalents, should be a high priority for training and implementation into the regular audits.

INTOSAI Field Standards

17. ***Planning***. The Court of Accounts is free to set its priorities and adopt appropriate audit methodologies. It also prepares an annual audit plan, with extensive requests from Parliament, ministers, Directors-General and the Civil Service Board. This results in an ad hoc planning process for its audits, which is reinforced by the *ex ante* visa controls it must administer in the budget execution process.

> As the COA moves to more standards-based attest audits to support its opinions on entity financial statements and to undertake performance auditing, it should work to develop a complementary audit plan that enables a proper balance between these new audits and the traditional compliance auditing.

18. ***Supervision and review***. There is a limited internal review process for completed audits. Individual audits are performed by audit teams and reviewed by senior auditors; the annual report is reviewed and voted by the assembly of all judges in the Court of Accounts.

> A Peer Review would expect to see clear written guidelines for the work process, including such areas as: the audit team's understanding of the audit plan; the audit goals and objectives; extent of compliance with auditing standards and institutional practice; compliance with each phase of the audit plan; and the completeness of audit documentation and facts supporting audit conclusions.

> The Court of Accounts must do additional work in this area, including documentation to support all steps in the audit process, plus ex-post reviews of the completed audits. These reviews should include feedback from auditees, evaluations of work by parliamentary committees and members of Parliament, self-assessments by management and staff and external peer reviewers, if any.

19. ***Reviewing internal controls***. Lebanon does not have advanced internal control systems or Internal Audit units. Consequently, the COA is unable to rely on the work of internal auditors. To the extent possible, it will rely on the results of investigations of Central Inspection. Assessments of internal control and accounting systems are not an integral part of the financial audits. As well, it can task the Central Inspection to carry out any inspections required by the Public Prosecutor or other part of the Court of Accounts.

> The present COA focus on compliance means that any examinations of efficiency and effectiveness of internal controls is incidental to the COA's main focus. This should change as the COA's future mandate is implemented.

20. ***Compliance with Laws and Regulations***. The main objective of the COA audits is to examine the validity of accounting entries and the financial operations' compliance with relevant laws and regulations. This is generally carried out in the form of comprehensive substantive testing or individual transactions. The Court of Accounts issues annual compliance statements to the House Speaker and the Minister of Finance on the accounts that were submitted to it, supported with the necessary documentation.

The audit for compliance with law and regulations should be an extended financial audit, looking at internal controls, risk analyses and attests using transaction sampling.

This is the main output expected from the Court of Accounts, and the reliability and external trust in the Lebanese State accounts relies mainly on it. It should be the highest short term priority.

21. ***Audit of government annual accounts***. Every year the Court of Accounts audits the correctness of the accounts of the public accountants and any employee involved in collecting or paying public funds or funds deposited in the Treasury.

22. ***Collection of audit evidence***. Despite having unfettered access to all required information to support the audits, the Court of Accounts advised the CFAA team that it did not have formal, well-documented policies and guidelines, and that every auditor had his own approach and method. This is a dangerous weakness, unexpected in a judicial SAI, one that could undermine the recommendations of the audit office.

The Court of Accounts should prepare formal documented policies and guidelines, consistent with international standards, for all of its audit process components. This should be done on a priority basis

23. ***Audit of financial statements***. The SAO issues opinions following audits of individual Budget units. The audits that the SAO refer to as attestation audits, do not appear to be done in accordance with ISA, as the audits do not follow the phases of the ISA, which includes preliminary systematic assessments of risk and materiality, accounting systems and internal control systems.

The COA should move to revise its attest audit procedures and processes to support the expression of an audit opinion on the Government's financial statements.

INTOSAI Reporting Standards

24. ***Fairness, accuracy and timeliness***. Due to the outstanding disagreement on opening balances of certain accounts, since 1997 the Court of Accounts has provided only a provisional visa for the State financial statements. It is unable to attest to the accuracy of the statements and hence cannot provide an opinion on the fairness of the financial statement presentations. It is clearly not timely. The existing compliance-focused audits will have to be completely changed in order to meet any reasonable deadline for an audit opinion on the Government's most recently-completed fiscal year.

A review of the auditor's annual report observations does not reveal a clear audit strategy beyond reporting on instances of non-compliance, with little follow up or monitoring of the Government's response to current and previous audit recommendations. This should change, and the annual reports should present more strategic analysis along with the lists of non-compliance detected during the course of the audits.

25. ***Statements of assurance.*** As discussed above the dispute over opening balances has precluded the Court of Accounts from providing a formal opinion on the Government's financial statements.

Given its lack of standards in many of the areas that would support an attestation on the fairness of the financial statements, the COA would be unable to provide an audit opinion that meets international standards even it the opening balance issue were resolved.

Appendix 7: PFM Risk Assessment Framework

This set of indicators is being developed by the World Bank as a more quantitative diagnostic approach to assessing a government's public financial management framework. It is not a numeric scoring process; rather, the different states for a particular indicator, ranging from Best Practice through other likely states are presented. The status of the indicator in question is then assessed by the CFAA team, as a basis for discussion and to assist in designing reforms to address areas of priority need.

