

# Manual on **Fiscal Transparency**



Fiscal Affairs Department

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## Abbreviations and Acronyms

COFOG	Classification of the Functions of Government
DQAF	Data Quality Assessment Framework
ESA	<i>European System of Accounts, 1995</i>
FSAP	Financial Sector Assessment Program
GAAP	Generally accepted accounting principles
GDDS	General Data Dissemination System
GDP	Gross domestic product
GFS	Government finance statistics
IFAC	International Federation of Accountants
IIA	Institute of Internal Auditors
IMF	International Monetary Fund
INTOSAI	International Organization of Supreme Audit Institutions
IPSAS	International Public Sector Accounting Standards
OECD	Organization for Economic Cooperation and Development
PRSP	Poverty Reduction Strategy Paper
QFAs	Quasi-fiscal activities
ROSC	Report on the Observance of Standards and Codes
SAI	Supreme audit institution
SDDS	Special Data Dissemination Standard
SNA	<i>System of National Accounts, 1993</i>
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
The Code	<i>Code of Good Practices on Fiscal Transparency</i>
The Guide	<i>Guide on Resource Revenue Transparency</i>
The Manual	<i>Manual on Fiscal Transparency</i>



## Preface

The revised *Code of Good Practices on Fiscal Transparency* and the accompanying revision of the *Manual on Fiscal Transparency* mark important milestones in the Fund's promotion of openness and clarity in the presentation of fiscal policies and developments. In the decade since work began on the *Code*, it has gained acceptance across the Fund membership as the standard against which fiscal transparency should be judged, while the *Manual* has become the principal source of reference on approaches to improving fiscal transparency.

The *Code* has been the basis on which nearly half of the Fund's membership has completed a Report on the Observance of Standards and Codes (ROSC) fiscal transparency module, and has allowed for more effective Fund surveillance of fiscal policies and developments. The *Manual* provides detailed guidance on good practices of fiscal transparency and, in this revision, further examples have been added drawing on ROSCs and other sources. The *Manual* also forges close links with the *Guide on Resource Revenue Transparency*, which was first published in 2005, and has now been updated in line with the revised *Code* and *Manual*.

A broad public consultation process was undertaken for the revision of the *Code*, which greatly enriched its coverage and clarity. The consultation process embraced a wide range of stakeholders including country authorities, civil society organizations, international institutions, parliamentarians, academia, and the private sector.

I would like to acknowledge the team from the Fiscal Affairs Department responsible for revising the *Code* and *Manual*: Richard Hemming, Jon Shields, Janet Stotsky, Taryn Parry, Dawn Rehm, Lynn MacFarlane, Ezequiel Cabazon, and Nadia Malikyar. I would also like to thank the many IMF colleagues who contributed to improvements in the *Code* and *Manual*, including the additional country examples of good practices. Martha Bonilla in the External Relations Department edited and coordinated the production of this publication.

Teresa Ter-Minassian  
*Director*  
Fiscal Affairs Department





# Code of Good Practices on Fiscal Transparency (2007)

## I. 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 clear.

1.1.2 The fiscal powers of the executive, legislative, and judicial branches of government should be well defined.

1.1.3 The responsibilities of different levels of government, and the relationships between them, should be clearly specified.

1.1.4 Relationships between the government and public corporations should be based on clear arrangements.

1.1.5 Government relationships with the private sector should be conducted in an open manner, following clear rules and procedures.

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

1.2.1 The collection, commitment, and use of public funds should be governed by comprehensive budget, tax, and other public finance laws, regulations, and administrative procedures.

1.2.2 Laws and regulations related to the collection of tax and non-tax revenues, and the criteria guiding administrative discretion in their application, should be accessible, clear, and understandable. Appeals of tax or non-tax obligations should be considered in a timely manner.

1.2.3 There should be sufficient time for consultation about proposed laws and regulatory changes and, where feasible, broader policy changes.

1.2.4 Contractual arrangements between the government and public or private entities, including resource companies and operators of government concessions, should be clear and publicly accessible.

- 1.2.5 Government liability and asset management, including the granting of rights to use or exploit public assets, should have an explicit legal basis.

## II. Open Budget Processes

2.1 Budget preparation should follow an established timetable and be guided by well-defined macroeconomic and fiscal policy objectives.

2.1.1 A budget calendar should be specified and adhered to. Adequate time should be allowed for the draft budget to be considered by the legislature.

2.1.2 The annual budget should be realistic, and should be prepared and presented within a comprehensive medium-term macroeconomic and fiscal policy framework. Fiscal targets and any fiscal rules should be clearly stated and explained.

2.1.3 A description of major expenditure and revenue measures, and their contribution to policy objectives, should be provided. Estimates should also be provided of their current and future budgetary impact and their broader economic implications.

2.1.4 The budget documentation should include an assessment of fiscal sustainability. The main assumptions about economic developments and policies should be realistic and clearly specified, and sensitivity analysis should be presented.

2.1.5 There should be clear mechanisms for the coordination and management of budgetary and extrabudgetary activities within the overall fiscal policy framework.

2.2 There should be clear procedures for budget execution, monitoring, and reporting.

2.2.1 The accounting system should provide a reliable basis for tracking revenues, commitments, payments, arrears, liabilities, and assets.

2.2.2 A timely midyear report on budget developments should be presented to the legislature. More frequent updates, which should be at least quarterly, should be published.

2.2.3 Supplementary revenue and expenditure proposals during the fiscal year should be presented to the legislature in a manner consistent with the original budget presentation.

2.2.4 Audited final accounts and audit reports, including reconciliation with the approved budget, should be presented to the legislature and published within a year.

## III. Public Availability of Information

3.1 The public should be provided with comprehensive information on past, current, and projected fiscal activity and on major fiscal risks.

- 3.1.1 The budget documentation, including the final accounts, and other published fiscal reports should cover all budgetary and extrabudgetary activities of the central government.
- 3.1.2 Information comparable to that in the annual budget should be provided for the outturns of at least the two preceding fiscal years, together with forecasts and sensitivity analysis for the main budget aggregates for at least two years following the budget.
- 3.1.3 Statements describing the nature and fiscal significance of central government tax expenditures, contingent liabilities, and quasi-fiscal activities should be part of the budget documentation, together with an assessment of all other major fiscal risks.
- 3.1.4 Receipts from all major revenue sources, including resource-related activities and foreign assistance, should be separately identified in the annual budget presentation.
- 3.1.5 The central government should publish information on the level and composition of its debt and financial assets, significant nondebt liabilities (including pension rights, guarantee exposure, and other contractual obligations), and natural resource assets.
- 3.1.6 The budget documentation should report the fiscal position of sub-national governments and the finances of public corporations.
- 3.1.7 The government should publish a periodic report on long-term public finances.

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

- 3.2.1 A clear and simple summary guide to the budget should be widely distributed at the time of the annual budget.
- 3.2.2 Fiscal data should be reported on a gross basis, distinguishing revenue, expenditure, and financing, with expenditure classified by economic, functional, and administrative category.
- 3.2.3 The overall balance and gross debt of the general government, or their accrual equivalents, should be standard summary indicators of the government fiscal position. They should be supplemented, where appropriate, by other fiscal indicators, such as the primary balance, the public sector balance, and net debt.
- 3.2.4 Results achieved relative to the objectives of major budget programs should be presented to the legislature annually.

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

- 3.3.1 The timely publication of fiscal information should be a legal obligation of government.
- 3.3.2 Advance release calendars for fiscal information should be announced and adhered to.

## IV. Assurances of Integrity

### 4.1 Fiscal data should meet accepted data quality standards.

- 4.1.1 Budget forecasts and updates 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 used in the compilation and presentation of fiscal data. Generally accepted accounting standards should be followed.
- 4.1.3 Data in fiscal reports should be internally consistent and reconciled with relevant data from other sources. Major revisions to historical fiscal data and any changes to data classification should be explained.

### 4.2 Fiscal activities should be subject to effective internal oversight and safeguards.

- 4.2.1 Ethical standards of behavior for public servants should be clear and well publicized.
- 4.2.2 Public sector employment procedures and conditions should be documented and accessible to interested parties.
- 4.2.3 Procurement regulations, meeting international standards, should be accessible and observed in practice.
- 4.2.4 Purchases and sales of public assets should be undertaken in an open manner, and major transactions should be separately identified.
- 4.2.5 Government activities and finances should be internally audited, and audit procedures should be open to review.
- 4.2.6 The national revenue administration should be legally protected from political direction, ensure taxpayers' rights, and report regularly to the public on its activities.

### 4.3 Fiscal information should be externally scrutinized.

- 4.3.1 Public finances and policies should be subject to scrutiny by a national audit body or an equivalent organization that is independent of the executive.
- 4.3.2 The national audit body or equivalent organization should submit all reports, including its annual report, to the legislature and publish them. Mechanisms should be in place to monitor follow-up actions.
- 4.3.3 Independent experts should be invited to assess fiscal forecasts, the macroeconomic forecasts on which they are based, and their underlying assumptions.
- 4.3.4 A national statistical body should be provided with the institutional independence to verify the quality of fiscal data.

# Overview

## Background

1. In 1998, the International Monetary Fund (IMF) introduced a *Code of Good Practices on Fiscal Transparency* (hereafter, the Code), which led to a voluntary program of fiscal transparency assessments called fiscal transparency modules of Reports on the Observance of Standards and Codes (hereafter, fiscal ROSCs). These developments reflected a clear consensus that fiscal transparency is a key ingredient of good governance, which is of central importance to achieving macroeconomic stability and high-quality growth. To expand and explain the principles of the Code, and to help guide the conduct of fiscal ROSCs, the first version of this *Manual on Fiscal Transparency* (hereafter, the Manual) was issued the same year.<sup>1</sup>

2. The original objectives that guided the development of the fiscal transparency program remain valid today and underpin the 2007 revisions of the Code and Manual. First, fiscal transparency requires providing comprehensive and reliable information about past, present, and future activities of government, and the availability of this information informs and improves the quality of economic policy decisions. Fiscal transparency also helps to highlight potential risks to the fiscal outlook, resulting in an earlier and smoother fiscal policy response to changing economic conditions, thereby reducing the incidence and severity of crises. Second, fiscal transparency benefits citizens by giving them the information they need to hold their government accountable for its policy choices. Third, more transparent governments also benefit from improved access to international capital markets.<sup>2</sup> The greater oversight by civil society and international markets further reinforces the first objective by encouraging governments to pursue sound economic policies and achieve greater financial stability.

