



MANUAL ON
**FISCAL
TRANSPARENCY**

FISCAL AFFAIRS DEPARTMENT

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The following symbols have been used throughout this paper:

- . . . to indicate that data are not available;
- to indicate that the figure is zero or less than half the final digit shown, or that the item does not exist;
- between years or months (e.g., 2000–01 or January–June) to indicate the years or months covered, including the beginning and ending years or months;
- / between years (e.g., 2000/01) to indicate a fiscal (financial) year.

“Billion” means a thousand million.

Minor discrepancies between constituent figures and totals are due to rounding.

The term “country,” as used in this paper, does not in all cases refer to a territorial entity that is a state as understood by international law and practice; the term also covers some territorial entities that are not states, but for which statistical data are maintained and provided internationally on a separate and independent basis.

Preface

I am pleased that the *Manual on Fiscal Transparency* and the *Code of Good Practices on Fiscal Transparency* can now be made available in printed format for the first time. The Code had been developed in response to a concern, highlighted by experience in a number of countries, that a lack of comprehensive and reliable information on fiscal activity made it difficult to properly assess the objectives and implications of fiscal policy. This created problems not only for financial markets, international organizations (like the IMF) and others outside a country, but also for the country's legislature and public, and often for the government itself. The Code is intended to promote improvements in fiscal transparency.

The Manual, earlier versions of which have been available on the IMF website, explains the requirements of the Code and provides illustrations of the various good practices included in the Code. It has been used primarily to help member countries undertake assessments of the transparency of fiscal management practices relative to the requirements of the Code, and to guide them in establishing priorities for improving fiscal transparency. In addition, it has been a reference on fiscal transparency for economists and financial analysts.

The Code and the Manual have been produced in consultation with other IMF departments, and with international organizations interested in fiscal transparency, including the World Bank and the Organization for Economic Cooperation and Development. Richard Hemming, William Allan, and Murray Petrie undertook most of the work involved, with the assistance of Helen Blyth and contributions from numerous other colleagues. Gail Berre of the IMF's External Relations Department coordinated the production of the publication.

After being discussed by the IMF Executive Board, the Code and the Manual were released on the IMF's website in 1998, the Code in April and the Manual in November. They were subsequently revised, and the current versions were posted on the website in March 2001. Further revisions are anticipated to reflect developments in fiscal management practices and experience with implementing the Code. In the meantime, and in response to many requests, a hard copy version of the Manual is being published. I hope that this will allow the Manual to better serve its intended purposes, and in the process help forward the cause of fiscal transparency.

Teresa Ter-Minassian
Director
Fiscal Affairs Department

Abbreviations and Acronyms

COFOG	Classification of the Functions of Government
ESA	European System of Accounts
FSAP	Financial Sector Assessment Program
GAAP	Generally Accepted Accounting Principles
GDDS	General Data Dissemination System
GFS	Government Finance Statistics
IFAC	International Federation of Accountants
INTOSAI	International Organization of Supreme Audit Institutions
IPSAS	International Public Sector Accounting Standards
OECD	Organization for Economic Cooperation and Development
PSC	Public Sector Committee (of IFAC)
PUMA	Public Management and Governance
ROSC	Report on the Observance of Standards and Codes
SDDS	Special Data Dissemination Standard
SNA	System of National Accounts
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law

Code of Good Practices on Fiscal Transparency*

1. Clarity of Roles and Responsibilities

1.1 The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.

1.1.1 The structure and functions of government should be clearly specified.

1.1.2 The responsibilities of different levels of government, and of the executive branch, the legislative branch, and the judiciary, should be well defined.

1.1.3 Clear mechanisms for the coordination and management of budgetary and extrabudgetary activities should be established.

1.1.4 Relations between the government and nongovernment public sector agencies (i.e., the central bank, public financial institutions, and nonfinancial public enterprises) should be based on clear arrangements.

1.1.5 Government involvement in the private sector (e.g., through regulation and equity ownership) should be conducted in an open and public manner, and on the basis of clear rules and procedures that are applied in a nondiscriminatory way.

1.2 There should be a clear legal and administrative framework for fiscal management.

1.2.1 Any commitment or expenditure of public funds should be governed by comprehensive budget laws and openly available administrative rules.

1.2.2 Taxes, duties, fees, and charges should have an explicit legal basis. Tax laws and regulations should be easily accessible and understandable, and clear criteria should guide any administrative discretion in their application.

1.2.3 Ethical standards of behavior for public servants should be clear and well publicized.

*Updated on February 28, 2001.

2. Public Availability of Information

2.1 The public should be provided with full information on the past, current, and projected fiscal activity of government.

2.1.1 The budget documentation, final accounts, and other fiscal reports for the public should cover all budgetary and extrabudgetary activities of the central government, and the consolidated fiscal position of the central government should be published.

2.1.2 Information comparable to that in the annual budget should be provided for the outturns of the two preceding fiscal years, together with forecasts of the main budget aggregates for two years following the budget.

2.1.3 Statements describing the nature and fiscal significance of central government contingent liabilities and tax expenditures, and of quasi-fiscal activities, should be part of the budget documentation.

2.1.4 The central government should publish full information on the level and composition of its debt and financial assets.

2.1.5 Where subnational levels of government are significant, their combined fiscal position and the consolidated fiscal position of the general government should be published.

2.2 A commitment should be made to the timely publication of fiscal information.

2.2.1 The publication of fiscal information should be a legal obligation of government.

2.2.2 Advance release date calendars for fiscal information should be announced.

3. Open Budget Preparation, Execution, and Reporting

3.1 The budget documentation should specify fiscal policy objectives, the macroeconomic framework, the policy basis for the budget, and identifiable major fiscal risks.

3.1.1 A statement of fiscal policy objectives and an assessment of fiscal sustainability should provide the framework for the annual budget.

3.1.2 Any fiscal rules that have been adopted (e.g., a balanced budget requirement or borrowing limits for subnational levels of government) should be clearly specified.

3.1.3 The annual budget should be prepared and presented within a comprehensive and consistent quantitative macroeconomic framework, and the main assumptions underlying the budget should be provided.

3.1.4 New policies being introduced in the annual budget should be clearly described.

3.1.5 Major fiscal risks should be identified and quantified where possible, including variations in economic assumptions and the uncertain costs of specific expenditure commitments (e.g., financial restructuring).

3.2 Budget information should be presented in a way that facilitates policy analysis and promotes accountability.

3.2.1 Budget data should be reported on a gross basis, distinguishing revenue, expenditure, and financing, with expenditure classified by economic, functional, and administrative category. Data on extrabudgetary activities should be reported on the same basis.

3.2.2 A statement of objectives to be achieved by major budget programs (e.g., improvement in relevant social indicators) should be provided.

3.2.3 The overall balance of the general government should be a standard summary indicator of the government's fiscal position. It should be supplemented where appropriate by other fiscal indicators for the general government (e.g., the operational balance, the structural balance, or the primary balance).

3.2.4 The public sector balance should be reported when nongovernment public sector agencies undertake significant quasi-fiscal activities.

3.3 Procedures for the execution and monitoring of approved expenditure and for collecting revenue should be clearly specified.

3.3.1 There should be a comprehensive, integrated accounting system which provides a reliable basis for assessing payment arrears.

3.3.2 Procurement and employment regulations should be standardized and accessible to all interested parties.

3.3.3 Budget execution should be internally audited, and audit procedures should be open to review.

3.3.4 The national tax administration should be legally protected from political direction and should report regularly to the public on its activities.

3.4 There should be regular fiscal reporting to the legislature and the public.

3.4.1 A mid-year report on budget developments should be presented to the legislature. More frequent (at least quarterly) reports should also be published.

3.4.2 Final accounts should be presented to the legislature within a year of the end of the fiscal year.

3.4.3 Results achieved relative to the objectives of major budget programs should be presented to the legislature annually.

4. Assurances of Integrity

4.1 Fiscal data should meet accepted data quality standards.

- 4.1.1 Budget data should reflect recent revenue and expenditure trends, underlying macroeconomic developments, and well-defined policy commitments.
- 4.1.2 The annual budget and final accounts should indicate the accounting basis (e.g., cash or accrual) and standards used in the compilation and presentation of budget data.
- 4.1.3 Specific assurances should be provided as to the quality of fiscal data. In particular, it should be indicated whether data in fiscal reports are internally consistent and have been reconciled with relevant data from other sources.

4.2 Fiscal information should be subjected to independent scrutiny.

- 4.2.1 A national audit body or equivalent organization, which is independent of the executive, should provide timely reports for the legislature and public on the financial integrity of government accounts.
- 4.2.2 Independent experts should be invited to assess fiscal forecasts, the macroeconomic forecasts on which they are based, and all underlying assumptions.
- 4.2.3 A national statistics agency should be provided with the institutional independence to verify the quality of fiscal data.

Overview

1. At its fiftieth meeting in Washington, D.C., on April 16, 1998, the Interim Committee of the Board of Governors of the International Monetary Fund adopted the *Code of Good Practices on Fiscal Transparency—Declaration on Principles*. This was done in response to a clear consensus that good governance is of central importance to achieving macroeconomic stability and high-quality growth, and that fiscal transparency is a key aspect of good governance.¹ Fiscal transparency should make those responsible for the design and implementation of fiscal policies more accountable. The stronger, more credible fiscal policies that follow should attract the support of a well-informed public, result in more favorable access to domestic and international capital markets, and reduce the incidence and severity of crises.

2. The Code, together with the explanatory *Manual on Fiscal Transparency*, a fiscal transparency questionnaire, and a summary self-evaluation report, were posted as fiscal transparency web pages on the IMF's external website in November 1998.² Since May 1999, fiscal transparency web pages have been part of a *Standards and Codes* website.³ Fiscal transparency modules of *Reports on the Observance of Standards and Codes* (ROSCs), which assess the extent to which fiscal management practices in a number of countries are consistent with the Code, are also available on the *Standards and Codes* website.⁴ Interactions with country authorities in connection with preparing ROSCs, and other contacts with fiscal policy specialists from a range of international, government, and private sector organizations, have confirmed the usefulness of the framework provided by the Code, and its supporting material, in analyzing fiscal transparency.

3. However, in response to an increased emphasis on ensuring the provision to the IMF and to markets of the best available economic and financial information, it has become apparent that more attention needs to be paid to the data quality aspect of fiscal transparency, and that this should be addressed in the Code. Accordingly, a new section has been added to the Code that includes good practices related specifically to the quality of fiscal data. There are also new good practices concerned with autonomy and openness in tax administration and reporting on *public sector*⁵ finances, and other changes have been made to the organization and drafting of the Code to make it clearer. The Manual has been revised to reflect the modifications to the Code, and in response to comments received on its detailed content and general user friendliness.

¹See IMF (1998a).

²This version of the Manual replaces earlier drafts first posted on the IMF website in November 1998 and April 1999.

³See <http://www.imf.org/external/standards/index.htm>.

⁴ROSC fiscal transparency modules, which were first published in March 1999, have made the summary self-evaluation report redundant and it has been taken off the external website.

⁵A number of technical terms are italicized on first usage and defined in the glossary.

4. The original definition of fiscal transparency—which emphasizes being open to the public about the structure and functions of government, fiscal policy intentions, public sector accounts, and fiscal projections (Kopits and Craig, 1998)—continues to form the basis of the Code.⁶ The following four general principles of fiscal transparency, which provide the organizational structure of the Code, also remain largely unchanged.

- The first general principle—Clarity of Roles and Responsibilities—is concerned with specifying the structure and functions of government, responsibilities within government, and relations between government and the rest of the economy.
- The second general principle—Public Availability of Information—emphasizes the importance of publishing comprehensive fiscal information at clearly specified times.
- The third general principle—Open Budget Preparation, Execution, and Reporting—covers the type of information that is made available about the budget process.
- The fourth general principle—Assurances of Integrity—deals with the quality of fiscal data and the need for independent scrutiny of fiscal information.

The fourth general principle has been amended compared to the previous version of the Code, where the focus was entirely on the provision of independent assurances of the integrity of fiscal information by an external auditor, a national statistics agency, and other experts. Reflecting the increased emphasis on the quality of fiscal data noted above, the fourth general principle now addresses more directly this aspect of fiscal transparency.

5. Specific principles and good practices correspond to each of the general principles. The good practices represent a standard of fiscal transparency that is judged appropriate to provide assurances to the public and to capital markets that a sufficiently complete picture of the structure and finances of government is available to allow the soundness of a country's fiscal position to be reliably assessed. It is therefore a standard that most countries should seek to meet.

6. In preparing the Manual, a number of points have been taken into account. First, the Code is being implemented on a voluntary basis. To promote an appreciation of the rationale for the Code, and an understanding of its fiscal transparency requirements, the Manual sets out in detail the principles and practices included in the Code. However, because of the complexity of fiscal management systems, the Manual does not provide comprehensive directions on how all the good practices are to be put in place. Instead, it contains numerous references and website addresses that can assist with the practical implementation of the Code. But even then, many countries will have to make a significant effort and will need considerable time to achieve a level of fiscal transparency consistent with the Code.

7. Second, fiscal transparency is only one aspect of good fiscal management, and care is needed to distinguish fiscal transparency from two other key aspects,

⁶From here on, the Code refers to the revised *Code of Good Practices on Fiscal Transparency*.

namely the efficiency of fiscal policy, and the soundness of public finances. As the introduction to the original version of the Code notes, attention has to be paid to all three aspects, which are clearly interrelated. But institutional changes that would lead to more efficient government and promote sound public finances are not advocated directly in the Code. Thus, if the government pursues fiscal policy objectives through *extrabudgetary funds* and *tax expenditures*, or if nongovernment public sector agencies engage in *quasi-fiscal activities*, the Code requires only that the purpose of such interventions should be clearly identified and their financial consequences reported. However, the expectation is that transparency about extrabudgetary funds, tax expenditures, and quasi-fiscal activities will provide less incentive for their extensive use, and lead to some of them being replaced by traditional practices of fiscal management.

8. Third, diversity of institutional backgrounds and capacity constraints to improving fiscal management are clearly recognized. For this reason, the Code is not a best practice standard. Rather, it is a set of good practices that can be implemented by most countries over the medium to longer term. Moreover, the Manual highlights a selection of good practices that should be the main focus of attention in countries with weaker fiscal management systems. These basic requirements of fiscal transparency, which are given in Box 1, emphasize good practices related to fiscal reporting and fiscal data quality.

9. The fact that the Code is pitched at the *general government* level, in the sense that it requires information to be provided by the *central government* about general government activities and finances, may also be a problem for some countries, and especially for those where weaknesses in fiscal management systems relate to fiscal relations between central government and subnational levels of government. It is therefore recognized that the application of the Code (and the basic requirements of fiscal transparency) in certain cases may have to be limited, at least in the first instance, to the central government. It is also realized that the constitutional relationship between central and subnational governments in a few countries makes it inappropriate for the central government to report on general government activities and finances.

10. The Manual also goes beyond the Code by identifying best practices of fiscal transparency which should be put in place by advanced economies which have already attained or are close to attaining the standard of the Code. In this connection, the Organization for Economic Cooperation and Development (OECD) has produced a set of best practice guidelines—*OECD Best Practices for Budget Transparency*—which provide a useful starting point.⁷ These OECD guidelines are derived from a compendium of OECD member country practices. However, they include much that is already in the Code. Also, by focusing only on budget (rather than fiscal) transparency, and the central government (rather than the general government), they are narrower in coverage than the Code. Box 2 therefore suggests best practices in all areas covered by the Code, drawing where appropriate on the OECD guidelines.

11. Fourth, in some areas covered by the Code there are already international standards that have been developed by the IMF and other organizations. The Code and the Manual are coordinated with these other initiatives. In particular, consistency has been maintained with those parts of IMF data

⁷See OECD (2000) at <http://www.oilis.oecd.org/olis/2000doc.nsf/87fae4004d4fa67ac125685d005300b3/c125692700623b74c1256a4d005c23be?OpenDocument>.

Box 1. Basic Requirements of Fiscal Transparency

1. Clarity of Roles and Responsibilities

The structure and functions of government should be clearly specified. *An institutional table should be published showing the structure of government and the rest of the public sector.*

Relations between the government and nongovernment public sector agencies (i.e., the central bank, public financial institutions, and nonfinancial public enterprises) should be based on clear arrangements. *Links between fiscal and monetary operations of the central bank should meet the requirements of Sections 1.2 and 1.3 of the Code of Good Practices on Transparency in Monetary and Financial Policies—Declaration of Principles. The annual reports of public financial institutions and nonfinancial public enterprises should indicate the noncommercial services that the government requires them to provide. Privatization of government assets should be open to independent audit.*

2. Public Availability of Information

The budget documentation, final accounts, and other fiscal reports for the public should cover all budgetary and extrabudgetary activities of the central government, and the consolidated fiscal position of the central government should be provided. *Detailed statements should be provided for all extrabudgetary funds.*

Statements describing the nature and fiscal significance of central government contingent liabilities and tax expenditures, and of quasi-fiscal activities, should be part of the budget documentation. *Such statements should indicate the public policy purpose of each provision, its duration, and the intended beneficiaries. Where possible, major provisions should be quantified.*

The central government should publish full information on the level and composition of its debt and financial assets.

Where subnational levels of government are significant, their combined fiscal position and the consolidated fiscal position of the general government should be published. *Subnational levels of governments should also report publicly on their extrabudgetary activities, debt and financial assets, contingent liabilities, and tax expenditures, and on the quasi-fiscal activities of public financial institutions and nonfinancial public enterprises under their control.*

The publication of fiscal information should be a legal obligation of government.

3. Open Budget Preparation, Execution, and Reporting

The annual budget should be prepared and presented within a comprehensive and consistent quantitative macroeconomic framework, and the main assumptions underlying the budget should be provided. *This information should be provided in a background paper that is part of the budget documentation.*

Budget data should be reported on a gross basis, distinguishing revenue, expenditure, and financing, with expenditure classified by economic, functional,

standards—the *Special Data Dissemination Standard* (SDDS) and the *General Data Dissemination System* (GDDS)—that relate to fiscal data, with the proposed revision to the IMF *Government Finance Statistics* (GFS) system, and with the IMF *Code of Good Practices on Transparency in Monetary and Financial*

and administrative category. Data on extrabudgetary activities should be reported on the same basis. *The GFS or another widely accepted classification system should be used.*

There should be a comprehensive, integrated accounting system which provides a reliable basis for assessing payment arrears. *Cash accounting reports should be supplemented by accounts-based reports of bills due for payment to assess arrears.*

A mid-year report on budget developments should be presented to the legislature *within three months of the mid-year*. More frequent (at least quarterly) reports should also be published. *Details of central government debt and financial assets should be published annually, within six months of the end of the fiscal year.*

Final accounts should be presented to the legislature within a year of the end of the fiscal year. *The coverage of final accounts, and the timing of their presentation, should be specified in the budget law.*

4. Assurances of Integrity

Budget data should reflect recent revenue and expenditure trends, underlying macroeconomic developments, and well-defined policy commitments. *Summary information on revenue forecasts and expenditure estimates should be provided in a background paper that is part of the budget documentation, and detailed supporting information should be available for independent scrutiny.*

The annual budget and final accounts should indicate the accounting basis (e.g., cash or accrual) and standards used in the compilation and presentation of budget data. *Reference should be made to the recognized or generally accepted accounting standards that are followed (e.g., International Public Sector Accounting Standards).*

Specific assurances should be provided as to the quality of fiscal data. In particular, it should be indicated whether data in fiscal reports are internally consistent and have been reconciled with relevant data from other sources. *Final accounts should be fully reconciled with budget appropriations, and each should be reconciled with GFS fiscal reports. The change in the stock of debt (and financial assets) should be reconciled with the reported budget balance. A background paper should be included with the budget documentation which analyses the difference between budget forecasts of the main macroeconomic and fiscal aggregates and the outturn for recent years. There should be rigorous reconciliation of fiscal and monetary data, and where reconciliation processes are weak, this should be drawn to public attention (e.g., in audit reports) in a timely manner. Countries should participate in the GDDS.*

A national audit body or equivalent organization, which is independent of the executive, should provide timely reports for the legislature and public on the financial integrity of government accounts. *Such a body should be set up under law. There should be mechanisms to help ensure that remedial action is taken in response to adverse findings in external audit reports.*

Policies—Declaration of Principles (the monetary and financial transparency code) insofar as it relates to links between the government and the banking and financial sectors.⁸ Public sector accounting standards developed by the Public Sector Committee of the International Federation of Accountants

⁸The SDDS, GDDS, and the monetary and financial transparency code are also available on the *Standards and Codes* website.

Box 2. Best Practices of Fiscal Transparency

1. Clarity of Roles and Responsibilities

There should be full compliance with SNA definitions of economic sectors.

Relevant disclosure and transparency requirements of Principle IV of the *OECD Principles of Corporate Governance* should be observed by public financial institutions and nonfinancial public enterprises.

OECD Policy Recommendations on Regulatory Reform dealing with the transparency of regulations should be fully implemented.

OECD-PUMA principles for managing ethics in the public sector should be observed.

2. Public Availability of Information

Aggregate fiscal projections for 5–10 years ahead should be provided in the budget documentation.

Contingent liabilities should be disclosed in the annual budget, the mid-year report to the legislature and the final accounts; they should be classified by category; and information on the past calls on the government to meet contingent liabilities should be disclosed (item 2.6 of the *OECD Best Practices for Budget Transparency*).

The estimated cost of all tax expenditure items should be provided in the budget documentation. To the extent possible, discussion of tax expenditures and general expenditure should be combined (item 2.2 of the *OECD Best Practices for Budget Transparency*). Reporting on quasi-fiscal activities should include quantified estimates of their fiscal significance, and information should be provided on the basis for quantification.

A government balance sheet should be published as part of the budget documentation. It should ideally cover financial liabilities and assets, and nonfinancial assets, of the government. Where nonfinancial assets are not covered, a register of nonfinancial assets should be maintained, and a listing of nonfinancial assets should be provided in the budget documentation.

SDDS requirements relating to the provision of information on central government debt and to the commitments made in advance release date calendars should be met.

Either comprehensive fiscal data should be compiled by all levels of government using a uniform classification and a consolidated general government financial position should be presented with the annual central government budget, *or* subnational levels of government that are independent fiscal agencies should observe the same standard of fiscal transparency as the central government.

Public availability of a wide range of fiscal information (including official policy papers), with clearly specified and justified exceptions, should be required by law.

3. Open Budget Preparation, Execution, and Reporting

A prebudget report should be presented no later than one month prior to the tabling of the annual budget, stating the government's medium-term economic and fiscal intentions, and highlighting the total revenue, expenditure, the deficit or surplus, and debt (item 1.2 of the *OECD Best Practices for Budget Transparency*). The draft budget should be presented to the legislature no less

than three months prior to the start of the fiscal year, and the budget should be approved prior to the start of the fiscal year (item 1.1 of the *OECD Best Practices for Budget Transparency*).

A long-term report assessing the sustainability of current fiscal policies should be published every five years (item 1.7 of the *OECD Best Practices for Budget Transparency*).

A comprehensive, rolling medium-term budget framework should be published as a central basis of fiscal management.

The estimated fiscal effects of all proposed central government legislation, including the cost implications for subnational levels of government, should be made publicly available.

A statement of fiscal risks should be included in the budget documentation as a basis for assessing the budget's reliability as a guide to likely fiscal outcomes.

Transactions should be classified by activity or output, and by program or outcome. Detailed financial and nonfinancial performance information for all outputs/activities and programs/outcomes, together with comparable information for the previous year, should be part of the budget documentation.

The accounting system should have the capacity for accounting and reporting on an accrual basis, as well as for generating cash reports.

The mid-year budget report should be presented to the legislature within six weeks of the mid-year (item 1.4 of the *OECD Best Practices for Budget Transparency*).

A monthly budget report should be published with a lag of a month.

Central government debt (and debt service projections) should be reported quarterly, with a lag of a quarter.

Reliable information on the general government outturn should be presented within 12 months of year-end.

Final accounts should be presented to the legislature within six months of the end of the fiscal year.

