

**REPUBLIC OF AZERBAIJAN**

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**ABSTRACT**

of the dissertation for the degree of Doctor of Philosophy

**THE ROLE OF THE TREASURY IN THE  
EXECUTION OF THE STATE BUDGET  
AND ITS IMPROVEMENT ISSUES**

Speciality: 5301.01 Internal fiscal policy and public finance

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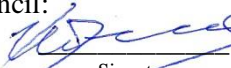
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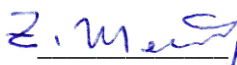
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## GENERAL CHARACTERISTICS OF DISSERTATION

**Relevance and development of the topic.** In a market economy, the appropriate structure and execution of the state budget are critical for a state's financial stability and security. States use budget and financial control methods to mobilize funds within the state budget and obtain results from these funds. Treasury bodies and structures are one of the organizations that implement complicated, extensive control procedures for the organization of the use of financial resources after the creation and acceptance of the draft budget. The Treasury, as an agency, is frequently directly accountable for the efficient execution of the state budget, reiterating the Treasury's important position in state budget execution. In a market economy, the treasury is a multi-functional institution that assumes control over the movement of all budget funds, utilizing a variety of tools and control mechanisms to ensure that the budget is correctly executed.

Governments are well aware that the state budget determines what goods and services are accessible throughout the year, what social payments are made, and how to finance the majority of their expenditures using various tax collections. The budget as an economic category is continually changing, and states and governments use it to solve a variety of unavoidable difficulties. New approaches and mechanisms for budget management have emerged in international practice (Medium Term Expenditure Frameworks (MTEFs), Results-Oriented Budgeting (ROB), program-target budget method), implying that countries are already participating in budget management structures and bodies are beginning to perform new functions. Azerbaijan, like other governments, has made the shift to new financial management systems one of its top priorities. The structure of the state budget execution stage and its quality control should be considered a topical problem in the new budget management model. On the other side, additional functions must be assigned to the treasury bodies, which have a de facto key position in budget execution.

The treasury authorities in Azerbaijan are in charge of organizing the financial execution of the budget. The treasury's key powers include monitoring revenue and expense transactions through the intra-treasury accounting system. Treasury activities are increasingly automated in

modern times, both globally and in Azerbaijan, lowering the cost of administering public funds. One of the most essential concerns for the Treasury to better exercise its powers is to develop the system's methodological and legal framework in order to organize the state budget implementation phase more effectively. In modern times, treasury bodies act as an organization that administers budget money and coordinates the receipt of extra revenues to the budget, in addition to controlling the use of budget funds for their intended purpose.

The importance of this topic stems from the fact that public finance management is evolving in response to emerging global concerns, with budget management moving away from traditional budget mechanisms and resulting in the introduction of new budget mechanisms. The organization of the state budget varies by country, and the functions of the treasury and other authorities in the administration of the budget process, including the organization of the state budget execution phase, range dramatically. The major component influencing the study's goals and objectives is to clearly define the Treasury's position in the execution of the state budget in modern times, as well as the breadth of effect on the state budget's implementation.

**Level of investigation into the problem.** It should be mentioned that there is a wealth of scientific literature, works, research, and publications on the budget, and it is possible to observe economists' theoretical and practical perspectives on the subject both in our nation and elsewhere. They looked at the budget as the foundation of the financial system, but they also expressed their opinions on issues relating to the budget system, including budget process management, budget accounting, budget revenues, budget expenditures, budget deficit management, state treasury, and treasury system. The dissertation summarizes scientific research and publications connected to the budget, budget procedures, budget execution stage, and treasury system regulation by economists from our country and other nations, as well as local and international professionals and experts.

In the domain of research on budget and treasury concerns, the names and research works of the country's economic researchers can be highlighted, including A.A.Alakbarov, B.A.Khankishiyev, D.A.Baghirov, Sh.Sh.Badalov, Z.F.Mammadov, H.Kh.Asadov,

S.T.Talibov, N.A.Novruzov, M.Kh.Hasanli, R.T.Hasanov, Sh.H.Aliyev, Z.T.Valiyev, N.I.Faracov, E.B.Suleymanov, E.A.Ibrahimov and others.

Authors of notable publications and researches on the budget economic category and the state treasury can be found among international economists including A.N.Kozirin, V.A.Malchev, I.Q.Akbarov, P.M.Qodme, I.Kh.Ozerov, I.M.Mislyaeva, S.E.Prokofyev, S.V.Zapolski, Q.B.Polyak, V.A. Lebedev, E.N.Berends, I.A.Azizova, N.V.Milyakov, D.L.Komyagin, S.Pattanayak, M. Robinson, C.Irwin, A.Shah and others.

Without diminishing the importance of the research done in this area, we can argue that the topic of arranging the Treasury's successful operation has not been thoroughly investigated. The issue of "Creating a mechanism to ensure expenditure discipline" in the priority areas outlined in the "Strategic Roadmap for the National Economic Prospects of the Republic of Azerbaijan," approved by the President of the Republic of Azerbaijan on December 6, 2016, was another important reason for the topic's selection and development. In this regard, new approaches to the structure of the state budget implementation stage entail the transfer of additional functions to the Treasury. In addition to the challenges relating to the functions to be given to the treasury, concerns relating to the improvement of the accounting system and control mechanisms in the treasury system must be considered, the answer to which has made the study topic important and chosen.

**The research's purpose and objectives.** The dissertation's goal is to investigate the theoretical and methodological issues surrounding the treasury system and treasury control, as well as to offer proposals and recommendations for improving the treasury's control in the implementation of Azerbaijan's state budget. The following connected objectives are necessary to achieve the given goal:

- Further research into the theoretical foundations of the treasury's essence, creation, and organization as a body;
- Summarize the parts of the state budget execution stage, including the budget execution normative bases on revenues and expenditures;

- Systematize and analyze the treasury system's role, functions, and organizational principles in the implementation of the state budget;
- Demonstrate the potential applicability of these approaches in Azerbaijan by examining international treasury management experience in developed nations;
- Examine the budget's revenue and spending indicators as they were formed during the state budget's execution;
- Assess the existing state of treasury control in Azerbaijan's Treasury Information Management System (TIMS);
- Establish its future development directions in order to effectively manage financial resources formed on a single treasury account;
- Define the key directions for the organization of the state budget's execution in Azerbaijan, as well as the treasury system's improvement and development prospects.

**The object of study.** The treasury system, which organizes and conducts the financial execution of the state budget in Azerbaijan, is the subject of the dissertation.