Indicator	Status	Guidance
A. PFM OUT-TURNS		
1. Aggregate fiscal deficit compared to original approved budget.	D	A. In no more than one out of the last three years has the actual deficit exceeded the budgeted deficit by an amount equivalent to more than 2% of total budgeted expenditure, and in that one year the excess was less than 5 % of total budgeted expenditure. B. In no more than one out of the last three years has the actual deficit exceeded the budgeted deficit by an amount equivalent to more than 5 % of total budgeted expenditure. C. In no more than two of the last three years has the actual deficit exceeded the budgeted deficit by more than an amount equivalent to 5% of total budgeted expenditure. D. Meets neither a, b or c.
2. Composition of expenditure out-turn compared to original approved budget.		A. The composition of expenditures is close to budget– an average of no more than 10 percent variance at administrative or functional level in at least two of the three years (excluding interest on debt), and no more than 10 percent variance on an economic basis in at least two of the last three years would indicate a composition close to budget. B. An average of no more than 15% variance at administrative or functional level in at least two of the three years (excluding interest on debt), and no more than 15% variance on an economic basis in at least two of the last three years. C. An average of no more than 20% variance at the administrative or functional level in at least two of the last three years (excluding interest on debt).

Indicator	Status	Guidance
	DNR	D. An average of more than 20% variance at the administrative or functional level in at least two of the last three years (excluding interest on debt). DNR. Did not rate
3. Aggregate revenue out-turn compared to original approved budget.	A	A. In no more than one out of the last three years has domestic revenue out-turn been below 95% of total budgeted domestic revenue. B. In no more than one out of the three years has domestic revenue out-turn been below 92% of total budgeted domestic revenues. C. In no more than two out of the last three years has domestic revenue out-turn been below 92% of total budget domestic revenue. D. Meets neither a, b, or c
4. Small stock of expenditure arrears; little accumulation of new arrears over past year.	DNR	A. There are very few or no expenditure arrears. B. There is a stock of some expenditure arrears (up to 5% of total expenditure), the accumulation of new arrears is low and the net stock level declined in the last year. C. It is estimated that there is a significant stock of expenditure arrears (5%-10% of total expenditure), though the information available may be incomplete. The accumulation of new arrears slowed down in the last year. This score will also apply if the estimated expenditure arrears are between 10% and 15%, but there has been a significant reduction in the level in the last year, and the accumulation of new arrears has slowed down in the last year. D. It is estimated that the stock of expenditure arrears exceed 10% of total expenditures, and/or no information on arrears is available. The stock of arrears has not been reduced significantly, and/or the accumulation of new arrears is continuing at a significant rate. Note: Financial statements do not disclose expenditure arrears. DNR. Did not rate

Indicator	Status	Guidance
B. KEY CROSS-CUTTING FEATURES: COMPREHENSIVENESS AND TRANSPARENCY		
5. Comprehensiveness of aggregate fiscal risk oversight.	D	A. (i) Well-established procedures are in operation for monitoring all major parastatals and SOEs on a quarterly basis, and reports are published on the full aggregate fiscal position annually (ii) Either sub-national governments cannot generate fiscal liabilities for central government, or where they can central government monitors the net fiscal positions of sub-national governments on an annual basis (iii) The central government takes corrective action to manage fiscal risks if these arise from actions of parastatals, SOEs and sub-national governments, in an appropriate manner, and reports the fiscal risks annually. B. (i) Procedures are in place for monitoring parastatals and SOEs on a quarterly basis, and these are largely complied with by central government and by the parastatals and SOEs. (ii) Central government monitors the net fiscal positions of the major tier of sub-national government on an annual basis (where they can generate liabilities for central government), (iii) Some mechanisms are available to central government to take corrective action to manage fiscal risks arising from actions of parastatals, SOEs and sub-national governments, and these are utilized from time to time. Government provides reports including major fiscal risks arising from parastatals/SOEs and sub-national government. C. (i) Parastatals and SOEs are monitored on an annual basis. (ii) Major fiscal risks arising from sub-national governments are monitored. D. The fiscal risks arising from parastatals, SOEs and sub-national governments are not routinely monitored.
6. Extent to which budget reports include all significant expenditures on central government activities, including those funded by donors.	D	A. The level of extra-budgetary activities of central government is not significant (below 1% of total spending). Alternatively, the level is somewhat higher (up to 10% of total spending) but fiscal reports include complete information on these expenditures. All major donor-funded expenditures on government activities are captured in annual budget documents. B. The level of extra-budgetary activities of central government is below 10% to total spending and some fiscal reports cover the majority of these expenditures; alternatively extra-budgetary activities may be as high as 15%, but fiscal reports provide complete information on these expenditures. C. The level of extra-budgetary activities of central government is less than 10% of total spending, but fiscal reports provide limited or no information on these expenditures; alternatively, extra-budgetary activities are higher than 10% and the majority of these expenditures are reported. Some donor-funded expenditures on government activities are captured in annual budget documents. D. The level of extra-budgetary activities of central government is more than 10% of total spending and fiscal reports provide limited or no information on these expenditures. Little or no donor-funded expenditures on government activities are captured in annual budget documents.