Results achieved relative to all performance targets should be independently audited and presented to the legislature within six months of the end of the fiscal year.

4. Assurances of Integrity

Mechanisms should be set up to provide for openness of the standard setting process for government accounting and financial reporting, and for its independence from government.

Fiscal forecasts and outturns should be reconciled and all significant differences should be explained.

A national audit body, or equivalent organization, should report to the legislature and the public on all matters relating to fiscal policy integrity and transparency.

Institutional mechanisms should be established to provide the public with independent assurance that macroeconomic and fiscal forecasts are of high quality.

(IFAC-PSC) are highlighted in the Manual, and auditing standards produced under the auspices of the International Organization of Supreme Audit Institutions (INTOSAI) are also taken into account.

12. Finally, as noted above, assessments of fiscal transparency in the form of ROSC fiscal transparency modules have commenced. A few countries have also undertaken independent assessments. Such assessments are based primarily on completed fiscal transparency questionnaires. While the Manual has provided a sufficient basis for country authorities in some cases to respond fully to the questions posed, in other cases expert help has been required to complete questionnaires. Such help is likely to be even more important when it comes to drawing up action plans in response to shortcomings that might be identified in ROSCs and with implementing measures included in those plans. Thus, the availability of the Manual notwithstanding, it is recognized that the provision of technical assistance—from the IMF, other international organizations, or bilateral government agencies—is an essential component of the effort to promote fiscal transparency through the implementation of the Code.

1

Clarity of Roles and Responsibilities

13. Establishing clear roles and responsibilities for government and the rest of the public sector is a key aspect of fiscal transparency, because it provides a basis on which accountability for the design and implementation of fiscal policy can be assigned. Principles and practices in this regard concern the scope of government and the framework for fiscal management.

The Scope of Government

1.1 The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.

14. The Code includes good practices relating to: (1) the structure and functions of government; (2) the allocation of responsibilities within government; (3) coordination and management of government activities; (4) relations between the government and the rest of the public sector; and (5) government involvement in the private sector.

The Structure and Functions of Government

1.1.1 The structure and functions of government should be clearly specified.

15. This is a basic requirement of fiscal transparency. The general government sector is defined in the United Nations (UN) *System of National Accounts*, 1993 (SNA) and in the current *GFS Manual*.⁹ It encompasses all institutions performing government functions as their primary activity. It should include therefore all national and subnational government units, including extrabudgetary funds, as well as all nonprofit institutions that provide mainly nonmarket services and are both controlled and mainly financed by government units.¹⁰

16. Defining the boundaries of government, and of the public sector, is a complex task, and one that is particularly challenging for countries in transition. To help achieve clarity in the description of the structure of government,

⁹See IMF (1986). Some differences exist between the SNA and the GFS, but the revised *GFS Manual* will be harmonized with the SNA. The revised *GFS Manual* is expected to be available early 2002. In the meantime, a revised draft *GFS Manual* has been posted on the IMF's external website for comment. See <http://www.imf.org/external/pubs/ft/gfs/manual/index.htm>.

¹⁰See Chapter 2 of the current *GFS Manual*, Coverage of the GFS System, for detailed discussion of the definition of the general government.

it is a basic requirement of fiscal transparency that an institutional table should be published showing the structure of government and the rest of the public sector. Such tables are available for most countries in the *IMF Government Finance Statistics Yearbook*, but they are neither comprehensive nor current. With relatively little effort these tables could be updated. An example of good practice in defining the boundaries of government is the application of the *European System of Accounts, 1995 (ESA)* to economic statistics in European Union countries.¹¹ Best practice in this area is that there should be full compliance with SNA definitions of economic sectors.

17. Government functions are those related to the implementation of public policy through the provision of nonmarket services, and the redistribution of income and wealth, financed primarily by taxes and other compulsory levies on nongovernment sectors. Separation of these functions from the monetary and commercial activities of government helps to establish clear accountability for the conduct of these very different activities and facilitates assessment of the macroeconomic impact of the fiscal activities of government. Although clarity of roles and responsibilities is required by the Code, the policy question as to whether, and to what extent, government should carry out commercial activities goes beyond transparency and is not addressed; nor is any specific form of institutional separation between commercial and noncommercial activities of government (or the public sector) advocated.

18. All government functions are fiscal activities. However, some fiscal activities are carried out by nongovernment public sector agencies whose primary activity is monetary or commercial. Such activities are referred to as being quasi-fiscal to indicate that they are not the primary activities of the agencies conducting them, and that their fiscal effects are not usually reflected in fiscal reports for the general government (as they would be, for instance, if the commercial or monetary institution was fully compensated from the central government budget for undertaking a quasi-fiscal activity). A central feature of fiscal transparency therefore is the open conduct of all fiscal activity, no matter where it takes place. For this reason, and to establish clear accountability, it is also important to distinguish the government from the central bank, public financial institutions, and nonfinancial public enterprises.¹² Where the central bank, public financial institutions, and nonfinancial public enterprises conduct extensive quasi-fiscal activities, this should be reflected in fiscal reports that cover the public sector.¹³

¹¹ESA is harmonized with the SNA. See <http://www.europa.eu.int/comm/eurostat/>.

¹²In the Code, and hereafter in the Manual, references to public financial institutions do not include the central bank. Given the particular significance of the central bank for fiscal analysis, it is important to distinguish it clearly from other public financial institutions.

¹³See paragraph 126 for further discussion of reporting on public sector finances.

Allocation of Responsibilities Within Government

1.1.2 The division of responsibilities between different levels of government, and between the executive branch, the legislative branch, and the judiciary, should be well defined.

19. A clear demarcation of roles within government is essential for transparency. At the broadest level, it is necessary to define the allocation of tax powers and expenditure responsibilities between different levels of government and, at each level of government, the fiscal role of the executive and legislative branches. This is often done as part of constitutional law.

Different Levels of Government

20. The relationship between different levels of government varies widely among countries, from federations in which individual states or provinces have considerable powers, through federal structures with a strong central government, to unitary forms of government. Precise distributions of tax powers and expenditure responsibilities vary accordingly. Fiscal transparency requires that such powers and responsibilities should be based on stable principles and/or agreed formulae, and that they should be clearly stated.¹⁴ They should also be exercised in an open and consistent way. Difficulties in establishing clear intergovernmental fiscal relations are often greater in larger and more diverse countries, particularly those in the process of economic or political transition. However, a number of such countries are attempting to address these difficulties.¹⁵

Roles of the Executive, Legislative, and Judicial Branches

21. Relationships between different branches of government are determined at the highest political and legal levels, vary greatly across countries, and are often subject to change as political and administrative systems develop. A number of recent studies illustrate the important influence that budget institutions have on fiscal outcomes.¹⁶ The Code does not advocate a particular structure of government that meets the needs of fiscal management. It only requires that the roles of different branches of government in fiscal management should be clearly defined. For example, there is a need for clarity over the executive's authority to conduct fiscal policy where the budget for the fiscal year has not been adopted by the legislature before the start of the fiscal year to which it relates. It is also important that the legislative and judicial branches play an active role in ensuring the availability and integrity of fiscal information.¹⁷ For example, there should be an active committee of the legislature that oversees the conduct of fiscal policy, and which facilitates civil society input into budget deliberations (e.g., through receiving public submissions). With respect to the judicial branch, taxpayers should be able to challenge the legality of taxation by appeal to the courts. As a rule, fiscal responsibilities should be defined in constitutional or administrative law. Given that these relationships may be emerging or subject to change, a high priority should be attached to clarifying ambiguity where it arises.

Coordination and Management of Government Activities

1.1.3 Clear mechanisms for the coordination and management of budgetary and extrabudgetary activities should be established.

22. The organization of responsibilities among central ministries (e.g., finance, economy, and planning) and spending ministries is a key issue. Countries approach this in different ways. In those countries with a tradition of development or central planning, responsibilities for fiscal management

¹⁴However, the intergovernmental framework should not be so inflexible as to constrain effective macroeconomic management by the central government.

¹⁵**Mozambique** has recently set up a new institutional framework for intergovernmental relations with relatively clear and simple rules. See the ROSC for Mozambique, Fiscal Transparency Module, paragraph 5, at <http://www.imf.org/external/np/rosc/moz/index.htm>.

¹⁶See, for instance, von Hagen (1992); Alesina and Perotti (1995, 1999); and Stein, Talvi, and Grisanti (1998). These studies suggest that fiscal performance in Europe and Latin America is strengthened by budget procedures that concentrate power in the executive (and, within the executive, in the finance ministry), and are more transparent.

¹⁷The Code is silent, however, on whether the legislature should have the power to amend the budget presented by the executive. This goes beyond transparency. See Alesina and Perotti (1999) for a discussion of the effects of different legislative budget amendment powers.

are divided between a finance ministry (responsible for the current budget) and the economy or planning ministry (responsible for the capital or development budget).¹⁸ Other countries divide responsibilities by making specific ministries or departments responsible for different fiscal management functions (e.g., macro-fiscal policy, budgeting, accounting). Countries also differ in the relative power of central ministries and spending ministries. There is no blueprint for an organizational structure that can be applied universally. However, to ensure adequate control over public finances, the division of fiscal management responsibilities should be specified.¹⁹

23. The way in which the term “budget” is defined is also crucial. In some countries, the term is restricted to the estimates related to *annual appropriations* of funds by the legislature. This concept, however, may capture only a small proportion of total fiscal transactions. Various kinds of operations may be set up outside the annual appropriations process, and are thus referred to as extrabudgetary, and some extrabudgetary funds (e.g., social security funds) are distinct from the general fund of government. Often there are transfers from the budget to extrabudgetary funds, and there is risk to the budget if fund revenue is lower or expenditure is higher than expected. Some countries have set up extrabudgetary funds and channel *earmarked taxes* to them. Although there may be valid reasons for setting up some funds outside the budget, and for earmarking, excessive use of such arrangements can diminish transparency (as well as reduce fiscal policy control and flexibility).²⁰ It is therefore important that the activities of extrabudgetary funds are subject to the same discipline as budget appropriations. Moreover, there should be rules and regulations regarding the accountability of extrabudgetary fund management, and the accounting and auditing of extrabudgetary funds.

24. It is not uncommon for government agencies to be allowed to use revenue from fees and charges directly for expenditure (e.g., hospital fees and charges that are used by the health administration without first being transferred to the general fund of government). *User charges* are increasingly being used in OECD countries as part of the control and incentive mechanisms for managers of agencies. Such arrangements should be recorded in gross terms, and reported both in the budget documentation (in aggregate form) and in detail in the annual reports of the agencies concerned, so that the full extent of government activity can be properly established.

25. The relationship between the domestic budget and externally financed expenditure raises transparency issues in many developing countries. Separate, nontransparent processes for determining the size and allocation of external and other budgetary receipts are often the source of financial control problems. Transparency is best served if externally financed expenditure is integrated into budget decision making and reporting.²¹

26. The more general point is that all fiscal activities should be subject to review and priority setting as part of the budget process.²² They should also be open to scrutiny by the legislature and the public. This requirement should apply even to extrabudgetary funds that are independently managed and under separate legislative authority.²³

¹⁸See paragraph 108 for discussion of the need to integrate current and capital budgets.

¹⁹The framework for fiscal management is discussed in paragraphs 40–41.

²⁰The channeling of earmarked taxes to extrabudgetary funds is common where there is a strong link between taxes and benefits, emphasis on which may result in earmarked taxes being more easily accepted than regular taxes. Also, activities undertaken through extrabudgetary funds should often be less influenced by the short-term considerations that affect the budget, and may even be governed by separate legislation. Social security has these characteristics.

²¹Reporting of externally financed transactions is discussed further in paragraphs 136–137.

²²Or through more extended reviews linked to medium-term budget targets or longer-term sustainability.

²³The new budget laws in **Moldova** and **Latvia** go as far as to incorporate extrabudgetary funds as special funds in the annual budget.

Relations Between the Government and the Rest of the Public Sector

1.1.4 Relations between the government and nongovernment public sector agencies (i.e., the central bank, public financial institutions, and nonfinancial public enterprises) should be based on clear arrangements.

27. This is a basic requirement of fiscal transparency. Fiscal responsibilities should generally be carried out by general government, or by public sector agencies outside government under clearly specified and open arrangements. The risk of having to provide financial support to such agencies, when their financial position is unexpectedly weakened as a result of having to meet fiscal policy objectives, is then reduced. A corollary is that if government carries out either banking or commercial functions, the nature of such activities should also be transparent.

General Government and the Central Bank

28. The primary responsibility of the central bank is to achieve monetary objectives. Increasingly, central bank responsibilities are being defined to give them as much autonomy as possible within a framework that ensures appropriate accountability.²⁴ In many countries, central bank laws emphasize the operational independence of the central bank and prohibit or restrict its direct financing of the fiscal deficit.²⁵

29. In some countries, however, a number of activities carried out by central banks are quasi-fiscal in nature. Quasi-fiscal activities may involve operations related to the management of the financial system (e.g., subsidized lending and directed credit) or the exchange system (e.g., multiple exchange rates and import deposits).²⁶ Such operations may be used by governments as a substitute for direct fiscal action, and will have similar economic effects in whichever part of the public sector they are conducted. They clearly need to be taken into account in assessing the overall fiscal position.²⁷ It is also a basic requirement of fiscal transparency that links between fiscal and monetary operations of the central bank should meet the requirements of Sections 1.2 and 1.3 in the monetary and financial transparency code.²⁸ Section 1.2 requires that the institutional relationship between monetary and fiscal operations should be clearly defined, while Section 1.3 requires that agency roles performed by the central bank on behalf of the government should be clearly defined.

General Government and Public Financial Institutions

30. Although privatization of state-owned banks has been increasing, they still account for a dominant share of the banking sector in many developing economies.²⁹ Public financial institutions have often been set up to provide assistance of a quasi-fiscal nature, such as a development bank providing loans to specific sectors at below-market rates. Governments also use public financial institutions on a more ad hoc basis to provide quasi-fiscal assistance, for example, through policy directions on lending. A basic requirement of fiscal transparency is that the annual reports of public financial institutions should indicate the noncommercial services that the government requires them to provide.

²⁴In **Sweden**, the central bank undertakes no quasi-fiscal activities, and its independence is assured under amendments to the 1997 Sveriges Riksbank Act. See the ROSC for Sweden, Fiscal Transparency Module, paragraph 5, at <http://www.imf.org/external/np/rosc/swe/index.htm>. The Bank of Korea is prohibited by the Central Bank Act from direct financing of the fiscal deficit. See the ROSC for the **Republic of Korea**, paragraph 6, at <http://www.imf.org/external/np/rosc/kor/index.htm>.

²⁵Although it is still possible for the central bank to buy government securities in the open market, or to influence the demand for such securities in other ways (e.g., by requiring their use in meeting reserve requirements).

²⁶Box 10 contains a more complete listing of the different types of quasi-fiscal activity.

²⁷Reporting of quasi-fiscal activities is discussed in paragraphs 70–77, and a discussion of how they can be incorporated into assessments of the overall fiscal position is contained in Box 18.

²⁸For detailed discussion, see <http://www.imf.org/external/np/mae/mlt/index.htm>.

²⁹See Goldstein (1997).

General Government and Nonfinancial Public Enterprises

31. It is also a basic requirement of fiscal transparency that the annual reports of nonfinancial public enterprises should indicate the noncommercial services that the government requires them to provide. Nonfinancial public enterprises in many countries provide noncommercial services, usually through charging less than cost-recovery prices (e.g., providing electricity at below cost to rural consumers). In a number of countries, nonfinancial public enterprises have also been required to provide social services. These noncommercial activities may be financed by cross-subsidization between different groups of consumers and/or by incurring losses that are financed from the budget or by borrowing. In some instances, excessive prices may be charged by certain nonfinancial public enterprises, and the supernormal profits earned transferred to other enterprises or to the budget. This confuses the fiscal responsibilities of government and commercial role of nonfinancial public enterprises, makes relations between government and nonfinancial public enterprises nontransparent, and creates difficulties in holding managers of nonfinancial public enterprises accountable for their performance.

32. Best practice is that relevant disclosure and transparency requirements of Principle IV of the *OECD Principles of Corporate Governance* should be observed by public financial institutions and nonfinancial public enterprises. Box 3 spells out these requirements. However, a few countries are also moving in a different direction, in that the government is contracting with a nonfinancial public enterprise to provide a noncommercial service in return for an explicit budgetary transfer which reflects the price the government is willing to pay for the service.³⁰ Similar contracts could also be agreed with public financial institutions.

33. Serious transparency concerns can also arise over the manner in which public financial institutions and nonfinancial public enterprises are privatized. Privatization should be conducted as openly as is consistent with sound marketing considerations. It is a basic requirement of fiscal transparency that the privatization of government assets should be open to independent audit (e.g., by a national audit body), to ensure that it is carried out in accordance with the law, that the business is properly valued, and that there is competition among bidders. Indemnities given to purchasers should also be disclosed (and included in a statement of *contingent liabilities*).³¹ INTOSAI has published *Guidelines on Best Practice for the Audit of Privatizations*.³²

Government Involvement in the Rest of the Economy

1.1.5 Government involvement in the private sector (e.g., through regulation and equity ownership) should be conducted in an open and public manner, and on the basis of clear rules and procedures that are applied in a nondiscriminatory way.

34. The government interacts with the private sector in a variety of ways, and transparency in government operations may be of limited benefit if there is not clarity in all kinds of interaction with the private sector.

³⁰In the **United Kingdom** nonfinancial public enterprises operate on a commercial basis, with the costs of noncommercial activities being compensated for and reflected in the budget. In **France**, some quasi-fiscal activities are being replaced by explicit subsidies. For example, airlines are explicitly contracted on a competitive basis to maintain some noncommercial routes and the cost of maintaining postal services in rural areas is now explicit. See paragraphs 2 (including footnote 2) and 9 of the ROSCs for the United Kingdom and France respectively, Fiscal Transparency Modules, at <http://www.imf.org/external/np/rosoc/index.htm>.

³¹See paragraphs 62–66 for a discussion of contingent liabilities.

³²See INTOSAI (1998) at <http://www.nao.gov.uk/intosai/wgap/bestprac.htm>.

Box 3. OECD Principles of Corporate Governance: Principle IV on Disclosure and Transparency

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

1. Disclosure should include, but not be limited to, material information on:
 - The financial and operating results of the company;
 - Company objectives;
 - Major share ownership and voting rights;
 - Members of the board and key executives, and their remuneration;
 - Material foreseeable risk factors;
 - Material issues regarding employees and other stakeholders; and
 - Governance structures and policies.
2. Information should be prepared, audited, and disclosed in accordance with high quality standards of accounting, financial and nonfinancial disclosure, and audit.
3. An annual audit should be conducted by an independent auditor in order to provide an external and objective assurance on the way in which financial statements have been prepared and presented.
4. Channels for disseminating information should provide for fair, timely, and cost-efficient access to relevant information by users.

Regulation of the Nonbank Private Sector

35. Governments have become increasingly aware of the need for transparency in regulatory practices. General regulatory standards go beyond the scope of the Code, which only requires that government regulation of the private sector should be conducted in an open and public manner. Guidelines for government regulation are provided in the *OECD Policy Recommendations on Regulatory Reform*, although these are concerned with efficiency as well as transparency.³³ The OECD recommendations relating to the characteristics of transparent regulations are set out in Box 4. Best practice is that these recommendations should be fully implemented.

36. There are other activities that the private sector carries out under the direction of or in conjunction with government which should share the characteristics of transparent regulations. These include the imposition of compliance costs of collecting taxes on private businesses and individuals,³⁴ compulsory contributions to private providers of old age pensions, health and insurance, and privately financed infrastructure projects. While these are not regulations in the traditional sense, such activities are often guided by complex rules and reciprocal arrangements about which information should be openly available.

³³See <http://www.oecd.org/subject/regreform/> for additional detail.

³⁴See paragraphs 46–47 on accessibility and understandability of tax laws; paragraph 55 on taxpayer rights; and paragraph 142, which refers to transparency of tax compliance costs.

Box 4. Characteristics of Transparent Regulations

- Regulations should have clearly identified policy goals, should be expressed in clear, simple terms, and should have a sound legal basis.
- Public consultation on new regulations will often be desirable.
- Procedures for applying regulations should be open and nondiscriminatory. They should apply equally to the public and private sectors, and should contain an appeals process.
- Overlapping responsibilities among regulatory authorities should be minimized.
- Regulations and their impact should be reviewed periodically in published reports.

Government Intervention in the Banking Sector

37. Government regulation of the banking sector—and the financial sector more generally—should also be based on clear policy goals. Heavy government involvement in the banking sector is often associated with a failure to impose adequate accounting and disclosure practices, and to ensure that there are appropriate incentives for bank owners, managers, and regulators to manage risks prudently. An appropriate framework for bank regulation, most notably that provided by the *Basle Core Principles for Effective Banking Supervision*,³⁵ and greater transparency in reporting government involvement in the banking system, including a rationale for each type of intervention, are essential components of a framework that promotes financial sector stability. The monetary and financial transparency code contains detailed good practices for government financial agencies responsible for regulation, supervision, and oversight of the financial and payment systems.³⁶

Direct Equity Investment

38. Governments also intervene by directly acquiring private equity in companies or commercial banks. All government equity holdings should be identified in the budget documentation.³⁷ The acquisition of new equity should be clearly explained in the budget documentation, and the policy objectives served by government equity holdings should be explained.³⁸

The Framework for Fiscal Management

1.2 There should be a clear legal and administrative framework for fiscal management.

39. The Code includes good practices relating to: (1) budgetary and extra-budgetary activities; (2) taxation; and (3) ethical standards of behavior.

³⁵ See Basle Committee on Banking Supervision (1997). See also <http://www.bis.org/publ/bchs30a.htm>. This is one of the core standards promoted through the Financial Sector Assessment Program (FSAP). In the FSAP, staff of the World Bank and IMF consider observance of relevant financial sector standards as an input in to a broader examination of financial sector stability.

³⁶ See <http://www.imf.org/external/np/mae/mft/index.htm>.

³⁷ See paragraphs 81–82 for a discussion of reporting information on the stock of financial assets, including equity investment in private companies.

³⁸ This should definitely be done when new equity is acquired. There should also be periodic reviews of all equity holdings, and the reasons for retaining equity positions should be given, especially where governments are in the process of privatizing assets.

Budgetary and Extrabudgetary Activities

1.2.1 Any commitment or expenditure of public funds should be governed by comprehensive budget laws and openly available administrative rules.

40. The effectiveness of the budget depends on the strength of its basis in law and on supporting regulations and administrative practices. The relative importance of codified budget laws, regulations, and administrative practices varies considerably among countries. Box 5 provides a summary of different traditions of budget law. Despite these differences, there are important elements that should be embedded in all legal/administrative frameworks. Public funds can only be spent by law; the budget should be comprehensive, covering all central government transactions (albeit possibly through different funds); budget transactions should be shown in gross terms; a minister responsible for government finance should be given effective power of budget management; individual agencies should be held accountable for funds they collect and/or use; contingency or reserve provisions should specify clear and stringent conditions for use of such funds; and independently audited reports showing clearly how public funds have been used should be prepared for the legislature and the public.

41. It is common for basic principles of budget management to be embodied in a general budget system law (which may have constitutional or near constitutional status). Often, such laws are supported by specific laws governing treasury operations or the management of public debt. This latter practice has become common in economies in transition. Where a comprehensive legal framework is not in place, its development should proceed at a pace that is consistent with policy and administrative capacity.³⁹

42. The existence of a budget law does not guarantee that its provisions will be observed in practice. There are several areas of budget law that are commonly abused, and they need special attention if fiscal transparency is to be fully achieved. These include the excessive use of *supplementary budgets*, abuse of *contingency funds*, and accumulation of *payment arrears*.⁴⁰ All of these practices tend to reduce transparency, both in terms of aggregate control and strategic priority setting.

43. Supplementary budgets, which are presented to the legislature during a budget year to seek additions or changes in legislative authority, are transparent in the sense that they are formally presented to the legislature. Often, however, their expected impact on fiscal outcomes is not reviewed. Moreover, in some countries supplementary budgets are used to authorize spending after the fact rather than to seek legislative authority prior to spending taking place.