**The study's subject.** The research's topic is defined by the socioeconomic, organizational, and financial relationships that emerge during the state budget's treasury execution.

**Database for research.** The dissertation's data base includes scientific publications, laws, and normative documents, such as electronic materials from the Ministry of Finance, State Statistical Committee, State Treasury Agency' normative documents, and annual reports from the Chamber of Accounts, as well as materials from the International Monetary Fund and various scientific conferences.

**The dissertation's research methodologies.** In the research process, generalization, historical-logical approach, systematic approach, statistical grouping, and comparative analysis methodologies have been applied.

**The main provisions of the dissertation.** The following main provisions are included in the defence, which contain new or innovative elements:

- Generalizations based on international experience about the institutional basis of budget execution and the development of the treasury system based on the budget legislation of different countries;
- Increasing the effectiveness of planning the financial execution of the budget in Azerbaijan ;
- Improving the chart of accounts in Azerbaijan’s treasury system to allow for the use of the modified accrual method in budget execution;
- Reinforcing Azerbaijan’s treasury system’s payment system on a treasury single account;
- Identification of new functions in the treasury system based on a results-based budgeting mechanism using a program-target method, and inclusion of these functions in the treasury bodies’ powers.

**The scientific novelty of the research** is as follows:

- Generalizations were developed on the scientific and theoretical bases of the state budget execution and treasury system based on international experience, and necessary proposals were developed to enhance the legislative framework in Azerbaijan on the basis of these generalizations;
- On the basis of worldwide experience, the directions for structuring financial reporting in the treasury system in Azerbaijan were highlighted, and necessary proposals were developed;
- Ways to improve financial execution of the budget in Azerbaijan were demonstrated, and pertinent proposals were provided;
- Relevant ideas for the efficient management of financial resources established on a treasury single account have been made;
- New treasury functions to be performed in the implementation of the state budget have been discovered and proposed;
- The key directions for organizing the state budget execution stage and improving the treasury system in Azerbaijan have been identified, as well as their development prospects.

**Theoretical and practical significance of the research.** The scientific findings of this study can be used as a theoretical and methodological foundation for budget execution and treasury system development. The key theoretical provisions, proposals, and recommendations can be used to draft necessary normative-legal papers, instructional materials, and treasury system documents. The study’s

findings may be valuable to budget execution participants in the future. The study work's ideas are targeted at resolving a number of methodological challenges, teaching relevant courses connected to people training for the budget system, as well as research, teaching, textbook creation, and other appropriate activities. The study's findings may also be valuable to government agencies.

**Approbation and application of the results of the dissertation.**

The dissertation's substance and primary findings are reflected in theses published in the proceedings of different international and national scientific-practical conferences, as well as eight journal publications (including 1 abroad).

**Name of the organization where the dissertation is performed.**

The dissertation work has been carried out at the “Finance and Financial Institutions” department of Azerbaijan State University of Economics.

**The scope and structure of the research.** The dissertation includes of an introduction (14363 symbols), 3 chapters (I chapter– 86620 symbols, II chapter – 119429 symbols, III chapter – 81909 symbols), a conclusion (18714 symbols), and a list of references, appendices, as well as 18 tables and 18 illustrations, totalling 186 pages written in 1.5 intervals on a computer. There are 138 sources in the bibliography.



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## MAIN SCIENTIFIC PROVISIONS FOR DEFENSE

### **1. Generalizations based on international experience about the institutional basis of budget execution and the development of the treasury system based on the budget legislation of different countries.**

In international practice, the characteristics of the stages of state budget revenue and expenditure execution that are controlled by the treasury system are reflected in the relevant articles in a broad and interpreted way in the budget legislation. These stages on budget revenue and expenditure, as well as the principal comments and provisions on these stages, are not mirrored in the framework of Azerbaijan's budget legislation. These stages and their meaning have not been established in Azerbaijan by the "Law on the Budget System" or other relevant normative regulatory instruments. The relevant articles and clauses on these phases may be appropriate to include in Azerbaijan's budget legislation.

The stage of state budget execution can be viewed as a system, and it necessitates the resolution of major issues and duties that are directly controlled by the treasury system. Control over the accounting of operations on the execution of the state budget's revenues and expenditures, the organization of accounting of revenues from sources of financing the budget deficit, and the organization and execution of financing of all expenditures related to public debt service are all addressed by this system. Taking a closer look, we can observe that the system of state budget execution clearly defines the full and timely receipt of anticipated revenues, the intentional and targeted use of expenditures, and the source and quantity of receipts utilized to finance the budget deficit. Making full and timely inter-budget transfers in compliance with the budget law is one of the most significant points.

The volume of budget revenues and expenditures in Azerbaijan, including the budget deficit and the cost of servicing domestic and foreign public debt, as well as their upper limit (limit), are reflected in the budget law that will take effect for the following year. When budget draft is prepared in Azerbaijan, it is necessary to clearly define the

composition of budget expenditures and the sources of financing the budget deficit as a composition of budget revenues.

The funds that constitute the source of funding for the budget deficit are not included in the composition of budget expenditures in Russia and Ukraine's "Budget Code." In addition, in Ukraine, "budget expenditures" do not include public debt service expenditures, budget funds placed in bank deposits, refunds of overpaid taxes and other payments to the budget, budget loans, budget donations, and purchased securities. It is not considered as a good practice to acknowledge cash funds which is not dedicated from the budget on one-time spending basis and builds mutual relationships, as budget expenditure.

Budget revenues and expenditures are implemented when the budget allocation document and the single cash plan, which contains cash inflows and outflows, are ready, which necessitates paying attention to the main procedures regulated.

There are legal procedures for budget execution on revenues in international practice, which usually include the following stages:

- Transfer and receipt of revenue to the treasury single account;
- Distribution of regulatory revenues at different budget levels in accordance with the approved state budget;
- Return of overpaid amounts of revenue to the budget;
- Accounting of budget revenues and reporting on the revenues in accordance with approved budget.

The state budget's expenditure portion is directly proportional to the quantity of revenues, whereas expenditures are based on the actual availability of budget funds. Important variables such as revenues are also included in the execution of the state budget on expenditures. These elements include budget expenditure classification based on various principles (functional, economic, administrative, etc. ), stages of the state budget on expenditures, budget expenditure blocking (suspension), and the treasury system provides the necessary control over the majority of these elements.