3. Fiscal transparency is a relevant goal for all countries. The Code therefore denotes good practices that are potentially achievable by countries at all levels of economic development. The Code is one of 12 financial standards that have been recognized by the international community and for which ROSCs are prepared.<sup>3</sup> In addition to fiscal transparency, the Fund has developed standards covering data, and monetary and financial policy transparency, as an integral part of its surveillance objectives. Member country compliance with the transparency standards is complementary to surveil-

<sup>1</sup>This version of the Manual (May 2007) replaces earlier versions posted on the IMF website in November 1998, April 1999, and March 2001.

<sup>2</sup>See Hameed (2005), Glennerster and Shin (2003), and Gelos and Wei (2002).

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

### Box 1. Selected Transparency Initiatives

#### IMF Fiscal Transparency Code

The Code, revised in 2007, is voluntary in nature. It provides a comprehensive framework for fiscal transparency and focuses on clear roles and responsibilities, transparent budget processes, public availability of information, and assurances of integrity.

#### OECD Best Practices for Budget Transparency

The OECD best practices were issued in 2001 and are to be used as a reference tool. They support the full disclosure of all relevant fiscal information in a timely and systematic manner and provide a series of best practices in the areas of principal budget reports, specific disclosures, quality, and integrity. <http://www.oecd.org/dataoecd/33/13/1905258.pdf>.

#### World Customs Organization (WCO) Arusha Declaration

The Arusha Declaration, revised in 2003, provides guidance on key elements needed to support effective national customs integrity programs. It has a specific section on transparency, which deals with customs laws, regulations, procedures, administration, review mechanisms, and performance standards. <http://www.wcoomd.org/ie/index.html>.

#### Open Budget Initiative

The Open Budget Index (2005) provides ratings of the openness of budget material in 59 countries to their citizens. It is based on a detailed and systematic survey of current practice by local experts. The Index assesses the availability of key budget documents, the quantity of information they provide, and the timeliness of their dissemination to citizens in order to provide reliable information on each country's commitment to budget transparency and accountability. <http://www.openbudgetindex.org>.

#### Extractive Industries Transparency Initiative (EITI)

The EITI is a multi-stakeholder initiative, launched in 2002, promoting the publication of regular reports of revenue received by the government and paid by the extractive industry sector with respect to specified natural resources. The EITI requires the involvement of civil society and a timetable for implementation of EITI requirements. Reports will be verified by an independent auditor, and a validation process will verify a country's status. On fulfillment of the EITI criteria, candidate countries may be judged EITI compliant. <http://www.eitransparency.org>.

lance, which entails monitoring and consulting with country authorities on a wide range of economic policies to assess economic vulnerabilities.

4. Interest in promoting fiscal transparency has grown considerably since the inception of the Code. A number of transparency initiatives in the fiscal area have been established, including the Organization for Economic Cooperation and Development (OECD) best practices for budget transparency, issued in 2001; the multi-stakeholder Extractive Industries Transparency

Initiative (EITI), launched in 2002, to address resource revenue transparency issues in resource-rich countries; and publication by the Open Budget Initiative of assessments of the information provided to citizens in key budget documents in 59 countries in 2005 (see Box 1). In addition, for countries that receive official development assistance, assessments under the multi-donor Public Expenditure and Financial Accountability (PEFA) program include a series of performance indicators covering aspects of fiscal transparency, crucial for effective public financial management, which are derived in part from the Code. The Code has also been used by the private sector as a framework for evaluating fiscal transparency.<sup>4</sup>

5. Reflecting the unique set of problems faced by countries that derive a significant share of revenues from natural resources, the IMF issued a *Guide on Resource Revenue Transparency* (hereafter, the Guide) in 2005. The Guide provided a summary overview of generally recognized good or best practices for transparency of resource revenue management consistent with the principles of the Code. The Guide, which gives a framework for the consideration of resource-specific issues as part of a fiscal ROSC, has been updated in line with the revised Code and Manual.

### **Fiscal ROSCs (Fiscal Transparency Modules of Reports on the Observance of Standards and Codes)**

6. The purpose of a fiscal ROSC is to identify a country's fiscal strengths and vulnerabilities and to establish priorities for reinforcing its fiscal institutions in order to improve fiscal transparency.<sup>5</sup> By identifying and raising awareness of important fiscal risks, fiscal ROSCs play a useful role in the surveillance process. The assessments and recommendations in fiscal ROSCs have proved helpful to governments in determining requirements for capacity building and have thus become an important resource for prioritizing possible technical assistance from the IMF and other providers. In some cases, countries may also seek technical assistance in public financial management, tax administration, or fiscal transparency, before undertaking a fiscal ROSC.

7. Fiscal ROSCs are carried out at the request of a country's authorities. Both a decision to undertake a ROSC assessment and a decision to publish the report are completely voluntary. The publication of the fiscal ROSC represents a commitment by the country to make improvements in fiscal transparency. These improvements can be periodically noted in published updates or reassessments of fiscal transparency, and may be reinforced by positive responses to fiscal ROSCs by private markets and donors. It is generally accepted that public trust in fiscal management is thereby enhanced, and a better informed civil society is able to make and promote better fiscal decisions.

8. Preparation and publication of a fiscal ROSC adheres to a set format. Following confirmation by Fund staff of a written request from a country's authorities, the participating country completes and returns a standard

<sup>4</sup>See Petrie (2003). One example of private sector use of the Code is Oxford Analytica's series of assessments for the California Public Employees' Retirement System, of monetary transparency and fiscal transparency against IMF standards, for 27 emerging market countries. <http://www.oxan.com/cr/projects/calpers.asp>.

<sup>5</sup>See <http://www.imf.org/external/np/ros/rosc.asp?sort=topic#FiscalTransparency> for published fiscal ROSCs.

questionnaire on fiscal institutions.<sup>6</sup> A Fund staff mission will then visit the country, normally for about two weeks, and prepare a draft report outlining observance of each of the good practices specified in the Code. In some cases, a resource revenue module is also completed by the IMF. A staff commentary in the draft ROSC will summarize achievements against the Code and provide recommendations for improving transparency. These recommendations are tailored for country-specific circumstances, with an indication of possible timelines and priorities. The draft report is discussed with country authorities and subject to internal IMF review before finalization.

9. By end-2006, about half the IMF membership had undertaken fiscal ROSCs and nearly all fiscal ROSCs had been published on the IMF external website. Participants represented all the major regions of the world and all levels of economic development. As countries strengthen their fiscal institutions and improve adherence to the Code's good practices, it is becoming increasingly important to follow up fiscal ROSCs on a systematic basis, either by undertaking further full ROSC exercises (known as fiscal ROSC reassessments) or by issuing a ROSC update, often completed in the context of a Fund surveillance or technical assistance mission. Publication of ROSC reassessments or updates on the IMF external website helps ensure that information remains accurate and gives recognition to countries for improving fiscal transparency.

10. Evidence from the fiscal ROSCs that have been undertaken to date suggests that some good practices of fiscal transparency are generally well observed across all countries. For example, data on the annual budget outturn are normally reported in a timely fashion. Comprehensive data on public debt are also regularly reported. Many countries, including developing and transition economies, use a uniform budget classification that is consistent with the *Government Finance Statistics Manual 2001* (GFSM 2001).

11. Other strengths and weaknesses in fiscal transparency tend to vary by region and by level of economic development.<sup>7</sup> There is some indication that countries are learning from the fiscal reform initiatives of their neighbors. Countries involved in the European Union (EU) accession process showed an early interest in undertaking ROSCs and made considerable progress, which is documented in numerous updates for these countries.<sup>8</sup> Interest has also been strong in Latin America and the countries of the Commonwealth of Independent States. For the latter, the area requiring most improvement is in defining the role of government and identifying and reducing quasi-fiscal activities (QFAs) of public corporations. Countries in all regions could improve fiscal transparency by improving budget realism, simplifying the tax system, and reducing discretion in tax administration. Many emerging market countries also need to improve reporting of contingent liabilities and quasi-fiscal activities, broaden coverage of the general government, and develop medium-term frameworks that fully inform the annual budget process. Low-income countries have more basic problems in producing quality data and developing stronger internal and external audit functions. Finally, those countries that are more decentralized tend to need to improve the transparency of intergovernmental relations.

<sup>6</sup><http://www.imf.org/external/np/fad/trans/index.htm>.

<sup>7</sup>IMF (2003b).

<sup>8</sup>See Allan and Parry (2003) for a description of fiscal transparency in the EU accession countries.



## The Revised Code (2007)

12. The revised Code (2007) is an updated version of the 2001 Code. It reflects several recent developments. In July 2005, the Executive Boards of the IMF and the World Bank evaluated the Standards and Codes Initiative, including fiscal ROSCs.<sup>9</sup> IMF Directors noted that the Standards and Codes Initiative had been particularly successful in identifying vulnerabilities and establishing priorities for strengthening domestic institutions, but had not yet had a large impact on the actual implementation of reforms. At the same time, in assessing experience to date with fiscal ROSCs, Fund staff had observed that several improvements to the structure and content of the Code might facilitate ROSC assessments. For example, a different ordering of the pillars of fiscal transparency (with budget processes addressed before provision of information to the public) could reduce duplication of material during ROSC assessments. Also, making explicit in the Code certain material that was previously only in the Manual would enhance the transparency of the process. The Code could in addition be revised to support more explicitly the Guide, which contains good practices related to the particularly complex transparency issues faced by countries with substantial resource-related revenues, and to reflect developments in public sector accounting and audit standards and emerging issues in public financial management.

13. A draft of the revised Code was issued for public consultation in October 2006 and a questionnaire was sent to country authorities, development agencies, academics, public and private sector users of fiscal ROSCs, and nongovernmental organizations working in the area of budget transparency. All the material was made available on the Fund website.<sup>10</sup> The Code was then further revised in light of the extensive comments received. Suggestions made during the public consultation process were also reflected in the revised versions of the Manual and Guide.

14. Public comments on the revised Code covered a broad range of issues. Respondents generally expressed substantial support for the enhanced references in the circulated draft Code to resource revenue, transparency of government contracts, and disclosure of the costs of government guarantees and other contingent obligations. In addition, suggestions were received during the consultation process that led to further revisions in the Code. These revisions included the need for a widely available summary, or “citizen’s guide,” to the budget, the broadening of long-term analysis beyond a focus on demographic change, and the inclusion in the Code of taxpayer rights. Other suggestions that were reflected in revisions to the Code were to provide estimates of the broader economic impact of new policies, to clarify the importance of accessibility to information and the actual implementation of policies, and to reinforce the role of the national audit office, including monitoring the response to audit findings. Some further topics raised in the public consultation process led to more extensive treatment of specific issues in the revised Manual, including problems related to giving notice of tax policy changes, increased coverage of tax administration, the importance of public-private partnerships, and the need to address fiscal transparency at the subnational level of government.