44. Contingency (or reserve) funds are also a common avenue for abuse of the law and a source of a lack of transparency. As noted above, a possible weakness in the budget law is that the conditions for use of contingency funds are not clearly specified. In some countries, this weakness is compounded by provisions in the budget law or the annual appropriation law that allow the use of unanticipated financial receipts to meet unspecified contingencies. In addition to ensuring that laws define the conditions under which contingency funds are used, actual practices should be closely monitored.

³⁹In some transition economies (e.g., **Kyrgyz Republic** and **Tajikistan**), treasury laws were enacted ahead of more comprehensive budget laws.

⁴⁰Arrears are discussed in paragraphs 132–135.

Box 5. Budget Law—Different Traditions

Continental European, civil law-based countries, such as **France**, tend to rely more on budget practices and procedures codified in detail in the law, consistent with a strong administrative control orientation in these countries. **United Kingdom**-based budget laws have tended to focus on broad principles of handling public funds, with detailed budget procedures reflected in regulations and administrative instructions. More recently, however, there has been a trend among some countries toward developing more comprehensive legislative frameworks that emphasize government responsibility for transparency and accountability. In the **United States**, much of the budget legislation is concerned with setting medium-term budget targets through the congressional budget process, because of the important role the United States Congress plays in shaping and controlling the budget.

Most developing countries have followed either a European- or United Kingdom-based budget legislative model, but in many cases have been unable to develop appropriate legal and administrative systems because of a lack of political and administrative capacity. Economies in transition are in various stages of developing a legislative basis for their budget processes, but many have difficulties in implementing realistic fiscal policies and in controlling budget execution in practice. The work of establishing a sound legal framework in these countries needs to be supported by development of the capacity to reflect that framework in realistic budgets.

Taxation

1.2.2 Taxes, duties, fees, and charges should have an explicit legal basis. Tax laws and regulations should be easily accessible and understandable, and clear criteria should guide any administrative discretion in their application.

Explicit Legal Basis for All Taxes

45. The constitutional framework of almost all countries embodies the principle that no tax may be levied unless it has a clear legal basis (although there are some differences in the application of this principle).⁴¹ It is fundamental to fiscal transparency that taxation should be under the authority of law and that the administrative application of tax laws should be subject to procedural safeguards.⁴² As with budget laws, however, the legal framework for taxation needs to be developed in a way that reflects policy and administrative capacity.

Accessibility and Understandability

46. Tax laws, regulations, and other documents relating to administrative interpretation of tax law should be accessible to the general public. Explanatory materials (e.g., instructions and pamphlets), usually prepared by the tax agency, should also be kept up-to-date. New budget revenue mea-

⁴¹The term “tax” in this section is used to refer to any compulsory payment under law, including customs duties.

⁴²For example, in the **Republic of Korea** taxes are levied under strict legal authority, tax laws are accessible, and they contain details of taxpayers’ rights, tax dispute procedures, and the application of tax laws. Taxpayers can contest rulings through internal dispute resolution procedures, recourse to the National Tax Tribunal, and finally by appealing to the judiciary. See the ROSC for the Republic of Korea, Fiscal Transparency Module, paragraph 8, at <http://www.imf.org/external/np/rosc/korea/fiscal.htm>.

asures should be given sufficient publicity so that taxpayers understand how they might be affected. To this end, the material the tax agency uses in applying the tax laws (e.g., manuals and legal opinions) should be publicly available and there should be mechanisms in place whereby taxpayers can have their queries answered (e.g., by setting up a dedicated office in the tax agency to do so).

47. In addition to being accessible, tax laws should be understandable to the public and avoid unwarranted complexity. Tax laws should be well organized and include all elements needed to determine tax liabilities and to establish procedures for tax collection.

Clear Criteria for Administrative Application

48. A corollary of requiring that taxes be imposed under law is that administrative discretion in applying tax laws must be limited. Case-by-case negotiation of tax liabilities between officials and taxpayers should not be the general rule in any country, both because of the nontransparency of such practices and the potential for corruption. However, appropriate provision should be made for settlement of tax cases, agreement on installment payment schedules, and writing off of uncollectible amounts, all with procedural safeguards. In addition, many countries find it convenient to provide taxpayers, on request, with advance rulings on how particular transactions that they are contemplating would be treated in a subsequent tax assessment. Where this practice is followed, it is important that the rulings are publicized. Tax laws should also clearly establish the powers and limitations of the tax administration to search the premises of taxpayers, demand information from taxpayers and third parties (including banks), apply indirect methods to determine income and sales, and enforce the collection of *tax arrears*.

49. Clarity and precision of legislation are emphasized as a means of promoting transparency and fighting corruption with respect to customs in the *Declaration of the World Customs Organization (Customs Cooperation Council), Arusha Declaration (1993)*,⁴³ which sets out guidelines for a program to achieve integrity in customs administration. To limit the size and complexity of tax laws, however, it is generally preferable that the explanation of a tax administration's powers be detailed in published administrative guidelines, policy statements or rulings, rather than being embodied in detail in the tax laws.

50. Tax administration should be organized in such a way as to minimize opportunities for collusion between taxpayers and tax officials. In this connection, administrative functions should be distributed across the tax administration, to provide a self-checking element whereby the work of staff engaged in one function serves as a control on the work performed by staff in other functions. It is also important that a tax agency does not become so fragmented that its staff cannot avoid becoming closely involved with the population it serves.

51. Internal audit systems should be established to ensure the financial accountability of tax collection staff and systems, and adherence to tax administration policies and procedures in dealings with taxpayers.

⁴³See <http://www.wcoomd.org/>.

52. Information technology can also play an important role in eliminating opportunities for discretionary action as well as providing for effective monitoring of tax arrears, exemptions, appeals, and payments. The computer systems should be designed to provide a full audit trail of the information recorded in the taxpayers' accounts, by cross-referencing this information to original source documents and to the names of the staff who entered it into the system.

53. Computer systems should have the capacity to readily exchange information among revenue departments. But it should be made clear that all taxpayer information is subject to confidentiality provisions and country-specific legal restrictions. In addition to taxes collected by the tax and customs departments, taxes collected under the social security system (if not collected by the tax department) should be accounted for in a clear manner, and audit information should be shared with tax departments. This arrangement would be facilitated by the use of a common taxpayer identification number by all revenue departments.

54. As in other areas of administration, earmarked taxes and netting operations, to the extent they are used, should be clearly shown and accounted for. If, for instance, a tax department is authorized to use a share of the revenue it collects from audits for staff bonuses or certain administrative expenditure, then the rules on the use of these funds should be clearly specified and normal accounting regulations should apply.

Taxpayer Rights and Openness of Administrative Decisions to Independent Review

55. An equally important aspect of transparency in tax and customs legislation and its administration is the system's openness to review of administrative decisions and the extent to which government is obliged to make taxpayers aware of their rights. Taxpayers' rights should be clearly stated and include the following: availability of timely, accurate information; fair and expeditious treatment; confidentiality in interactions with the authorities; and a reasonable penalty structure. Taxpayers should have access to a well-functioning system of administrative review of decisions, as well as the opportunity to appeal to an independent judiciary. Adjustments to taxpayers' tax returns (e.g., following an audit) should be accompanied by clear and complete statements to taxpayers as to the reasons for adjustments. In most countries, these rights exist on paper; however, they often function imperfectly. In particular, the appeals system may fail to provide safeguards against arbitrary administrative action and keep the tax administration within the bounds of the law. A number of countries have a taxpayer bill of rights or the equivalent.⁴⁴ Taxpayer rights can be established in law or incorporated in a taxpayers' charter or equivalent which is used to communicate taxpayer rights and to hold agencies accountable for their performance.

Ethical Standards of Behavior

1.2.3 Ethical standards of behavior for public servants should be clear and well publicized.

⁴⁴For the **United States**, see http://www.irs.gov/prod/ind_info/advocate.html.

Box 6. Code of Conduct for Public Officials

The *International Code of Conduct for Public Officials*, adopted by the UN on December 12, 1996, includes the following provisions:

- a public office is a position of trust, implying a duty to act in the public interest;
- public officials shall avoid conflicts of interest;
- public officials shall comply with any applicable requirements to disclose their personal assets and liabilities;
- public officials shall not solicit or accept any gift or favor that may influence the performance of their duties;
- public officials shall respect the confidentiality of any information in their possession; and
- public officials shall not engage in political activity outside the scope of their office such that it impairs public confidence in the impartial performance of their duties.

56. Officials handling or making decisions about the receipt or use of public funds, and otherwise exercising their official powers, should be subject to a code of conduct that precludes unethical behavior.⁴⁵ Some aspects of such a code could be included in the budget and tax legislation; other aspects may need separate legislation or regulations. The *United Nations' International Code of Conduct for Public Officials*,⁴⁶ which is summarized in Box 6, provides a basis for implementing a standard of ethics and for strengthening an existing standard.⁴⁷ Best practice is that OECD-PUMA principles for managing ethics in the public sector should be observed.⁴⁸ These principles assume that an adequate statement of core ethical standards is in place, and emphasize the necessary supporting environment, including the legal framework, clear procedures for exposing wrong-doing, political commitment, and the active promotion of ethical conduct.

⁴⁵The recent experience with addressing problems of corruption in the public service in the **Republic of South Africa** illustrates some of the problems in implementing ethical standards. See van der Westhuizen (1998).

⁴⁶See <http://www.un.org/ga/documents/gares51/gar51-59.htm>.

⁴⁷See UN (1996). INTOSAI has also published the *INTOSAI Code of Ethics for Auditors in the Public Sector*. See http://www.intosai.org/3_ETHICe.html.

⁴⁸See <http://www.oecd.org/puma/gvrnance/ethics/>.

2

Public Availability of Information

57. Making fiscal information available to the public is a defining characteristic of fiscal transparency.⁴⁹ Principles and practices in this regard concern the provision of comprehensive information on fiscal activity and to obligations regarding publication.

Provision of Comprehensive Information on Fiscal Activity

2.1 The public should be provided with full information on the past, current, and projected fiscal activity of government.

58. The Code includes good practices relating to: (1) the coverage of the annual budget; and the provision of information on (2) outturns and forecasts, (3) contingent liabilities, tax expenditures, and quasi-fiscal activities, (4) debt and financial assets, and (5) the consolidated position of the general government. Underlying budget accounting and reporting principles and procedures are dealt with in detail in Section 3.

Coverage of the Annual Budget

2.1.1 The budget documentation, final accounts, and other fiscal reports for the public should cover all budgetary and extrabudgetary activities of the central government, and the consolidated fiscal position of the central government should be published.

59. This is a basic requirement of fiscal transparency. The central government budget is usually the focus of fiscal policy, and comprehensive coverage of all fiscal activity undertaken by the central government is essential from a transparency standpoint. This requires that all extrabudgetary activities should be covered, and it is therefore also a basic requirement of fiscal transparency that detailed statements should be provided for all extrabudgetary funds. Similarly, information on the activities of autonomous central government agencies should also be part of the budget documentation. Such agencies are often established as separate legal entities to provide health,

⁴⁹There is an issue as to the language(s) in which information should be made available. It is unclear whether countries should routinely publish fiscal information, and economic information more generally, in a commonly used language. Outsiders following a country can usually arrange for fairly quick translation. However, for countries seeking access to international capital markets, there is likely to be some benefit from translating key documents and reports for release simultaneously with national language versions.

education, and other services, or to conduct specialized regulatory or quasi-judicial functions. Any grants or transfers such agencies receive from central government should be identified in the central government budget, and information on their gross expenditure and revenue, including revenue from earmarked taxes, user charges and other sources, should be reported.

60. The various fiscal reports that are issued in connection with the budget are described in Box 7. To clarify the analytical basis of each type of report, its relationship to GFS classification and reporting is described. Classification issues are discussed in more detail in Section 3. The relationship between financial, fiscal, and GFS reporting is covered in Box 17.

Outturns and Forecasts

2.1.2 Information comparable to that in the annual budget should be provided for the outturns of the two preceding fiscal years, together with forecasts of the main budget aggregates for the two years following the budget.

61. For a more complete picture of the current fiscal position, information on past fiscal performance should be presented in the annual budget or elsewhere in the budget documentation. Original and revised budget estimates for the two years preceding the budget should be included with the annual budget, together with the actual outturn (or expected outturn, if the final outturn for the current year is not available).⁵⁰ The information should include both main budgetary aggregates, and more detailed information on subaggregates (item of expenditure, function, and where available, program or output). The status of the outturn information should be disclosed (for example, provisional and unaudited, final and audited). This allows an assessment to be made of recent performance compared to budget, and may draw attention to significant forecasting, policy, or macroeconomic risks and, more generally, to the realism of the budget. Any changes to the classification or presentation of items from year to year should be disclosed, together with the reasons for the changes. Forecasts of key budget aggregates for the two years following the budget should also be provided. Providing aggregate fiscal projections for 5–10 years ahead in the budget documentation is best practice.⁵¹

Contingent Liabilities, Tax Expenditures, and Quasi-Fiscal Activities

2.1.3 Statements describing the nature and fiscal significance of central government contingent liabilities and tax expenditures, and of quasi-fiscal activities, should be part of the budget documentation.

Contingent Liabilities

62. Contingent liabilities are costs which the government will have to pay if a particular event occurs. They are therefore not yet recognized as liabilities.⁵² A common example of a contingent liability is a *government-guaranteed loan*. At the time a guarantee is entered into there is no liability for the government, since this is contingent on the borrower failing to repay the loan as

⁵⁰In Uganda, historical information on the budget and outturn information for the preceding four years is provided by sector and vote in the “Background to the Budget” presented with the budget each year. See the ROSC for Uganda, Fiscal Transparency Module, paragraph 27, at <http://www.imf.org/external/np/rosca/uga/index.htm>.

⁵¹Medium-term fiscal forecasts are discussed in more detail in paragraphs 107–108 and Box 15.

⁵²More precisely, IFAC-PSC defines a contingent liability as either . . . (a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or nonoccurrence of one or more uncertain future events not wholly within the control of the enterprise; or (b) a present obligation that arises from past events but is not recognized as a liability because: (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or (ii) the amount of the obligation cannot be measured with sufficient reliability.

Box 7. Budget and Fiscal Reports

Report/Document	Comment	Relationship to GFS
The annual budget	Appropriation accounts containing details of the expenditure authorized or to be authorized by the legislature through a budget (appropriation) law. Includes estimates of revenue and borrowing. Transactions are generally classified by administrative unit and item of expenditure.	GFS classification facilitates compilation of national accounts and fiscal reports, but is not universally applied.
Budget supporting documents	Include various statements (e.g., on extrabudgetary funds, autonomous agencies, quasi-fiscal activities, fiscal risks) and background papers (e.g., on the fiscal and economic outlook). The annual budget and supporting documents make up the budget documentation.	GFS presentation of the <i>overall balance</i> is preferred, and should be reconciled with the presentation in the annual budget.
Within-year budget reports	Monthly or quarterly reports on budget outturns from government accounts. May be compared to the projected outturn for the period. Also includes regular reports on debt.	An administrative presentation (identical to that in the annual budget) is common, but a GFS summary is preferred for monitoring fiscal developments.
Final accounts	Final audited accounts are presented to the legislature at year-end to provide assurance of regularity and consistency with appropriations.	As for the annual budget. A GFS summary is rarely provided.
Financial reports	General purpose reports on the financial position and performance of the government are increasingly being provided. Such reports are more common under <i>accrual accounting</i> , but IFAC-PSC has recently developed reporting standards applicable to <i>cash accounting</i> (see IFAC, 2000b). Where the government budgets on an accrual basis, as in Australia and New Zealand , these financial reports also fulfill the function of reporting on compliance with budget appropriations. In other countries (e.g., the United States and France) <i>accrual reporting</i> is separate from budgeting, which is mainly on a cash basis.	A GFS summary is rarely provided. In some countries (e.g., Australia), financial reports meet a number of analytical needs including GFS reporting.
GFS reports	Reports that provide analytical information on government finances in GFS format. Such reports can be generated from data compiled for one of the above reports, but as accrual accounting is adopted by GFS and applied more widely in government, classification in all fiscal reports is likely to converge.	

contracted. However, in the event of default, the lender can invoke the guarantee and the government will be obliged to repay the amount of the loan still outstanding. At that point, the contingent liability will become an actual liability of government, and a payment must be made. Box 8 gives other examples of contingent liabilities, and describes the links between contingent liabilities and certain other potential obligations of government.

63. Contingent liabilities complicate fiscal management because of the inherent uncertainty about their fiscal impact. The fact that they have traditionally not been subject to the discipline of the budget process is also a problem. In many countries, guarantees have proliferated, resulting in a large “hidden deficit” which is not reported.⁵³ Guarantees can also create moral hazard, by weakening incentives for prudent behavior by the beneficiaries of guarantees, which increases the likelihood that the guarantee will be called.

64. Contingent liabilities will only be recognized under cash accounting if and when the contingent event actually occurs and a payment is made. Thus while a loan by government will be recorded as expenditure at the time the loan is made, a government-guaranteed loan will be recorded only when the government is required to honor the guarantee by making a cash payment to the lender. This can result in governments using guarantees rather than more transparent direct expenditure. Even under accrual accounting, many contingent liabilities would not be recognized as liabilities, unless they can be quantified and are judged likely to require a future payment by the government.⁵⁴ They would instead be disclosed in supplementary statements.⁵⁵

65. Given the difficulties involved in quantification, including in budget documentation a statement that indicates the public policy purpose of each provision giving rise to a central government contingent liability, its duration, and the intended beneficiaries is a basic requirement of fiscal transparency.⁵⁶ But where possible, major contingencies should be quantified. Disclosure of contingent liabilities in the annual budget, the mid-year report to the legislature, and the final accounts is included in the OECD best practice guidelines. These should be classified by major category, and information on the past calls on the government to meet contingent liabilities should be disclosed.⁵⁷

66. A number of judgments need to be made as to what items should be included when reporting contingent liabilities. Further guidance on these matters is being developed by IFAC-PSC. Specific issues include the following.

- To qualify as a contingent liability, the likelihood that a future expenditure will result should be more than remote. It would, however, be desirable to report contingent liabilities where the likelihood of actual expenditure is remote but the amount potentially at risk is very large. Guarantees below some minimum country-specific threshold need not be separately disclosed, but should be included in an “other quantifiable contingent liabilities” total.
- Some contingent liabilities are inherently unquantifiable. An indemnity against prosecution for public officials is an example. In this situation, it is sufficient to provide details on the nature and scope of the indemnity.

⁵³See Polackova (1999).

⁵⁴Where there is a portfolio of similar contingent liabilities, such as a large portfolio of loan guarantees with similar characteristics (e.g., in housing or agriculture sectors), there may be sufficient reliable historical data on loan loss experience to allow a reliable estimate of the expected cost of the guarantee program to be made. This estimate might then be appropriated as expenditure in the budget.

⁵⁵Supplementary disclosure is also possible under cash accounting, as recommended in the IFAC Exposure Draft 9 (2000b).

⁵⁶Disclosure of contingent liabilities should be included in a broader statement of fiscal risks (see paragraph 110 and Box 16). Reporting on contingent liabilities will require development of an underlying information system for recording them.

⁵⁷The **Czech Republic** provides a good example of a country where there are significant contingent liabilities in the form of guarantees, and where steps have been taken to provide information on guarantees in budget documents. See Box 2 in the ROSC for the Czech Republic, Fiscal Transparency Module, at <http://www.imf.org/external/np/ros/cze/index/htm>.

Box 8. Contingent Liabilities, Policy Obligations, and Implicit Liabilities

In addition to government guarantees, other examples of contingent liabilities are indemnities, uncalled capital, and legal action against the government.

Indemnities are commitments where the government assumes certain specified risks. For example, when a state enterprise is privatized, the government sometimes provides an indemnity to the purchaser against particular risks—such as protection against future legal action relating to preexisting conditions. The government can also issue indemnities in the context of privately financed infrastructure projects. Uncalled capital is an obligation on government to provide additional capital on demand to an entity of which it is a shareholder. An example is uncalled capital in official international financial institutions. And the government may at any time be subjected to legal action if it is judged to have acted outside its authorized powers.

Contingent liabilities need to be distinguished from other obligations or responsibilities of government, such as obligations to pay pensions in the future. For civil service pensions, these will generally be recognized as liabilities under accrual accounting. But they are current obligations arising from past events and not contingent liabilities. Future obligations to pay public pensions have not been recognized as a liability to date in any country that has adopted accrual reporting. Only amounts currently due and payable are recognized as a liability.¹

Contingent liabilities also need to be distinguished from situations where the government has a potential future obligation, but where there is no policy or contractual requirement that a payment be made should a future contingency occur. Such *implicit contingent liabilities* reflect the fact that there may be strong pressure on a government to step in and provide assistance should some event occur, even in the absence of any explicit prior policy or commitment to do so. The notable example in recent years has been financial sector restructuring, where governments have made payments far in excess of any explicit prior commitment to protect depositors or institutions. Because of *moral hazard*, it will generally be inappropriate that such potential obligations be quantified and reported as explicit contingent liabilities. However, such potential obligations should be considered openly in policy discussion.²

¹Civil service pensions and public pensions are discussed further in Box 12.

²See Financial Stability Forum (2000) for a discussion of shifting from blanket guarantees to protect the financial system from collapse to limited coverage deposit insurance.

- Quantification of some contingent liabilities may be undesirable on public policy grounds, because it may result in unnecessary additional cost or risk to the government. For example, reporting the potential cost of a contingency that is the subject of negotiation with another government could prejudice the government's negotiating position. In such a situation, it would again be sufficient to disclose the nature and scope of the provision. Reporting the potential cost of legal action against the government should, however, include disclosure of the amount claimed, together with a proviso that this does not represent

either an admission that the claim is valid or an estimate of the possible amount of any award against the government.

- Where the government has set aside reserves against a specific contingency, this should be noted in the statement of contingent liabilities. For example, a deposit insurance fund may have substantial dedicated assets available to be drawn down should a covered financial institution fail. Details of these assets should be reported, together with the extent of the government's remaining loss exposure.⁵⁸

Tax Expenditures

67. Tax expenditures include exemptions from the tax base, allowances deducted from gross income, tax credits deducted from tax liability, tax rate reductions, and tax deferrals (such as accelerated depreciation). Tax expenditures are often identical in their effects to explicit expenditure programs. For example, assistance to individuals, families, or firms can be delivered either through expenditure programs or through concessional tax treatment. Once introduced, however, tax expenditures do not require formal annual approval by the legislature (though some may be subject to sunset clauses), and are therefore not subject to the same degree of scrutiny as actual expenditure. A proliferation of tax expenditures can therefore result in a serious loss of transparency.

68. The inclusion of a statement of the main central government tax expenditures as part of the budget documentation is a basic requirement of fiscal transparency. Such statements should indicate the public policy purpose of each provision, its duration, and the intended beneficiaries. Where possible, major tax expenditures should be quantified.⁵⁹

69. Providing the estimated costs of all tax expenditures in the budget documentation is included in the OECD best practice guidelines, which also call to the extent possible for the discussion of tax expenditures and general expenditure to be combined. Although there can be serious difficulties in cost estimation, reporting the approximate cost of tax expenditures and describing the basis of the estimates can significantly enhance transparency.⁶⁰ A number of OECD countries regularly publish estimates of tax expenditures. Box 9 provides information on selected country practices.

Quasi-Fiscal Activities

70. Quasi-fiscal activities may be conducted by the central bank, public financial institutions, and nonfinancial public enterprises. Box 10 presents a listing of different types of quasi-fiscal activities. In contrast to explicit fiscal activities, quasi-fiscal activities are often introduced by simple administrative decision, are not recorded in budgets or budget reporting, and typically escape legislative and public scrutiny. They are introduced by governments to achieve a variety of objectives, such as promoting certain activities, redistributing income or collecting revenue. Because they lack transparency, quasi-fiscal activities can be self-perpetuating. They can also have implications

⁵⁸Section 7.6 of the monetary and financial transparency code requires that, where there are deposit insurance guarantees, information on the nature, operating procedures, financing, and performance of such arrangements should be publicly disclosed.