The budget's expenditures execution also contains crucial stages, such as revenues, where the treasury system's management is ensured, beginning with the stage of making commitments. The steps of budget expenditure sanctioning in Azerbaijan and the CIS are as follows:

- The stage of distribution of budget allocations.
- Commitment stage.
- Confirmation of purchase and inspection of ordered goods (works and services).
- Payment stage.
- Accounting stage.

The definition of “commitment” under Azerbaijan’s budget legislation, which is crucial in terms of budget expenditures, should be defined. As a result, the substance of commitments concepts and words in terms of legal commitments, as well as economic obligations, and financial liabilities must be expressed in the law. Legal commitments are a government contract that is registered and is frequently used to manage budgets for the current year and the future.

The characteristics of the stages of state budget revenue and expenditure that are controlled by the treasury system are represented in the relevant articles in the framework of budget legislation in international practice in a broad and interpreted fashion. The required provisions on these stages are mirrored in the Western approach and in the CIS countries, as well as in pertinent parts of the budget legislation of Russia, Ukraine, Belarus, and Georgia (typically the Budget Code). The Law on the Budget System and other relevant normative regulatory legislation in Azerbaijan have not established these stages or their interpretation. It may be acceptable to incorporate pertinent articles and clauses on these stages in Azerbaijan's budget legislation.

## **2. Increasing the effectiveness of planning the financial execution of the budget in Azerbaijan.**

According to reports on the state budget’s execution in Azerbaijan, there was a consistent deficit in the budget’s execution, particularly between 1995 and 2000. The primary reasons include low revenues, insufficient planning, a lack of expenditure control systems, and the fact that state budget legislation does not fit the requirements of the time period. Even the gradual implementation of the treasury system in 1995 could not have made a significant difference on the current situation. Following that, the formation of the treasury system resulted, in the first place, in the application of effective financial planning for financial management, resulting in the elimination or

minimization of the budget deficit. Treasury planning is based on the state budget legislation, which is established each year in the country, and the treasury offers cash predictions based on the forecast indicators of the revenue and expenditure sections of the state budget stipulated in these laws. Budget revenues and expenditures have both increased significantly since 2000.

**Table 1**  
**Comparison of forecast and execution of state budget revenues and expenditures for the years 2000-2020, in million manats and %**

Years	Forecast for budget revenues	Forecast for budget expenditures	Difference between forecast and execution	Execution of budget revenues	Execution of budget expenditures	Execution difference	Execution of budget revenues (percentage)	Execution of budget expenditures (percentage)
<b>2000</b>	712,3	808,2	- 95,9	714,6	764,0	- 49,4	100,3%	94,5%
<b>2001</b>	835,0	840,0	- 5,0	784,8	807,5	- 22,7	94,0%	96,1%
<b>2002</b>	956,0	1026,0	- 70,0	910,2	931,8	- 21,6	95,2%	90,8%
<b>2003</b>	1218,4	1284,6	- 66,2	1220,9	1234,5	-13,6	100,2%	96,1%
<b>2004</b>	1503,7	1566,7	- 63,0	1509,5	1502,1	7,4	100,4%	95,9%
<b>2005</b>	2044,4	2203,2	- 158,8	2055,2	2140,7	- 85,5	100,5%	97,2%
<b>2006</b>	3836,8	4024,8	- 188,0	3868,8	3790,1	78,7	100,8%	94,2%
<b>2007</b>	5771,0	6315,0	- 544,0	6006,6	6086,2	- 79,6	104,1%	96,4%
<b>2008</b>	10484,0	11060,6	- 576,6	10762,7	10774,2	- 11,5	102,7%	97,4%
<b>2009</b>	12177,0	12355,0	- 178,0	10325,9	10503,9	- 178,0	84,8%	85,0%
<b>2010</b>	11505,0	12275,3	- 770,3	11403,0	11765,9	- 362,9	99,1%	95,9%
<b>2011</b>	12061,0	12748,0	- 687,0	15700,7	15397,5	303,2	130,2%	120,8%
<b>2012</b>	16438,0	17072,0	- 634,0	17281,5	17416,5	- 135	105,1%	102,0%
<b>2013</b>	19159,0	19850,0	- 691,0	19496,3	19143,5	352,8	101,8%	96,4%
<b>2014</b>	18384,0	20063,0	- 1679,0	18400,6	18709,0	- 308,4	100,1%	93,3%
<b>2015</b>	19438,0	21100,0	- 1662,0	17498,0	17784,5	- 286,5	90,0%	84,3%
<b>2016</b>	16822,0	18495,0	- 1673,0	17505,7	17751,3	- 245,6	104,1%	96,0%
<b>2017</b>	16766,0	17941,0	- 1175,0	16516,7	17594,5	- 1077,8	98,5%	98,1%
<b>2018</b>	22149,0	23100,0	-951,0	22508,9	22731,6	- 222,7	101,6%	98,4%
<b>2019</b>	23168,0	25190,0	-2022,0	24218,1	24425,9	- 207,8	104,5%	97,0%
<b>2020</b>	24124,0	27492,2	-3368,2	24681,7	26416,3	- 1734,6	102,3%	96,1%
<b>Сmi</b>	<b>239552,6</b>	<b>256810,4</b>	<b>-17258,0</b>	<b>243370,4</b>	<b>247671,5</b>	<b>- 4301,1</b>		

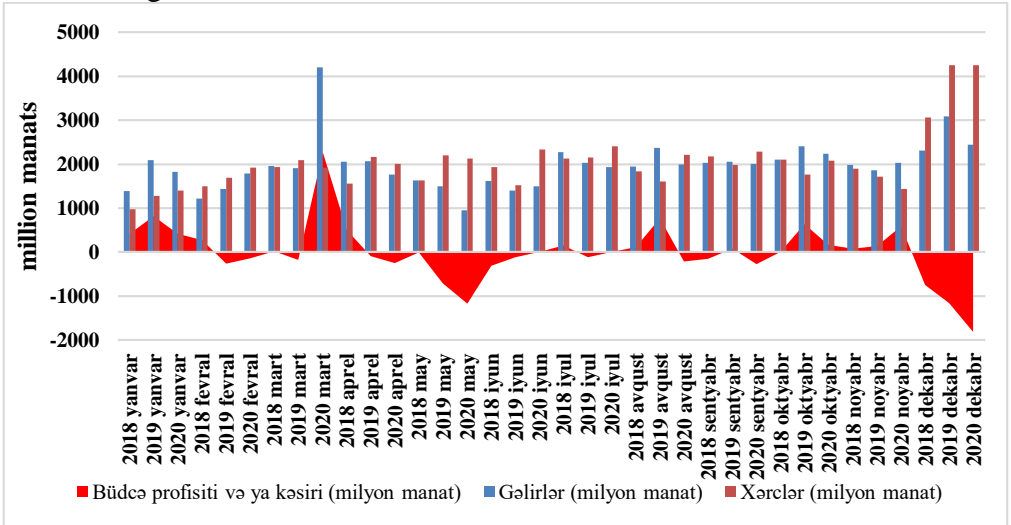
*Source: Prepared by the author on the basis of data of the Ministry of Finance of the Republic of Azerbaijan.*