<sup>9</sup>Public Information Notice (PIN) No. 05/106.

<sup>10</sup><http://www.imf.org/external/np/sec/pr/2006/pr06223.htm>.

## How Has the Code Changed?

15. 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. The four pillars<sup>11</sup> of the Code also remain unchanged; the only difference is the order in which they are presented, and some reorganization to improve the overall coherence of the Code.

16. The first pillar of the Code—*Clarity of Roles and Responsibilities*—contains two core practices, on the clear distinction between government and commercial activities and on a clear legal framework governing fiscal administration. Supporting practices with respect to a clear legal framework have been extended or strengthened and treat more explicitly transparency issues regarding natural-resource-related activities and similar issues regarding contractual arrangements between the government and either public or private operators. The practice on extrabudgetary funds has been moved to the second pillar of the code.

17. The second pillar of the Code has been reordered and renamed—*Open Budget Processes*—and covers core practices on transparent budget preparation, execution, and monitoring. New elements in the second pillar include the requirement of adequate time for legislative consultation, and an increased emphasis on the importance for transparency of the quality of the assumptions and realism of the overall budget, as well as on the presentation of final audited accounts to the legislature. A few practices have been shifted to the third or fourth pillars of the Code.

18. The third pillar—*Public Availability of Information*—continues to emphasize the importance of publishing comprehensive fiscal information. This pillar now contains a more complete list of information requirements that may be found in either budget documentation or other fiscal reports, and encompasses a number of practices related largely to the provision of information that were previously covered under *Open Budget Process*. Good practices in fiscal reporting have been clarified or strengthened, and a new practice has been added to cover long-term assessments.

19. The fourth pillar—*Assurances of Integrity*—deals with the quality of fiscal data and the need for independent scrutiny of fiscal information. A number of practices from other areas in the original Code have been relocated to this pillar and grouped under a new core principle on internal oversight and safeguards for added emphasis.

20. The Code has been strengthened by the addition of some new good practices and the enhancement of others. Many of these changes to the Code were designed to permit a fuller treatment of resource revenue transparency (1.2.4, 1.2.5, 3.1.4) and transparent revenue administration (1.2.1, 1.2.2, 1.2.3, 4.2.6). New practices include

- a period of time for public consultation on proposed policy or regulatory changes (1.2.3);

<sup>11</sup>The pillars were called “general principles” in the first edition of the Manual.

- contractual arrangements between the government and public or private entities that are clear and publicly accessible (1.2.4);
- a legal basis for liability and asset management practices, including rights to use or exploit public assets (1.2.5);
- a calendar for budget preparation that is followed in practice, allowing sufficient time for legislative review (2.1.1);
- supplemental revenue or expenditure proposals that are classified in a manner consistent with the original budget (2.2.3);
- separate identification of major revenue receipts, including from resource-related activities and foreign assistance, in budget documents (3.1.4);
- publication of a periodic report on long-term public finances (3.1.7);
- wide distribution of a clear and simple summary of the annual budget (3.2.1); and
- purchases and sales of public assets to be conducted in an open manner with major transactions separately identified (4.2.4).

21. Other revisions to the Code broaden some practices to incorporate additional requirements, such as presenting the budget within a medium-term fiscal framework (2.1.2); requiring an audit of the final accounts (2.2.4); specifying reporting on “significant nondebt liabilities,” including government guarantees and unfunded pensions (3.1.5); explaining historical data revisions or changes in classification (4.1.3); and a monitoring mechanism to ensure that recommendations of external audit reports are addressed (4.3.2).

## The Role of the Manual

22. The Manual seeks to expand and explain the pillars and principles of the Code and to provide richer and more in-depth coverage of each good practice. Improvements in public financial management and tax administration usually enhance fiscal transparency, and in recognition of this positive relationship, the Manual contains relevant references to these important matters. However, it is not intended as a guide to good financial management. Similarly, the Manual avoids making general fiscal policy recommendations, while providing guidance on how to make certain activities more transparent. In a number of areas, such as public-private partnerships, extrabudgetary funds, and fiscal responsibility laws, the inclusion of transparency requirements should not be taken as an endorsement of the practices themselves. Although some good practices are relatively straightforward, others require more explanation. Therefore, the length of discussion in the Manual regarding each practice should not be interpreted as an indication of greater or lesser importance.

23. The Manual aims to inform a range of different audiences. First of all, country authorities with an interest in promoting fiscal transparency can

review the detailed descriptions, country examples, and research, and use them to guide the development of more robust fiscal transparency practices.<sup>12</sup> Second, the Manual is a comprehensive tool for the IMF itself, and assists staff in undertaking fiscal ROSC assessments and other country surveillance work. Third, civil society organizations have used the Manual to support and complement their efforts in promoting fiscal transparency. Complementary transparency initiatives are also referenced in the Manual. Fourth, it serves as a useful reference document for academia. Finally, and importantly, the Manual is a helpful tool to assist legislatures in holding the executive accountable for more transparent practices.

24. Fiscal transparency is important for all levels of government. Most of the Code can be equally applied to subnational governments, and their compliance with good practices should be encouraged. Similarly, many good practices also apply to public corporations, which should, in particular, operate in an open manner, publish annual reports, and be subject to an annual external audit. Although the Code is primarily focused on transparency practices for central government, it requires that reports on subnational governments and public corporations be available to the central government so that it can monitor general government and public sector finances. It is recognized that this could be a challenge for some countries, especially for those where the subnational levels of government have weak financial management systems. Therefore, the application of some elements of the Code may, in certain cases, be limited, at least in the first instance, to the central government. It is also recognized that the constitutional relationship between central and subnational governments in a few countries constrains the reporting by central government of general government activities and finances.

25. Implementation of all the good practices of the Code may be challenging for many countries because of weak capacity in public financial management. To assist such countries in setting priorities, the Manual sets out some basic requirements of fiscal transparency, which should help them build a sound foundation for fiscal transparency. These basic requirements should not be considered minimum standards, but rather a starting point toward fulfilling all Code practices. A number of complementary best practices are also highlighted in the Manual for countries that already meet good practice and are interested in improving fiscal transparency even further.<sup>13</sup> Countries that have implemented many or most good practices are encouraged to view best practices as their ultimate goal for fiscal transparency.

<sup>12</sup>The Manual's discussion of how the good practices in the Code might be implemented is drafted to apply to most countries. It is recognized, however, that institutional, constitutional, and legal differences among countries will mean that the specific desirable implementation of good practices in a particular country may differ from what is described in the Manual.

<sup>13</sup>Some examples include OECD, the International Organization of Supreme Audit Institutions (INTOSAI), and the United Nations.

## Revisions to the Manual

26. While the structure and much of the core contents remain intact, extensive changes have been made within various sections of the Manual. In part, these are the consequence of reorganizing and deepening some material to be consistent with the revised Code. But there have also been detailed revisions to the text to expand content, document additional country examples from ROSC findings, and add references. As before, the Code and the

Manual draw on the work of other standard setters, including the International Accounting Standards Board, the International Federation of Accountants, the International Organization of Supreme Audit Institutions (INTOSAI), and the work of international organizations, such as the United Nations, the World Bank, the European Union, the World Trade Organization, and the Organization for Economic Cooperation and Development. The Manual has been expanded to include links to the Guide and to address more specifically the unique set of challenges faced by countries that derive a significant share of revenues from natural resources.

27. The practical examples in the Manual of good and best practices in fiscal transparency to be shared with member countries have been updated to incorporate more recent information. The identification of basic requirements of fiscal transparency has also been simplified (Appendix): the aim now is to indicate broad principles that need to be observed, rather than to list specific good practices.

28. As before, the first chapter of the Manual discusses roles and responsibilities and sets out clear definitions of the public sector and its parts and other terms used throughout the Code and Manual. However, the discussion and definition of government has been expanded and is consistent with general government as defined in the IMF *Government Finance Statistics Manual 2001*. Additional material and boxes include nonmarket nonprofit institutions, intergovernmental relations, public-private partnerships, transparent debt and asset management, and issues related to resource revenue transparency.

29. The second chapter, which now focuses on the budget process, begins with new material on budget calendar requirements, the need for budget realism, and transparency of supplemental budgets. New boxes have been added covering topics on fiscal responsibility and transparency laws, poverty and social impact analysis, extrabudgetary activities, performance-based budgeting, and international public sector accounting standards.

30. The third chapter, which now discusses publication and reporting content requirements, includes new material on the separate identification of major revenue receipts, a citizens' guide to the budget, types of nondebt liabilities, transparency of natural resource assets, periodic reporting on long-term public finances, government guarantees, and freedom of information acts.

31. The fourth chapter continues to cover issues related to data quality and assurances of integrity, but now includes new information on accounting standards, transparency in revisions of historical data or reclassification, transparency requirements in the sale of public assets including privatization, the INTOSAI *Lima Declaration*, and INTOSAI guidelines for internal control standards.



## Clarity of Roles and Responsibilities

32. This chapter discusses fiscal transparency principles and practices that concern the scope of government and the framework for fiscal management. They are crucial as a basis for assigning accountability for the design and implementation of fiscal policy. Identification of all those entities that provide a public good or service provides the public with an understanding of the true scope of government. A legal and administrative framework that clearly assigns the roles and responsibilities of government in the collection and use of public resources promotes accountability and good governance.

### 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 be publicly disclosed.

33. The Code includes good practices relating to (1) structure and functions of government; (2) roles of the executive, legislative, and judicial branches of government; (3) responsibilities of levels of government; (4) relationships between government and public corporations; and (5) government involvement in the private sector.

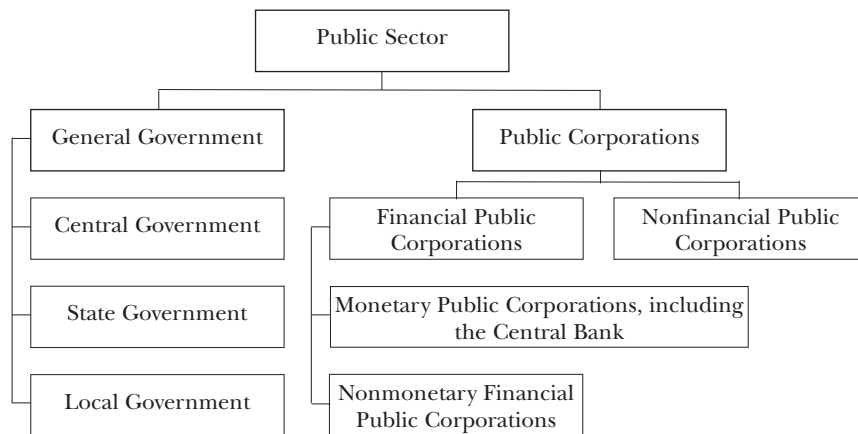
34. Basic requirements under this principle are to ensure that

- a published institutional table clearly shows the structure of the public sector, identifying all government entities by level of government, as well as public corporations;
- the extent and purpose of all quasi-fiscal activities is explained; and
- revenues and responsibilities are clearly assigned between different levels of government.