⁵⁹A special case that falls outside the usual definition of tax expenditure occurs where government, public financial institutions, and nonfinancial public enterprises are exempt from taxes applied to similar transactions carried out by the private sector. Where such exemptions apply, these should be noted and quantified to the extent possible in the budget documentation.

⁶⁰The quantification of tax expenditures is particularly complex, requiring the specification of a benchmark tax structure in the absence of tax expenditures and, in more sophisticated approaches to quantification, assumptions about the behavioral impact of tax expenditures. See OECD (1984, 1996). See also Government of Canada, *Tax Expenditures and Evaluations 2000*, at http://www.fin.gc.ca/toc/2000/taxexp_e.html.

Box 9. Tax Expenditure Reporting

Germany and the **United States** were the first countries to report tax expenditure information, in the late 1960s. Tax expenditure reports are now a legal requirement in at least nine OECD countries (**Australia, Austria, Belgium, France, Germany, Greece, Portugal, Spain,** and the United States). Most of the countries reporting information do so annually; in Australia, Belgium, **Finland,** France, Greece, Portugal, Spain and **Sweden** the tax expenditure report is linked explicitly to the budget process. In Greece the central government budget must be accompanied by an attached budget of tax expenditures. An OECD survey in 1999 indicated that three-quarters of OECD countries regularly report tax expenditures. About half of these do so in the budget documentations. **Brazil** also reports some tax expenditure information in its annual budget. This information is required by the constitution, and by the Fiscal Responsibility Law. In **Korea,** the government began to report direct tax expenditures to the National Assembly from 1999.

In Germany, tax expenditures are reported as part of a “subsidy report,” which includes all forms of federal support through both direct expenditure and tax expenditures. (Most states provide similar subsidy reports to state legislatures.) The forgone revenue is reported for two prior years, the current year, and the following year. The federal subsidy report lists for each tax expenditure item the revenue forgone to the federal budget and to all the territorial authorities. The report covers a wide range of direct and indirect taxes, and classifies them by industrial sector and within sector by type of tax. In addition to regular biennial reports, more detailed reports are prepared on individual sectors, and supplementary calculations are made if changes to the law are planned. To prevent certain types of tax expenditure from becoming permanent parts of the tax system, they may be designed to phase out over time (e.g., the tax incentives for investment in eastern Germany). The subsidy reports are submitted to the federal legislature, where they are considered by various committees. The reports are subjected to scrutiny by the Federal Court of Audit. Independent economic research institutes conduct their own analyses of the economic effects and efficiency of subsidies, and make their own calculations of the magnitude of tax expenditures (and subsidies more generally).

which lead to further nontransparency. For example, requirements on nonfinancial public enterprises to purchase inputs from government-owned monopoly suppliers may result in pressure from the nonfinancial public enterprise to be exempted from other regulations or taxes in order to compensate them for the loss of profitability arising from the quasi-fiscal activity.

71. There are a number of reasons why it is important to identify, where possible to quantify, and to report information on quasi-fiscal activities. First, where quasi-fiscal activities are sizable, the budget balance ceases to be a reliable indicator of the government’s financial position, complicating the design of fiscal policy. Second, official government revenue and expenditure statistics do not accurately reflect the actual size of government. Third, quasi-fiscal activities can generate implicit contingent liabilities. This would happen, for example, if the

Box 10. Types of Quasi-Fiscal Activity

Operations related to the financial system

Subsidized lending

- Administered lending rates
- Preferential rediscounting practices
- Poorly secured and subpar loans
- Loan guarantees

Underremunerated reserve requirements

Credit ceilings

Rescue operations

Operations related to the exchange system

Multiple exchange rates

Import deposits

Deposits on foreign asset purchases

Exchange rate guarantees

Subsidized exchange risk insurance

Operations related to the commercial enterprise sector

Charging less than commercial prices

Provision of noncommercial services (e.g., social services)

Pricing for budget revenue purposes

Paying above commercial prices to suppliers

government directs a public financial institution to guarantee a loan which could impair its profitability and ultimately require a capital injection from the government. Finally, because quasi-fiscal activities often have redistributive effects, it is important that they be subjected to public scrutiny.

72. Reporting quasi-fiscal activities is, however, complex, and raises a number of issues. For example, with respect to central bank quasi-fiscal activities, only where the financial effects are fully reflected in the profit and loss account in the financial year in which they occur will the impact of such quasi-fiscal activities be captured in the budget, through central bank profits transferred to the government.⁶¹ This has a number of consequences from a transparency standpoint.

- Even if all quasi-fiscal activities impact immediately on the profit and loss account of the central bank, and profits are transferred in full to the central government, these fiscal activities are effectively being reported on a net basis, and little information is available on the underlying gross flows.⁶²
- If some portion of central bank profits is retained as central bank reserves, the cost of quasi-fiscal activities is met in part by the central government budget and in part by a smaller increase in central bank reserves than would have occurred in the absence of the quasi-fiscal activities.⁶³

⁶¹In some instances, revenue earned by a central bank from a quasi-fiscal activity may be transferred directly to the budget (e.g., revenue earned from the operation of a multiple exchange rate system).

⁶²There is also typically a time lag between the time when a quasi-fiscal activity occurs and impacts on the central bank's profit and loss account, and when central bank profit is transferred to the central government.

⁶³In some cases, the central bank law may provide that all profits are to be transferred to the central government once reserves reach a certain level. More generally, the marginal rate of transfer may vary over time.

- In some cases, the central bank engages in such extensive quasi-fiscal activities that it makes a loss, but central bank losses are not reported as expenditure of the central government.⁶⁴
- The effects of some quasi-fiscal activities are not reflected immediately in the central bank profit and loss account. For example, subsidized lending may result in an overvaluation of the central bank assets rather than a reduction in its operating surplus.⁶⁵ Also, contingent liabilities of the central bank—such as exchange rate guarantees—are not recorded as expenditure unless the contingency arises and the liability must be met.

Some of these considerations apply also to the transparency of quasi-fiscal activities conducted by public financial institutions and nonfinancial public enterprises. In the case of the central bank, there may also be significant fiscal effects from its monetary policy operations. For example, sterilization of foreign currency inflows may have a significant negative impact on central bank profitability, and hence on the profit transfer to the budget. While sterilization is undertaken for monetary purposes (and hence is not a quasi-fiscal activity), it is important that its financial implications are reported in the central bank's annual report.

73. Given the nature and potential fiscal significance of quasi-fiscal activities, they should ideally be taken into consideration in assessing the fiscal position. However, the identification and quantification of quasi-fiscal activities is difficult and contentious. This is especially the case for public enterprises, where taxes and subsidies are often not transparent. Some pragmatism is called for in deciding on the range of quasi-fiscal activities to be reported, and financial magnitude is certainly a criterion that should be applied in making such a decision.

74. After taking the preceding factors into account, it is a basic requirement of fiscal transparency that a statement on quasi-fiscal activities should be included in the budget documentation which indicates the public policy purpose of each quasi-fiscal activity, its duration, and the intended beneficiaries. Meeting this requirement necessitates the following.

- Independently audited financial statements of the central bank, public financial institutions, and nonfinancial public enterprises should be publicly available shortly after the end of each financial year.
- The annual report of the central bank should indicate any nonmonetary policy activities it conducts on behalf of the government; annual reports of individual public financial institutions and nonfinancial public enterprises should indicate the noncommercial services that the government requires them to provide; and public financial institutions should disclose any connected lending to other government-owned agencies, and provide information on nonperforming loans.

Statements on quasi-fiscal activities could be compiled by the central ministry responsible for the budget on the basis of information provided by the central bank and other public sector agencies undertaking quasi-fiscal activities.⁶⁶

⁶⁴Significant central bank losses are not uncommon in developing countries; in some instances annual losses have exceeded 5 percent of GDP. See Robinson and Stella (1993.)

⁶⁵Such subsidized credit needs to be distinguished from rediscounting by central banks. The latter activity is monetary in character and should generally be regarded as involving an exchange of assets of equal value. Rediscounting is provided to solvent institutions on a fully collateralized basis, often at market or penal rates of interest. Where rediscounting is provided at below market interest rates, however, the interest rate subsidy should be regarded as a quasi-fiscal activity. Similarly, unremunerated (or underremunerated) reserve requirements, which can impose a significant tax on financial institutions where interest rates are high, should be regarded as a quasi-fiscal activity.

⁶⁶The monetary and financial transparency code provides a basis for the provision of such information by the central bank.

Box 11. Estimating the Fiscal Effects of Quasi-Fiscal Activities

Estimating the fiscal effects of some quasi-fiscal activities is relatively straightforward. The necessary information may be contained in accounting records (e.g., the cost to a nonfinancial public enterprise of providing social services). Others, however, are more difficult to quantify. Worked examples are provided below to illustrate quantification of quasi-fiscal activities in two relatively straightforward cases.

Example 1: A subsidized loan provided by a public financial institution

A state-owned bank provides a loan of \$10 million at a 5 percent rate of interest. Commercial rates of interest for comparable loans range from 15 percent to 20 percent, depending on specific elements bearing on credit risk. The annual subsidy should be estimated as between \$1 million and \$1.5 million. In the absence of any relevant factors indicating an alternative treatment, the cost of the quasi-fiscal activity should be reported as the midpoint of the range, or \$1.25 million.

Example 2: A multiple exchange rate

The central bank operates a special appreciated exchange rate of 2.75 local currency units to the dollar for mineral exports, and of 2 to the dollar for imports of a staple foodstuff. The central exchange rate is 3 to the dollar, entailing a tax on mineral exports and a subsidy on imports of food. If total mineral exports are \$3 billion, and total food imports are \$300 million, the effects of the quasi-fiscal activity can be estimated and reported as follows:

Quasi-fiscal tax on mineral exports: $(3-2.75)\$ \times (\$3,000,000,000) = 750,000,000$

Quasi-fiscal subsidy to food imports: $(3-2)\$ \times (\$300,000,000) = 300,000,000$

In this example, the central bank gains a net 450,000,000 local currency units.

75. Statements on quasi-fiscal activities should include sufficient information to enable at least some assessment of the potential fiscal significance of each quasi-fiscal activity,⁶⁷ and where possible, major quasi-fiscal activities should be quantified. However, while it is often possible to provide an indication of the order of magnitude of fiscal effects as illustrated in Box 11, precise quantification may be difficult.⁶⁸ Thus reporting of an exchange rate guarantee issued by the central bank could readily include the value of guarantees outstanding and the cost if they were called at the current exchange rate. But precise quantification requires an estimate of the probability that a guarantee will be called, and this is difficult to know. If an estimate is provided, its basis should also be indicated.

76. It is a matter of judgment whether the private sector, if called upon to undertake activities of a quasi-fiscal nature, should be covered by reports on quasi-fiscal activities. In general, and as indicated earlier, such activities are best examined from the perspective of transparency of regulations. However, guarantees or indemnities given by government in the context of private sector activity (e.g., in connection with private infrastructure projects) should be disclosed in the statement of contingent liabilities.⁶⁹

⁶⁷For example, reporting of a guaranteed loan might include the amount and duration of the loan; reporting of a subsidized loan might include the amount and duration of the loan and the rate of interest; and reporting of a consumer subsidy by a nonfinancial public enterprise might include at least some indication of the divergence between the price charged and a price based on full cost recovery.

⁶⁸See Mackenzie and Stella (1996) for a detailed discussion of issues in estimating the size of quasi-fiscal activities.

⁶⁹See for instance reporting by the **United Kingdom** government in the budget documents of details of privately financed infrastructure projects. Information is given on estimated sectoral capital spending by the private sector, under contracts signed with the government, for the previous year and the next three years; and forecasts of the estimated payments for services flowing from new private investment projects over the next 25 years. See <http://www.hm-treasury.gov.uk/budget2001/fsbr/chapc.htm>.

77. The OECD best practice guidelines do not cover reporting on quasi-fiscal activities. However, best practice is to report quantified estimates of the fiscal significance of quasi-fiscal activities, and to provide information on the basis for quantification.

Debt and Financial Assets

2.1.4 The central government should publish full information on the level and composition of its debt and financial assets.

78. This is a basic requirement of fiscal transparency. Sound information on liabilities and financial assets is essential to enable a government to assess its ability to finance its activities and service its debt, and to estimate the amount of future revenue required to meet all existing *commitments*. It also provides a basis for assessing fiscal sustainability. Best practice in providing information on debt and financial assets is the publication of a *government balance sheet* as part of the budget documentation. As indicated in Box 12, a number of complex issues need to be addressed in preparing a government balance sheet. However, where a government balance sheet is published, it should ideally cover financial liabilities and assets, and nonfinancial assets, of government. Where nonfinancial assets are not covered, a register of nonfinancial assets should be maintained, and a listing of nonfinancial assets should be provided in the budget documentation.

Reporting of Debt

79. Reporting should cover the comprehensive debt of central government, including securities, loans, and deposits.⁷⁰ The level of debt at the reporting date and the previous reporting date (for comparison purposes) should be disclosed. Valuation methods and practices (e.g., revaluation of indexed debt),⁷¹ together with any special characteristics of debt instruments or any liabilities not reported, should be noted as memorandum items. The classification and definition of debt should be in accordance with internationally recognized practices (e.g., the GFS or OECD, 1988). Information should also be provided on any sinking funds established for debt amortization.

80. Debt should be broken down by remaining maturity, and classified as short (less than 12 months), medium or long term.⁷² Breakdowns of debt should also be provided, where relevant, by domestic and foreign components according to residence, by currency of issue (including indexing), by debt holder, and/or by debt instrument. Any debt arrears should be disclosed, with arrears on interest and principal identified separately. In addition, debt swaps should be disclosed. Best practice in debt reporting is represented by the SDDS, which in addition requires reporting of guaranteed debt and encourages that debt service projections are reported.

Reporting of Financial Assets

81. Reporting of financial assets should cover all such assets of central government at the reporting date as well as those at the previous reporting date.

⁷⁰The reporting standards for debt set out here are based on those in the GDDS (<http://dsbb.imf.org/#gdds>). For a discussion of issues in the reporting of government debt and financial assets, see IFAC (2000a).

Government-guaranteed debt should be reported in a statement of contingent liabilities.

⁷¹Indexed debt is that denominated in domestic currency but with its nominal value indexed to a foreign currency, inflation, or a commodity price (such as the price of oil or gold).

⁷²Where remaining maturity is not available, original maturity may be reported.

Box 12. Government Balance Sheets: Some Issues

With respect to reporting balance sheet information, best practice is to publish with the annual budget and final accounts either:

- a balance sheet showing all liabilities of government (not just public debt), and disclosing in addition a register of all physical assets of central government; or
- a full balance sheet showing all liabilities and all financial and physical assets of central government.

Governments generally have significant liabilities other than public debt. One important example is the future obligation to pay civil service pensions under existing contractual or legal arrangements. These obligations are typically underfunded and, under accrual accounting, the unfunded liability is usually shown on the balance sheet as a liability. The key assumptions underlying the valuation of the liability are shown, together with the change in the liability compared to the previous year, and an explanation of the main reasons for the change. Other liabilities include accounts payable, accrued interest and accrued salaries and wages, transfer payments payable, environmental liabilities, and obligations under accident compensation schemes.¹

Under accrual accounting, a range of additional disclosures are typically made in supplementary notes. These include information on contingent liabilities and on commitments. Commitments are existing contractual agreements under which government will be responsible for a future liability. Examples include multi-year leases for buildings, and agreements to purchase or construct capital assets in the future. Information on available undrawn lines of credit is also included.

Under full accrual accounting, all physical assets are valued and recorded on the balance sheet. This presents significant and complex issues of valuation, and industrial countries have adopted different positions on whether the benefits of such an exercise outweigh the costs. Under *modified accrual accounting*, information on physical assets is limited to supplementary reporting (such as the date and cost of acquisition) from a register of assets.

However, even a full government balance sheet, prepared in accordance with generally accepted accounting principles (GAAP), falls well short of providing all relevant information on government resources and obligations. This is because some important obligations of government, such as future social security and welfare payments, have not generally been recognized to date as a liability in any country that has adopted accrual accounting. Only amounts currently due and payable are recognized as a liability. Future obligations have not been judged to meet the definition and recognition criteria of a liability. Nor are future taxes, or the power to tax, recognized as an asset of government. In recognition of the substantial differences between public and private sector balance sheet reporting, governments that produce full balance sheets often also give extensive disclosures of “stewardship” assets and liabilities. The **United States**, for instance, includes disclosures on such assets as defense, natural assets, heritage assets, and social security obligations in addition to its balance sheet statement.² Long-range projections on government receipts and outlays are also provided in this context.

¹For a discussion of the definition and recognition of liabilities of governments see IFAC (2000a).

²For further discussion of the approach to balance sheets in the **United States**, see *United States: Analytical Perspectives*, Budget of the United States (annual publication) at <http://www.access.gpo.gov/usbudget/fy2001/maindown.html>.

The report should include a clear statement of the accounting policies that have been followed with respect to asset valuation.

82. Financial assets are those available to the government to settle liabilities or commitments, or to finance future activities. Financial assets to be reported include cash and cash equivalents;⁷³ other monetary assets, such as gold and investments; and loans and advances. In addition to reporting financial assets according to these categories, additional breakdowns should be provided within each category. For example, investments might be broken down into direct marketable securities, equity investment in private companies, portfolio investment in private companies, and investment in international institutions. Loans and advances receivable might be broken down by sector (e.g., agricultural loans, student loans, and housing loans), and within sector by major loan programs.

83. Foreign exchange reserves held by the central bank should not be reported as part of the central government statement of financial assets for fiscal policy purposes. They are generally held to provide import cover and for possible exchange market intervention, although it is acknowledged that in some countries foreign exchange reserves have been run down as a matter of central government policy for other purposes, including debt repayment, even when held by an independent central bank. Foreign exchange reserves should, however, be reported as part of other transparency requirements (i.e., in the context of monetary or statistical standards), generally by the central bank.

84. Any special characteristics of financial assets, such as being secured against a debt or other specific liability, or any restrictions on the use of an asset or the income deriving from it, should be noted as memorandum items. Any financial assets excluded from reporting should also be noted.

85. The OECD best practice guidelines include disclosure of nonfinancial assets, but not the publication of a government balance sheet. The valuation of nonfinancial assets would be required under accrual accounting.

Consolidated Position of the General Government

2.1.5 Where subnational levels of government are significant, their combined fiscal position and the consolidated fiscal position of the general government should be published.

86. Although the Code is intended to cover the operations of the general government, it is recognized that there are often problems in providing budget data for subnational levels of government at the time the central government budget is presented. This would be the case where subnational levels of government are not required to coordinate their budget presentations with that of the central government. There may also be practical limitations to collecting budget data on a timely basis when the structure of subnational levels of government is quite complex. Under such circumstances, some countries may not be able to present timely information on the consolidated budget position of the general government.

87. While presentation of the consolidated budget position of the general government may not be feasible for many countries, there should be an

⁷³Cash and cash equivalents cover cash on hand, demand deposits, and short-term highly liquid investments readily convertible to cash.

attempt to provide at least ex post information on general government. This can be done through national accounts-based reports, provided these reflect actual budget outturns for the various parts of general government.⁷⁴ A basic requirement of fiscal transparency is that—where they have significant tax powers, expenditure responsibilities, and/or borrowing capacity, and/or they receive sizable transfers—the combined fiscal position of subnational levels of government and the consolidated fiscal position of the general government should be published. Subnational levels of government should also report publicly on their extrabudgetary activities, debt, financial assets, contingent liabilities, and tax expenditures, and on the quasi-fiscal activities of public financial institutions and nonfinancial public enterprises under their control.

88. Best practice is that there should be comprehensive reporting by all levels of government. Countries differ considerably in their approach to this issue, however. Two possible benchmarks could designate best practice. Either comprehensive fiscal data should be compiled by all levels of government using a uniform classification and a consolidated general government financial position should be presented with the annual central government budget; or subnational levels of government that are independent fiscal agencies should observe the same standard of fiscal transparency as the central government.⁷⁵

Obligations Regarding Publication

2.2 A commitment should be made to the timely publication of fiscal information.

89. The Code includes good practices relating to: (1) commitments to publication; and (2) the timing of publication.

Commitments to Publication

2.2.1 The publication of fiscal information should be a legal obligation of government.

90. The use of discretion in deciding whether, when, in what detail, and to whom to release fiscal information can damage a government's credibility. It will often be tempting for governments to be more forthcoming with favorable than with unfavorable information. A long period of inconsistent observance of a policy of full and timely disclosure can result in a high level of uncertainty about the true fiscal position.

91. To build credibility, it should be a legal obligation of governments to publish fiscal information. This is a basic requirement of fiscal transparency. Best practice is that the public availability of a wide range of fiscal information (including official policy papers), with clearly specified and justified exceptions, should be required by law. Examples of national legislation representing best practice in setting clear standards for fiscal reporting are discussed in Box 13.

⁷⁴In the case of subnational levels of government, the compilation need not be based on the actual outturns of all individual governments. It can be based instead on a sample survey that covers the actual budget outturns for a significant portion of total transactions undertaken by subnational government.

⁷⁵**Australia** provides a good example that broadly meets both of these benchmarks. States are independent sovereign agencies and present their budgets independently from the central government. However, states rely heavily on grants from the central government. Therefore, there has been a considerable effort to standardize statistical presentation in line with international standards for all jurisdictions, so that the focus of fiscal policy can be shifted to general government. The **United States** provides a good example of reliance on market forces (and voluntary self-regulation) to discipline the finances of lower levels of government. Because of the degree of independence of state governments, the focus of national fiscal policy is the federal budget. High standards of fiscal transparency are generally observed at all levels of government. The federal government compiles consolidated general government information ex post.

Box 13. Budget Law and Fiscal Transparency

New Zealand's Fiscal Responsibility Act of 1994 is a benchmark piece of legislation, which sets legal standards for transparency of fiscal policy and reporting, and holds the government formally responsible to the public for its fiscal performance. Similar legislation, the Charter of Budget Honesty, has been enacted in **Australia**; and the **United Kingdom** has enacted a Code for Fiscal Stability. Standards of fiscal transparency under such national legislation are generally more demanding than those suggested under the Code.

The Fiscal Responsibility Act principles and standards

The Fiscal Responsibility Act sets out five principles of responsible fiscal management: reducing public debt to prudent levels; requiring an operating balance to be maintained on average over a reasonable time; maintaining a buffer level of public net worth; managing fiscal risks; and maintaining predictable and stable tax rates. The government is permitted to depart from these principles temporarily, provided such departure is clearly justified and a clear plan and time to return to the principles are given.

The Fiscal Responsibility Act then specifies clearly how the government is to report on proposed policies and actual achievements to assure the legislature and the public that the fiscal management principles are being followed. The Fiscal Responsibility Act requires governments:

- to publish a “Budget Policy Statement,” containing strategic priorities for the upcoming budget, short-term fiscal intentions, and long-term fiscal objectives, no later than March 31 for a July 1 fiscal year;
- to disclose the impact of fiscal decisions over a three-year forecasting period in regular “economic and fiscal updates”;
- to present all financial information according to GAAP. This requires presentation of a full set of forecast financial statements and reports—an operating statement, balance sheet, cash flow statement, statement of borrowings, and anything else that is necessary to fairly reflect the financial position of the government; and
- to refer all reports required under the Act to a parliamentary select committee.

Some of the specific fiscal reporting requirements included in the Fiscal Responsibility Act are: a preelection economic and fiscal update to be published between 42 and 14 days before any general election; projections of fiscal trends over a ten-year period, at least; and statements of the government’s commitments and specific fiscal risks, including contingent liabilities. See <http://www.treasury.govt.nz/publications/>.

Similar legislation

Australia’s Charter of Budget Honesty, and the United Kingdom’s Code for Fiscal Stability, are similar in principle to the Fiscal Responsibility Act. Partly because of its federal structure, the Charter of Budget Honesty gives some emphasis to the role of the Australian Bureau of Statistics to set fiscal reporting standards for all levels of government. It also specifically requires an intergenerational report every five years, and a report on tax expenditure. Some of these elements, such as tax expenditure reporting, consolidate and extend existing administrative practice, while others are new requirements.