To summarize the budget implementation from 2000 to 2020 (21 years), state budget expenditures totalled over 247.7 billion manats, while budget receipts totalled around 243.4 billion manats (Table 1). The entire budget deficit during these years was around 4.3 billion manats. However, the total budget deficit for the anticipated budget has surpassed 17 billion manats over the years. Between 2000 and 2020 (21 years), expected and

performed budget revenues were in surplus (about 3.8 billion), while projected and executed budget expenditures were in deficit (roughly 9.1 billion).

Budget expenditures and revenues should be arranged in such a way that the state budget can be implemented without difficulty. In this regard, the amount of budget revenue should be determined during budget planning depending on the number of essential budget expenditures. Overall it is a complicated issue to decide whether or not to prefer budget expenditures to budget revenues in the process of budget planning. A prerequisite for budget planning under the “top-down” approach to budgeting is determining the entire amount of budget expenses. Looking at other countries’ budget codes, we can see that the Russian Federation’s Budget Code prioritizes the preparation of budget expenditure indicators while developing a draft budget. The draft budget is based on the funding of budget expenditures that lead to socioeconomic growth, according to Article 169 of the Budget Code. Budget revenues, in other words, are merely a method of spending. When planning budget expenditures, it is critical to start with expenditure commitments (current year) and future expenditure commitments (for the next year). For example, in France, expenditure commitments are employed particularly in budget expenditure planning, and the long-term constraints of expenditure commitments on investment expenditures are considered. Some of the budget money required for expenditure commitments is utilized this year, while the remainder is used the following year. The main goal of expenditure planning before revenue planning is to estimate the expenditures that are required by the country's economic, social, and political situations, followed by the calculation of revenues to pay for these expenditures. Analysis of budget indicators in the budget execution system of Azerbaijan shows that budget revenues are collected every year as forecasted, but budget expenditures in most cases is decreased and is adjusted to budget revenues. Efficiency in budget execution system should not be interpreted as absence of divergence between these figures. The most essential reform in budget planning in Azerbaijan is proving the necessity for budget expenditures in various areas, followed by planning and finally planning budget revenues.

The indicators of state budget execution are inextricably linked to the indicators of financial execution of the budget. Although the Treasury seeks to balance between cash revenues and cash payments during cash execution, this is not always possible, and there are instances when a cash deficit occurs. Cash deficits are determined in advance under Treasury oversight, and these issues are resolved by attracting financial resources.

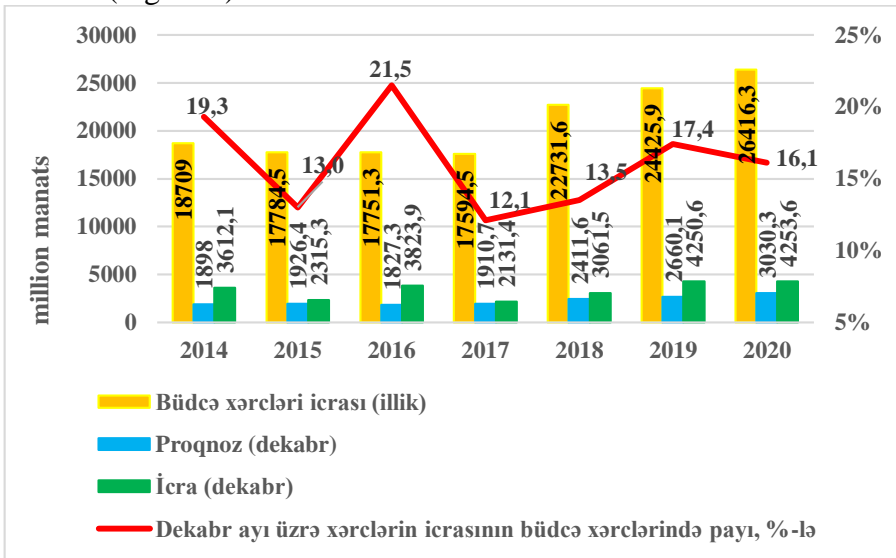


**Figure 1. Monthly execution of state budget revenues and expenditures, in million manats**

*Source: Prepared by the author on the materials of the Chamber of Accounts of Azerbaijan.*

An examination of the budget’s cash execution in Azerbaijan reveals that various issues have been identified in guaranteeing the budget’s revenue and spending balance for the months, which is not a desirable condition (Figure 1). On the other hand, the fact that revenues and, in particular, expenditures for all three years are higher in december than in other months implies that december is the most stressed month in budget execution. Such budget spending inflation, in our opinion, is a perilous condition, and the cause should be a lack of quality planning for the budget treasury’s implementation and an overestimate of the demand for expenditures. In most years, approximately 30% of budget expenditures are carried out in the fourth

quarter, such as in October, November, and December, which is a significant deviation from the proportion in other months. The substantial share of investment expenditures in the budget, as well as the practice of spending the majority of investment expenditures in recent months, is two of the key reasons for this. In 2019 and 2020, the share of funds conducted in the fourth quarter was larger than in 2018, and expenditures were executed more in December than in other months (Figure 2).



**Figure 2. Execution of state budget expenditures in December between 2014-2020, in million manats**

*Source: Prepared by the author on the materials of the Chamber of Accounts of Azerbaijan.*

Long-term commitments, particularly on investment expenditures, must be considered in Azerbaijan’s cash planning, and the link between control on commitment and cash planning must be strengthened.

Azerbaijan considers the amount of current and capital expenditures on budget expenditures separately, however the sources of funding for investment expenditures are examined as part of a single consolidated budget, which is regarded a successful strategy.



Simultaneously, this technique is one of the most essential features that will make future applications of the accrual method easier. However, improvements in medium-term budget planning and the employment of program-target method, as well as the implementation of budget rules (legislative application of the gold rule, constraints on budget deficits and public debt, and imposing expenditure ceilings), are all crucial. In any case, Azerbaijan's acceptance of a proposed three-year budget law for the medium term must be secured in the future. In Russia, one of the CIS countries, the medium-term structure of spending is established, as well as the approval of a three-year budget law. The approved budget is re-approved with some changes in succeeding years.