### The structure and functions of government

1.1.1 The structure and functions of government should be clear.

Figure 1. Public Sector



35. The public sector consists of the general government sector and public corporations.<sup>14</sup> The two main types of public corporations are nonfinancial public corporations and financial public corporations, which include the monetary authority (central bank) and nonmonetary financial corporations.<sup>15</sup> Separation of government functions from commercial and monetary activities helps to establish clear accountability for the conduct of these very different activities and facilitates assessment of the macroeconomic impact of fiscal activities. To help achieve clarity in the description of the structure of government, the publication of an institutional table<sup>16</sup> showing the structure of government and the rest of the public sector is a requirement of fiscal transparency. The institutional table should include entities that make up the subsectors of the public sector shown in Figure 1.

36. A fundamental first step in developing fiscal transparency is to identify all those entities that carry out government functions. Government functions are defined as activities related to the implementation of public policies through the provision of nonmarket<sup>17</sup> services and the redistribution of income and wealth, financed primarily by taxes and other compulsory levies on nongovernment sectors. However, defining the boundaries of government and of the public sector is a complex task, and one that is particularly challenging for countries undergoing rapid change.

37. The Code uses the term “government” to describe the general government sector as defined in the United Nations (UN) *System of National Accounts*, 1993 (SNA) and the 2001 IMF *Government Finance Statistics Manual 2001* (GFSM 2001).<sup>18</sup> The general government sector consists of all government units and all nonmarket nonprofit institutions (NPIs) that are controlled and mainly financed by government. Government units encompass all national and subnational institutional units that perform functions of government as their primary activity. This would include any entities that receive the majority of their funds through transfers, earmarked revenues, or other government sources to carry out government functions, as well as any spending of public money for fiscal purposes even if not covered

<sup>14</sup>The terms and concepts defined in this section are based on the definitions provided in Chapter II of the IMF’s *Government Finance Statistics Manual 2001* (GFSM 2001). Readers are encouraged to refer to this manual and companion material (<http://www.imf.org/external/pubs/ft/gfs/manual/index.htm>) for a more in-depth understanding.

<sup>15</sup>The GFSM 2001 uses the term “public corporation” uniformly to replace the terms “public enterprise” and “public financial institution,” and this practice is followed throughout this document.

<sup>16</sup>Examples of institutional tables for selected countries can be found in the annual *Government Finance Statistics Yearbook*.

<sup>17</sup>Output is defined as nonmarket if it is supplied free or at prices that are not considered economically significant to influence its demand or supply. The GFSM 2001 (p. 10) notes that it can be difficult to determine whether an entity should be classified as government or a public corporation when it sells its output. Although the main criterion for classifying a public corporation is that it sells most or all of its output at market prices, the market price can be difficult to determine for many public sector goods and services.

<sup>18</sup>See the GFSM 2001 at <http://www.imf.org/external/pubs/cat/longres.cfm?sk=15203>.

### Box 2. Nonmarket Nonprofit Institutions

Identification of government entities is sometimes difficult. For example, entities may have a separate legal identity; substantial autonomy from the executive, including discretion over composition of their expenditures; and a direct source of revenue through a transfer or earmarked revenue. However, if they engage in nonmarket activities, are financed primarily by taxes (or other compulsory transfers), and/or are directed by a government entity, these entities are in fact government entities and should be included in the formal definition of government operations. These entities are nonmarket nonprofit institutions (NPIs) and should be included in general government operations.

Governments may choose to use nonmarket NPIs rather than government agencies to carry out certain activities because they may be seen as detached, more objective, and less subject to political pressure. Examples include institutions for research and development, and for the setting and maintenance of health, safety, education, or environmental standards. Sometimes nonmarket NPIs may be created for efficiency reasons, including where legal requirements that apply to government would otherwise impede their operations. Determining whether a government exercises control over the operations of an entity is a judgment call that is based on whether it has the ability to determine general policy, either by having the right to appoint the officers managing the NPI or through financial means. According to the GFSM 2001, an NPI is financed mainly by government when most of its operating funds are provided by a government unit or earmarked tax revenue.

Fiscal transparency requires that all nonmarket NPIs (also sometimes referred to as autonomous entities) be fully included in budget documentation and reports on general government activities. Evidence from fiscal ROSCs indicates that many countries currently fall short of this requirement. In some of these countries these types of entities undertake a substantial amount of fiscal activity, and their omission from general government statistics greatly skews the understanding of the size and scope of government and may lead to understating government involvement in key sectors, such as health and education. Furthermore, the existence of nonmarket NPIs and autonomous entities that carry out a mixed bag of activities, some market and some nonmarket, often leads to different official definitions of general government by different government agencies. This can make it particularly difficult to interpret and reconcile different statistical reports.

by institutional arrangements.<sup>19</sup> Revenue and expenditure that are not included in the annual budget appropriations are referred to as “extrabudgetary” and may be associated with two types of institutions that can be found at all levels of government and should be included in the institutional table: “extrabudgetary funds” (see Box 13 in Chapter II for further details) and nonmarket nonprofit institutions. Nonmarket NPIs perform activities on a noncommercial basis and are financed mainly by government transfers or earmarked revenues, but may also have other sources of revenue. Extrabudgetary funds and nonmarket NPIs are both quite common, but the latter are more problematic for defining government, as explained in Box 2 (see also the GFSM 2001 for further details on nonmarket NPIs). As such,

<sup>19</sup>This includes ad hoc or regular expenditure of public money not appropriated by the legislature. For example, the expenditure of oil bonus revenue should be included in general government revenue and expenditure, even if it is not appropriated or included in the budget of any government entity.



the general government sector can be defined as all the public institutional units that are nonmarket producers. Government-controlled units that are market producers are not part of general government; they comprise the rest of the public sector.

38. Good practice for fiscal transparency requires that all of these types of activities be included when referring to government, not only conceptually by including them in an institutional table of government, but in budget documentation and fiscal reports.<sup>20</sup> Furthermore, the definition of general government and institutional table should be uniformly applied by all agencies reporting on government activities. 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.<sup>21</sup>

## Roles of the executive, legislative, and judicial branches

### 1.1.2 The fiscal powers of the executive, legislative, and judicial branches of government should be well defined.

39. The Code requires that the roles of different branches of government in fiscal management be clearly defined but does not advocate a particular structure of government on the basis of fiscal management concerns. Relationships between different branches of government 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 of budget institutions on fiscal outcomes.<sup>22</sup> The authority of different branches of government at different stages of the budget process should be clearly defined in a budget system law or the constitution. For example, the executive may be given power to conduct fiscal policy when the budget for the fiscal year has not been adopted by the legislature before the start of the fiscal year to which it relates.

40. The powers and limits of each branch with respect to changes in the budget during the fiscal year should be clearly specified in the legal framework. In presidential (as opposed to parliamentary) systems it is more common for the legislature to introduce changes to the draft budget. Where this occurs, the draft budget submitted by the executive to the legislature as well as the final budget approved by the legislature should be publicly available to allow the public to hold each branch accountable for its part in the budget process.

41. The legislative and judicial branches should play an active role in ensuring the availability and integrity of fiscal information.<sup>23</sup> This would include having an active committee of the legislature to oversee the conduct of fiscal policy and to facilitate civil society input into budget deliberations (e.g., through receiving public submissions). With respect to the judicial branch, taxpayers as well as recipients of specific public services, public pensions, or other social insurance should be able to challenge the legality of a ruling by appeal to the courts. In some cases decisions by the courts can have significant fiscal impact.

<sup>20</sup>An example of good practice is *Honduras*, where the new budget system law passed in 2004 defines general government and public sector in accordance with the GFSM 2001. This entailed budgeting and reporting for noncommercial decentralized agencies that were previously excluded (see *Honduras*, Fiscal ROSC-Update, 2005, paragraph 4). *El Salvador* is another country where there is a fairly clear distinction between decentralized public institutions performing noncommercial functions, which are included in the budget and government finance statistics, and those performing commercial functions, which are included only in statistics on the public sector. However, some extrabudgetary expenditures remain (see *El Salvador*, Fiscal ROSC, 2005, paragraph 2).

<sup>21</sup>See <http://www.europa.eu.int/comm/eurostat>.

<sup>22</sup>See, for instance, Alesina and Perotti (1995 and 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.

<sup>23</sup>The 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.

## Responsibilities of different levels of government

1.1.3 The responsibilities of different levels of government, and the relationships between them, should be clearly specified.

42. A clear demarcation of roles within government is essential for transparency. At the broadest level, it is necessary to clearly define the allocation of tax powers, powers to borrow or incur debt, and expenditure responsibilities between different levels of government. The intergovernmental structure varies widely among countries, ranging from federations in which individual states or provinces have considerable powers to unitary forms of government. At the local level the inclusion of many informal as well as formal government structures may further complicate the picture. Even within governmental structures that look similar, the precise allocation of revenue and financing powers and expenditure responsibilities varies widely. It may also vary substantially over time. Fiscal transparency requires that the allocation of powers and responsibilities be based on clear principles, stated within the law or constitution. The powers and responsibilities at each level of government should also be exercised in an open and consistent way.

43. Where they exist, shared revenues and intergovernmental transfers should be clearly specified, preferably based on stable criteria or formulas rather than discretionary criteria or negotiations. Unfortunately it is common for transfers to be negotiated annually, which is neither stable nor transparent. A formula with well-defined parameters provides the most transparent option for distributing intergovernmental fiscal transfers. Distribution based on “need” where “need” is not well defined opens the process to subjectivity and reduces transparency. Project grants are also more subjective in nature, but transparency can be enhanced if the criteria and basis for decisions are made public.