Indicator	Status	Guidance
7. Adequacy of information on fiscal projections, budget and out-turns provided in budget documentation	B	A. Annual budget documentation includes complete information on debt and financial assets, some information on contingent liabilities, and comparable information on prior year out-turns and future year projections. B. Annual budget documentation includes information on the debt level and comparable information to the prior year. out-turn C. Annual budget documentation provides information on the level of debt, or comparable information of the prior year. D. Annual budget documentation provides no information on debt or comparable information of the prior year.
8. Administrative, economic, functional and programmatic classification of the budget.	D	The Budget and Budget expenditures are classified: A. On an administrative, economic, functional, programmatic basis. B. On an administrative, economic, and functional (to sub-functional level) or administrative, economic and programmatic basis C. On an administrative, economic and functional level (10 main COFOG functions) basis. D. On another basis.
9. Identification of poverty related expenditure in the budget	DNR	The identification and tracking of poverty-reducing spending is undertaken: A. Through the existing budgetary classification system, either through a pre-existing comprehensive system or by adding a special, virtual fund code. B. By the prior identification of poverty reducing expenditure items in the budget and by reporting on those items (without the addition of a special code to the classification of expenditures). C. Through the use of a separate institution/fund. D. Poverty reducing spending is not identified. DNR. Did not rate
10. Publication and		A. There is comprehensive, timely publication of key fiscal information and external audit reports, these are readily

Indicator	Status	Guidance
public accessibility of key fiscal information, procurement information and audit reports.	B	accessible to the general public, and are provided in a clear, readable format. B. Most key fiscal information and all external audit reports are published without major delays, and the format is understandable. C. Some key fiscal information and external audit reports are published, but not on a timely basis. The format/presentation makes it very difficult for non-experts to understand. D. Either little fiscal information or no audit reports are published.
C. BUDGET CYCLE		
Medium Term Planning And Budget Formulation		
11. Extent of multi-year perspective in fiscal planning, expenditure policy-making and budgeting.	D	A. Multi-year aggregate fiscal forecasts and forward expenditure estimates (based on economic and sectoral breakdown) are prepared on a rolling annual basis, costed statements of national and major sector strategies exist, and there is a strong direction provided in the budget circular (or equivalent) regarding the multi-year forecasts to be adhered to in budget submissions. B. Multi-year aggregate fiscal forecasts and forward expenditure estimates (based on an economic breakdown) are prepared on a rolling annual basis, statements of national strategy and sectoral strategy exist, and the budget circular (or equivalent) makes a link between the annual and multi-year forecasts and the national strategy. C. Multi-year aggregate fiscal forecasts are updated annually but no forward estimates of expenditure other than at the aggregate level, a statement of national strategy exists, and there is reference to the multi-year fiscal forecasts in the budget circular (or equivalent). Alternatively, fiscal forecasts cover the budget year only but the budget circular makes clear reference to national strategy. D. The fiscal forecasts cover the budget year only. No linkage is made between the annual budget and national strategy in the budget circular.

Indicator	Status	Guidance
12. Orderliness and participation in the annual budget process.	C	A. Spending ministries are given clear guidance for the preparation of budget submissions, including indicative ceilings that are informed by specific agreement at the political level on the relative spending priorities across sectors. Ministries adhere to the budget calendar and are generally able to fulfill the requirements of the budget calendar, including ceilings and data submissions. Negotiations with ministry of finance are open and transparent; line ministries know their final allocation at the conclusion of such negotiations. B. Spending ministries are given clear guidance for the preparation of budget submissions, and indicative ceilings are informed by general guidance from the political level concerning relative spending priorities. Ministries adhere to the budget calendar and circular requirements in most cases. Negotiations between ministry of finance and line ministries are rather opaque, and there may be a delay in line ministries learning the outcome of negotiations. C. There are occasional delays in the budget calendar and budget submissions from line ministries may be incomplete or lack the detail requested by ministry of finance. The political level is involved in reviewing and approving the estimates only after they have been prepared by ministry of finance, thereby constraining their ability to make adjustments. Budget conferences between ministry of finance and line ministries are highly restricted, with final outcomes reflecting the will of ministry of finance. D. Although a budget calendar and budget instructions may exist, they are generally not adhered to. Budget submissions are often late and if indicative ceilings are given, they are normally exceeded by line ministries. The political leadership generally only gets involved prior to the budget being submitted to the legislature, at which time little opportunity for adjustment exists. Ministry of finance prepares the budget with little input from line ministries, and the latter may only learn of their budget allocations when the budget is submitted to the legislature.
13. Coordination of the budgeting of recurrent and investment expenditures.	D	A. There is a single budget process, based on a single calendar and circular, that fully coordinates the budgeting for investment and recurrent expenditures at the central, ministry/agency and sub-functional/program levels. Recurrent implications of investment decisions are budgeted. B. Linkages between the processes for budgeting for investment and for recurrent expenditures are made at key points, for the central and ministry/agency levels. The budgets are documented together at the central and ministry/agency levels. C. The budgets for investment and recurrent expenditure are only brought together towards the end of the budget process. D. The budgeting for investment and recurrent expenditures are separate processes and produce separate documents.

Indicator	Status	Guidance
14. Legislative scrutiny of the annual budget law.	C	The power to give the Government authority to spend rests with the legislature, and is exercised through the passing of the annual budget law. If the legislature does not rigorously examine and debate the law, that power is not being effectively exercised and will undermine the accountability of the Government to the electorate. Assessing the legislative scrutiny and debate of the annual budget law will be informed by consideration of several factors : I. (i) The scope of the legislature's review in particular the extent to which it covers fiscal policies and medium term fiscal framework, in advance of the review of details of expenditure and revenue. (ii) The extent to which the legislature's procedures are well-established, provide adequate time, and involves scrutiny of the budget by specialized committee(s) ;(iii) The adequacy and user-friendliness of the information received by the legislature. II. Whether the budget is generally passed before the beginning of the financial year. Delays in passing the budget may create uncertainty about the level of approved expenditures and delays in some government activities including major contracts. Adequate performance on <u>both </u>I and II is required to receive A, B or C score. a. I. Legislative scrutiny is comprehensive, well-informed by summary and detailed information, and involves in-depth review by specialized committee. II. The budget is passed before the financial year commences. b. I. Legislative scrutiny covers aggregates and detailed estimates of expenditure and revenue, is informed by user-friendly information, and involves some review by specialized committees. II. The budget is generally passed before the financial year commences. c. I. Legislative scrutiny covers the details of expenditure and revenue, only budget estimates are provided, some procedures exist and are partially followed. II. The budget is generally passed within two months of the start of the financial year. d. I. Legislative scrutiny is extremely limited and procedures are generally not followed. II. The budget is not generally passed within two months of the start of the financial year.
Budget Execution		
15. Effectiveness of cash flow planning, management and monitoring.		A. There is daily calculation and consolidation of all government cash balances. Forecasts of all cash inflows and outflows are prepared for the fiscal year and updated monthly, based on revenue forecasts and budget implementation and procurement plans. Borrowing is planned on the basis of cash flow forecasts. B. There is daily calculation and consolidation of government cash balances, though some transactions such as those from extra-budgetary funds may remain outside the cash planning and consolidation arrangements. Cash flow forecasts are