92. Some countries also have freedom of information legislation that requires government agencies to make available to the public on request any information they hold, subject to certain clearly specified exceptions (which generally include national security, foreign relations, national economic interest, obligations of confidentiality to a third party, law enforcement, and personal privacy). Such legislation can create a presumption in favor of public release and place the onus on government to demonstrate an overriding public interest in nondisclosure.⁷⁶

The Timing of Publication

2.2.2 Advance release date calendars for fiscal information should be announced.

93. In line with the GDDS, advance release date calendars should be announced for the year ahead showing no-later-than release dates for annual reports and a range of dates for more frequent reports.⁷⁷ For example, notice could be given that a particular fiscal report will be released between, say, the fifteenth and eighteenth of a specified month. Countries should also make widely known the name and address of an office or person responsible for providing the latest information about the likely release date. Governments should make a commitment that fiscal reports and data will be released simultaneously to all interested parties.

94. Best practice is represented by the more demanding requirements of the SDDS.⁷⁸ For example, where the release calendar specifies a no-later-than date or a range of dates, the country would announce, by the close of business the prior week, the precise date of release during the following week.

⁷⁶The country with the longest tradition of such a commitment to open government is **Sweden**, where the principle has been enshrined in the constitution since 1776. Members of the public in Sweden (and in a number of other countries) have the right to appeal to the ombudsman—an office independent of the executive that receives and investigates complaints of maladministration—any government agency's decision to withhold information. **Thailand** has recently enacted freedom of information legislation. In other countries, such as the **United States**, there is a right of appeal to a court.

⁷⁷Release calendars could include a statement that the dates are "expected" or "target," but any subsequent delays due to unforeseen events should be announced as soon as they are evident.

⁷⁸For discussion of advance release date calendars, see IMF (1996) and IMF (1998b). See also <http://dsbb.imf.org/>.

3

Open Budget Preparation, Execution, and Reporting

95. Since the annual budget is almost without exception the main instrument of fiscal policy, the budget process and the information contained in and presented with the budget are central to fiscal transparency. Budget preparation and execution should be open in the sense that information is readily available on how budgets are prepared and executed (for instance, budget circulars and information on the budget process should be available to the public). The Code does not specifically advocate participation of civil society in budget processes, though such approaches are not excluded. Nor does openness imply full disclosure to the public at all stages of the budget process. Transparency in this context is necessarily limited by considerations of market sensitivity, due process in policy formulation, and the costs of providing information to the public relative to the expected benefits.

96. Principles and practices relating to openness of the budget process concern budget documentation, budget presentation, procedures for budget execution, and fiscal reporting. The OECD best practice guidelines, which focus on budget transparency, are most relevant to this section of the Code. Box 14 describes the coverage of the OECD guidelines. As they include much that is already in the Code, this section as a result refers only selectively to them.

Budget Documentation

3.1 The budget documentation should specify fiscal policy objectives, the macroeconomic framework, the policy basis for the budget, and identifiable major fiscal risks.

97. The Code includes good practices relating to: (1) fiscal policy objectives and sustainability; (2) fiscal rules; (3) the macroeconomic framework; (4) identifying new policies; and (5) major fiscal risks.

Box 14. OECD Best Practices for Budget Transparency

The OECD issued the *OECD Best Practices for Budget Transparency* in September 2000. While there is a significant overlap between the OECD best practice guidelines and the fiscal transparency Code, the former focuses solely on central government, and on the budget rather than all fiscal and quasi-fiscal activities.

The OECD best practice guidelines are in three parts.

Part I lists the principal budget reports that governments should produce and their general content: the budget; a prebudget report; monthly reports on budget implementation; a mid-year report; a year-end report; a preelection report; and a long-term report.

Part II describes specific disclosures to be contained in the reports: economic assumptions; tax expenditure; financial liabilities and assets; nonfinancial assets; employee pension obligations; and contingent liabilities.

Part III highlights practices that ensure the integrity of reports: accounting policies; systems and responsibility; audit; and public and parliamentary scrutiny.

Fiscal Policy Objectives and Sustainability

3.1.1 A statement of fiscal policy objectives and an assessment of fiscal sustainability should provide the framework for the annual budget.

Fiscal Policy Objectives

98. While the budget has an annual perspective, it should be placed in a wider context. It is important to make a clear statement about the broad objectives of fiscal policy and the sustainability of fiscal policy over the longer term. At the very least, it should be indicated in the budget documentation how the annual central government budget fits in with the government's broader objectives regarding government or public sector finances, and longer-term deficit and debt targets. This could be a mainly qualitative statement supported by a few key figures, in which case it could be included in the preamble to the annual budget or the budget speech. However, such statements are more helpful if they include quantitative detail on government or public sector finances and the longer-term fiscal outlook, in which case this information should be provided in a background paper that is part of the budget documentation.⁷⁹

99. The OECD best practice guidelines suggest the presentation of a prebudget report no later than one month prior to the tabling of the annual budget, stating the government's medium-term economic and fiscal intentions, and highlighting the total revenue, expenditure, the deficit or surplus, and debt.⁸⁰ Such a report can facilitate legislative and public debate on overall fiscal policy objectives and strategy prior to the finalization of the budget by the executive and presentation of the detailed revenue and expenditure proposals to the legislature. It is by no means suggested, however, that the executive

⁷⁹In **Hong Kong SAR**, the annual budget documentation provides a clear statement of fiscal policy objectives and medium-term sustainability. See the ROSC for Hong Kong SAR, Fiscal Transparency Module, paragraph 32, at <http://www.imf.org/external/np/rosc/hkg/index.htm>.

⁸⁰In **South Africa**, a Medium Term Budget Policy Statement is presented to parliament three months before budget day. It contains the macroeconomic assumptions, proposed inter-provincial allocations, the expected functional classification of expenditure, and the expected split between capital and current spending. See Folscher (1999) at <http://www.idasa.org.za>. For a discussion of the prebudget consultation phase in **Canada**, see OECD (1999).

should formulate the whole budget in public. Governments need the space for careful deliberation and decision-making before they expose the full detail of the proposed budget for legislative and public consideration. This is particularly important for tax policy changes. In general, however, the detailed budget proposals should be presented to the legislature in sufficient time to allow careful deliberation before passage of the necessary legislation. The OECD best practice guidelines suggest the presentation of the draft budget to the legislature no less than three months prior to the start of the fiscal year, and approval of the budget prior to the start of the fiscal year.

Fiscal Sustainability Analysis

100. While all countries should provide some indication of the sustainability of fiscal policy, more formal fiscal sustainability analysis would be a demanding requirement for many countries, especially since there are no clear and practical rules for establishing whether fiscal policy is sustainable or not.

101. Fiscal policies are unsustainable if they lead to a buildup of debt to an excessive level, in which case there is a need for change to current policy. However, judgments about excessive debt, and particularly about excessive debt-to-GDP ratios, are hard to make. Economic theory provides little guidance on this. A common approach, therefore, is to rely on a simple rule that specifies, for example, that the debt ratio cannot rise or cannot exceed a specific limit. But this and similar rules are arbitrary, and provide little guidance as to whether a particular debt ratio is a threat to macroeconomic stability, could lead to a loss of fiscal policy credibility, result in higher interest rate premia, etc. This being the case, assessments of fiscal sustainability have to be made on a country-specific basis, relying on particular knowledge about the implications of, and market reactions to, the government's past and future fiscal policies. In this connection, reporting a country's sovereign debt rating, and changes to the rating in recent years, provides one useful guide to sustainability.

102. At a technical level, assessments of fiscal sustainability involve decomposing the change in the debt ratio into components reflecting the *primary balance* (the overall balance excluding interest payments), the interest rate on debt, the growth rate of the economy, and the initial debt stock.⁸¹ From a policy perspective, attention is focused on the change in the primary balance required to meet a debt target (starting from a debt ratio which is judged excessive) or to stay under a debt ceiling over a specified time period. This provides an indicator of the fiscal adjustment required for sustainability. Of course, more relevant for a policymaker is the discretionary adjustment that has to be made, so it is important in the short to medium term that likely cyclical movements in fiscal aggregates are distinguished from necessary structural changes.⁸²

103. The OECD best practice guidelines suggest that a long-term report assessing the sustainability of current fiscal policies should be published every five years, with more frequent publication if there are major revenue or expenditure policy changes. The assumptions underlying the analysis and alternative scenarios should be provided. In the longer term, it is important that, in addition to public debt, policy commitments with a future financial

⁸¹The emergence of new debt-creating obligations that may be excluded from routine fiscal projections—such as contingent liabilities that may have to be honored—should also be taken into account.

⁸²For further discussion of approaches to assessing fiscal sustainability, including for countries where the assessments are affected by special circumstances such as the availability of an exhaustible mineral resource, see Chalk and Hemming (2000).

impact also be properly taken into account. Especially relevant in this regard are public pension programs, the costs of which will be adversely affected by population aging. One way of doing this would be to look at *unfunded public pension liabilities* alongside public debt in assessing sustainability.⁸³

104. An alternative means of looking at the longer-term effects of fiscal policy is through the use of *generational accounting*. This shows the net tax burden on cohorts of individuals over their remaining lifetime. By comparing the net tax burden faced by different cohorts, it is possible to examine the extent to which current policies imply a transfer between generations, and to use this information as a basis for judgments about the sustainability of these policies.⁸⁴

Fiscal Rules

3.1.2 Any fiscal rules that have been adopted (e.g., a balanced budget requirement or borrowing limits for subnational levels of government) should be clearly specified.

105. Fiscal rules are forms of agreement (usually in law) that restrict the fiscal policy action of government. Examples are a balanced budget requirement, borrowing limits (e.g., on access to central bank financing) for the central government or subnational levels of government, a “golden rule” (that public borrowing cannot exceed public investment), the criteria for fiscal convergence in the Maastricht Treaty, and the “close to balance” requirement of the Stability and Growth Pact. It is necessarily true that any rule adopted by a government must be specified in some form. The transparency issue that arises relates to the clarity with which the rule is defined, and the adequacy of reporting against the rule. The golden rule, for instance, is open to interpretation as to what constitutes public investment and so needs to be supported by a clear budget classification. Obviously, if a fiscal rule is to be durable, there must be some flexibility in its application when a departure from the rule is justified by economic conditions. However, the circumstances under which such a departure is justified should be clearly explained. Reporting on performance relative to a rule should also be consistent with other practices of the Code.⁸⁵

Macroeconomic Framework

3.1.3 The annual budget should be prepared and presented within a comprehensive and consistent quantitative macroeconomic framework, and the main assumptions underlying the budget should be provided.

106. This is a basic requirement of fiscal transparency. As part of the broader context in which fiscal policy must be placed, its aggregate impact on the economy and its relation to other macroeconomic policies are critical. Most countries have some formal methodology for macroeconomic forecasting and policy formulation, and advanced economies use sophisticated quantitative models to help frame the budget. Information on the macroeconomic framework should be provided in a background paper that is part of the bud-

⁸³See Chand and Jaeger (1996). Also, the **United States** budget for 1999 contains detailed information on the long-term implications of current fiscal policies. In an “Analytical Perspectives” publication provided as part of the budget documentation projections are given for the budget to the year 2070. The key assumptions are described, and illustrations provided of the sensitivity of the projections to alternative assumptions and scenarios. Long-term (75 year) projections of the income and outgoings of the Social Security and Hospital Insurance Trust Funds are also provided, including the estimated 75-year actuarial balance of the Trust Funds as a summary measure of their financial status (see <http://www.access.gpo.gov/usbudget/fy2001/maindown.html>).

⁸⁴The **United Kingdom** budget for 2000 contains information on generational accounts for the United Kingdom (including comparative information for other countries), in the context of a detailed discussion of long-term fiscal sustainability (see <http://www.hm-treasury.gov.uk/budget2000/fsbr/annexa.htm>).

⁸⁵Kopits and Symansky (1998) discuss fiscal rules in detail.

Box 15. Medium-Term Budget Frameworks: Some Lessons from the Experience of Selected OECD Countries

A medium-term budget framework, if applied rigorously, provides a very clear statement of the revenue and expenditure effects of maintaining current government policies, and a mechanism for controlling the introduction of new policies and tracking budget implementation beyond a single year. It provides a transparent basis for accountability of the executive branch, and a necessary foundation for more detailed results-oriented budgeting. Medium-term budget frameworks have been used successfully by **Germany**, the **United Kingdom**, and **Australia**. Experience in these and other countries, however, suggests that stringent conditions have to be fulfilled before the full benefits can be attained.

What is a medium-term budget framework?

The key characteristics of a medium-term framework are as follows:

- a statement of fiscal policy objectives;
- integrated medium-term macroeconomic and fiscal forecasts;
- estimates of expenditure and receipts of ministries and agencies for two to four years beyond the budget year;
- formal “forward” or “out-year” estimates—the first out-year estimate of expenditure becomes the basis of budget negotiations for the following year; and
- ministries’ and agencies’ budget appropriations become hard budget constraints.

The forward-estimates process has significant technical advantages both for central agencies and individual spending agencies. For the latter, funding for their programs is given a greater degree of predictability, and the requirement for agencies to maintain multiyear estimates also provides greater clarity of policy at a program level. It should also be noted that, particularly in the United

get documentation. One possibility is that this is combined with the discussion of fiscal policy objectives and fiscal sustainability in a fiscal and economic outlook paper, in which context the macroeconomic framework should be extended to support fiscal sustainability analysis.

Medium-Term Budget Frameworks

107. Many countries already present basic fiscal and economic policy statements. In this connection, a distinction needs to be drawn between statements based on medium-term projections of fiscal aggregates, and those based on integrated, consistent, medium-term estimates broken down by individual spending agencies. The latter is sometimes referred to as a *medium-term budget framework*, with the former representing a necessary step toward a medium-term budget framework. Box 15 describes medium-term budget frameworks in more detail. They are administratively and politically demanding, and have been implemented mainly in advanced economies. However, some other countries have successfully implemented them.⁸⁶

⁸⁶In **Hong Kong SAR**, a medium-range forecast is prepared and published as an annex to the budget speech (see <http://www.info.gov.hk/budget01-02/index.htm>). The medium-range forecast involves projections for the budget year plus three years. **Hungary** has also started to present its budget in the context of a three-year outlook for the budget and the economy (see <http://www.meh.hu/default.htm>), as has **Uganda**—see the ROSC for Uganda, Fiscal Transparency Module, paragraph 28, <http://www.imf.org/external/np/rosc/uga/index.htm>.

Kingdom and Australia, the establishment of a strong forward-estimates process has been associated with much greater flexibility for agencies in resource use within the aggregate and program ceilings.

Some lessons drawn from experience

The experiences of the three above-mentioned countries suggest the following conclusions with regard to medium-term budget frameworks:

- fiscal policy objectives and quantitative fiscal targets need to be articulated and defended at the highest level of government;
- robust revenue forecasts are critical, and the target levels of expenditure must be rigorously related to the macroeconomic prospects over the medium term;
- budget and forward estimates are better set in nominal terms to ensure that program managers respond to price changes;
- the framework should be based on clearly defined and fully costed policy proposals; and
- the medium-term budget framework should be accompanied by strengthened measures to review individual expenditure policies and their institutional delivery mechanisms.

Medium-term budget frameworks provide better, more transparent tools for formulating, assessing, and implementing fiscal policy, but they will only be effective if there is a real, stable, transparent, and well-publicized commitment to fiscal control. Medium-term budget frameworks must also be based on fundamental institutional improvements, sustained political commitment, an appropriately phased introduction of improved forecasting and rigorous costing of programs, and disciplined budget management.

108. An important advantage of a medium-term budget framework for developing countries and countries in transition is that it helps link the capital and current budgets. Without the coordination that results from such a link, the usefulness of budget information is limited, and there is often inadequate provision made for operating and maintenance costs. However, for many developing countries and countries in transition, only an aggregate forecast will be feasible. This will nonetheless provide a useful starting point for considering medium-term changes in budget policy. Best practice is that a comprehensive, rolling medium-term budget framework (covering 3–5 years) should be published as a central basis of fiscal management.⁸⁷

Identifying New Policies

3.1.4 New policies being introduced in the annual budget should be clearly described.

109. Clear description, including careful costing, of continuing government programs and new policies are vital elements of budget discipline.

⁸⁷In **Germany**, the Law on Budgetary Principles, for instance, explicitly requires multiyear financial planning by all levels of government. To coordinate this task, a Financial Planning Council comprising the minister of finance (chairman), the minister of economics, the state ministers responsible for financial affairs, and four representatives of municipalities was created in 1968.

Box 16. Statement of Fiscal Risks

A statement should be provided with the annual budget giving an overview of all material fiscal risks, quantified to the extent possible. Where allowance for a risk has been made in a budget contingency reserve this should be noted. The statement should contain information on risks broken down into the following categories:

- (1) **variations in key forecasting assumptions**—the fiscal effects of variations in key assumptions underpinning the macroeconomic forecasts (e.g., the effect on the fiscal deficit of a 1 percent increase or decrease in GDP growth, inflation, interest rates, or the exchange rate from the central rate assumed in the budget forecast); and the fiscal effects of variations in key assumptions underpinning the budget forecasts of revenue and expenditure (e.g., a variation in the effective tax rates, public sector wage increases, or the average number of claimants for social assistance).
- (2) **contingent liabilities**—these may include guarantees, indemnities, and warranties; uncalled capital (e.g., in international financial institutions); and litigation against the government.
- (3) **uncertainty about the size of specific expenditure commitments**—where provision has been made in the budget for expenditure on an item or activity but there is a greater-than-usual degree of uncertainty about the likely cost, the risk should be disclosed. For example, the government may have given a blanket undertaking to depositors of a specified distressed financial institution that their deposits would be honored. However, at the time of finalizing the budget, the cost of this commitment may still be highly uncertain.
- (4) **other items that have not been included in the budget because of the extent of uncertainty about their timing, magnitude, or eventuality**—for example, the government may have announced a general intention to introduce a tax or expenditure policy change, the details of which have not been finalized sufficiently for inclusion in the budget.

⁸⁸A good example of this is the reporting of budget measures in the **United Kingdom**, where a summary table of new budget measures and their estimated fiscal effects is provided in the budget document, and an annex expands upon each new measure in more detail. In **France**, existing policy expenditure (“appropriations for current services”) is clearly distinguished from “items of expenditure reflecting new policies.” This distinction is required by the organic budget law and, under that law, current services appropriations are subject to only one vote in parliament while new policy items are subject to detailed voting processes. See the ROSC for France, Fiscal Transparency Module, paragraph 13, at <http://www.imf.org/external/np/rosc/fra/index.htm>.

⁸⁹In the **United States**, the Congressional Budget Office is required by law to advise the legislature of the estimated costs (and the basis of the estimate) that proposed federal legislation would impose on state and local governments (and on the private sector). See “About CBO,” at <http://www.cbo.gov/respon.shtml>.

Countries should include a statement which describes tax and expenditure policy changes being introduced and their expected fiscal effects as part of the budget documentation.⁸⁸ This allows clear identification of factors causing budget outcomes to diverge from planned spending and thus improves accountability for fiscal policy implementation. It also provides a basis for a disciplined medium-term budget framework. Best practice is that the estimated fiscal effects of all proposed central government legislation, including the cost implications for subnational levels of government, should be made publicly available.⁸⁹

Major Fiscal Risks

3.1.5 Major fiscal risks should be identified and quantified where possible, including variations in economic assumptions and the uncertain costs of specific expenditure commitments (e.g., financial restructuring).

110. Budget estimates and the economic forecasts underlying the budget are subject to a variety of risks, including the effects of variations in the assumptions and parameters underlying the macroeconomic forecasts and individual program estimates, as well as uncertainty over the costs of specific expenditure commitments.⁹⁰ Best practice is that a statement of fiscal risks should be included in the budget documentation as a basis for assessing the budget's reliability as a guide to likely fiscal outcomes.⁹¹ Box 16 describes what should be covered in a statement of fiscal risks.

Budget Presentation

3.2 Budget information should be presented in a way that facilitates policy analysis and promotes accountability.

111. The Code includes good practices relating to: (1) data classification; (2) program objectives; and (3) indicators of the government's fiscal position.

Data Classification

3.2.1 Budget data should be reported on a gross basis, distinguishing revenue, expenditure, and financing, with expenditure classified by economic, functional, and administrative category. Data on extrabudgetary activities should be reported on the same basis.

112. This is a basic requirement of fiscal transparency. Budget transactions need to be capable of being reviewed from the perspective of their economic impact, the form of appropriation, administrative control, and their purpose. A recording and classification system that meets these needs provides the foundation for the presentation of the budget, final accounts, and other fiscal reports.

Comprehensiveness and Compatibility with GFS

113. The data classification system should comprehensively cover the broadly defined budget. The data classification system should also be compatible with GFS standards for data classification in the sense that distinctions at a transactions level should permit generation of GFS-consistent reports.⁹² The use of the GFS or another widely accepted classification system is also a basic requirement of fiscal transparency. A classification by administrative category is important for internal control purposes. Classifications and subclassifications should be consistent with the analytical distinctions in the current *GFS Manual*.⁹³ However, it should be emphasized that the GFS is a reporting standard for fiscal statistics and not an accounting or financial reporting standard. The differences are discussed in Box 17.

114. Aside from providing an analytical framework that facilitates assessment of the aggregate impact of government transactions on the economy, the GFS provides a widely accepted standard for an *economic classification* of

⁹⁰There may be some instances where there are legitimate public policy reasons not to quantify a fiscal risk; this might be the case, for example, where to do so would result in disadvantage to the government in negotiations with third parties. The existence and nature of the risk should however still be disclosed.

⁹¹In recent years **Greece** has strengthened its reporting of fiscal risks. Risks from variations in macroeconomic assumptions, contingent liabilities, and other uncertainties are now examined in the budget document. See <http://www.imf.org/external/np/rosc/index.htm.gr>, where IMF Staff Country Report No. 99/138 (pp. 49–53) discusses fiscal transparency in Greece. An example of comprehensive reporting of information on fiscal risks in the annual budget is provided by **New Zealand**. See <http://www.treasury.govt.nz/forecasts/befu/2001/>.

⁹²See Box 7 for discussion of the relationship between GFS classification and various types of fiscal reporting.

⁹³Although the GFS is not the only fiscal statistical reporting standard (the SNA and ESA provide alternatives that are close in concept), the current *GFS Manual* provides the most generally accepted international point of reference for purposes of classification of fiscal statistics.

Box 17. Fiscal Transparency and International Standards for Financial and Fiscal Reporting

Efforts are being made to improve accounting and financial reporting standards by a number of governments. The work of IFAC and the proposed revision of the *GFS Manual*, together with the Code, are further steps toward development of standards that will help improve international comparability of data and contribute to improved fiscal transparency. It is important to distinguish the different objectives of these initiatives, and to coordinate work in all three areas as closely as possible.

IFAC-PSC Study (<http://www.ifac.org>)

The Public Sector Committee (PSC) of IFAC in May 2000 released its study on financial reporting *Governmental Financial Reporting* at <http://www.ifac.org/Guidance/Pub-Download.tmp?PubID=960182179426> to help national governments prepare financial statements that provide information on the financial performance and position of the government. The study discusses the principles that are the basis for international public sector accounting and reporting standards now being developed by the PSC as part of its continuing standards project. The PSC has released the first eight International Public Sector Accounting Standards (IPSAS) and a further six exposure drafts that are intended to lead to standards. For the most part, the IPSAS are based on modification of International Accounting Standards designed for the private sector and modified for applicability to the public sector. ED 9, however, proposes to establish requirements for financial reporting under cash accounting. These principles will be of value for most governments that operate a near cash basis system.

GFS revision

The GFS is not an accounting or financial reporting standard, but a standard for analytical reporting of fiscal statistics; GFS looks at economic impact rather than accounting entity performance. It is desirable that government accounts classification and financial reporting standards be developed in a way that is compatible with the generation of such statistical reports, so that a single information

revenue and expenditure and adopts the UN *Classification of the Functions of Government* (COFOG)⁹⁴ as its *functional classification* framework. Using these standards of classification facilitates international comparisons of budget statements and provides a basis for tracking the economic impact of the budget. However, neither classification is intended to meet the needs of administrative or program control, which requires a breakdown of major economic and functional categories of expenditure for individual spending agencies or programs.