44. Fiscal transparency of subnational levels of government and in relationships between levels of government is especially important where countries are devolving fiscal responsibilities. Decentralization has become a popular strategy based on the premise that lower levels of government can better respond to local demands and needs at lower cost. Many countries have recent legislation that assigns or reassigns the responsibilities of the different levels of government.<sup>24</sup> Under these circumstances, the opportunities for duplication of responsibilities and unclear assignment of revenue or expenditures are many. Furthermore, because of inequality across regions, most countries that pursue decentralization have introduced new legislation regarding tax sharing and intergovernmental transfers to address such inequalities. Finally, the effectiveness of this strategy critically depends on the ability of citizens to hold local government officials accountable. Numerous factors may impact local government accountability, but one critical factor is the quality and public availability of fiscal data at the local level. The more decentralized the revenue and spending decisions, the more important it becomes to ensure that lower levels of government also follow good practices on fiscal transparency.

45. For countries with significant resource revenues, the distribution of resources between levels of government has an added dimension.

<sup>24</sup>*Mozambique* has recently set up a new institutional framework for intergovernmental relationships, with relatively clear and simple rules (see *Mozambique*, Fiscal ROSC, 2001, paragraph 5). In *Colombia*, legislation clearly and transparently establishes the amount of resources to be transferred, the rules of growth of the transferred resources, and criteria applicable for distributing resources among departments, districts, and municipalities (see *Colombia*, Fiscal ROSC, 2003, Box 1).

Arrangements to assign or share revenues from these resources between central and lower levels of government should be well defined and any modification of the system should be subject to clear rules and procedures.<sup>25</sup> There are a number of arguments that favor placing control of resources at the national level, such as the ability to control spending and save windfall revenues and to facilitate policy coherence for achieving macroeconomic objectives. But in many instances resource revenues are either under the control of subnational governments or are used to finance their activities. In countries where subnational levels of government enjoy a high degree of independence, it can be challenging to design a transparent revenue-sharing system that meets all objectives.

46. Central governments need adequate information on fiscal activities of lower levels of government in order to have a full picture of general government activities. This is particularly important where subnational governments have access to borrowing, including from international lenders. In many countries central governments carry an implicit contingent liability on subnational government debt, and in these cases monitoring of subnational governments is particularly important. This can be very challenging because many subnational governments do not provide good fiscal data in a timely manner. Furthermore, subnational governments may have hidden liabilities such as unmonitored arrears, or contingent liabilities for local public corporations. In some countries fiscal responsibility legislation includes reporting and other requirements for subnational governments.<sup>26</sup> In cases where subnational governments have become overindebted and central government bailouts have been required, the bailouts usually come with certain agreements with the subnational government to ensure that it improves its fiscal position and eventually repays the central government. When such agreements are made, their terms should be publicly available.

## Relationships between the government and public corporations

1.1.4 Relationships between the government and public corporations should be based on clear arrangements.

47. Fiscal transparency requires that the financial relationships between the government and public corporations be clearly stated. In particular, because public corporations are owned in whole or in part by the government, there should be clear expectations of how profit transfers or dividend payments to the government will be determined. The annual report of the public corporation should provide details on total profit, retained earnings, any other uses of profit, and the amount transferred to the budget, and this information should also be included in the annual budget documentation. In some countries profits may be transferred to extrabudgetary funds, used directly to finance or purchase a public good, or even paid in kind for government use. For purposes of fiscal transparency, all payments by public corporations, including taxes, royalties, dividends, or profits, should be reported in the annual report of the corporation as well as in budget documentation. Any in-kind payments should be

<sup>25</sup>*Nigeria* has reached agreement on revenue sharing formulas for oil- and gas-related revenues among federal, state, and local governments. Disbursements to all territorial entities are published every month at <http://www.fmf.gov.ng>. To manage the macroeconomic impact of the oil resources, consensus was reached to limit release of oil revenues to the budgets by saving revenues in excess of a budgetary reference oil price.

<sup>26</sup>In *Peru*, the 2003 *Fiscal Responsibility and Transparency Act* requires that the central government guarantee external debt contracted by subnational administrations; such external debt is to be used only to finance public investment; the debt-to-current revenue ratio and annual debt service-to-current revenue ratio must be below 100 and 25 percent, respectively, for each subnational government; and the three-year average primary balance of subnational governments must be positive.

valued at their market value in the budget. Conversely, if the government makes transfers to the public corporation, they should be included in the annual budget. Again, both the budget and the annual reports of the corporation should identify transfers from the government to the corporation.

48. Some functions, referred to as quasi-fiscal activities (QFAs), are carried out on behalf of the government by public corporations or, more rarely, private entities. QFAs can have significant implications for public policy and the general government financial position, but these fiscal effects are not usually reflected in fiscal reports for the general government. For instance, financial or commercial institutions may be asked to undertake lending at subsidized rates, the subsidy component representing a loss to the institution. However, if the government had directly subsidized the activity, it would have appeared as a subsidy in the government's budget and the policy cost would have been transparent. Hence, QFAs are a nontransparent means of implementing a fiscal policy that introduces significant fiscal risk. The costs of QFAs will be borne by the budget either through smaller profit transfers or, eventually, through a need to subsidize or recapitalize the public corporation. A central feature of fiscal transparency, therefore, is the open conduct of all fiscal activity, no matter where and how it takes place.

49. Fiscal responsibilities should generally be carried out by government entities, but because public corporations may also undertake noncommercial activities on behalf of government, fiscal transparency requires that the annual reports of public corporations identify these activities. These QFAs could be eliminated by including their cost in the budget through either a well-defined budget transfer to the public corporation or direct budget subsidy for the activity.<sup>27</sup> The cost and associated transfer from the government should also be explicit in the financial statements and annual reports of the public corporation. These clear arrangements reduce the risk that the nongovernment public sector, particularly financial corporations, will require unexpected financial support as a result of being asked to carry out fiscal policy objectives.

50. The converse of this situation can also be found, where government agencies provide commercial services, and hence have income from commercial charges. This was particularly common in transition economies where central planning had previously blurred the distinction between public and private sector activities. If a government agency carries out either banking or commercial functions, fiscal transparency requires that they be identified along with the fiscal policy objectives of these activities. The agency's budget should state both income from and costs for providing commercial activities. In many cases the agency is assigned regulatory oversight of the commercial activities it performs. To avoid this type of conflict of interest, and to clearly establish the fiscal responsibilities of government, commercial activities of government entities should be privatized or assigned to a public corporation that does not have regulatory functions.

### ***General government and the central bank***<sup>28,29</sup>

51. The primary responsibility of the central bank is to conduct the government's monetary policy. Increasingly, central bank responsibilities are

<sup>27</sup>In *Azerbaijan*, fuel subsidies provided by the national oil company, SOCAR, were eventually put on budget by recognizing the amount of the subsidy in the budget, while SOCAR received credit for taxes owed for the same amount (see *Azerbaijan*, Fiscal ROSC-Update, 2005, Section II).

<sup>28</sup>In the Code, and hereafter in the Manual, references to public financial corporations 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 corporations.

<sup>29</sup>The relationship between the central bank and government should be consistent with the principles of the International Monetary Fund's *Code of Good Practices on Transparency in Monetary and Financial Policies*.

being defined to give the bank as much autonomy as possible within a framework that ensures appropriate accountability.<sup>30</sup> 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.<sup>31</sup> In such countries, any activities carried out for the government are conducted on a commercial or at least cost-recovery basis.

52. 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). These operations may be used by governments as a substitute for direct fiscal action and will have similar economic effects. They will affect the operating balance of the central bank and hence should be taken into account in explaining and projecting the overall fiscal position. Fiscal transparency requires a clear definition of the institutional relationships between monetary and fiscal operations and a clear definition of the agency roles performed by the central bank on behalf of the government. See the *Code of Good Practices on Transparency in Monetary and Financial Policies* for more details.<sup>32</sup>

### **General government and public financial corporations**

53. Public financial corporations 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 corporations on a more ad hoc basis to provide quasi-fiscal assistance, for example, through policy-directed lending. Although an increasing number of state-owned banks have been privatized in recent years, they still account for a dominant share of the banking sector in many developing economies and may carry out QFAs.<sup>33</sup>

### **General government and nonfinancial public corporations**

54. Nonfinancial public corporations in many countries provide non-commercial services, usually by being required to charge less than cost-recovery prices (e.g., pricing electricity below cost to rural consumers). In a number of countries, nonfinancial public corporations 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, certain nonfinancial public corporations may charge excessive prices and transfer the supernormal profits to other corporations or to the budget. This practice confuses the fiscal responsibilities of government and the commercial role of nonfinancial public corporations, makes relationships between government and nonfinancial public corporations nontransparent, and creates difficulties in holding managers of nonfinancial public corporations accountable for their performance. Best practice

<sup>30</sup>In *Sweden*, the central bank undertakes no quasi-fiscal activities, and its independence is assured under amendments to the *1997 Sveriges Riksbank Act* (see *Sweden*, Fiscal ROSC, 2000, paragraph 5).

<sup>31</sup>Some examples include *Moldova*, *Mongolia*, and *Brazil*. Even if direct financing is prohibited, it is still possible for the central bank to buy government securities on the open market, or to influence the demand for such securities in other ways (e.g., by requiring their use in meeting reserve requirements).

<sup>32</sup>For a detailed discussion, see <http://www.imf.org/external/np/mae/mft/index.htm>.

<sup>33</sup>See Goldstein (1997).

### Box 3. OECD Principles of Corporate Governance: Principle V 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;
  - remuneration policy for members of the board and key executives, and information about board members, including their qualifications, the selection process, other company directorships, and whether they are regarded as independent by the board;
  - foreseeable risk factors;
  - issues regarding employees and other stakeholders; and
  - governance structures and policies, in particular the content of any corporate governance code or policy and the process by which it is implemented.
2. Information should be prepared and disclosed in accordance with high-quality standards of accounting financial and nonfinancial disclosure.
3. An annual audit should be conducted by an independent, competent, and qualified auditor in order to provide an external and objective assurance on the way that the financial statements have been prepared and presented.
4. Channels for disseminating information should provide for equal, timely, and cost-efficient access to relevant information by users.

<sup>34</sup>See the International Financial Reporting Standards (IFRS) (<http://www.iasb.org/Home.htm>) or the U.S. generally accepted accounting principles (<http://cpaclass.com/gaap/gaap-us-01a.htm>) as the primary examples. The Public Sector Committee of the International Federation of Accountants (PSC) has issued a Guideline stating that IFRS are applicable to government business entities.