Indicator	Status	Guidance
	D	prepared for the fiscal year and updated monthly. C. The calculation of most government cash balances takes place regularly, though some accounts are not included in the cash planning arrangements. The system used does not allow for daily consolidation of bank accounts. Cash flow forecasts are updated periodically. D. The calculation of cash balances takes place irregularly, or cash flow planning is not undertaken.
16. Procedures in operation for the management and recording of debt and guarantees.	B	A. Domestic and foreign debt records are maintained on a single computerized debt management system and produce comprehensive reports for government routinely. Debt sustainability analysis is undertaken regularly. The issue of government guarantees is made against transparent criteria and fiscal targets, and approved by the ministry of finance. B. Regular reports on domestic and foreign debt are recorded on computerized debt management systems, or, in cases where debt levels are low, using spreadsheet records which have been demonstrated to be accurate and robust. These produce regular reports. Debt sustainability analysis is undertaken from time to time. All guarantees are approved by the ministry of finance, and a limit is placed on the total that may be issued. C. Spreadsheet or manual records are maintained on debt, and reports on debt stock and service are prepared periodically. Debt sustainability is undertaken only infrequently. Some guarantees may be issued without ministry of finance approval. D. Debt records are incomplete or inaccurate to a significant degree. Government guarantees are issued on an ad hoc basis in an opaque manner.
17. Extent to which spending ministries and agencies are able to plan and commit expenditures in accordance with original/revised budgets.		A. Spending ministries and agencies are able to commit expenditures (e.g. sign contracts with contractors and suppliers) in an orderly manner throughout the year, broadly in accordance with cash flow forecasts (agreed with finance ministry) and with the budget. Adjustment to the allocations takes place only once during the year and is done in a predictable, transparent way. B. Spending ministries and agencies have reliable information about the resources available/to be provided for a given quarter; adjustments to budget allocations are transparent and occur only a limited number of times each year. C. Spending ministries and agencies have reliable information about the resources available/to be provided for a given quarter or more, but adjustments are not undertaken in a systematic and transparent manner. Alternatively, spending ministries and agencies have reliable information about the resources available/ to be provided for a given month, and the

Indicator	Status	Guidance
	D	variation in the non-salary resources available to individual line ministries on a month-to- month basis is limited. D. Spending ministries and agencies have information about resources available for a month or less, and there is significant variation in the non-salary resources available to individual line ministries on a month-to-month basis.
18. Effectiveness of internal controls	C	A. The internal control system is relevant, incorporates a comprehensive and generally cost effective set of controls which are widely understood, the rate at which rules are not complied with is very low (no more that 3% error rate in routine financial procedures, as demonstrated by audit), the controls are only rarely bypassed, and top management takes clear and full responsibility for the effective operation of the system. B. The internal control system has a comprehensive set of controls, which are generally understood and which audit indicates are complied with (no more than 5% error rate in routine financial procedures). Emergency procedures are utilized on occasion, but in a deliberate and controlled manner. C. The internal control system consists of a basic set of rules for the processing and recording of transactions, which are well understood by those directly involved in their application, and which audit indicates are observed in a significant majority of transactions. Emergency procedures are utilized in non-emergency situations from time to time. D. The core set of rules are not complied with on a routine and widespread basis due to direct breach of rules or routine use of emergency procedures. ***Corruption is widespread within the Government and civil society and the Government has initiated limited steps to address this important issue.***
19. The effectiveness of internal audit	D	A. An effective internal audit (or systems monitoring) function is in operation. B. The internal audit (or systems monitoring) function is in operation, and provides regular reports to top management on systemic issues which are widely disseminated. Its mandate and access may not fully meet professional standards. C. The internal audit (or systems monitoring) function exists and undertakes some systems review. Reports are often not disseminated and little evidence is available of follow up action by management. D. There little or no internal audit or systems monitoring.
20. Effectiveness of payroll controls		A. Payroll records and nominal roll are directly linked through a computerized information system to which the ministry of finance has easy access, authority to change the payroll is restricted, and changes result in an computerized audit trail being created. Changes required to the nominal roll and pay requirements are updated in a timely way. There is a strong system of