### **3. Improving the chart of accounts in Azerbaijan's treasury system to allow for the use of the modified accrual method in budget execution.**

The International Monetary Fund (IMF) has recommended three different options for organizing treasury system, including models for developed countries, developing countries, and countries in transition. Some aspects of each of the three countries' models have been included as best practices in Azerbaijan's treasury system. In the Group of Developed Countries, accounting and reporting in the treasury system is delivered directly to the central treasury by the budget organizations (ministries), rather than through treasury departments. In these countries, on the other hand, the treasury uses the accrual method for accounting and reporting, and treasury control is done directly on an automated system. The treasury system in Azerbaijan is already highly automated, but if the treasury system applies the accrual method for budget accounting and reporting, then the treasury system model in Azerbaijan may be similar to the treasury system model in developed countries.

In international practice, reports on the implementation of the state budget are created using a unified chart of accounts that contains three key categories that governments must consider at a minimum:

- Statistical reporting system for countries created by the International Monetary Fund (IMF) (Government Financial Statistics Manual (GFSM) - 1986, 2001, 2014);
- reporting on budget execution (this reporting on budget

classification is prepared by the treasury and usually on a cash basis);

- reports submitted by budget organizations on the basis of national and international accounting standards (mainly on the basis of accrual method).

The chart of accounts used in the framework of budget accounting in world countries is well known for its importance in guaranteeing state financial reporting. Previously, the chart of accounts generated for budget classification in the context of budget accounting in the countries was administered in a manner that was not incorporated into the chart of accounts of accounting, and Azerbaijan had a similar scenario. In modern practice, however, the chart of accounts of budget classification is maintained in a way that is fully integrated into the chart of accounts that follows accounting standards. Most nations have adapted their chart of accounts of budget accounting to the Government Financial Statistics Manual (GFSM) chart of accounts based on international accounting principles, which is generally regarded as a single statistical reporting system for governments. In the GFSM, the chart of accounts is divided into seven segments (functional, source of funds, organizational, economic, project, program, and regional), and many countries usually create chart of accounts by integrating the economic segment with the economic classification from the budget classification.

In order to establish chart of accounts proposed in GFSM, the CIS countries have undertaken significant modifications in this area. In this regard, several nations have incorporated budget revenues classification, as well as functional and economic classification of budget expenditures which composes the structure of the unified budget classification, into the chart of accounts. Only Moldova has improved the content of the budget classification for virtually all segments (excluding the regional segment) in the CIS by meeting the GFSM's requirements and ensuring its integration into the GFSM's chart of accounts. Thus, there is a need to review the structure of the unified budget classification in Azerbaijan and re-improve its composition. Simultaneously, complete integration of the new categories (if a program classification is to be created) into the proposed GFSM chart of accounts is required. Formed separately by the decision of the Ministry of Finance of Azerbaijan, budget reports are prepared according to the budget classification, and financial reports are

prepared according to the chart of accounts formed according to the economic classification that meets the requirements of the GFSM. The prepared financial statements do not cover a wide range of information, since the elements of the cash basis are used precisely when registering transactions, and this approach does not determine the exact amount of accrued expenses. Thus, in the future, Azerbaijan should develop a comprehensive unified chart of accounts, and the project segment should be included in this chart of accounts. The project segment contributes to the provision of mechanisms for separate budgetary control over capital expenditures, as well as the timing of their implementation.

Revenues and expenditures created for the implementation of state commitments in the execution of the state budget are known to be monitored within the budget accounting framework. Budget accounting in the treasury system relates to two areas: accounting for budget execution (treasury) and the structure of accounting for revenue and expenditure estimates (on budget organizations). Budget revenues, budget expenditures, sources of financing the budget deficit, loans, revenues of budget organizations, expenditures of budget organizations, cash, funds and stocks, tangible assets are the traditional accounting objects when expressed in the sectors mentioned in budget accounting. The accrual method and the cash method are the two main accounting methods used in world practice to record transactions on these accounting objects .

In addition to the cash method and accrual method, modified cash and modified accrual accounting methods are also implemented in the world practice in the public sector (budget organizations) as well as in the treasury that implements the budget. Additional accounts are formed for the registration of some assets and liabilities under the modified cash method, in addition to cash flows. The balance contains precise information about debts and budget loans when this method is applied. Revenues are recorded when they are received, and expenses are recorded when expenditure transactions are occurred, according to the modified accrual method (at the time the expenditure commitments arise). Expenses for the acquisition of non-financial assets are immediately recognized as an expense. These accounting approaches are employed at various phases of the budget process in international practice. Cash

method is used in budget planning by the most countries while accrual method is widely used for budget reporting purposes (preparation of financial statements). In Azerbaijan, the cash method is used to construct the budget, the modified cash method is used to execute the state budget, but the cash method is used to prepare the final consolidated financial report.

Within the accrual approach, we can consider the state budget's revenue and expenses as tools that influence the increase or reduction of the government's net worth. Under accrual method, the objects of budget accounting are known as assets, liabilities, revenues, expenses, financial results or government's net worth, which makes it easier to prepare financial statements in compliance with international accounting standards. In accrual accounting, governments account for all assets and liabilities, including financial assets (such as stocks or other equity securities), non-financial assets (such as land and buildings), and accounts payable incurred as a result of public sector commitments .

The chart of accounts developed by the Treasury Information Management System (TIMS) is fully compliant with and based on the International Public Sector Accounting Standards (IPSAS) and statistical reporting system criteria (GFSM (Government Financial Statistics Manual)). Countries have already begun to establish a new chart of accounts as a result of the development of a new methodology for the public sector in the Government Financial Statistics Manual (GFSM - 2014) by the International Monetary Fund (IMF). The chart of accounts used in the TIMS in Azerbaijan, in our opinion, should be enhanced, and the transition to a modified accrual method in budget implementation should be carried out. In this regard, applying the chart of accounts used in Croatia in accordance with international practice in Azerbaijan can result in high-quality budget execution reports. The Treasury accounts for TIMS is used in budget implementation using a modified cash method in Azerbaijan, however budget reporting is produced and presented on a cash basis. Because such accounting procedures in budget accounting do not reflect the whole situation with state budget execution, at the very least a modified accrual method should be implemented in transaction accounting to assure comprehensive reporting. Croatia's chart of accounts for budget accounting is particularly efficient and modified accounting

method is used in accounting (Table 2).