<sup>35</sup>In the *United Kingdom*, nonfinancial public corporations operate on a commercial basis, with the costs of noncommercial activities being compensated for and reflected in the budget. In some countries, such as *France*, *Chile*, *Honduras*, and *Brazil*, QFAs have been reduced considerably by making explicit budget transfers for certain noncommercial activities conducted by public corporations (see *France*, Fiscal ROSC, 2000, paragraph 2; *Chile*, Fiscal ROSC-Update, 2003, paragraph 5; *Honduras*, Fiscal ROSC-Update, 2005, paragraph 4; and *Brazil*, Fiscal ROSC, 2001, paragraph 11).

for fiscal transparency, in these cases, would be the inclusion of a direct budgetary transfer to public corporations that covers the costs of QFAs. In a few countries, the government is contracting with a nonfinancial public corporation to provide a noncommercial service in return for an explicit budgetary transfer that reflects the price the government is willing to pay for the service. Similar contracts could also be agreed upon with public financial corporations.

55. Although the Code was not written for public corporations, many of its practices can and should be applied to them. In particular, they should operate in an open manner and their audited financial reports should be presented by the executive to the legislature and be published. Public corporations should apply internationally recognized accounting standards<sup>34</sup> so that their accounts can be properly audited by international accounting firms. Best practice is that public corporations should observe the relevant disclosure and transparency requirements of Principle V of the *OECD Principles of Corporate Governance* (OECD, 2004b). Box 3 spells out these requirements.<sup>35</sup>

**Box 4. Characteristics of Transparent Regulations:  
OECD Policy Recommendations**

- 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.

***National resource companies***

56. National resource companies (NRCs) are often responsible for both commercial operations and noncommercial activities, such as the provision of social or other services normally provided by the government; specific requirements for employment; and the provision of products for domestic consumption at less than cost recovery or below-market prices. Clarity of fiscal policy requires that the ministry of finance oversee such noncommercial activities. In addition, the cost of these activities in terms of lowering dividends and tax payments should be quantified and reported to the public. Clarity is also needed in defining the policy and regulatory role of the NRC vis-à-vis the sector ministry and ministry of finance. Good practice would be to clearly separate the commercial and noncommercial roles of the NRCs and leave oversight and policy decisions related to noncommercial activities to government ministries.

57. It is important to hold NRCs to the same corporate governance standards as other enterprises (see Box 4), including making audited accounting statements available to the public. Best practice statements would clearly identify all payments to the budget in the form of taxes, royalties, dividends, or any other form, such as in-kind payments.<sup>36</sup> Any transfers from the government to the NRC should also be disclosed. For instance, in some countries, the government has to make contributions to the production costs of joint ventures with private companies (*cash calls*) through the NRCs. The latter should be held accountable for the use of these government contributions.

**Government involvement in the private sector**

1.1.5 Government relationships with the private sector should be conducted in an open manner, following clear rules and procedures.

58. The government regulates 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 regulatory interaction with the private sector.

<sup>36</sup>See the Guide for further discussion of these issues and additional examples of QFAs provided by national resource companies.

### ***Regulation of the nonbank private sector***

59. Governments have become increasingly aware of the need for transparency in regulatory practices. This aspect of regulation is explicitly recognized in the *OECD Policy Recommendations on Regulatory Reform*, which also address the efficiency of regulation.<sup>37</sup> Best practice is that these recommendations be fully implemented.

60. There are other activities that the private sector carries out under the direction of or in conjunction with government that should share the characteristics of transparent regulations. These include the imposition of compliance costs of collecting taxes on private businesses and individuals; compulsory contributions to private providers of old age pensions, health, and insurance; and privately financed infrastructure projects. If policy or regulatory changes impose significant compliance costs on citizens or taxpayers, they should be given appropriate time to comply with the new laws or rules. To this end, explanatory material for the application of new laws or regulations should be publicly available and mechanisms should be in place whereby citizens can have their queries answered (e.g., by setting up a dedicated office to do so). A recent development in some advanced countries is a requirement to accompany the publication of new or amended tax legislation with a statement of the compliance cost of proposed measures.<sup>38</sup>

### ***Government involvement in the banking sector***

61. Government regulation of the banking sector—and the financial sector more generally—should also be based on clear policy goals. An appropriate framework for bank regulation, most notably that provided by the *Basel Core Principles for Effective Banking Supervision*,<sup>39</sup> 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 *IMF Code of Good Practices on Transparency in Monetary and Financial Policies* contains detailed good practices for government financial agencies responsible for regulation, supervision, and oversight of the financial and payment systems.

<sup>37</sup>See [http://www.oecd.org/topic/0,2686,en\\_2649\\_37421\\_1\\_1\\_1\\_1\\_37421,00.html](http://www.oecd.org/topic/0,2686,en_2649_37421_1_1_1_1_37421,00.html) for additional detail.

<sup>38</sup>In *Australia*, these are referred to as “compliance cost impact statements.”

<sup>39</sup>See Basel Committee on Banking Supervision (1997). 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 into a broader examination of financial sector stability.

### ***Direct equity investment***

62. Governments also intervene by directly acquiring private equity in companies or commercial banks. All government equity holdings should be identified in the budget documentation. See practice 1.2.5 for a discussion of transparent asset management, and practice 3.1.5 for a discussion of reporting requirements for financial assets, including equity investment in private companies. The acquisition or sale of equity should be clearly explained in the budget documentation (see also practice 4.2.4), and the policy objectives served by government equity holdings should be explained.

63. Direct equity participation in projects to develop natural resources is common, but often not very transparent. As noted in the Guide, equity can



be acquired under commercial terms or through concessionary purchases, including tax swapped for equity or other, often complicated, deals. As a general rule, favorable terms for government participation are usually offset elsewhere in terms of a lower share of profits or tax revenue. In these cases fiscal transparency requires not only disclosure of equity but an attempt to fully cost any offsetting concessions.

## Framework for Fiscal Management

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

64. The Code includes good practices relating to (1) comprehensive laws, regulations, and administrative procedures; (2) revenue collection; (3) public comment on legislative or regulatory changes; (4) contractual arrangements; and (5) liability and asset management.

65. Basic requirements under this principle are to ensure that

- no public funds can be spent without publicly available evidence of appropriation by the legislature; and
- revenue collection is governed by clear and easily accessible laws and regulations.

### Comprehensive laws, regulations, and administrative procedures

1.2.1 The collection, commitment, and use of public funds should be governed by comprehensive budget, tax, and other public finance laws, regulations, and administrative procedures.

66. One of the fundamentals of fiscal transparency is the need to have firm footing for the implementation of fiscal policies. This can be achieved by having clarity of purpose and a comprehensive framework for fiscal management, including legislation, regulations, and administration. Fiscal transparency requires that the legal framework for fiscal activity avoid excessive complexity and opportunities for official discretion. As noted in part 3.1.3, the framework should also require disclosure of fiscal activities and any quasi-fiscal arrangements. Although clear laws and regulations are critical for fiscal transparency, it is just as important for them to be followed in practice. Experience with fiscal ROSCs indicates that the key weakness is often in the effective implementation of the laws and regulations rather than in the laws themselves.

### *Explicit legal basis for revenue collection*

67. 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).<sup>40</sup> It is fundamental to fiscal transparency that taxation be under the authority of law and that the administrative application of tax laws be subject to procedural safe-

<sup>40</sup>The term “tax” in this section is used to refer to any compulsory payment under law, including customs duties.

guards, such as taxpayer rights and tax dispute procedures.<sup>41</sup> Tax laws should 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*. Taxpayers should have the right to challenge property or wealth assessments or any other tax ruling. As with budget laws, however, the legal framework for taxation needs to be developed in a way that reflects administrative capacity.

68. The practice of countries differs greatly in terms of where the administrative provisions of the tax laws are located. In some countries, each substantive tax law (e.g., for income tax or value-added tax) contains all the provisions necessary for its administration. In countries that organize all of their tax laws into one code, the tax administration provisions can be one or more titles of this code. Other countries have what may be called a tax administration law or a general law on taxation. Under this arrangement, the general law on tax administration contains those administrative provisions common to all tax laws, whereas each substantive tax law contains the administrative rules that are particular to that tax.

69. Tax laws should be well organized and include all elements needed to determine tax liabilities and to establish procedures for tax collection. To limit the size and complexity of tax laws, 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 (see practice 1.2.3 for further discussion).

70. Tax laws should provide taxpayers with the following rights or safeguards: (i) confidentiality—the right to have personal information accorded the greatest possible confidentiality with the tax authorities; (ii) notice—the right to be notified of an assessment, a decision on adjudication, or any collection action against the taxpayer's assets; (iii) explanation—the right to an explanation of why a tax is being assessed in the way it is and to an explanation of the reasons for a decision by adjudication; (iv) appeal—the right to an independent administrative appeal and a final judgment appeal; and (v) representation—the right to be represented by a qualified professional (attorney, accountant, etc.) in any dealings with the tax authority. These rights should be established in law and can also be incorporated in a taxpayers' charter or equivalent that is used to communicate taxpayer rights and to hold agencies accountable for their performance, including administrative discretion.

71. Collection of customs and non-tax revenues, such as duties, fees, and charges, should also have a legal basis. These laws should also specify the rights of citizens, dispute procedures, and the powers and limitation of the agencies involved in the collection of these revenues. These revenue measures should be easily accessible to the public and stable over time so that their existence and purpose are known to the public.

### ***Fiscal regime for resource sectors***

72. Governments raise revenue from resource companies by various means, including corporate income tax, as well as royalties, signature bonus payments,

<sup>41</sup>For 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 *Republic of Korea*, Fiscal ROSC, 2001, paragraph 8).

and/or profit oil in the case of production-sharing agreements. The combination of instruments for raising revenue is referred to as the fiscal regime. At one end of the spectrum of fiscal regimes, resource companies are subject to the same regime as other industries, with the addition of royalty charges or their equivalent. Inclusion of corporate tax provisions for petroleum in the general tax law offers a high degree of fiscal transparency. At the other extreme, various instruments and rates are applied on a case-by-case basis. According to the *Guide on Resource Revenue Transparency*, fiscal transparency requires that the government's policy framework and legal basis for taxation or production-sharing agreements with resource companies be clearly and comprehensively presented to the public. The more complex and discretionary the system, the more difficult it is to achieve fiscal transparency.

73. Investors often seek to protect themselves from unfavorable changes in the fiscal regime, and therefore agreements with private companies often include fiscal stability clauses that “freeze” the tax system at the time of the agreement or guarantee some sort of compensation if there is a change in taxes. While reducing risk for investors and perhaps increasing the flow of investment, such clauses limit the flexibility of tax policy, and may have an impact on the overall design of the tax system. The existence of such clauses and their potential implications should be disclosed to the public.