Indicator	Status	Guidance
	B	payroll audit to identify control weaknesses and/or ghost workers. B. Payroll data is supported by the nominal roll records. The authority and basis for changes to the payroll database are clear. Some delays exist in processing changes to the nominal roll and payroll database. The routine controls are complemented, from time to time, by payroll audits to identify weaknesses and/or ghost workers. Payroll information is regularly provided to the ministry of finance. C. The nominal roll, which supports the payroll data, is not fully maintained. Controls exist over changes to the nominal roll and payroll database but these are not adequate to ensure full integrity of the system. There may be significant delays in processing of payroll changes. Aggregate payroll information only is provided to the ministry of finance. D. The lack of controls significantly undermines the integrity of the payroll database.
21. The existence of a transparent procurement system as an integral part of the overall PFM system which is supported by a clear regulatory framework that provides for competition, value for money and effective controls.	DNR	A. The system is defined by a clear regulatory framework which is consistently implemented under the oversight of both internal and external control systems. Contracts are awarded on the basis of competition, in accordance with rules, or justified when other methods are employed. There is regular advertisement of opportunities and publication of data on public contracts. There are few unexplained delays in awarding contracts and in making payments. The system provides for timely feedback of cost data and execution against plans to support the PFM process. B. The system is defined by a regulatory framework which is consistently implemented. The majority of contracts are awarded on the basis of competitive procedures. There is regular advertisement of opportunities but little publication of information on public contracts. Control mechanisms and linkages to the overall PFM system are not well established leading to budgeting issues and delays in contract award and payments. C. The system is defined by an outdated regulatory framework which enables inconsistent and poorly controlled implementation. Lack of competition as the basis for contract awards is evidenced by poor comparison between prices paid in the public sector when compared to market prices. Delays in award of contracts and payments are frequent. Disclosure of information is poor leading to a lack of transparency and confidence in the system. D. There is a lack of definition and clarity in the regulatory framework with inconsistent implementation evidenced by a lack of competition in the award of contracts and little disclosure of information. Control systems are weak or non-existent. Delays in awards and in payments are common and contribute to overall lack of efficiency in the system and consistent over payment by the public sector. DNR. Did not rate.

Indicator	Status	Guidance
Accounting And Reporting		
22. Timeliness and regularity of data reconciliation.	DNR	A. High quality bank reconciliation is undertaken at aggregated and detailed levels at least monthly, with very little backlog. Suspense accounts are routinely reconciled and cleared quarterly, and advances accounts are reconciled quarterly. Few suspense and advance accounts have old, brought-forward balances. B. High quality bank reconciliation is undertaken monthly for bank accounts through which revenues are collected and expenditures made, with no major backlog. There is no major backlog in the annual reconciliation of suspense and advances accounts, and in the annual clearing of the suspense account balances. There are old, brought-forward balances in some suspense and advances accounts. C. Bank reconciliation is undertaken quarterly for bank accounts through which revenues are collected and expenditures made, with no major backlog. Not all differences are explained. Reconciliation of suspense and advances accounts generally takes place annually, though there are a significant number of accounts with old, brought-forward balances. D. There is a major backlog in quarterly bank reconciliation, and in annual reconciliation of suspense and advances. No commitment accounting practiced in the Government, which precludes proper reconciliation of all expenditures and commitments. DNR. Did not rate
23. Timeliness, quality and dissemination of in-year budget reports.	A	A. Budget reports, with classification that allows direct comparison to the budget and which incorporate expenditure, revenue and debt information, are disseminated within government within four weeks of month and quarter end. There are no material concerns about the quality of the information. B. Budget reports, with classification that allows comparison to the budget at some levels and which incorporate expenditure and revenue information, are disseminated within government within four weeks of quarter end. Where there is some information that is lacking this is recognized and adequately reflected in the reports, and there may be some limited concerns about accuracy, but these shortcomings do not fundamentally compromise the overall consistency and usefulness of the reports. C. Budget reports are prepared within six weeks of quarter end, but major gaps exist in the information and the manner of compilation allows for a significant level of inaccuracy. Dissemination to line ministries is limited. D. Budget reports are not prepared within six weeks of the quarter end. Process of preparation is entirely manual.

Indicator	Status	Guidance
24. Timeliness and quality of audited financial statements submitted to the legislature	C	A. The complete set of financial statements, certified by the external auditor, are presented to the legislature within 12 months of the year end. The financial statements are presented in accordance with IPSASs, GFS or an acceptable national standard. B. A complete set of financial statements were presented to the legislature within 12 months of year end. The financial statements are presented in accordance with IPSASs, GFS or an acceptable national standard. C. Financial statements were presented to the legislature within 12 months of year end. The financial statements are presented in a consistent manner over time and there is some disclosure of accounting policies applied. D. Financial statements were not to the legislature within twelve months of year end.
External Accountability, Audit And Scrutiny		
25. The scope and nature of external audit.	C	A. The external audit is adequately empowered, covers all major entities in the public sector and the full range of financial audit, focuses on significant and systemic issues in its reports, and generally adheres to auditing standards. B. All central government expenditures and revenues are covered by the external audit. Audit work includes assessment of internal control systems, and reports identify systemic issues as well as irregular transactions. C. 80% or more of central government expenditures are covered by the external audit. The external auditor has authority to obtain information and reports identify significant issues. Audit work is predominantly transaction level testing. D. Less than 80% of central government expenditures are covered by external audit, and/or external audit has very weak authority and so is unable to obtain the basic information required.
26. Follow up of audit reports by the executive or audited entity.	C	A. There is evidence of effective follow up being taken to audit findings, in a timely manner. B. There is a formal response to audit findings, provided in a timely manner, but the follow up is not taken systematically. C. There is a formal response to audit findings, though delayed. Little follow up takes place. D. These is little evidence of response or follow up taken to audit findings.