115. It is important that all military spending is recorded and reported under the defense function, including that which is financed by off-budget or commercial revenue sources. While national security considerations are often used to argue against transparency in this area, a multilateral approach to greater openness could reduce security risks. Security considerations may,

⁹⁴See <http://esa.un.org/unsd/cr/registry/regrt.asp>.

system can meet both accounting and fiscal reporting needs. It is also important that GFS fiscal reports be completely reconciled with government budget reports and the final accounts to provide assurance of data reliability and comprehensive coverage of the fiscal accounts. The GFS is being revised and a full draft is available at <http://www.imf.org/external/pubs/ft/gfs/manual/index.htm>. The revisions recognize the growing importance of accrual concepts for government accounting and aims to harmonize GFS completely with other international financial statistics systems (notably the SNA) that use accrual concepts. The proposed revision would not require that countries adopt accrual accounting; a staged transition is envisaged, and countries could adjust data from their cash accounts, or, in many cases use cash data where differences between cash and accrual are not substantial.

Fiscal transparency

The Code is fully supportive of the application of an accrual basis GFS and IPSAS. It is highly desirable for countries operating on a near cash basis that disclosure of fiscal activity go beyond a simple cash flow report. As discussed below, a number of the basic requirements of the Code stipulate reporting of data that go well beyond pure cash financial reporting standards. Some of these are encouraged under the proposed IPSAS on cash accounting as additional disclosures, others would be adopted in financial statements as a government moves toward an accrual system. The Code, however, is intended to apply irrespective of the nature of the accounting system. The Code emphasizes as basic requirements that (1) all countries report on financial assets and liabilities—introducing some elements of a modified accrual standard; and (2) all countries should aim to have an accounting system that can produce reliable reports on payment arrears. Such reports could be produced at a memorandum level by a cash system. The need to extend to an accruals system—in which accounts payable are automatically recorded as expenditure—should be determined by each country on an as-needed basis.

however, warrant a somewhat different approach to auditing the details of military spending.⁹⁵

Consistency with Administrative Accountability

116. The classification system should also allow a clear tracing of responsibility for the collection and use of public funds. Most countries have relatively sound administrative classifications for this purpose, often to subdepartmental levels; in some countries, however, the classification does not allow detailed specification of administrative responsibilities. This is a particular problem in countries in transition where, under the former planning regime, the primary budget allocation was by broad functional category and allocations were made to individual spending units during the year. Many of

⁹⁵See paragraph 170.

these countries are changing their classification system to promote administrative accountability.⁹⁶

Program Objectives

3.2.2 A statement of objectives to be achieved by major budget programs (e.g., improvement in relevant social indicators) should be provided.

117. Transparency and accountability in government require that the budget and accounts be related to objectives and results of government activity, rather than simply to the items on which money is spent as in traditional *line-item budgeting*. Modern budgeting tries to identify as far as possible the objectives of government activities and to measure *outputs and outcomes* in relation to these objectives. An important element of early efforts in this direction is the classification of expenditure into “program,” “subprogram,” and “activity” categories, defined with increasing specificity at the more detailed levels in relation to a clearly stated set of objectives.⁹⁷ Thus expenditure on a “public health” program could be linked to governments’ broad aims of promoting preventative health care, and more specific objectives would be given in, say, an antimalarial subprogram. Classification of government activities by program is now widely practiced, and its further implementation will help improve transparency. However, it must be stressed that a *program classification* supplements rather than replaces the traditional administrative classification discussed in the preceding section.⁹⁸ The elements of a program classification will be particularly important for those countries seeking to identify and track expenditure aimed at poverty reduction in connection with Highly Indebted Poor Countries debt relief or a Poverty Reduction and Growth Facility arrangement with the IMF.

118. Recent efforts in advanced economies have emphasized a need to increase the authority and incentives for line managers to achieve agreed results. A number of countries are developing sophisticated systems of results-oriented budgeting and accounting. These efforts are very important for increasing transparency of strategic and operational choices made through government budgets. Best practice is that transactions should be classified by activity or output, and by program or outcome. Detailed financial and nonfinancial information for all outputs/activities and programs/outcomes, together with comparable information for the previous year, should be part of the budget documentation.⁹⁹ The emphasis is primarily on transparency at an aggregate level, and on putting in place a framework that is conducive to the provision of progressively more detailed information on the impact of budget decisions. Many of the techniques being applied in advanced economies place a heavy demand on administrative resources, and are not therefore appropriate for developing countries or countries in transition. But all countries have the capacity to specify clear objectives for at least the major services provided by the government.

⁹⁶For example, the 1998 budget in **Ukraine** introduced a basic GFS-consistent economic classification of expenditure and, for the first time, showed budget allocations by main spending agency.

⁹⁷The **United States**, through its Planning, Programming, and Budgeting System, represented the leading example in the mid-1960s.

⁹⁸It should be noted that a program classification is conceptually distinct from the GFS/COFOG functional classification, since government program objectives may be served by activities in several functional areas (an antimalaria subprogram, for instance, could have an educational component, an agricultural drainage component, and a health component). Nonetheless, in practice, some program classifications have been based on COFOG at higher levels of categorization.

⁹⁹Access to detailed work on these issues in the OECD and to individual country sites is provided through the OECD/PUMA website, <http://www.oecd.org/puma/links.htm>.

Indicators of the Government's Fiscal Position

3.2.3 The overall balance of the general government should be a standard summary indicator of the government's fiscal position. It should be supplemented where appropriate by other fiscal indicators for the general government (e.g., the operational balance, the structural balance, or the primary balance).

119. The current GFS definition of overall balance of government,¹⁰⁰ while not adopted universally, provides a widely used reference point for fiscal policy analysis. It aims to identify those transactions of government that result in net borrowing from other economic sectors (and are “deficit or surplus creating” or “above the line”), and provides a focus for analysis of the size of the deficit/surplus and its components, as well as the sources of deficit financing (or “below-the-line” transactions). The overall balance provides an indication of the impact of fiscal policy on aggregate demand. While components of deficit financing indicate more specific consequences of fiscal policy (e.g., the impact of borrowing from the central bank on money supply and inflation and the impact of domestic borrowing on interest rates, investment, and growth).

120. While it is recommended that analysis of the government's fiscal position should be based on the overall general government balance, there are some qualifications to this. First, practical or constitutional reasons may mean that in many countries the overall balance of central government is the standard measure of the fiscal position. Second, in some situations the central or general government balance should be supplemented by a measure of the broader *public sector balance*.¹⁰¹

121. Third, the overall balance measure has acknowledged shortcomings in some circumstances. However, these can be largely overcome by providing supplementary information on alternative balance measures to meet particular policy needs. The primary balance should be routinely reported for countries with substantial public debt or deteriorating debt dynamics. The operational balance (the overall balance minus the part of debt service that compensates debt holders for inflation) is often reported when there is high inflation.¹⁰² The structural or cyclically adjusted balance (which, in various forms, removes the effects of cyclical fluctuations or exogenous shocks from the overall balance) is used in a number of advanced economies to judge the stance of fiscal policy. There are also circumstances where it might be appropriate to exclude certain items from the overall balance where these items are large and possibly highly variable, and thus make the overall balance a misleading indicator of the macroeconomic impact of fiscal policy and fiscal trends. The overall balance excluding grants and the nonoil fiscal balance are examples.¹⁰³

122. In addition to the need for such supplementary measures, a further concern about the overall balance is that it is a cash-based indicator which does not properly reflect the impact of balance sheet transactions. It is generally recommended, for instance, that the proceeds from asset sales be treated as financing rather than revenue, negative capital expenditure, or negative net

¹⁰⁰The term actually used throughout the current *GFS Manual* is “overall deficit/surplus.”

¹⁰¹See paragraph 126 for further discussion of the public sector balance.

¹⁰²See Tanzi, Bléjer, and Teijeiro (1993).

¹⁰³The various concepts of the fiscal balance are discussed in Bléjer and Cheasty (1993).

lending.¹⁰⁴ More generally, some countries identify an “underlying balance” net of asset sales to remove these proceeds from above the line in a cash presentation of the balance. Similarly, bank restructuring costs, which usually reflect a combination of balance sheet operations (transfer of government bonds or assumption of debt) and quasi-fiscal activities (central bank loans), do not impact the overall deficit in the same way as direct budget support.

123. In an integrated government *accounting system*, under accrual or modified accrual accounting, it would be necessary to reconcile debt transactions with the operating accounts. Under cash accounting, IFAC recommends that the disclosure of assets and liabilities should be comprehensive and permit such a reconciliation to be made. However, accounting for transactions in this way does not necessarily give a true reflection of their economic impact, which may reflect earlier policies. Thus the need to recapitalize a bank may result from accumulated past quasi-fiscal activities (e.g., directed credit), so that the impact would have been understated in the past but overstated when recapitalization takes place. This point notwithstanding, it is essential for transparency that such transactions be fully identified and made public by the government.

124. Another point of contention is the appropriate way to treat grants. In the current *GFS Manual*, these are treated as “above the line” or deficit-reducing receipts. However, since these flows are not directly under the policy direction of the recipient government, some argue that they are better treated “below the line” as financing items. To indicate potential issues related to these receipts, in countries with large grant inflows it is common to identify the overall balance inclusive and exclusive of grants.

125. Many of these issues will be addressed by adopting an accrual basis for fiscal reporting since it fully and properly reflects changes in government assets and liabilities. Although a cash overall balance will continue to be used by many countries for some time, the revised *GFS Manual* will use accrual standards for fiscal reports, in line with other economic statistics standards. Moreover, the need to supplement cash basis financial reporting by at least some elements of accrual reporting is being increasingly recognized. Several countries are adopting an accrual or modified accrual accounting standard.¹⁰⁵ In addition to using the overall balance and supplementary indicators for macroeconomic analysis, it is important that these concepts be clearly applied in presenting the annual budget to the legislature and in public discussion. In many countries, budget estimates and the final accounts are presented simply in a cash-accounting format (showing gross receipts and outlays). To provide assurance of the reliability of data in GFS fiscal reports, the overall balance should be reported in budget and accounting reports with an analytical table showing its derivation from budget data.

The Public Sector Balance

3.2.4 The public sector balance should be reported when nongovernment public sector agencies undertake significant quasi-fiscal activities.

126. As emphasized elsewhere, many governments conduct extensive quasi-fiscal activities outside the budget, which are not captured in the con-

¹⁰⁴See Mackenzie (1998).

¹⁰⁵See the ROSCs for **Australia, France, and the United Kingdom**, at <http://www.imf.org/external/np/rosoc/index.htm>.

ventional measure of the overall fiscal balance. This means that standard measures of the fiscal position can present a distorted picture of the extent of fiscal activity, and can contribute to poorly designed fiscal policies. It can also mean there are incentives to move fiscal activities outside government to make the fiscal position look better than it is. The publication of a statement on the nature and extent of quasi-fiscal activities is therefore a basic requirement of fiscal transparency. However, identification and quantification of quasi-fiscal activities depend critically on high-quality reporting by public financial institutions and nonfinancial public enterprises. Given that improvement in this regard is unlikely to be rapid, an alternative is to establish a system of reporting that covers the broader public sector and to use the public sector balance as an additional measure of the government's fiscal position. This is clearly appropriate where quasi-fiscal activities are judged to be extensive, and is desirable in any country where the public sector is much larger than general government. Some of the issues involved in reporting the public sector balance are discussed in Box 18. It should be emphasized that reporting the public sector balance does not mean that clear boundaries no longer need to be established between different parts of the public sector, nor does it diminish the need to identify and report on quasi-fiscal activities.

Procedures for Budget Execution

3.3 Procedures for the execution and monitoring of approved expenditure and for collecting revenue should be clearly specified.

127. The Code includes good practices relating to: (1) the accounting system; (2) procurement and employment; (3) internal audit; and (4) tax administration.

The Accounting System

3.3.1 There should be a comprehensive, integrated accounting system which provides a reliable basis for assessing payment arrears.

128. This is a basic requirement of fiscal transparency. Accounting systems should be based on well-established internal control systems, allow for the capture and recording of information at the commitment stage, generate reports on payment arrears, cover all externally financed transactions in a timely way, and maintain records on *aid-in-kind*. Best practice is that the accounting system should have the capacity for accounting and reporting on an accrual basis, as well as for generating cash reports.

Internal Control Systems

129. Internal control systems are intended to provide assurance that management's objectives are being achieved.¹⁰⁶ Responsibility for internal control therefore rests with the head of each individual government agency. However,

¹⁰⁶Under this broad definition, internal control covers administrative controls (procedures governing decision-making processes) and accounting controls (procedures governing the reliability of financial records).

Box 18. The Public Sector Balance

Public sector quasi-fiscal activities can be conducted through the central bank, public financial institutions, or nonfinancial public enterprises. A relatively narrow extension of the general government balance could be where the main concern is with quasi-fiscal activities of the central bank and public financial institutions. Mackenzie and Stella (1996) suggested that central bank losses could be amalgamated into an adjusted fiscal deficit. Other forms of *augmented balance* (see, for instance, Daniel, Davis, and Wolfe, 1997) have also been advocated to capture balance sheet transactions such as assumption of debt, and some forms of these are used on a pragmatic basis in some Fund programs. Operationally, however, it is now considered more practicable to encourage broader institutional-based reporting rather than to attempt to derive a hybrid balance concept.

A fully consolidated public sector balance would in principle have the potential to capture many quasi-fiscal activities wherever they are conducted, and to present a more accurate measure of fiscal activity and the macroeconomic impact of government. Consolidated reporting would also facilitate cross-checking of transaction flows between subcomponents of the public sector.

In practice, the overall balance of the nonfinancial public sector is the expanded balance concept of most relevance. In many countries, nonfinancial public enterprises are used for a variety of quasi-fiscal purposes. In such cases the balance of the nonfinancial public sector should be reported, calculated by adding the net balance of public enterprises to government revenue or expenditure. This will be particularly important where nonfinancial public enterprises are large, where government taxes or subsidizes through them, crowds out the private sector through them (e.g., by paying above-market interest or wages), and accumulates debt or lends through them.

Consolidating only the nonfinancial public sector in the overall balance preserves the separate identification of the financing of the government and nonfinancial public enterprises by the central bank and/or public financial institutions. In those countries where the central bank and/or public financial institutions are also involved in extensive quasi-fiscal activity, it may be desirable for some analytical purposes to also calculate and report a fully consolidated public sector balance.

The overall balance of the nonfinancial public sector should be presented alongside the overall balance of general government. This is important for diagnosing the sources of fiscal problems, and for preserving the key distinction between general government and nonfinancial public enterprises, which, while used to some extent to carry out fiscal policy, are usually primarily concerned with commercial objectives. Separate treatment of subsectors also helps reduce the possibility that presentation of a nonfinancial public sector balance could be construed as implying the government is more likely to use nonfinancial public enterprises for fiscal purposes.

On the other hand, the fact that governments own these institutions and have the capacity to direct them to conduct quasi-fiscal activities—whether or not they currently exercise that capacity—argues for the importance of more general reporting of supplementary information on the nonfinancial public sector balance. The application of generally accepted accounting standards (which focus on the ability to control as a criterion for consolidated reporting) to government financial reporting may in the future provide added impetus to reporting on the fully consolidated public sector, with separate reporting by subsector.

Box 19. INTOSAI Guidelines for Internal Control Standards

INTOSAI has issued a set of general and detailed standards defining a minimum level of acceptability for a system of internal control.

General standards

- Specific control objectives are to be set for each activity of the organization, and are to be appropriate, comprehensive, reasonable, and integrated into the organization's overall objectives.
- Managers and employees are to maintain a supportive attitude to the standards at all times, and are to have the integrity and sufficient competence to meet the standards.
- The system is to provide reasonable assurance that the objectives of an internal control system will be met.
- Managers are to continually monitor their operations and to take prompt remedial action where necessary.

Detailed standards

- Full documentation of all transactions and of the control system itself are to be provided.
- Transactions and events should be promptly and properly recorded.
- Execution of transactions and events should be properly authorized.
- Key responsibilities at different stages of a transaction should be separated among individuals.
- Competent supervision is to be provided to ensure control objectives are being achieved.
- Access to resources and records is to be limited to authorized individuals who are accountable for their custody or use.

a central government agency might be assigned responsibility for developing a government-wide standard approach to internal control.

130. As defined by INTOSAI, the objectives of internal control systems are to promote orderly, economical, efficient, and effective operations; to safeguard resources against loss due to waste, abuse, mismanagement, errors, and fraud; to adhere to laws, regulations, and management directives; to develop and maintain reliable financial and management data; and to disclose these data in timely reports.¹⁰⁷ To be effective, internal controls must be appropriate, function consistently as planned throughout the period, and be cost-effective. A set of guidelines for internal control standards issued by INTOSAI is summarized in Box 19. Internal control systems in all countries should conform to INTOSAI guidelines.

131. An example of a government-wide approach to internal control is that taken in **France** and in countries based on the French administrative system, where there is a clear distinction imposed by law between the public agency requesting a payment, a special unit of the ministry of finance that approves

¹⁰⁷See INTOSAI (1992).

all expenses, and the accounting department of the ministry of finance that makes all payments.¹⁰⁸ Other systems also separate the power to authorize commitments from that of making payments, but are more decentralized and emphasize the responsibility of management of each individual government agency for setting a sound control environment.

Assessment of Arrears

132. In addition to being an indicator of serious flaws in fiscal management, a failure to identify arrears—on the payments or receipts side—can be a major impediment to fiscal transparency. To the extent that arrears are unreported, the fiscal position is wrongly stated. Effective government accounting systems should provide enough information to assess the extent of payment or tax arrears.

133. Cash accounting in government understates the real government deficit to the extent that governments have substantial or persistent payment arrears (e.g., to suppliers, employees, and pensioners). Payment arrears are rarely an issue in advanced economies, but are only too common in developing countries and countries in transition, for the reasons given in Box 20. This problem can often arise more from poor budget preparation than from accounting system weaknesses, but a robust accounting system does help to remedy the problem and avoid its recurrence.

134. A basic requirement of fiscal transparency is that cash accounting reports should be supplemented by accounts-based reports of bills due for payment to assess arrears.¹⁰⁹ Data on arrears would not be generated as a matter of course from a simple cash accounting system, but should be provided in supplementary reports. Therefore, all governments should move toward an accounting standard that facilitates end-period reports on accounts due for payment as well as reports on a cash basis—whatever basis of accounting is used. An accrual or a modified accrual system would achieve this objective, and may be appropriate for some countries.

135. On the revenue side, governments must also account for taxes and other revenue that have not been received on time.¹¹⁰ For example, the stock of tax arrears can be substantial, but it is difficult to know how much of the stock is actually collectible because many countries do not write off bad debts. As with the expenditure side, it is essential that the tax administration and accounting systems recognize and record payments due, and that, to the extent possible, they report the monthly and annual flows of unpaid taxes, penalties, and interest.¹¹¹

Coverage of Domestic and Externally Financed Transactions

136. The accounting system should bring all public transactions to account in a timely way, and cover both domestic and externally financed transactions. In developing countries with large external aid inflows, it is common that many externally financed transactions are not captured by the government accounting system. Sometimes this occurs as a direct consequence of donor

¹⁰⁸Tunisia provides a good example of this organization of internal control following the French system. See the ROSC for Tunisia, Fiscal Transparency Module, at <http://www.imf.org/external/np/rosc/tun/index.htm>.

¹⁰⁹See more detailed discussion of these issues in Potter and Diamond (1998) and IFAC (2000a).

¹¹⁰Since tax revenue is compulsory and unrequited, there are more difficulties in establishing recognition points to establish tax liability than on the expenditure side. IFAC (2000a) notes a number of possible recognition points that could apply under an accrual system and gives examples of recognition points for different taxes (paragraphs 517–28), but notes that “because of the differences in legislation and administrative systems across countries, it is possible that different countries will have different recognition points for similar taxes” (paragraph 524).

¹¹¹Although offsetting arrangements are generally not recommended in government transactions, it is important that a unified approach be taken to assessment of tax liabilities. A single taxpayer identification number and tax file for each taxpayer would permit such an assessment; if a taxpayer is in arrears for one tax and entitled to a refund from another tax, the refund could be used to offset the tax arrears.

Box 20. Stages of Payment and Payment Arrears

A payment arrear occurs when a bill or other obligation is due for payment but is not paid on or before the due date. To assess arrears, it is necessary to identify both when a bill is due for payment and whether or not actual payment has occurred. In a typical payment process, all accounting systems observe four basic stages:

- **commitment:** a prospective expenditure resulting from placement of an order, signing of a contract, or other agreement for the provision of goods or services;
- **verification:** confirmation by the authorized receiving agent that an ordered good or service has been received and, thereby, that a liability and due date of payment are recognized;
- **payment issue:** issuance of a check or payment order to the supplier of a good or service or to meet a transfer obligation fallen due; and
- **cash payment:** payment of cash or transfer of funds to a supplier or recipient's account after presentation and processing of check or payment order.

In advanced economies, it is customary for many suppliers of goods and services to provide between 30 and 60 days of credit from the verification to the payment-issue stage. That is, bills are “payable” after verification, and “due for payment” after the lapse of whatever credit period is allowed. Cash and *modified cash accounting* systems record and report expenditure on a “payments issue” (or sometimes on a “cash-payment”) basis. However, with less-developed accounting systems, it is often difficult to get reliable estimates of earlier payment stages and of accounts due for payment. Accrual and modified accrual accounting systems record and report expenditure at the point of verification, and generally maintain more comprehensive records for all stages of payment. It is therefore easier to assess payment arrears from these latter systems.

financing arrangements. For example, expenditure may be debited directly to donor agency or trust accounts, and special accounting arrangements may be set up to ensure accountability to the donors, usually at the expense of transparency and accountability in the recipient country. All countries (with donor country support, where appropriate) should develop comprehensive and integrated accounting systems covering public transactions, irrespective of the source of financing. Cash systems can meet this objective, the principal requirement being that special measures should be taken to ensure that all transactions are accounted for in a timely way.

Aid-in-Kind

137. A related and very common weakness in accounting systems of many developing countries is that noncash aid is rarely fully recorded. This means that the public accounts do not reveal the true level of resources used nor their allocation by sector, organization, or region. An equally important fail-

ing is that assets thereby created or acquired are not recorded in a way that helps to identify long-term operations and maintenance needs. The transfer of such assets to the government when donor financing is completed can then lead to unexpected pressures on the budget. There are also problems with the timely recording and valuation of such assistance, and some measures should be taken to include aid-in-kind transactions to improve transparency. Cash systems are generally unsatisfactory as a means of tracking such transactions, and a full accrual system would be needed to deal with nonfinancial assets in a fully integrated way. It is proposed that all countries maintain at least memorandum-level records of significant receipts of aid-in-kind, showing forecast receipts in the budget and audited receipts with the annual accounts.

Procurement and Employment

3.3.2 Procurement and employment regulations should be standardized and accessible to all interested parties.

¹¹²Korea provides a good example of a clear, comprehensive and transparent framework at all levels of the general government for procurement and tendering. See the ROSC for the Republic of Korea, Fiscal Transparency Module, paragraph 22, at <http://www.imf.org/external/np/rosc/kor/index.htm>, paragraph 22.

¹¹³Guidelines on public procurement are available through the OECD/PUMA website, <http://www.oecd.org/puma/sigmaweb/pubs/pbno3.htm>, which cites relevant legislation under multilateral trade arrangements like the World Trade Organization's *Government Procurement Agreement* (http://www.wto.org/english/docs_e/legal_e/final_e.htm) and the European Union's *Procurement Directives* (<http://formby.wiganmbc.gov.uk/pub/hsu/eudirect.htm>), which set legal obligations for national systems and practices.