#### ***Use of public funds and resources***

74. The effectiveness of the budget depends on its being well grounded in law, with supporting regulations and administrative practices. Many countries have a budget system law that provides the legal framework for budget formulation, approval, and execution. In some countries, this is an organic law, which has higher status than ordinary laws. The relative importance of codified budget laws, regulations, and administrative practices varies considerably among countries.<sup>42</sup> Despite these differences, certain important elements should be embedded in all legal/administrative frameworks. All spending should be approved by the legislature through an appropriation; 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 or other responsible authority 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.

75. It is common for basic principles of budget management to be embodied in a 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. Where a comprehensive legal framework is not in place, its development should proceed at a pace that is consistent with policy and administrative capacity.<sup>43</sup> Weaknesses in institutional and administrative capacity often impede the enforcement of laws and regulations.

<sup>42</sup>For more discussion on the legal traditions for budget systems, see OECD (2004a).

<sup>43</sup>Many developing countries inherit their legal systems either from continental Europe, where the legislation for public financial management relies on budget principles and procedures that are codified in detail in the law, or from Britain, where the legislative model tends to legislate broad requirements, with the detailed budget procedures reflected in regulatory and administrative instructions.

Also, economies in transition are in various stages of developing a legislative basis for their budget processes, but many have difficulties implementing realistic fiscal policies and 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.

76. Legal title to the nation's natural resources should also be included in the basic legal framework. Such rights are often established in the constitution but can also be covered in national or even subnational government laws. In most countries, resources in the ground are the property of the sovereign state, which can grant private parties rights to access them. As noted in the Guide, the power to grant rights to explore, produce, and sell these resources should be established in laws, regulations, and procedures that cover all stages of resource development. The clarity of the legal framework in this regard provides important safeguards for private investors and helps ensure that the exploitation of natural resources benefits the nation as a whole. Laws and regulations should give assurance that revenues and accumulated wealth are managed transparently through the budget process. Best practice legislation would provide standardized agreements and terms for exploration, development, and production with minimum discretion for officials; disputes would be subject to international arbitration; and individual agreements and contracts regarding production would be disclosed.

## **Revenue collection**

1.2.2 Laws and regulations related to the collection of tax and non-tax revenues, and the criteria guiding administrative discretion in their application, should be accessible, clear, and understandable. Appeals of tax or non-tax obligations should be considered in a timely manner.

### ***Accessibility and understandability***

77. Revenue laws, regulations, and other documents relating to administrative interpretation of revenue laws should be accessible to the general public. In addition to being accessible, tax and other revenue collection laws should be understandable and avoid unwarranted complexity. Clear, understandable tax rules and regulations aid fiscal transparency by limiting discretion in their interpretation. However, tax and customs laws and their implementing regulations can be very complicated, particularly regarding corporate income tax and the calculation of profits. Therefore, it is critical to provide taxpayers with up-to-date explanatory materials (e.g., instructions and pamphlets), which are usually prepared by the tax agency. Tax administration staff should be able to offer professional advice and assistance to help taxpayers understand their rights, obligations, and entitlements under the tax laws. 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 be publicized.

78. Any exception to the application of tax laws should also be published. General tax exemptions, deductions, or special rates are normally a part of the tax law and hence, published and known to the public. However, the larger the number of exemptions, the greater the complexity and room for interpretation of the law, thus reducing transparency. Also, many countries offer (or negotiate) special tax treatment for new businesses. Transparency requires that all such tax incentives be made public—ideally with an estimate of the revenue forgone (see the discussion under practice 3.1.3).

### ***Clear criteria for administrative application***

79. A corollary to requiring that taxes be imposed under law is that administrative discretion in applying tax laws must be limited. Tax incentives that involve a high degree of administrative discretion and case-by-case negotiation of tax liabilities between officials and taxpayers should be avoided, because such practices lack transparency and have the potential for corruption. However, appropriate provision should be made for the treatment of taxpayers who cannot comply with complex rules, settlement of tax cases, agreement on installment payment schedules, and writing off of uncollectible amounts, all with procedural safeguards. Similarly, non-tax obligations should be transparently determined and nonnegotiable in their application.

80. Customs administration is another area in which transparency is critical, especially given the still high reliance on import duties in many developing countries. The *Declaration of the World Customs Organization (Customs Cooperation Council), Arusha* (revised 2003),<sup>44</sup> which sets out guidelines for a program to achieve integrity in customs administration, emphasizes clarity and precision of legislation as a means of promoting transparency and integrity, and fighting corruption with respect to customs. Other resources available from the Internet can also promote greater transparency in customs administration.<sup>45</sup> Transparency is frequently lacking in the formulation of import tariffs, where there may be several overlapping schedules that apply to any particular import, or a confusing combination of ad valorem and specific levies. In addition, customs valuation is often based not on an accurate assessment of the import value, but rather on some notional reference price or flawed assessment procedure. This creates a gap between the nominal and effective rates of ad valorem customs tariffs. It is thus important that customs have a clear statement of tariffs and how different tariffs applying to the same import relate to each other, and also have an accurate way of measuring import value. Similar considerations apply to exports, although export taxes have become increasingly rare and generally play a small role in revenue systems.

### ***Judicial appeal for tax and regulatory impositions***

81. Citizens and taxpayers should have access to clear regulatory and administrative procedures, including a well-functioning system of administrative review of decisions, as well as the opportunity to appeal to an independent judiciary. The proper administration of tax and customs matters,

<sup>44</sup>See <http://www.wcoomd.org>.

<sup>45</sup><http://www.wcoomd.org/ie/en/recommendations/recommendations.html>.

through the articulation of clear procedures, is an important transparency matter. 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 to keep the tax administration within the bounds of the law.

82. An impartial mechanism for appealing and adjudicating decisions when the taxpayer is dissatisfied with the results of the administrative objection process should be established. This would include a full judicial process through the courts system to resolve matters of legal interpretation. The appeals process should not be overly difficult or onerous, appeals decisions should be made in a timely manner, and, subject to issues of privacy of all parties to the dispute, all decisions should be in writing. The legal and regulatory framework should be clear on the recovery of disputed debt, including that subject to appeal, and designed to ensure that tax debtors do not postpone payment by making frivolous objections or appeals. A number of countries require payment of up to half of the total sum due. Where the taxpayer has paid tax that is found on appeal not to be owed, it should be refunded with interest.

### ***Revenue administration***

83. Revenue administration should be organized in such a way as to minimize opportunities for collusion between taxpayers and officials. In this connection, administrative functions should be distributed across the 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.

84. Reinforcing this, revenue administration should be supported by a strong headquarters responsible for the design of sound work processes and annual work programs, and for monitoring the performance of local offices in delivery. In modern tax systems, taxpayers assess their own tax liabilities with minimal intervention by tax officials, subject to ex post review by the tax administration on a selective basis. This extensive reliance on self-assessment combined with targeted enforcement is the basic strategy that permits tax administrations throughout the world to administer the tax system efficiently and to limit the opportunities for collusion between taxpayers and tax officers.

85. 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. 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.

86. 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. The sharing of taxpayer information for enforcement

purposes is facilitated by the use of modern taxpayer identification numbers. In addition to revenues collected by the tax and customs departments, contributions collected under the social security system (if not collected by the tax department) should be clearly accounted for, and audit information should be shared with tax departments, where appropriate.

87. 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 expenditures, then the rules on the use of these funds should be clearly specified to prevent abuse, and normal accounting regulations should apply.

88. 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. Notwithstanding the importance of avoiding collusion and negotiation between tax officers and taxpayers, potential sources of tax disputes should be eliminated during the course of an audit. Discussion with the taxpayer to clarify facts, proper evidence gathering, and third-party verification by the auditor can often prevent fact-based disputes from arising in the audit. A clear explanation by the auditor to the taxpayer of the law applicable to a transaction (including provision of a copy of the law and technical interpretations thereof by the tax administration) can often prevent a dispute on matters of interpretation at the assessment stage. Good training must be given to auditors on their responsibilities, emphasizing that the primary role is not negotiation, but rather the acquisition of facts and the correct application of the law to those facts to verify that the self-assessed liability by the taxpayer is correct.

## Public comment on legislative or regulatory changes

1.2.3 There should be sufficient time for consultation about proposed laws and regulatory changes and, where feasible, broader policy changes.

89. Citizens should be made aware of major new policy proposals, and, if feasible, a process to permit public consultation is recommended. It is especially important for governments to give notice of legislative or regulatory changes related to key spending programs. Good practice would be to provide a period of notice regarding changes in eligibility requirements for important spending programs such as social security, welfare, or other social transfer programs that affect a large number of persons. This allows for public debate and understanding of the changes, and in some instances public consultation may lead to refinements of proposed changes.

90. Consideration should also be given to the incentives this practice creates for tax avoidance behavior. In cases where tax avoidance is expected to be large, it may not be in the interest of tax collection to preannounce the changes. Once new revenue measures have been approved, it is recommended they be sufficiently publicized so that taxpayers understand how they might be affected.

## Contractual arrangements

1.2.4 Contractual arrangements between the government and public or private entities, including resource companies and operators of government concessions, should be clear and publicly accessible.

91. Good practice requires making the terms of any contract open to public scrutiny through the publication of such contracts or, at a minimum, disclosure of the key terms of the contract. Some countries are moving in the direction of contracting out provision of a public good or service to the private sector. A form of contracting out that is gaining increasing popularity is public-private partnerships (PPPs). As with procurement decisions, the process for determining the provider and issuing a contract needs to be open and transparent.

For all contracts, best practice disclosure requirements are as follows:

- Contracts, including any renegotiations, should be publicly disclosed. Standardization and simplification of contracts would be desirable.
- Future payments required under existing contracts should be reported and included in medium-term planning.
- Government guarantees associated with PPPs or other contractual arrangements should be fully disclosed.
- When the government bears the majority of risks associated with a project, the assets should be considered government assets and accounted for in the fiscal accounts.

### *Public-private partnerships*

92. Public-private partnerships refer to arrangements in which the private sector supplies infrastructure assets and services that have traditionally been provided by the government.<sup>46</sup> PPPs are attractive because they can increase infrastructure investment, and sometimes they can add to government revenue. It is also believed that better management and greater efficiency in the private sector can lead to better-quality, lower-cost services. Box 5 describes PPP arrangements in Chile that have been managed effectively.

93. A PPP typically takes the form of a build-operate-transfer scheme in which the government specifies the services it wants and the private provider designs, builds, finances, and operates the facility. Typically the asset is transferred to the government at the end of the operating contract, but other options are possible. The main purchaser of the PPP services is the government in many cases, but PPPs can sell services directly to the public, as is usually the case with toll roads or railways. Investment projects involve various types of risk, including construction/performance risk, financial risk (related to variability of interest and exchange rates), demand risk (whether demand for the service is estimated correctly), and residual value risk. PPPs seek to transfer some of these risks from the government to the private sector. However, contract renegotiations are common with most PPPs, so the burden of risk may change over time.