Indicator	Status	Guidance
27. Legislative scrutiny of external audit reports.	**B**	A. A committee examines the external audit reports and completes in-depth hearings on key findings within one year of the report's issue and within two years of the end of the relevant period. Follow up actions are recommended to the executive, and are generally acted upon. B. A committee examines the external audit reports and completes hearings within 18 months of the report's issue, and within three years of the end of the relevant period. Follow up actions are recommended to the executive, some of which are acted upon. C. A committee examines the external audit reports but this is not completed within 30 months of the report's issue. Follow up actions may be recommended but are rarely acted upon. D. There has been no examination of the external audit reports within the last three years, or the examinations are for periods ended 5 years or earlier.

Appendix 8: Summary of Recommendations

Item	Recommendation	Responsible Party	Basis (Administrative, legislative)	Timing Short/ Medium	TA Needed (Y/N)
1. CAPACITY DEVELOPMENT					
1.1	The MOF should prepare and implement a comprehensive human resource strategy for the budget, financial and audit staff within the MOF and all government entities on a priority basis.	**Minister of Finance**	**Administrative**	**Short / Medium**	**YES**
2. REPORTING ENTITY					
2.1	The CDR's investment and ad hoc budgets should be consolidated into the budget entity. The investment and ad hoc budgets would be part of the State budget, subject to the same MOF oversight and monitoring as for any other budget entity;	**COM**	**Legislative**	**Short**	**NO**
2.2	The financial accounting and reporting processes should be strengthened so that MOF, COM and Parliament would have timely and accurate information on the results of the CDR's operations throughout the year. Accounting and reporting activities should be in full compliance with international accounting and reporting standards. The CDR would be required to meet the six month deadline for annual reports recommended for other entities elsewhere in this report.	**COM**	**Legislative**	**Short**	**YES**
2.3	The Board should consist of a tutelage minister, representatives of the major ministry clients on whose behalf the CDR implements investment projects and a senior representative from the private sector (who has no conflicts of interest). CDR executive management membership on the Board should be restricted in number and should be non-voting executive members.	**COM**	**Legislative**	**Short**	**YES**
2.4	The National Social Security Fund's governance and organizational structures, objectives and operating principles should be subject to an independent review by an external independent expert to establish what changes should be made in law, in operations and in practices to assure that the funds will be financially viable in the medium and long term.	**COM**	**Legislative**	**Short**	**YES**

2.5	The National Social Security Fund should provide Parliament and the public with full disclosure of its financial budget and performance, including: • preparation and tabling its detailed receipts and expenditure budget for its forthcoming fiscal year by activity, together with a statement of component fund assets and liabilities, and submit it to MOF for tabling in Parliament at the same time as the budget; • preparation of audited financial statements and tabling them in Parliament within 6 months of the fiscal year end and posting all of its tabled documents on its website immediately after tabling them in Parliament. • a critical analysis by MOF of the NSSF budget, using the same rigor as the review it provides for all budget submissions, and submitting it to Parliament within one week after its budget submission is tabled.	**Director-General** **MOF**	**Legislative** **Legislative**	**Short** **Short**	**YES** **No**
2.6	The NSSF should conduct an internal efficiency review to ascertain where its processes can be streamlined through internal redesign, cooperation with other agencies of the Government and by comparison of the expense ratios with those for other similar countries in the region.	**Director-General**	**Administrative**	**Short**	**YES**

2.7	The Government should prepare a new law for all Public Entities that moves them to a more corporatised form, where appropriate. It should, *inter alia*: • strengthen the governance processes for these entities, with the appointment of independent directors as a majority of Board members (including appointments from outside the Government) and a chairman who is external to the entity; • enforce a legal requirement for the use of International Accounting Standards for operations and reporting on the results of the enterprise's activities in its financial statements; • strictly enforce the requirement that the financial statements be audited by an external auditor using international standards for auditing; • require the annual publication of all audited financial statements of public entities and their distribution to the Government, Parliament and to the public on a timely basis (e.g. within 4 months of fiscal year end), beginning with the 2006 fiscal year. • require that all audited financial statements be permanently posted on a Government website (such as that of the tutelage ministry or MOF). The external auditor's report is an integral part of these financial statements and must be included in them before their publication;	**COM**	**Legislative**	**Short to Medium**	**YES**

2.8	The Government should further strengthen the governance structures for public enterprises by: • requiring MOF to more proactively monitor the financial performance of public enterprises, including monitoring of assets and actual and contingent liabilities, revenues and expenses and to report quarterly to the COM and to Parliament. • requiring MOF to prepare a consolidated annual report of all public enterprises with a statement of assets and liabilities (actual and contingent) and revenues and expenditures, distribute it within 9 months of fiscal year end to Cabinet, Parliament and the public, and post it on the MOF website.	**COM**	**Legislative**	**Short**	**YES**
3. BUDGET PREPARATION					
3.1	The Government should implement the recommendations of the IMF and discontinue the process of converting loans to budgetary expenditures at the fiscal year end, with no ex ante parliamentary approval.	**MOF**	**Administrative**	**Short**	**NO**
3.2	The Government should continue in its efforts to implement the IMF recommendations on the multi-year fiscal framework, the COM-approved budget ceilings in the budget call letter and the revised budget preparation framework.	**MOF**	**Legislative**	**Short to Medium**	**YES**
3.3	Individual ministries should provide an internal budget challenge function to assist in the preparation of a ministry budget submission that reflects the Government priorities and stays within the established budget ceilings.	**Tutelage Ministers**	**Administrative**	**Short**	**NO**
3.4	The Law on Public Accounting should be amended to restrict the lifetime of such carry forwards to five years, after which time they would lapse Parliament should be informed in the budget of all carryovers from prior fiscal years by project. This would ensure that Parliament has complete knowledge of all spending authorities available to the entity for the budget year.	**COM**	**Legislative**	**Short to Medium**	**NO**