**Table 2**

**Chart of accounts used in budget accounting in Croatia**

General ledger accounts		
0.	Non-financial assets	Cash and non-cash transactions
1.	Financial assets	Cash and non-cash transactions
2.	Liabilities	Cash and non-cash transactions
3.	Operating expenses	Cash and non-cash transactions
4.	Expenditures for the acquisition of nonfinancial assets	Cash flows only
5.	Expenditures on financial assets and repayment of loans	Cash flows only
6.	Operating revenues	Cash and non-cash transactions
7.	Receipts for the sale of non-financial assets	Cash flows only
8.	Receipts from financial assets and loans	Cash flows only
9.	Net assets	Cash and non-cash transactions

*Source : Compiled based on Оптимизация структуры плана счетов / Передовой опыт стран-членов Казначейского Сообщества, PEMPAL (Public Expenditure Management Peer Assisted Learning), 2019.*

The experience of other countries suggests that using a modified accrual method in budget accounting is more efficient. As a result, using the direct accrual method in budget accounting takes a long time, and one of the most difficult aspects of doing so is determining the specific period (days, months) of receipts (cash) inside budget revenues. The treasury in Azerbaijan has complete cash flow information through accounting for revenues on a cash basis in order to manage the budget's necessary expenditures. However, if Azerbaijan's budget expenditures are carried out using the accrual method, it will be feasible to acquire information on the overall state of total expenditures throughout the year, making it much easier to control payable accounts. The Treasury, in our opinion, can generate more advanced budget and financial reports on budget execution in Azerbaijan using the modified accrual accounting method, which allows to measure budget revenues based on the cash method while also allowing to measure the budget expenditures with accrual method.

#### **4. Reinforcing Azerbaijan’s treasury system’s payment system on a treasury single account.**

In foreign practice, the treasury not only carries out the state’s budget management tasks, but also ensures their use both inside and outside the country by determining the amount of remaining funds generated during the current fiscal year’s budget execution, which entails attracting additional funds. The management of the balance of money in the treasury single account is sometimes directly dependent on the country’s budget strategy, but in all situations, the country’s development of quality financial management is a necessity for the effective use of these funds. The treasury should be assigned the job of “cash flow forecasting” in order to ensure quality cash management in Azerbaijan and the liquidity of the treasury single account. The single treasury account method should be enhanced, and the “Cash Concentration” mechanism or a treasury single account should be developed on the principles of this mechanism for successful implementation of this function.

In current times, the proper organization of a treasury single account is regarded as the most essential reform in international practice for improving budget cash execution, and many approaches are employed to ensure the liquidity of the money to be formed on this account.

If Azerbaijan’s treasury single account mechanism is properly organized, the number of bad decisions about managing the single treasury account’s free balance will be reduced (especially when making decisions about inappropriate borrowing in managing the budget deficit), and the quality of budget planning will improve.

**Table 3**

**Indicators related to the treasury single account's (TSA) liquid funds**

Treasury single account's liquid funds, million manats	2015		2016		2017		2019		2020	
	beginning of the year	end of the year	beginning of the year	end of the year	beginning of the year	end of the year	beginning of the year	end of the year	beginning of the year	end of the year
	1728.6	1433.9	1433.9	2307.2	2307.2	1644.7	872.3	2343.2	2343.2	1526.1
Years	2015		2016		2017		2019		2020	
<b>Budget deficit</b>	-286.5		-245.6		-1077.8		-207.8		-1734.6	
<b>TSA's funds used financing budget deficit, million manats</b>	285.5		15.2		586.7		-		589.0	
Years	2015		2016		2017		2019		2020	
<b>Nominal GDP, million manats</b>	54380.0		60425.2		70337.5		81681.0		72432.2	
<b>Budget revenues, million manats</b>	17498.0		17505.7		16516.7		24218.1		24681.7	
<b>TSA's funds / GDP, percentage</b>	2.6		3.8		2.3		2.9		2.1	
<b>TSA's funds / Budget revenues, percentage</b>	8.2		13.2		10.0		9.7		6.2	
Years	2015		2016		2017		2019		2020	
	forecast	execution	for.	exe.	for.	exe.	for.	exe.	for.	exe.
<b>Revenues on TSA's funds, thousand manats</b>	3340.0	4546.1	2678.0	17136.0	3074.0	7153.9	1000.0	1124.1	35000.0	20513.0

*Source: Prepared by the author on the materials of the Chamber of Accounts of Azerbaijan.*

The establishment of a balance in the Treasury Single Account (TSA) is seen as a budget planning shortfall. The establishment of a fund balance in the TSA is regarded one of the most serious dangers in worldwide practice. According to the data, the TSA fund balance formed in Azerbaijan at the start of 2017 grew to 13.2 percent of 2016 state budget receipts (Table 3). In addition, the 4 percent growth in the ratio of this balance to nominal GDP generated in 2016 highlights the need for a strong budgeting strategy.

Budget forecasting and cash management, as opposed to cash planning for allocations, are both lacking in Azerbaijan. Even if the budget balance for some months of 2020 is projected and executed as a surplus, superfluous receipts from sources of financing the budget deficit were forecasted and executed, with a large portion of these funds borrowed from abroad. The lack of a concept, word, and legislative regulations governing this process in the country's legislation is to blame for this scenario.

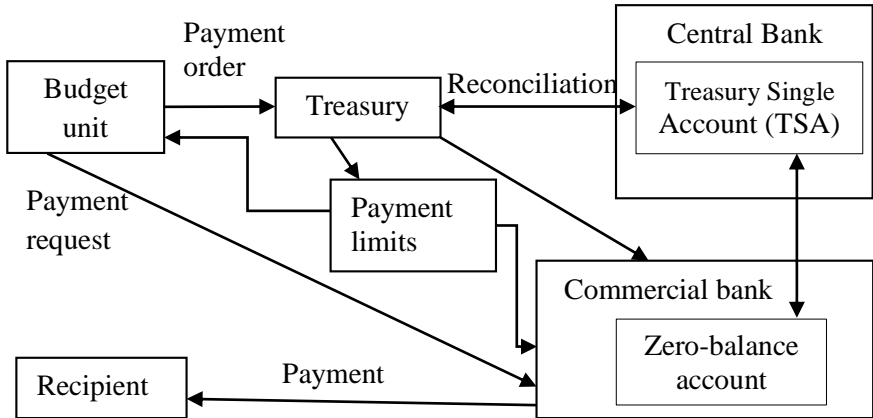
In Azerbaijan, the Treasury is in charge of drafting an annual summary cash plan for budget year cash planning. However, in current treasury systems, a new role known as cash forecasting in terms of the liquidity of the single treasury account has been established, which is conducted separately from the cash planning (creation of cash plans) function by allocation as the treasury's principal duty. The treasury should act as a source of either borrowed funds or more income in the future by identifying the condition of cash (surplus or deficit) in the single treasury account at least on a daily basis by performing the role of "cash flow forecasting" in Azerbaijan. The main reform of Azerbaijan's treasury system should be the daily identification of the balance of funds in the single treasury account, which would lead to better financial resource management.