¹¹⁴See <http://www.uncitral.org/english/texts/procurem/proc93.htm>. One such country is **Poland**, which received technical assistance from OECD/SIGMA. It operates a highly decentralized procurement system, with a central public procurement office responsible for developing rules and regulations.

Procurement and Tendering

138. Contracting for goods and services, particularly where large contracts are involved, must be open and transparent to provide assurance that opportunities for corruption are minimized and that public funds are being properly used. Similar considerations should apply to contracting out government services or management processes, and to privatization.

139. Appropriate tendering mechanisms should be set up for contracts above a threshold size, and procurement regulations should give independent authority to a tender committee or board and require that its decisions be open to audit.¹¹² Where services formerly provided within government are contracted out to the private sector, these procedures should be subject to the same or similar procurement regulations.¹¹³ In this area, the OECD and the World Bank have helped a number of countries establish modern procurement systems, and good progress has been made in countries in transition toward establishing sound and transparent procurement systems. Some countries developed a procurement law based on the United Nations Commission on International Trade Law (UNCITRAL) *Model Law on Procurement of Goods, Construction, and Services*.¹¹⁴

Employment

140. Procedures governing employment in the public service should be clearly specified and accessible. Any public-service-wide recruitment and pay regulations should be published. Vacancies should be advertised and filled through competition, with clearly defined selection criteria. In a number of advanced economies, significant powers are being delegated to agency heads to set their own recruitment and—within varying limits—pay policies. Clarity and openness of procedures, of course, remain fundamental requirements.

Internal Audit

3.3.3 Budget execution should be internally audited, and audit procedures should be open to review.

141. Effective internal audit by government agencies is one of the first lines of defense against misuse and/or mismanagement of public funds.¹¹⁵ It should be based on a sound internal control environment, and not seen as a substitute for one. Checking by internal auditors also provides valuable material for the review of financial compliance by external audit agencies. The existence and effectiveness of internal audit should be assured by requiring that internal audit procedures be clearly described in a way that is accessible to the public, and that the effectiveness of these procedures should be open to review by the external auditors.

Tax Administration

3.3.4 The national tax administration should be legally protected from political direction and should report regularly to the public on its activities.

142. Tax administration should be, and be seen to be, conducted in a fair and impartial manner, free of political intervention. For this reason, heads of tax administration should be appointed by law, and be given some statutory protection against removal from office and political direction in interpreting tax laws. The statutory appointment of tax commissioners with clearly specified powers over interpretation of tax laws is one approach that helps to provide assurance of integrity. The tax collection process should also be open, and to this end revenue collecting agencies should provide a timely annual report to the legislature on their activities during the year. These reports, as well as covering performance data such as actual collections relative to budget, should provide details of actions being taken to improve compliance with tax laws. A recent development in some advanced countries is a requirement to publish with new or amended tax legislation a statement of the compliance cost of proposed measures.¹¹⁶

Fiscal Reporting

3.4 There should be regular budget reporting to the legislature and the public.

143. The Code includes good practices relating to: (1) budget and extrabudgetary outturns; (2) final accounts; and (3) program results.

Budget and Extrabudgetary Outturns

3.4.1 A mid-year report on budget developments should be presented to the legislature. More frequent (at least quarterly) reports should also be published.

¹¹⁵Internal audit is defined here as internal to the executive branch of government, and independent audit as external to the executive. Internal audit therefore covers both an audit of an agency by staff of the agency itself (ideally, reporting directly to senior management) and an audit of an agency by another agency (e.g., by an audit body under the control of the ministry of finance or the prime minister).

¹¹⁶In **Australia**, these are referred to as “compliance cost impact statements.”

Periodicity and Timeliness

144. This is a basic requirement of fiscal transparency. Effective fiscal management depends on timely, reliable, within-year information on the government's fiscal position. The mid-year budget report should contain a comprehensive analysis of budget implementation, including comparisons for all major revenue, expenditure, and financing items with mid-year figures for the preceding year and mid-year estimates for the budget. There should also be an updated forecast of the budget outcome for the current fiscal year, identifying the main factors causing a deviation between the budget and the expected budget outcome (e.g., changed economic assumptions, new policies, contingencies, changes in the timing of revenue or expenditure). It is a basic requirement of fiscal transparency that this report should be presented to the legislature within three months of mid-year. This is consistent with establishing accountability for appropriate responses to changing economic or fiscal circumstances, and is therefore a basic requirement of fiscal transparency. The OECD best practice guidelines suggest that the mid-year report should be presented to the legislature within six weeks of the end of the mid-year. GDDS standards for periodicity and timeliness of other central government fiscal reports to the public should be followed (each quarter within a quarter of the end of the period). These reports should contain details of revenue, expenditure, the fiscal balance, and financing with breakdowns (debt holder, instrument, currency, as relevant). Reporting of interest payments is encouraged. The SDDS requires that a monthly budget report should be published with a lag of a month, and this is best practice.¹¹⁷ For ease of reference, Box 21 sets out the GDDS and SDDS standards relevant to fiscal transparency.

145. It is also a basic requirement of fiscal transparency that details of central government debt and financial assets should be published annually, within six months of the end of the fiscal year. However, where public debt is significant, quarterly reporting should be an objective. Financial assets should generally be reported with the same frequency as debt. Information on debt should include the outstanding stock of debt for the current year and two prior years, and debt servicing costs for the same period. Best practice in debt reporting is the SDDS requirement that the central government debt should be reported quarterly, with a lag of a quarter.¹¹⁸ It is also recommended under the SDDS that debt service projections for medium- and long-term debt should be reported quarterly for the coming four quarters and on an annual basis thereafter. Projected repayments of short-term debt should always be reported on a quarterly basis.

General Government Coverage

146. Ideally, quarterly or mid-year reports should cover the general government fiscal position and provide a basis for assessing whether or not the broader fiscal targets that provide context for the budget can be achieved. However, as already noted, many governments will not be able to provide full and timely coverage of subnational levels of government in fiscal reports. But

¹¹⁷In Sweden the government is required to report to parliament at least twice a year on the expected budget outcome, the state debt, and discrepancies between outcome and the original budget forecasts. Detailed monthly reports on fiscal performance are published on the website of the National Financial Management Authority. See the ROSC on Sweden, Fiscal Transparency Module, paragraph 17, at <http://www.imf.org/external/np/rosc/swe/index.htm>.

¹¹⁸The OECD best practice guidelines suggest that debt should be reported with a lag of a month.

Box 21. Fiscal Transparency and Data Dissemination Standards

The fiscal transparency Code and Manual generally adopt identical standards for coverage, periodicity, and timeliness of data dissemination to those set by the SDDS and the GDDS. The Code does, however, deal in addition with dissemination through budget documentation and published audited final accounts, which are not explicitly covered in SDDS/GDDS. It also gives greater emphasis to disclosure of certain elements, such as contingent liabilities. In the terminology used in the fiscal transparency Manual, standards under the SDDS generally correspond to best practice, and the GDDS to basic requirements. The relevant SDDS/GDDS standards are set out in the table below.

Fiscal sector	SDDS	GDDS
Central government operations		
Coverage	A	A
Periodicity	Monthly	Quarterly
Timeliness	One month	One quarter
Central government debt		
Coverage	B	D
Periodicity	Quarterly	Annual—quarterly encouraged
Timeliness	One quarter	1–2 quarters
General government/public sector operations		
Coverage	C	E
Periodicity	Annual	E
Timeliness	Two quarters	E

A Covers budget and extrabudgetary funds, showing fiscal balance and main components of deficit/surplus and financing; identification of interest payments is encouraged.

B Breakdown by maturity, domestic/foreign, currency; guaranteed debt (as relevant); quarterly debt service projections encouraged.

C General government as for A. If public sector, may be defined in a variety of ways.

D As for B; but guaranteed debt encouraged; debt service projections not required.

E An encouraged extension of GDDS requirements. Coverage as for C, dissemination within 6–9 months.

where the fiscal responsibilities of subnational levels of government are significant, an aggregate summary statement of their fiscal position should be published where practicable, if necessary using partial indicators of their fiscal position, such as bank borrowing or bond issues. Best practice is that reliable information on the general government outturn should be published within 12 months of year-end.

Final Accounts

3.4.2 Final accounts should be presented to the legislature within a year of the end of the fiscal year.

147. This is a basic requirement of fiscal transparency. The coverage of final accounts, and their timing, should be specified in the budget law. The

final accounts should demonstrate compliance with the budget as adopted by the legislature; they should be reconciled in detail with budget appropriations, and a summary table presented showing the major causes of deviation from the original appropriation; they should be in the same format as the budget, and show any within-year changes to the original budget agreed to by the legislature; and they should also contain comparative information for the previous two fiscal years. As a rule, final accounts for each level of government will be audited and presented only within the relevant jurisdiction. The central government, however, should present a reliable picture of the accounts of subnational levels of government where these activities have a significant fiscal impact, and summarize the fiscal outturn for general government. Best practice is that final accounts of central government should be presented to the legislature within six months of the end of the fiscal year.

Program Results

3.4.3 Results achieved relative to the objectives of major budget programs should be presented to the legislature annually.

148. It is a basic requirement of fiscal transparency that a statement of the objectives of major budget programs be reported. The outputs and outcomes of government programs should then be monitored and the legislature should be provided with a description and assessment of results against program objectives specified in the budget documentation within 12 months of year-end. Comparative information should be provided for the previous two fiscal years. Best practice is that results achieved relative to all performance targets should be independently audited, and presented to the legislature within six months of the end of the fiscal year.

4

Assurances of Integrity

149. It is essential for fiscal transparency that fiscal data reported by the government meet basic criteria that attest to their quality, and that there are mechanisms in place which provide assurances to the legislature and the public about data integrity. Principles and practices in this regard concern data quality standards, and public and independent scrutiny of fiscal data.

Data Quality Standards

4.1 Fiscal data should meet accepted data quality standards.

150. The Code includes good practices relating to: (1) budget data; (2) the *accounting basis*; and (3) assurances of data quality. All of these good practices are basic requirements of fiscal transparency.

Budget Data

4.1.1 Budget data should reflect recent revenue and expenditure trends, underlying macroeconomic developments, and well-defined policy commitments.

151. Serious problems with budget execution—such as ad hoc short-term cash rationing, payment arrears, unappropriated expenditure, frequent supplementary budgets—can often be traced to poor budget preparation. A credible budget that functions as an effective tool of fiscal management requires at the outset that the revenue forecasts and expenditure estimates on which it is based are of high quality. It is a basic requirement of fiscal transparency that summary information on revenue forecasts and expenditure estimates should be provided in a background paper that is part of the budget documentation, and that detailed supporting information should be available for independent scrutiny.¹¹⁹

152. Realistic revenue forecasts are especially important since relatively small errors in forecasting this large aggregate can have a large impact on the fiscal balance given that expenditure is often difficult to adjust in response to revenue shortfalls. Revenue forecasts should be fully explained in terms of recent revenue trends, likely macroeconomic developments, and

¹¹⁹See paragraphs 174–176 for a discussion of independent assessment of fiscal and macroeconomic forecasts.

¹²⁰For instance, IPSAS, GAAP, as in the **United Kingdom** and **New Zealand**, or Federal Financial Accounting Standards applied by the **United States** federal government (see <http://www.financenet.gov/fasab.htm>).

¹²¹"Accounting policies are the specific principles, bases, conventions, rules and practices adopted . . . in preparing and presenting financial statements;" see paragraph 7, IFAC (2000b). The accounting basis may differ between budget documents and financial reports, as it does for example in the **United States**. In **France**, accounting standards used in the preparation of the final accounts have recently been changed to reflect accrual principles in a number of areas, and these standards are clearly explained in the Final Accounts—see the ROSC for France, Fiscal Transparency, Box 1, at <http://www.imf.org/external/np/rosc/fra/index.htm>. Some countries that have moved to accrual budgeting first went through a transitional period of reporting on an accrual basis while still budgeting on a cash basis.

¹²²For example, in the **United States** the Federal Accounting Standards Advisory Board is responsible for developing proposals to improve accounting and financial reporting in the Federal Government. In **New Zealand**, the Fiscal Responsibility Act requires the government to prepare and present all its fiscal reports in accordance with GAAP, i.e., accrual accounting. GAAP is the responsibility of the New Zealand Accounting Standards Review Board, a body independent of the government that establishes accounting standards for the private and public sectors.

the estimated impact on revenue of any emerging consequences of existing tax policies and of any new tax changes. Countries will differ in their capacities to apply advanced revenue forecasting techniques. All, however, should indicate as precisely as possible the method used. Different approaches to revenue forecasting are outlined in Box 22.

153. On the expenditure side, reliability of estimates is more a function of rigorous costing and effective control mechanisms than of forecasting. Clearly, recent expenditure trends (which may reveal rising demand for certain public services) and likely macroeconomic developments (which will affect spending on interest payments and certain price or cyclically sensitive programs, for example, unemployment compensation) are important. However, the key requirement for reliable expenditure estimates is that they include all past and current spending obligations of the government. Persistent emergence of payment arrears is usually evidence that existing obligations are not fully covered in the budget, and therefore that there is a systemic data quality problem. Frequent and substantial use of supplementary budgets within the year is likely to indicate that the original budget does not fully reflect the government's underlying obligations. Open budget procedures and thorough costing of budget policies provide a general assurance that supplementary budgets are unlikely to be needed.

Accounting Basis

4.1.2 The annual budget and final accounts should indicate the accounting basis (e.g., cash or accrual) and standards used in the compilation and presentation of budget data.

154. Although there is no internationally accepted standard for government accounting or financial reporting, work by IFAC-PSC to develop such standards has progressed substantially, as indicated in Box 17. It is a basic requirement of fiscal transparency that reference should be made to the recognized or generally accepted accounting standards that are followed.¹²⁰ Accounting policies should also be indicated.¹²¹ It should be clear where accountability lies within government for setting accounting standards and policies, and for monitoring and certifying compliance with standards. Any recent revisions in accounting methodology and practices should be disclosed, together with the reasons for the changes and an indication of their impact on fiscal aggregates (to facilitate comparability between years). Advance notice should be given of any significant planned changes in accounting policies or practices. Best practice is that mechanisms should be set up to provide for openness of the standard setting process for government accounting and financial reporting, and for its independence from government.¹²²

Assurances of Data Quality

4.1.3 Specific assurances should be provided as to the quality of fiscal data. In particular, it should be indicated whether data in fiscal reports are internally consistent and have been reconciled with relevant data from other sources.

Box 22. Revenue Forecasting

There are four main approaches to revenue forecasting.

Effective rate approach. Under this approach, the forecast for each tax is made by multiplying a forecast of the tax base by the corresponding effective tax rate. The effective tax rate is calculated by dividing the tax collected for the latest available period by the estimated tax base.¹ Typically, the effective tax rate will differ from the statutory rate because of exemptions or incomplete taxpayer compliance. This approach can yield poor results when the tax base, tax rates, tax administration capacity, and taxpayer compliance are changing. For transparency, it is necessary to disclose the way in which the effective tax rate is calculated, the economic assumptions underlying the tax base forecast, and any adjustments that are made to reflect any of the aforementioned changes.

Elasticity approach. This approach establishes a stable empirical relationship between the growth in revenue for each tax and the growth in the corresponding tax base, which is specified as an elasticity. The increase in revenue is then forecast by multiplying the forecast increase in the tax base by the elasticity, and adding the estimated impact of changes in the tax structure and tax administration/compliance. For transparency, these components of the revenue forecast should be shown separately.

Model-based approach. Some advanced economies use aggregate general-equilibrium models to produce revenue forecasts which take into account the interdependence of the tax system and the economy. Others use a sample of tax returns to build micro-simulation models that describe the actual provisions of tax law, and use such models to produce micro-level forecasts that are then aggregated. These models can also be used in combination with the above two approaches. The effective rate approach or the elasticity approach can be used to produce a forecast on the basis of current policies, and micro-simulation models can be used to produce estimates of the revenue impact of tax changes. Transparency requires that information on the models used, and various parameter values, are made available.

Trend and autocorrelation approach. In some cases, it is difficult to link revenue developments to underlying macroeconomic variables. This particularly applies to nontax revenue, which is linked to specific fees and charges, to profits of enterprises, or to property values. In such cases, past trends, supplemented by specific information related to each source of revenue, may be the only practical approach to forecasting. For transparency, the way in which the underlying trend has been determined should be specified, along with the relevant specific information that influences the forecast.

¹Ideally, the tax base used should align closely with the category of tax collections but where such information is not available a broader measure, such as GDP, may have to be used.

155. The Code requires a public commitment to timely publication of fiscal information. The term “fiscal information” implicitly embodies a concept of quality. There is a presumption that any data published should be both reliable and relevant to fiscal analysis. However, it has become apparent that, in practice, more explicit standards need to be set to ensure that fiscal data are indeed of a high quality. For this reason, the Code has been modified to iden-

tify all data quality related aspects more clearly. Many aspects dealt with in earlier sections of the Code, such as classification, and coverage, timeliness, and periodicity, are aspects of data quality, but are sufficiently important in their own right to be dealt with separately. Fiscal data consistency and reconciliation are emphasized in this section of the Code.

Internal Consistency

156. Cross-checks of internal consistency of fiscal data should be undertaken, and the effectiveness of these procedures reported. Fiscal reports, as indicated in Box 7, include the budget documentation, within-year budget reports, final accounts, financial reports, and GFS fiscal reports. It is essential that all of these reports meet high standards of reliability. It is a basic requirement of fiscal transparency that final accounts should be fully reconciled with budget appropriations, and that each should be reconciled with GFS reports. The latter provides assurance that all relevant accounts are covered by GFS reports. GFS reports should be compiled in parallel with budget reports, and should be actively used in the process of formulating and evaluating fiscal policy. Another basic requirement of fiscal transparency is that the change in the stock of debt (and financial assets) should be reconciled with the reported budget balance. Maintenance of a comprehensive government balance sheet is a systematic way of tracking changes in debt and assets, and can therefore provide a means of checking overall data reliability.

157. Assurance should also be provided as to the quality of fiscal data over time. For instance, where aggregate fiscal data are presented in the budget documentation for prior years (which is a good practice included in the Code), the status of the numbers (e.g., provisional or final) should be indicated. Any changes to the classification or presentation of items in the budget and fiscal reports from year to year should be disclosed, together with the reasons for the changes and their approximate fiscal consequences. Revisions to fiscal should follow a regular, established, and published schedule.

158. A further basic requirement of fiscal transparency is that a background paper should be included with the budget documentation which analyzes the difference between budget forecasts of the main fiscal aggregates and the outturn for recent years. Best practice is that fiscal forecasts and outturns should be fully reconciled and all significant differences should be explained (preferably in the background paper mentioned above). In particular, differences between fiscal forecasts and outturns should be broken down into those due to macroeconomic factors, those that reflect the costs of existing policies, and those that reflect the costs of new policies.¹²³ Where it is known that data are internally inconsistent, or that the reconciliation necessary to verify consistency has not been done, this should be clearly stated.

Reconciliation with Other Data

159. Reconciliation should be undertaken between fiscal data and related nonfiscal data, primarily monetary data but also balance of payments and national accounts data.¹²⁴ It is a basic requirement of fiscal trans-

¹²³Australia provides a good example of routine accountability in these terms. See <http://www.budget.gov.au/finaloutcome/>.

¹²⁴In Albania, fiscal financing data are reconciled with financial sector claims on and liabilities to the government; and government debt and official flows are reconciled with the balance of payments. See *Toward a Framework for Assessing Data Quality*, by Carol S. Carson, Annex IV, Sample C, at http://dsbb.imf.org/dqrs_work.htm.

parency that there should be rigorous reconciliation of fiscal and monetary data, and that where reconciliation processes are weak, this should be drawn to public attention (e.g., in audit reports) in a timely manner.¹²⁵ *Individual government ledger accounts* should be fully reconciled with bank accounts. The overall balance measured as the difference between revenue and expenditure should be reconciled with domestic and external financing data as reported both by the government and by the central bank, the rest of the banking system, and other lenders. Financing data should also be reconciled with detailed information on changes in debt and financial assets. For all reports, any unexplained discrepancy between the government ledger accounts and bank accounts should be disclosed.

160. One way for countries to signal a commitment to improving the quality of fiscal data is to participate in the GDDS, and this is a basic requirement of fiscal transparency. A key purpose of the GDDS is to encourage member countries to improve data quality. The GDDS provides a framework for evaluating needs for data improvement and setting priorities in this respect. Participation requires, among other things, a commitment to using the GDDS as a framework for statistical development, that meta data are prepared describing current practices in the production and dissemination of official statistics, and that plans are announced for short and long-term improvements in these practices.

161. The general topic of data quality is also being dealt with systematically by the IMF through the development of a data quality assessment framework comprising a generic framework and a number of dataset-specific applications.¹²⁶ A specific application for fiscal data is being developed that is consistent with the revised *GFS Manual*.¹²⁷ The data quality assessment framework gives structure and provides a common language for the assessment of data quality. It is designed to be a flexible, comprehensive tool that can be used in a variety of country situations by experts and non-experts alike. The framework aims to bring together best practices and internationally accepted concepts and definitions in statistics, including those of the UN *Fundamental Principles of Official Statistics*¹²⁸ and the SDDS and GDDS.

162. A summary of the draft generic data quality assessment framework is presented in Box 23. The framework follows a cascading structure that flows from five main dimensions that have been identified as critical constituents of data quality. For each of these interrelated and somewhat overlapping dimensions, the framework identifies pointers, or observable features that can be used in assessing quality. These pointers to quality are broken down into elements (major identifiers of the quality dimensions), and further, into more detailed and concrete indicators (not shown in Box 23).

163. The data quality assessment framework recognizes that the quality of an individual dataset, in this case, government finance statistics, is intrinsically bound with that of the institution producing it. This theme runs throughout the data quality assessment framework, but can be seen most clearly in the first two items in Box 23. Quality-of-the-institution issues with respect to the production of fiscal data are discussed in the next section.

¹²⁵In Pakistan, following a significant breakdown of the processes of accounts reconciliation, and the discovery of substantial fiscal data discrepancies, the government has begun to reestablish basic processes of accounting and reconciliation. The creation of an inter-agency Fiscal Monitoring Committee—and its strong support by the government—is an important step toward improving the quality of data used for monitoring budget performance. It has also resulted in a strengthening of internal reconciliation and control. See the ROSC for Pakistan, Fiscal Transparency Module, paragraph 26 and Box 1, at <http://www.imf.org/external/np/rosc/pak/fiscal.htm>.

¹²⁶For detailed information concerning this framework, which was developed by the IMF's Statistics Department, see *Toward a Framework for Assessing Data Quality*, by Carol S. Carson (2000), at http://dsbb.imf.org/dqrs_work.htm.

¹²⁷The fiscal data quality assessment framework is undergoing an intensive process of consultation with international experts and IMF staff, as well as field-testing.

¹²⁸See <http://www.un.org/Depts/unsd/statcom/1994docs/e1994.htm>. To further promote these principles, the UN Statistical Commission established a task force to develop a draft code of best practice. See United Nations Statistical Division, "Common Code of Statistical Practice in the United Nations Systems," Part I and Part II, April 1996 at <http://www.un.org/Depts/unsd/demotss/tnjun96/tony.htm>.

Box 23. Data Quality Framework—Main Dimensions

Prerequisites of quality	The legal and institutional environment is supportive of statistics; resources are commensurate with the needs of statistical programs; and quality is recognized as a cornerstone of statistical work.
Integrity	Professionalism in statistical policies and practices is a guiding principle; statistical policies and practices are transparent ; and are guided by ethical standards .
Methodological soundness	Concepts and definitions used are in accord with standard statistical frameworks; the scope of the statistics is in accord with internationally accepted standards; classification and sectorization systems are in accord with internationally accepted standards; and flows and stocks are valued and recorded to internationally accepted standards (basis for recording).
Accuracy and reliability	Source data available provide an adequate basis to compile statistics; statistical techniques employed conform with sound statistical procedures; there is regular assessment and validation of source data.
Serviceability	Statistics cover relevant information in the subject field; timeliness and periodicity follow internationally accepted dissemination standards; statistics are consistent over time, internally and with other major data systems; and data revisions follow a regular and predictable procedure.
Accessibility	Statistics are presented in a clear and accessible manner, forms of dissemination are adequate, and statistics are made available on an impartial basis; up-to-date and pertinent metadata are made available; and prompt and knowledgeable assistance to users is available.