4. BUDGET EXECUTION					
4.1	The Government should amend the Law on Public Accounting to redefine the point at which a commitment is created and to define an appropriation as an authority to expend an amount that is in an MOF-approved annual and MOF-approved monthly expenditure plan	**MOF**	**Legislative**	**Short**	**YES**
4.2	An audited annual financial statement of the Independent Municipal Fund should be prepared by the MOF and reported to Parliament as a schedule to the final budget execution report. The annual audit of these financial statements should be conducted by the Court of Accounts.	**MOF**	**Legislative, Administrative**	**Short**	**NO**
4.3	The Government should resubmit the proposed amendment of the Law on Public Accounting to immediately remove the Court of Accounts from the ex ante approval process. The amendment should retain the MOF commitment controller function until the ministry, in the opinion of the COM, on the recommendation of the Minister of Finance, agrees that the ministry's internal control framework is sufficiently robust to permit the delegation of this function to ministry financial staff • The delegations shall be reported to Parliament in the annual budget submission, and shall be subject to periodic MOF audit. • In cases of loss of effective internal control, the delegation shall be withdrawn by the Minister of Finance	**MOF**	**Legislative**	**Short**	**NO**
4.4	The Government should remove from the Law on Public Accounting the unenforceable requirement for the commitment controller to certify that proposed transactions are not in violation of *all relevant laws or regulations*.	**MOF**	**Legislative**	**Short**	**NO**
4.5	The Government should remove the minister from the process of scheduling payments before submission to the Treasury and substitute a strict first-in, first-out (FIFO) for processing and payment. All deviations from this FIFO principle must be reported to the Court of Accounts; material deviations must be reported by the COA in its annual report to Parliament;	**MOF**	**Legislative**	**Short**	**NO**
4.6	The CFAA recommends that the Government adopt more realistic revenue forecasts for all of its component revenue streams to bring forecasts closer to actual revenue collections.	**MOF**	**Administrative**	**Short**	**YES**

4.7	The Law on Public Accounting should be amended to require the submission of regular cash management plans by all entities in receipt of budgetary resources to the MOF and to empower the Treasury to undertake cash management activities on behalf of the Government of Lebanon.	**MOF**	**Legislative**	**Short**	**NO**
4.8	The Parliamentary Budget Committee should remain as the principal point of parliamentary contact for the COA when it is granted its independence from the Government and should actively monitor the Government's implementation of COA recommendations.	**PBC**	**Administrative**	**Short**	**No**
4.9	Parliament should allocate expert staff support resources to the Budget and to the other parliamentary committees to enable them to effectively discharge their functions with respect to the Government.	**Parliament**	**Administrative**	**Medium**	**No**
5. ACCOUNTING					
5.1	The Law on Public Accounting should be amended to require full compliance by government entities with the IPSAS international standards for accounting and reporting.	**MOF**	**Legislative**	**Short**	**NO**
5.2	The Minister of Finance should be given new authority in law to prescribe new accounting policies that reflect a migration from cash-based accounting to full accrual accounting. The Law on Public Accounting should be amended to require: -compliance of the migration policies with IPSAS standards; - compliance of the accounting standards used by public entities with IPSAS or IASB standards, depending on their public or commercial basis.	**MOF**	**Legislative**	**Short**	**YES**
5.3	The staff of the MOF Public Accounting Bureau should receive training and technical assistance in: the development and implementation of IPSAS modified cash accounting policies and procedures for government entities; migration strategies towards accrual accounting; and consolidation accounting techniques to prepare the consolidated financial reports that accompany this migration.	**MOF**	**Administrative**	**Short**	**YES**

6. FMIS					
6.1	The CFAA recommends that the Government examine the requirements of individual line ministries to interface their financial systems with the central MOF FMIS and take those steps necessary to increase their interoperability.	**MOF**	**Administrative**	**Short**	**Yes**
6.2	The CFAA recommends that the MOF begin now the process of defining its next generation FMIS in terms of the needs of all users and the functionality it will be required to provide; - These future processes should take advantage of the electronic transaction and digital signature legislation - Senior MOF management must lead this process.	**MOF**	**Administrative**	**Short**	**Yes**
6.3	A rigorous, formal cost-benefit analysis of the make or buy decision for a new FMIS should be undertaken by an independent third party, reporting directly to the MOF Director General.	**MOF**	**Administrative**	**Short**	**YES**
7. REPORTING					
7.1	The appropriate laws relating to financial reporting for all entities should be revised to reflect, at a minimum, current reporting practices of the MOF.	**MOF**	**Legislative**	**Short**	**NO**
7.2	The Government should begin the process of accelerating the preparation of an audited set of financial statements to be tabled in Parliament within 9 months of the fiscal year end and made available on the MOF web site.	**MOF**	**Legislative & Administrative**	**Short**	**YES**
7.3	The Government's financial statements should be progressively expanded to include the central budget entities and the extra-budgetary funds and entities for fiscal year 2005, expanded for FY 2006 to include municipalities and extended in 2007 to include public enterprises.	**MOF**	**Legislative & Administrative**	**Short to Medium**	**YES**
7.4	The Law on Public Accounting should be amended to require the preparation and tabling of these audited financial statements within 9 months of the fiscal year end.	**MOF**	**Legislative**	**Short**	**NO**
7.5	The Court of Accounts will also have to modify its procedures in order to prepare an audit opinion on the fairness of the Government's financial statements within six months of the fiscal year end.	**COA**	**Legislative & Administrative**	**Short**	**YES**