Integration of the system of bank accounts opened and linked to the personal treasury accounts of all budget organizations into a single treasury bank account payment system, which will completely eliminate regional treasury bodies, should be one of the fundamental reforms related to the improvement of the single treasury account in Azerbaijan.

A single treasury account opened with the Central Bank becomes more efficient in a decentralized payment system. As a result, all budget organizations integrated from the bottom up have the right to open separate operating accounts, according to the hierarchy principle with a single treasury account. All balances in the operating accounts must, however, be reflected in the main account of the single treasury account at the end of the day. A decentralized payment system's single treasury account is made up of bank accounts held by ministries and accounts maintained by individual budget organizations of each ministry, all of which have a zero balance. Budget organizations are more independent



and administer zero-balance accounts within their authority. The Treasury, on the other hand, will not be harmed. Establishment of a single treasury account under the decentralized payment system is reflected in the following figure (Fig. 3.):



**Figure 3. Treasury Single Account (TSA), Decentralized Model ( Decentralized Payments Through ZBAs (Zero-balance accounts) )**

Source : Developed based on [www.imf.org/external/pubs/ft/wp/2010/wp10143.pdf](http://www.imf.org/external/pubs/ft/wp/2010/wp10143.pdf) - S.Pattanayak, I.Faynboym (2010). *Imf working paper, "Treasury single account: concept, design and implementation issues"*.

There are countries with decentralized payment systems (Germany and Sweden) that use zero-balance accounts merged into a single treasury account, allowing you to get entire balance information immediately. Individual budget organizations have the right to separate operating accounts that they can control. In the globe, this technique, which is based on zero-balance accounts, is known as “cash concentration.” The creation of such a system has effectively disrupted the operation of Sweden's treasury mechanisms.

- Individual budget organizations' accounts are opened in either the central bank or commercial banks; in both circumstances, the Ministry of Finance should have direct authority to open accounts;
- These must have zero balance accounts so that funds are sent to

the accounts if pre-approved payments are made;

- The balances in the accounts must be automatically moved to the primary account of the single treasury account (to enable daily clearing by the banking infrastructure);

- The Central Bank automatically collects the balances in all state accounts at the end of the day.

It should be noted that if a decentralized payment system on a single treasury account is developed in Azerbaijan, budget organizations can now directly participate in the control over the execution of budget expenditures, and the treasury's control burden will be reduced as the principle of decentralization emerges. Such an approach, in which direct budget organizations are directly involved, can considerably improve the effectiveness of control over the implementation of the state budget. The Treasury's role in budget execution has shifted dramatically in recent years. The centralized control of the treasury system to ensure budget implementation (control over the limits of liabilities), approval of the purchase and inspection of goods (works and services, payment, accounting) has been transferred to the main distribution ministries, and the treasury is engaged in forecasting cash flows on a single treasury account, according to the experience of developed countries.

**5. Identification of new treasury functions based on a result-based budgeting mechanism and the use of a program-targeted strategy, and inclusion of these functions in the treasury bodies' authorities.**

In order to use the program-target method effectively in Azerbaijan, a separate program classification must be created within the budget classification. It is vital to guarantee that the programs are included in the budget classification and the chart of accounts within the budget accounting, in order to strengthen effective control by the treasury during program budgeting.

The treasury system as a financial category is directly related to the budget, which is the foundation of public finance and is considered an economic category, so the implementation of new reforms, approaches, mechanisms, and tools within the budget can lead to new changes in the treasury system. The following primary directions, in

our opinion, should be at the core of Azerbaijan's budget and treasury system reforms:

- Adoption of the Budget Code;
- Application of Medium Term Expenditure Frameworks (MTEFs);
- Application of Results-Oriented Budgeting mechanism;
- Financial reporting organization, including the use of a modified accrual accounting method in budget execution and the construction of a distinct accrual-based accounting system in the future.

In these directions, Azerbaijan has made important decisions. Thus, the "Strategic Roadmap for the Republic of Azerbaijan's National Economic Prospects", adopted by Presidential Decree dated December 6, 2016, focuses on the construction of medium-term expenditure frameworks, as well as the creation and implementation of results-oriented budgeting mechanism. The changes that will be made in the general budget system, the state budget execution system, and the changes that will be noticed in the treasury system will be the most critical issue in the context of the specified goals.

The program-target budget method is especially used for planning budget expenditures in the results-based budgeting mechanism. Of course, a separate program classification can be developed in a budget classification for the implementation of the program-target technique. As a result, Azerbaijan's unified budget classification, which has been in effect since 2005, should be reassessed, and a program classification of budget expenditures should be formed. Programs and sub-programs should be classified within this classification, and the titles of these programs should be identified, as well as the years in which they will be implemented. Countries want to construct a separate program classification in the budget classification due to the application of the program-target method in the practice of other countries. Canada, Denmark, Finland, Sweden, the United Kingdom, and the United States are among these nations. However, in certain nations, such as Canada, France, and the United States, programs are designed and implemented within the classification of expenditure items. Administrative, functional, and economic classifications are more commonly employed in the budget categorization in the CIS countries. Moldova, Ukraine, Georgia, and Belarus are among the countries that

use the program classification. Various programs in Kazakhstan are included in the enlarged functional classification. In Russia, the budget is implemented using the newly developed general expenditure classification, which includes both program and non-program spending categories, which covers the entire budget system.

In Azerbaijan, the formation of a separate program classification and its dominance over other classifications will result in the emergence of the feature of “prioritization of expenditure” in the budget process. Expenditure prioritization is a budget method used in medium-term planning based on the distribution of funds by sector and program, following which developed countries abandoned traditional budget management based on the "line-item budgeting" tool. Budgeting (budget planning) on expenditure items will be limited in the future if Azerbaijan takes this method. On the other hand, in the new budget approach, the practice of guaranteeing budget balance through expenditure items can be limited to a maximum.