Public and Independent Scrutiny

4.2 Fiscal information should be subjected to independent scrutiny.

164. The Code includes good practices relating to: (1) independent audit; (2) independent assessment of fiscal and macroeconomic forecasts; and (3) the integrity of fiscal statistics.

Independent Audit

4.2.1 A national audit body or equivalent organization, which is independent of the executive, should provide timely reports for the legislature and public on the financial integrity of government accounts.

165. This is a basic requirement of fiscal transparency. National audit bodies¹²⁹ are found in most countries, although precise forms and degrees of

¹²⁹These are also known as supreme audit institutions. The national audit body is the highest level audit body in a country.

independence vary. However, new institutions need to be created in many countries in transition. In francophone countries, such institutions are known as the *Cour des Comptes*, in Commonwealth countries they are often designated as the National Audit Office or Auditor-General's Office,¹³⁰ and in Latin American countries as the *Contraloría General*. Their essential function is to uphold and promote public accountability. Their role can take on added importance in ensuring adequate public accountability as many governments move to devolve decision-making authority. It is a basic requirement of fiscal transparency that a national audit body should be set up under law.

166. The core component of government auditing is the regularity audit. This covers attestation of financial accountability of individual agencies—involving evaluation of financial records—and the expression of opinions on financial statements; attestation of the financial accountability of the government as a whole; and audit of financial systems and transactions, and of internal control and audit functions—including an evaluation of compliance with regulations and statutes.

167. In completing a regularity audit, the auditor expresses a written opinion on his or her findings. An unqualified opinion is given when the auditor is satisfied that: the financial statements have been prepared using acceptable accounting bases and consistently applied policies; the statements comply with statutory requirements and regulations; the view presented by the financial statements is consistent with the auditor's knowledge of the audited agency; and there is adequate disclosure of all material matters relevant to the financial statements.

168. An important feature of national audit bodies is that they should not be under the control of the government of the day. The INTOSAI 1977 *Lima Declaration of Guidelines on Auditing Precepts* had the chief aim of calling for independent government auditing. The guidelines call for the establishment of supreme audit institutions to be laid out in the constitution, and for their independence to be protected by a Supreme Court.¹³¹ Establishment of procedures independent of the executive for the appointment of the chief auditor, and for his or her removal from office, is a common mechanism to assure independence. In a number of countries, however, chief auditors are appointed by the president or prime minister, and report to that official rather than to the legislature. The independence of chief auditors can be strengthened in such cases by ensuring that they are at least appointed by the legislature.

169. The chief auditor should be allowed to report directly to the legislature.¹³² There should also be a presumption that all reports of the national audit body are automatically publicly available once submitted to the legislature—either immediately or within a specified period of time. In contrast, in some countries the audit office's report on the final accounts is transmitted to the legislature, or to the Speaker of the legislature, but may not be tabled in the legislature and become public information until some considerable time later.

170. One area where external audit reports are often not published is the area of military or security spending. National security considerations may warrant special provisions limiting publication of audit reports. In these situations it is important, however, that all military spending be audited by a non-

¹³⁰The main elements of institutional independence have been established for the Audit Office in **Uganda**. See the ROSC for Uganda, Fiscal Transparency Module, paragraph 29, at <http://www.imf.org/external/np/rosc/uga/index.htm>.

¹³¹See http://www.intosai.org/2_LIMADe.html.

¹³²In **India**, an independent comptroller and auditor general reports only to the parliament. It should also be noted that state governments have their own accountants general—working under the comptroller and auditor general—who provide audit reports directly to state legislatures.

military authority, and that the results of the audit be presented to a legislative body, such as a public accounts committee.¹³³

171. It is a basic requirement of fiscal transparency that mechanisms should be in place to help ensure that remedial action is taken in response to adverse findings in external audit reports. One mechanism would be a regulatory requirement that the audited agency respond to the findings publicly, in writing, and indicate the actions it will take in response. Another mechanism would be for a public accounts committee to review the public accounts, to consider the chief auditor's report, and to hold the executive accountable for remedying deficiencies exposed through audit.¹³⁴

172. To ensure that the executive cannot render the national audit body ineffective by denying it adequate funding, by controlling its staffing, or by delaying consideration of its reports—which are problems in some countries—there should be procedural mechanisms for providing a greater-than-usual degree of legislative oversight of the operation of the office. One mechanism would be to assign to a legislative committee the responsibility for proposing the office's annual budget and for setting broad areas of priority for the office, while leaving chief auditors some flexibility to initiate reports on any aspect of concern within their brief. It is important that the national audit body be given full access to all necessary records, documents, and personnel. Legislative requirements to this effect would assist in obtaining the cooperation of audited agencies.

173. Standards of external audit practice should be consistent with international standards, such as those set by INTOSAI,¹³⁵ which are described in Box 24, or by a regional body. The national audit body should have the necessary core of professionally trained staff, and all staff should be required to exhibit independence in thought and action in the conduct of their duties. The work of the office should be subject to internal assurances of quality and independent appraisal. Some advanced economies give national audit bodies a mandate to report to the public and the legislature on a broad range of issues, including auditing nonfinancial performance information against announced performance targets. Although implementation of the fiscal transparency code has not yet been taken up as a formal audit issue in any country, most of the elements considered under the Code are appropriate subjects for a broad performance audit. It is therefore best practice that a national audit body, or equivalent organization, should report to the legislature and the public on all matters relating to the integrity and transparency of fiscal policy.

¹³³In **Pakistan**, for instance, defense appropriation accounts are provided to the Public Accounts Committee, but circulation of the documents is restricted for security reasons. See the ROSC for Pakistan, Fiscal Transparency Module, paragraph 30, at <http://www.imf.org/external/np/rosc/pak/fiscal.htm>.

¹³⁴For example, in the **United Kingdom**, the Public Accounts Committee reports its findings both to parliament and to the treasury, and the treasury must subsequently report back to the committee on actions taken or not taken in response. The Public Accounts Committee in **India** plays the same role.

¹³⁵See INTOSAI (1995).

Assessment of Fiscal and Macroeconomic Forecasts

4.2.2 Independent experts should be invited to assess fiscal forecasts, the macroeconomic forecasts on which they are based, and all underlying assumptions.

174. As noted earlier, budget estimates should be based on coherent and consistent macroeconomic forecasts, and the fiscal forecasts themselves should be of high quality. Publication of detailed information on the analytical basis of the macroeconomic and fiscal forecasts is a necessary first step that

Box 24. INTOSAI Auditing Standards

INTOSAI auditing standards consist of four parts: basic postulates, general standards, field standards, and reporting standards.

Basic postulates: the development of adequate information, control, evaluation, and reporting systems within the government will facilitate the accountability process; appropriate authorities should ensure the promulgation of acceptable accounting standards for financial reporting and disclosure relevant to the needs of the government; and each audit body should establish a policy on which INTOSAI standards, or other specific standards, it will follow in order to ensure its work is of high quality.

General standards: individual auditors and the audit body must be independent of the executive, of the individual entity being audited, and of any political influence; they must possess the required competence; and they must exercise due care and concern in complying with INTOSAI auditing standards.

Field standards: auditors should design regularity audit procedures to provide reasonable assurance of detecting errors, irregularities, and illegal acts that could have a direct and material effect on the financial statement amounts; auditors should evaluate the reliability of internal control; and an objective of the regularity audit should be to provide assurance that the budget and accounts are complete and valid.

Reporting standards: following each audit, the chief auditor should prepare a written opinion or report setting out the findings in an easy-to-understand form, including only information that is supported by competent and relevant audit evidence; audit reports should be independent, objective, fair, and constructive (i.e., they should address future remedial action).

makes possible independent assessment and public debate on the quality of forecasts. This information should be included in summary form in a background paper that is part of the budget documentation. More detailed supporting information should be openly available on request.

175. Additional steps should also be taken, however, to facilitate independent assessment. Inclusion with the budget forecasts of a statement of responsibility, which makes it clear which agencies have produced the fiscal and macroeconomic forecasts respectively, would facilitate assessment of the forecasts by making it clear who within the government is accountable for the quality of the forecasts.¹³⁶ Regular publication in budget background papers of ex post assessments of the fiscal and macroeconomic forecasts to previous budgets against the actual outcomes would contribute to informed discussion. Regular publication by the central bank of its macroeconomic forecasts, including the technical basis underpinning them, would also facilitate informed debate over the robustness of the government's official macroeconomic forecasts.¹³⁷ Working methods and assumptions used in producing fiscal and macroeconomic forecasts should be made publicly available no later than at the time the annual budget is presented to the legislature, and preferably some time in advance of budget presentation. Advance presentation allows time for the legislature, independent forecasters and analysts, the financial press and the general media to scrutinize and comment on the robustness of the macroeconomic forecasts.¹³⁸ The public accounts

¹³⁶The OECD best practice guidelines (item 3.2) go further by requiring that each fiscal report should contain a statement of responsibility by the finance minister and the senior official responsible for producing the report.

¹³⁷The **Bank of Norway** regularly publishes its internal staff macroeconomic forecasts. The **Swedish Riksbank** publishes macroeconomic forecasts sanctioned by its policymaking body, not just by the staff, which further aids transparency. Publication by the central bank on a specified schedule of a report on the evolving macroeconomic situation is a requirement of the monetary and financial transparency code (item 2.4.2).

¹³⁸In **South Africa**, the macroeconomic assumptions on which the budget forecasts are based are presented to parliament in a Medium Term Budget Policy Statement three months before budget day. See Folscher (1999) at <http://www.idasa.org.za>.

¹³⁹In **Australia**, for example, the Treasury Macroeconomic Model can be viewed at <http://www.treasury.gov.au/> and purchased from the Australian Bureau of Statistics. In the **United Kingdom**, the treasury is required by law to make the macroeconomic model publicly available.

¹⁴⁰In **Canada**, the average of private sector economic forecasts is used as the basis for the economic assumptions underpinning the budget. See OECD (1999).

¹⁴¹In **France**, for example, the macroeconomic forecasts are reviewed by the National Economic Commission, chaired by the minister of economy and finance and including 22 members chosen for their economic and financial expertise. The National Economic Commission is supported by a technical group, which reviews macroeconomic forecasts prepared by key independent institutes and banks. See the ROSC for France, Fiscal Transparency Module, paragraph 20, at <http://www.imf.org/external/np/rosc/fra/index.htm>. In the **Czech Republic**, twice a year and before the budget forecasts are released, a panel of experts, including individuals from the private sector, scrutinize the macroeconomic assumptions. See the ROSC for the Czech Republic, Fiscal Transparency Module, paragraph 19, at <http://www.imf.org/external/np/rosc/cze.htm>.

¹⁴²In the **United States**, the Congressional Budget Office, which reports directly to the legislature, prepares a complete set of macroeconomic and fiscal forecasts to be considered alongside those contained in the president's budget proposal.

¹⁴³In a number of countries, most notably those in Latin America, fiscal data are produced and disseminated by the central bank rather than by the national statistics office.

Box 25. The UN Fundamental Principles of Official Statistics

The following features of the UN Fundamental Principles are particularly important in fostering the integrity of fiscal statistics:

- official statistics are to be compiled and made available on an impartial basis by official statistical agencies;
- methods and procedures for the collection, processing, storage, and presentation of fiscal data are to be determined solely by the head of the statistical agency according to professional considerations; and
- statistical agencies are to be entitled to comment on the erroneous interpretation and misuse of statistics.

committee of the legislature may have support staff available to assist it to assess the forecasts, and/or it may invite submissions from independent experts.

176. Best practice is that institutional mechanisms should be established to provide the public with independent assurance that fiscal and macroeconomic forecasts are of high quality. This could include making the fiscal and macroeconomic models available to outside experts.¹³⁹ The macroeconomic assumptions used in the budget could also be drawn from those produced by private sector forecasters.¹⁴⁰ Some countries have put in place mechanisms for formal quality reviews by experts, which are made public.¹⁴¹ Others give an independent public agency the task of critiquing and reporting on the quality of forecasts.¹⁴²

National Statistics Agency

4.2.3 A national statistics agency should be provided with the institutional independence to verify the quality of fiscal data.

177. The national statistics agency, or other principal official producer of government finance statistics, should be set up under legislation that grants it technical independence in the compilation and publication of official statistics.¹⁴³ This will enhance the quality and integrity of fiscal and other statistics. In the fiscal area, such an agency would play a vital role by coordinating the collection of basic fiscal data by other official bodies, and by serving as the focal point for the production and dissemination of government finance statistics.

178. To build confidence among users of official statistics, transparency of the practices and procedures of the national statistics agency is also required. Among other things, this means that the statistics agency should be provided with all the basic data it requires; it should compile fiscal data on an impartial basis; it should be entitled to comment on erroneous interpretation and misuse of the information; and it should reveal any government access to fiscal data prior to their release. In addition, terms and conditions under which fis-

cal data are produced and disseminated should be available to the public, and guidelines for the behavior of the staff of the statistics agency should be clear and well publicized. One way to promote these aspects of quality is through observance of the UN *Fundamental Principles of Official Statistics*—see Box 25—and by meeting the standards for data integrity contained in the SDDS/GDDS.

Glossary

Accounting basis: Defined in IFAC (2000a) as “the body of accounting principles that determine when the effects of transactions or events should be recognized for financial reporting purposes. It relates to the timing of the measurements made, regardless of the nature of the measurement.” There are many variations of the accounting basis. IFAC identifies two basic reference points (cash and accrual) and two variations (modified cash and modified accrual).

Accounting system: The set of accounting procedures, internal mechanisms of control, books of account, and plan and chart of accounts that are used for administering, recording, and reporting on financial transactions. Systems should embody double-entry bookkeeping, record all stages of the payments and receipts process needed to recognize accounting transactions, integrate asset and liability accounts with operating accounts, and maintain records in a form that can be audited.

Accrual accounting: Accrual accounting systems recognize transactions or events at the time economic value is created, transformed, exchanged, transferred, or extinguished, and all economic flows (not just cash) are recorded.

Accrual reporting: Reporting based on accrual accounting systems.

Aid-in-kind: Flows of goods and services with no payment in money or debt instruments in exchange. In some cases, “commodity aid” goods (such as grain) are subsequently sold and the receipts are used in the budget, or more commonly through a special fund, for public expenditure.

Appropriations: Refers to an authority under a law given by the legislature to the executive to spend public funds for a specified purpose. **Annual appropriations** are made through annual budget laws. **Supplementary budgets/appropriations** are sometimes granted subsequent to the annual law if the annual appropriation is insufficient to meet the purpose. “Standing appropriation” is sometimes used for authority extending beyond a single budget year under separate legislation (such as social security legislation). In some countries, such as the **United States**, the term “authorization” is used to denote a general law setting up a program and permitting appropriation but not giving any specific authority to spend. In most countries, agencies and departments require specific executive authorization (“apportionment, allotment, or warrant”) to actually incur an obligation against appropriation.

Augmented balance: The overall balance plus any losses incurred by the central bank, and any issuance of government debt to recapitalize public financial institutions not recorded in the overall balance.

Cash accounting: Cash accounting systems recognize transactions and events when cash is received or paid.

Cash reporting: Reporting based on cash accounting systems.

Central government: All government units that are agencies or instruments of the central authority of a country and that are covered by or financed through the budget or extrabudgetary funds at that level.

Commitments: In accounting usage, commitments refer to a stage in the expenditure process at which contracts or other forms of agreement are entered into, generally for future delivery of goods or services. A liability will not be recognized until delivery of the item, but the government is contractually committed to meeting the obligation once delivery is made. The term is also used in a more general, noncontractual sense to mean firm promises of the government made in policy statements.

Contingency funds or reserves: A separate fund or a budget provision set aside to meet unforeseen and unavoidable requirements that may arise during the budget year. Certain types of contingency (such as meeting loan guarantee obligations) may be specified as a potential use for such funds.

Contingent liabilities: Obligations that have been entered into, but the timing and amount of which are contingent on the occurrence of some uncertain future event. They are therefore not yet liabilities, and may never be if the specific contingency does not materialize.

Earmarked taxes: Taxes raised and allocated to specific expenditure programs, often through an extrabudgetary fund (*see below*).

Economic classification: The current *GFS Manual* refers specifically to a “classification of expenditure by the nature of transaction, that is, whether required or unrequired, for current or capital purposes, kind of goods or services obtained, and sector or subsector receiving transactions” (p. 325). It is generally used to identify the nature and economic effects of government operations. Though not formally described as “economic” in the GFS, the classification of revenue into current (tax and nontax), capital, and grants serves a similar purpose.

Extrabudgetary funds: The term generally refers to sets of government transactions that are not included in the annual budget presentation. These may not be subject to the same level of scrutiny or accounting standards as the annual budget. A wide variety of extrabudgetary arrangements are used, including funds (such as social security funds) set up under separate legislation, commodity funds that use proceeds of commodity aid, and earmarking specific kinds of revenue for specific purposes.

Functional classification: The current *GFS Manual* refers specifically to the Classification of the Functions of Government (COFOG), which is the inter-

national standard for classifying expenditures of government according to broad purposes for which transactions are undertaken. It is generally used to measure the allocation of resources by government for the promotion of various activities and objectives (such as health, education, and transportation and communication).

General government: Defined in the SNA as the following group of resident institutional units:

- (a) all units of central, state, or local government;
- (b) all social security funds at each level of government; and
- (c) all nonmarket, nonprofit institutions that are controlled and mainly financed by government units.

The sector does not include public corporations, even when all the equity of such corporations is owned by government units. It also does not include quasi-corporations that are owned and controlled by government units. However, unincorporated enterprises owned by government units that are not quasi-corporations remain integral parts of those units and, therefore, must be included in the general government sector.

Generational accounting: Generational accounts are used to assess the distributional implications of fiscal policy for different cohorts. This is accomplished by estimating the present value of net tax payments (taxes paid less benefits received) over the lifetime of different generations under current tax and spending policies. A generation is defined as including all males and females (separately accounted for, because of differing tax and benefits profiles) born in the same year. The technique has heavy data requirements and the results depend on a large number of simplifying assumptions. It is generally regarded as a supplementary technique for analysis of sustainability and intergenerational distribution.

Government balance sheet: A comprehensive statement of the assets, liabilities, and net worth (assets less liabilities) of government at a point in time—usually year-end. In practice, very few governments prepare statements of their financial position that could be described as balance sheets. Adoption of accrual accounting reports and generally accepted methods of asset valuation are prerequisites for a reliable balance sheet presentation.

Government-guaranteed loan: A loan contracted by a nongovernment public sector agency with a guarantee that the government will repay any amount outstanding in the event of default.

Implicit contingent liabilities: Liabilities that reflect noncontractual obligations of government (e.g., potential liabilities arising in connection with financial sector restructuring).

Individual government ledger accounts: The government (or general) ledger is the book where all transactions by the central government, as a debit or a credit, are recorded. The government ledger is generally maintained by the general accounting office. Each transaction affecting a specific bank account

is reflected in a corresponding individual account of the government ledger, thus allowing for a full reconciliation with the bank statement.

Line-item budgeting: A general term used to describe a relatively unsystematic budgetary chart of accounts. In addition to standard votes or “lines” for items such as “salaries and wages,” separate lines for new requirements are introduced as they arise, thus giving rise to lengthy, ad hoc forms for appropriating and accounting for spending.

Medium-term budget framework: A framework for integrating fiscal policy and budgeting over the medium term by linking a system of aggregate fiscal forecasting to a disciplined process of maintaining detailed medium-term budget estimates by ministries reflecting existing government policies. Forward estimates of expenditures become the basis of budget negotiations in the years following the budget and the forward estimates are reconciled with final outcomes in fiscal outcome reports.

Modified accrual accounting: Modified accrual accounting differs from accrual accounting in that physical assets are expensed at the time of purchase.

Modified cash accounting: Modified cash accounting differs from cash accounting in that it recognizes receipts and disbursements committed in the budget year and allows a specified period after year-end for payments of these to be recorded and reported.

Moral hazard: The possibility that the signal or expectation of possible future government support may induce an undesirable change in behavior by management of an enterprise or bank, for example, by engaging in more risky activities because some of the potential losses are seen as being effectively underwritten by the government.

Outputs and outcomes: In performance assessment in government, outputs are defined as the goods or services produced by government agencies (e.g., teaching hours delivered, welfare benefits assessed and paid); outcomes are defined as the impacts on social, economic, or other indicators arising from the delivery of outputs (e.g., student learning, social equity).

Overall balance: This term corresponds to the GFS terminology of “Overall Deficit/Surplus,” which is defined as revenue plus grants received less expenditure less “lending minus repayments.” The balance so defined is equal (with an opposite sign) to the sum of net borrowing by the government, plus the net decrease in government cash, deposits, and securities held for liquidity purposes. The basis of this balance concept is that government policies are held to be deficit or surplus creating and thus the revenue or expenditures associated with these policies are “above the line.” Borrowing or a rundown of liquid assets, however, is deficit financing or “below the line.” It should be noted that the term **lending minus repayments** included above the line in the current GFS covers government transactions in debt and equity claims on others undertaken for purposes of public policy rather than for management of government liquidity or earning a return.

Payment arrears: Amounts that have not been paid by the date specified in a contract or within a normal commercial period for similar transactions. Payment arrears may arise from nonpayment by government in such areas as bills due from suppliers, due salaries or transfers, or due debt repayment or service.

Primary balance: The overall balance excluding interest payments. Since interest payments represent the cost of past debt, and the determinants of future debt that are under policy control of government are other spending and revenue measures exclusive of interest payment, the primary balance is of particular importance as an indicator of the fiscal position in countries with high levels of debt.

Program budgeting/program classification: “Programs” are groupings of government activities in relation to specific government objectives. Program classification applies this principle across all government activities. Program budgeting attempts to apply cost-benefit analysis to the allocation decision, allocate expenditures by program, and assess results of programs in relation to objectives. A full system of program budgeting (or subsequent proposals such as **zero-based budgeting**) has not been successfully realized in any country, in large part because of the high information and complex management requirements of such systems.

Public sector: A classification drawn from sectors and subsectors of the SNA classification consisting of general government and the public subsectors of nonfinancial and financial corporations. The principle of classification is that of government ownership and/or control rather than function (as in the primary classification of SNA). An important subdivision within this sector for fiscal analysis purposes is the “nonfinancial public sector” comprising general government and nonfinancial public enterprises.

Public sector balance: The overall balance of the public sector. It is distinct from public sector borrowing requirement, which is the overall balance of general government plus the net borrowing requirements of nonfinancial public enterprises.

Quasi-fiscal activities: Activities (under the direction of government) of central banks, public financial institutions, and nonfinancial public enterprises that are fiscal in character—that is, in principle, they can be duplicated by specific fiscal measures, such as taxes, subsidies or other direct expenditures, even though precise quantification can in some cases be very difficult. Examples include subsidized bank credit and noncommercial public services provided by an enterprise.

Supplementary budgets/appropriations (*see appropriations*)

Tax arrears: Taxes due to government but not paid. Other arrears in receipts could arise from nonpayment of loans by government or nonpayment of bills for government services.

Tax expenditures: Concessions or exemptions from a “normal” tax structure that reduce government revenue collection and, because the government pol-

icy objectives could be achieved alternatively through a subsidy or other direct outlays, the concession is regarded as equivalent to a budget expenditure. Precise definition and estimation of tax expenditures thus require definition of the normal base as well as determination of the most appropriate way of assessing costs (i.e., by revenue forgone or the expenditure required to achieve the policy objective).

Unfunded public pension liabilities: This term refers to future liabilities of government under unfunded (pay-as-you-go), or partially funded public pension schemes. Liabilities for such schemes are generally not recognized in accounting terms until the obligation to pay arises (see IFAC, 2000a), though this will depend on institutional arrangements in particular countries. (These points are under continuing consideration by the IFAC-PSC.) Such future liabilities need to be taken into account in assessing fiscal sustainability over the long term.

User charges: Payments made by consumers to providers of government services.

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