8. INTERNAL CONTROL					
8.1	The law on Public Expenditures should be amended to reflect the modern internal control standards used by the EU and the responsibilities of the Minister of Finance for all aspects of this framework should be clearly specified in law.	**MOF**	**Legislative**	**Short**	**YES**
8.2	The Government should accelerate its planned rev to expenditure processing to uniquely specify one responsible for each step and to establish their spe accountabilities.	**MOF**	**Legislative**	**Short**	**YES**
8.3	The Government should minimize the number of approvals required to complete an expenditure transaction in the new expenditure control process	**MOF**	**Legislative**	**Short**	**NO**
8.4	When implemented, internal auditors should be ta include an assessment of the risk of corruption in regular audits of existing government processes.	**MOF**	**Administrative**	**Medium**	**YES**
9. INTERNAL AUDIT					
9.1	In the short term, the Government should establish an internal audit directorate within the MOF, reporting to the Minister of Finance. The Directorate should consist of two Bureaus: Internal Audit Operations for audits within MOF or as directed by the Minister of Finance and the COM; and Internal Audit Harmonisation for the development of the policies and processes required supporting all internal audit units.	**MOF**	**Legislative**	**Short**	**YES**
9.2	The Government should amend the Law on Public Accounting (or otherwise provide a supporting COM directive) to require the phased implementation of internal audit units in all significant budget entities in a manner that is consistent with EU requirements for internal audit functions in government. The implementation plan should be approved by the COM. And overseen by MOF.	**MOF**	**Legislative**	**Medium**	**YES**
9.3	Staff for the MOF Internal Audit unit should be obtained from the annual graduates of the Training Institute's orientation program for new hires or from redeployments from Central Inspection; all should be provided with internal audit training prior to deployment in the internal audit unit.	**MOF**	**Administrative**	**Short to Medium**	**YES**

9.4	The Government should adopt the strategy of harmonizing all future changes to its internal control and audit systems to conform to the EU public internal financial control standards, amending the Law on Public Accounting to reflect the principles of the EU's internal control framework and its assignment of responsibilities to various defined positions in the financial control process.	**MOF**	**Legislative & Administrative**	**Short to Medium**	**YES**
9.5	The Minister of Finance should be assigned the responsibility for proposing all internal controls and audit policies, guidelines, processes and procedures and for overseeing their effective implementation across Government.	**MOF**	**Legislative**	**Short**	**YES**
9.6	In the medium term, the Government should conduct the phased implementation of internal audit units in budgetary entities according to the COM-approved implementation plan.	**MOF**	**Legislative**	**Medium**	**YES**
10. COURT OF ACCOUNTS					
10.1	The CFAA recommends that the Court of Accounts adopt the INTOSAI SA standards internally to monitor its development against international standards as it implements future reforms.	**COA**	**Administrative**	**Short**	**NO**
10.2	The CFAA recommends that the COA be required by law to monitor the Government's implementation of the COA's current and previous audit recommendations and to report on the Government's progress in its annual report to Parliament.	**COA**	**Legislative**	**Short**	**NO**

10.3	The CFAA recommends that the COA acquire donor support to assist it in making the transition to a modern SAI, by providing technical assistance to: • Determine the best organizational structure to accommodate the two new audit types and the discontinuance of the ex ante control function; • Revise the internal processes within the SAO to accommodate the attest and performance audit processing and quality assurance requirements; • Update audit guides and procedures that comply fully with the international standards; • Diversify the recruitment to include candidates who are trained in financial accounting, auditing and technical areas necessary for the conduct of performance audits; • Prepare training course syllabi to provide the basis for training of all auditors and judges on the international standards-based audit principles, processes and procedures;	**COA Donors**	**Administrative**	**Short**	**YES**
10.4	The CFAA recommends that the three COA courts presently committed to ex ante controls redirect their efforts to reviewing the results of performance audits undertaken by the COA auditors.	**COA**	**Administrative**	**Short**	**YES**
11. PARLIAMENTARY OVERSIGHT					
11.1	The Parliamentary Budget Committee should remain as the principal point of parliamentary contact when the COA is granted its independence from the Government: - It should be the active client for the COA's monitoring of the Government's implementation of COA recommendations	**Parliament**	**Administrative**	**Short**	**NO**
11.2	The Parliamentary Budget Committee should be: given sufficient resources to have permanent expert staff support for its mounting workload; and given greater time to review the Government's final budget report. This review should be carried out coincident with the accelerated tabling of the COA's audit report for the completed year.	**Parliament**	**Administrative**	**Short**	**NO**

11.3	The Parliamentary Budget Committee should require the COA to monitor the Government's implementation of its recommendations and to prepare an annual summary of all new and outstanding recommendations, together with the status of the Government's implementation of each. This summary should be prominently displayed in the annual report of the Court of Accounts and reflected in law.	**Parliament**	**Legislative / administrative**	**Short**	**NO**
11.4	The Government should establish relationships with other interlocutors such as NGOs, citizen coalitions, etc in order to improve its effectiveness in communicating the fiscal messages to the public.	**Parliament**	**Legislative / administrative**	**Short**	**YES**