The treasury bodies in charge of the state budget implementation in Azerbaijan should exert, in our opinion, oversight over the programs conducted throughout the year. If Azerbaijan adopts the program-targeted technique of budget expenditures, the body in charge of state budget execution (treasury) should not be content with preserving records of operations during the state budget's execution. As a result, the treasury body will oversee the expenditure operations of budget funds already allocated within the programs to be implemented, preventing overspending in the allocation of funds to the programs. Within the framework of budget accounting, it should also be reflected in the chart of accounts. An entirely new approach to public budget management will be formed by a medium-term expenditure framework, results-oriented budgeting, and a program-target method. This approach will result in major changes in the Treasury's functions during budget execution, as follows:

- Treasury entities will accept state obligations on budget expenditures to budget organizations on their target programs on behalf of the state, and long-term expenditure commitments will be recorded here;

- Registration of long-term contracts will be carried out in the

execution of the state budget on expenditures in the presence of long-term commitments;

- Treasury will carry out various expenditure operations on the program classification, which is more necessary to regulate than the economic classification, generated within the budget classification;

- The budget resources required for budget programs will now be justified before the Treasury, and these expenditures will be assessed.

- The Treasury will implement accounting functions on implemented program, as well as evaluate the results and indicators on the executed programs.

## **RESULT AND SUGGESTIONS**

The existing treasury control in Azerbaijan is relatively effective in terms of implementing the national budget, but significant improvements, as well as new ideas and methods, are required for the treasury system to operate more efficiently.

- Important provisions linked to the budget system, budget process, budget execution stage, treasury system, and financial control should be introduced and interpreted in the appropriate articles with the passage of the “Budget Code,” which has been on the agenda in Azerbaijan for a long time.

- The approval of the Budget Code should be included in the statute “On the Treasury System.” The creation of this law is critical because all treasury actions within the treasury system must be governed by legal guidelines.

- International experience with the treasury system has shown that treasury body participation is not always required for effective treasury system control during budget execution, and this control can be conducted directly by the budget organizations themselves. The control over the execution of the state budget on expenditures in Azerbaijan is based on a centralized system of control over the treasury system, with the treasury bodies having a high level of responsibility. If budget organizations build an internal control system, it may be able to secure the transition to decentralized control in the treasury system,

where one of the primary prerequisites is the development of an efficient government payments system.

- The treasury bodies will be required to execute new responsibilities as a result of the program-target method being implemented in Azerbaijan as part of the result-oriented budgeting mechanism, which will greatly expand the role of the treasury in the implementation of the state budget. With the development of the program classification, the Treasury will prefer direct program classification to other classifications (functional, economic) when regulating budget resources in terms of efficiency during budget execution.

- Getting faster information about the balances in personal treasury accounts is one of the most essential issues in the treasury system. The replacement of personal treasury accounts of budget entities with bank accounts should be one of the most significant serious changes to be done in Azerbaijan. All revenue and expense transactions will be conducted through a single bank account, with transit accounts with agent banks being closed, and regional treasury bodies eventually disappearing as a result of this reform. However, we believe that Azerbaijan should construct the Treasury Single Account (TSA) on a decentralized payment system (on zero-balance accounts). There are several countries with decentralized payment systems (Germany and Sweden) that use zero-balance accounts merged into a single treasury account to acquire entire balance information. Individual budget organizations have the right to separate operating accounts which they can control. In the globe, this technique, which is based on zero-balance accounts, is known as “Cash Concentration”. The Ministry of Finance (Treasury) in Azerbaijan will receive immediate information on the level of balances in all budget organizations’ bank accounts created and linked using the “Cash Concentration” system, preventing inappropriate borrowing in terms of budget deficit financing.

- A new role has been introduced in modern treasury systems as a cash forecasting function in terms of liquidity of the treasury single account, which is conducted separately from the allocation cash planning function as the treasury’s principal purpose. As a result,

Azerbaijan's treasury should have a broad variety of cash forecasting capabilities, which should be implemented separately from the "control over the execution of budget expenditures" process.

- The deficit of the planned budget is one of the concerns that is regarded a challenge for the proper implementation of the budget. This is a problem that arises during budgeting and has recently grown more prevalent in Azerbaijan. The net method to budgeting is the approach that results in a budget surplus. Spending on public debt is excluded in the composition of budget expenditures in Russia's net approach, so that these expenses are treated as money that directly lowers the budget deficit. When the budget is regarded to be in surplus, the net approach avoids new borrowing, and the excess proceeds are utilized to pay off various debts and liabilities. The essence of this approach is that the budget balance between revenues and expenditures for the budget year (excluding public debt service expenditures as part of budget expenditures) is organized in such a way that it prevents both increasing budget deficits and inappropriate borrowing in terms of budget deficit financing.

- In Azerbaijan, the Treasury should execute the budget using a modified accrual approach that combines the features of both the cash method and the accrual method. The Treasury will make the transition to this system quickly, and expenditures will be recorded by the Treasury at an earlier stage of budget execution, such as when commitments are made or when financial liabilities are incurred. Of course, the chart of accounts must be modified in order to apply this strategy for the treasury system. In this context, using the chart of accounts used in Croatia to Azerbaijan in accordance with international practice can improve the quality of budget implementation reports. An important condition for choosing a chart of accounts used in the Croatian treasury system is its compliance with the requirements of the modified accrual method.

- In terms of budget accounting, switching from the modified cash technique to the modified accrual method will not be difficult given the current state of the treasury system in Azerbaijan. However, in the future, Azerbaijan will need to completely comply with the requirements of the GFSM (Government Financial Statistics Manual),

as referred to by the Treasury, for the preparation of a comprehensive consolidated financial report utilizing the accrual accounting method. The state budget deficit in Azerbaijan is a cash deficit, however, in developed countries, the accrual deficit in the government sector is a more significant fiscal deficit. A legislative basis for the accrual method should be implemented, and a distinct accounting-based accounting system should be formed, in order to acquire information on the accrual method fiscal deficit in the government sector in Azerbaijan. Although Azerbaijan's government treasury publishes a cash-based revenue and expenditure report, but accrual-based method report (balance sheet) on the assets (financial assets and non-financial assets) and liabilities in many years has not been created by treasury, which has to be rectified. The state in Azerbaijan creates non-financial assets (buildings, structures, machinery and equipment, infrastructure assets, military property, and investment property) with capital expenditures that are part of budget expenditures, the current market value of which must be evaluated and recorded in the balance sheet.

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