<sup>46</sup>A number of advanced economies have well-established PPP programs. The *United Kingdom* started its Private Finance Initiative in 1992 and it now accounts for about 14 percent of public investment. *Australia, Canada, Finland, Germany, Greece, Ireland, Italy, Japan, the Netherlands, and Spain* also have PPP programs, but their share in total public investment is modest. Countries in Eastern Europe, including the *Czech Republic, Hungary, and Poland*, are also launching PPP programs. Among other emerging market economies, *Chile* and *Mexico* have well-developed PPPs.



### Box 5. PPP Arrangements in Chile

Chile's PPP program covered 44 projects (valued at 6.25 percent of 2004 GDP) in 2004, mainly for highways, urban roads, and airports. Chile demonstrates a number of good practices with regard to PPPs and fiscal transparency. One important lesson for other countries is to have the institutional framework in place before launching a PPP program. In Chile this institutional framework was established with the 1991 *Concessions Law*, which requires competitive bidding for concession contracts and establishes the rights and obligations of each party, including dispute resolution procedures and cancellation of contracts. Another good practice is to apply the same rigorous evaluation methods, including cost-benefit analysis, to all public investment projects, whether they are undertaken by the public sector or contracted to the private sector. Projects must also be consistent with a broad infrastructure plan and acceptable from a fiscal sustainability perspective to ensure that PPPs are not a source of unsustainable liabilities.

In Chile, PPP contracts must clearly specify the risks that are borne by the government, and since October 2003 the government's exposure to contingent liabilities related to guarantees provided in concession contracts has been reported in the *Report on Public Finances*. These include the net present value of expected minimum and maximum revenue guarantee payments (net of receipts under the revenue-sharing agreement). Recent reports include a detailed discussion on the analytical approach used and its shortcomings. In addition, Chile not only reports current cash payments to and from the concession firms, but it also reports the present value of future payments for the period 2004–30. This makes it possible to have a complete picture of the long-term costs and risks associated with the PPPs. However, transparency could be further strengthened by publishing full information on original and renegotiated contracts. A uniform template could be developed to summarize the key provisions of contracts on the Ministry of Public Works' website and as part of budget documentation.

For additional case studies of PPPs, including a number in Eastern Europe, see the European Commission's *Reference Book on PPP Case Studies*, June 2004, at [http://europa.eu.int/comm/regional\\_policy/sources/docgener/guides/pppguide.htm](http://europa.eu.int/comm/regional_policy/sources/docgener/guides/pppguide.htm).

94. A concern with PPPs is that they may be used to move public investment off budget and debt off the government balance sheet, in some cases to circumvent restrictions on the overall fiscal balance or public debt. In addition, the contractual obligation to purchase services from the PPP private operator has fiscal implications over the medium term, which reduces expenditure flexibility for the government. Furthermore, resorting to guarantees to secure private financing can expose the government to hidden and possibly higher costs than traditional public financing.

95. Government guarantees can be used to reduce or eliminate the risks incurred by the private sector in connection with PPPs. All forms of guarantees related to PPPs should be disclosed, and their likely fiscal cost assessed. In addition, the public policy purpose of each guarantee, the total amount of the guarantee classified by sector and duration, and the intended beneficiaries should be disclosed. Loan guarantees can reduce the private sector's financ-

ing risks, while demand guarantees or guaranteed payments for services sold to the government can reduce demand risk.<sup>47</sup> Residual value risk is reduced through price guarantees at which the government will purchase the assets when the operating contract ends.

### *Accounting for PPPs*

96. A fiscal accounting and reporting standard has not yet been developed for PPPs. Statistical and accounting guidelines tend to allocate the ownership of the PPP assets to either the public or the private partner, depending on a determination of how risks are apportioned between the two sectors. Eurostat issued a decision that says a private partner will be assumed to bear the balance of PPP risk if it bears most construction/performance risk or demand risk. This decision has often been criticized because it would allocate PPP assets too often to the private sector. The practice in a number of countries is to record PPP assets as government assets—accounting for them as public investment or as a financial lease.

97. Assessing risk transfer is difficult because the complexity of PPP contracts makes them hard to interpret. Furthermore, political pressure on the government to bail out a large (but failing) project or “essential” services means that the government may in fact bear more risk than the contract suggests.<sup>48</sup>

98. According to the GFSM 2001, PPP operations should be treated as follows:

- *Operating contracts:* Payments by the government under contracts for services should be recorded as expenses in the government operating statement.
- *Concession fees and operating leases:* Payments by private operators to the government should be recorded as revenue on the operating statement.
- *Financial leases:* The acquisition of an asset under a financial lease is recorded in the operating statement at cost,<sup>49</sup> together with the incurrance of a lease liability to the private sector. These asset and liabilities would be recorded on the government balance sheet. Subsequent depreciation, interest, and amortization would then be recorded on the operating statement. As the lease liability is reduced, the asset value will build up on the balance sheet.
- *Transfer of PPP assets to government:* If there is provision for a PPP asset to be transferred at zero cost to the government, it is recorded as the acquisition of a nonfinancial asset at its residual value, balanced by capital transfer from the private owner. Any purchase price involved would be recorded as an expense, and the capital transfer would decrease accordingly.

99. Under cash basis accounting, the liability under a financial lease is recorded as government debt. Interest and amortization would be recorded as expenditure and financing. When a PPP asset is transferred to the government, any purchase price is recorded as investment.

<sup>47</sup>[http://epp.eurostat.ec.europa.eu/cache/ITY\\_PUBLIC/2-11022004-AP/EN/2-11022004-AP-EN.HTML](http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-11022004-AP/EN/2-11022004-AP-EN.HTML).

<sup>48</sup>For example, Engel, Fischer, and Galetovic (2003) note that Mexican taxpayers spent more than US\$8 billion to bail out both franchise owners and the banks that financed their projects. Other countries, such as *Chile* (see Box 5), have had successful and transparent PPP programs.

<sup>49</sup>Under generally accepted accounting principles (GAAP), the acquisition of an asset is not included in the operating statement, but treated as strictly a balance sheet transaction. However, under the GFSM 2001 presentation, the operating balance is arrived at in accordance with GAAP, and then the acquisition of nonfinancial assets is deducted from the operating balance to arrive at net lending/borrowing.

### **Contracts for resource development**

100. Although many countries have state-owned companies to exploit natural resources such as oil, minerals, and timber, licensing to private firms is also a common practice. Production-sharing contracts—whereby the company is contracted to extract and develop the resource in return for a share of the production—are becoming standard features in the oil and gas industries.<sup>50</sup> The main parameters of production-sharing contracts for oil are the *cost oil* retained by the contractor to cover cost; *profit oil*, which covers the remaining production; and an agreed-upon formula for dividing profit oil between the government (or national resource company) and the contractor. However, production-sharing agreements may also determine tax and/or royalty liabilities by defining individual rates, payment scales, or other variables. Although the contracts may be based on a model contract, some parameters are individually defined and decided through either bidding or negotiation. Best practice is to publish actual contracts in addition to publishing the model contract, which provides only limited information. Especially where production-sharing contracts are the central instrument of the fiscal regime, all the key parameters should be available to the public in the same way that tax rates, exemptions, and deductions are publicly known. The *Guide on Resource Revenue Transparency* should be consulted for further details.

101. Clarity and openness of licensing procedures are fundamental to transparency through all stages of resource development. Open tendering with clear procedures and sealed bids constitutes best practice and is the basis for licensing in many advanced economies. Negotiated deals, which are more common in the mining industry, do not have sealed bids or a firm bid deadline, and the government exercises discretion in deciding terms and awarding contracts. Fiscal transparency requires limiting complexity and full disclosure of final agreements. Good practice would at minimum include ex post publication of contract awards.<sup>51</sup>

### **Liability and asset management**

1.2.5 Government liability and asset management, including the granting of rights to use or exploit public assets, should have an explicit legal basis.

102. In addition to covering taxation and public expenditure, the framework for fiscal management should include primary legislation, such as a budget system law or debt management law that covers all transactions that result in a change in public assets or liabilities. In addition to a legal requirement for debt and asset management, there should be requirements for the transparent management of nondebt liabilities, including monitoring government guarantees, unfunded pensions, arrears, and any other contractual obligations of government. These disclosure requirements are discussed further in Chapter III, under practice 3.1.5.

### **Debt management**

103. Debt management legislation should clearly assign authority to a single person, usually the minister of finance, to select the instruments necessary

<sup>50</sup>In some cases a national oil company may have a production-sharing agreement with a private investor. This is just as much a granting of rights to a public resource, and hence, these contracts should be subject to the same transparency requirements.

<sup>51</sup>An example of good practice is *Egypt*, where all contracts are made public, whether awarded through negotiated deals or bid rounds.

for borrowing; to produce a debt management strategy; to assign debt limits (if no limit is set by law), usually with reference to a sustainable debt strategy; to establish and control the organization responsible for debt management (whether it is located within the ministry or is a separate agency); and to issue regulations covering debt management. The granting of government guarantees should legally rest with a single individual, usually the minister of finance or the head of the agency responsible for debt management, with clearly specified constraints. In some countries the legislature must approve all government guarantees. The legislation should define the role of the central bank as fiscal agent of the government so that issuance of treasury securities cannot be confused with monetary policy operations. All loans should be credited to a bank account under control of the finance ministry, with liabilities incurred and terms of the loans fully disclosed to the public. For fiscal transparency, legislation should set requirements to report annually on debt stock and flows, including data on government-guaranteed debt, to the legislature and public, though more frequent reporting would be preferable. Best practice would be a requirement for an annual audit of debt management operations performed by the external audit institution.<sup>52</sup>

104. Legislation on public debt should cover all debt transactions and guarantees, including by subnational governments, extrabudgetary funds, and public corporations. Because it can be difficult to monitor debt incurred by these other entities, some countries avoid this fiscal risk by simply prohibiting these entities from holding debt, except possibly on-lending from the central government. Some countries, such as the United States, implement a credible “no-bailout” policy for subnational governments. Other countries either require central government authorization for debt-creating transactions or set limits on the debt that subnational governments or other public entities may incur. A public debt law (or other primary legislation) should clearly define all limits placed on subnational governments, extrabudgetary funds, and public corporations, and it should also cover monitoring (through secondary regulations) of these limits.

105. Fiscal transparency requires that public debt management have a legal basis that is supported by clear secondary regulations. Regulations may be in the form of an official procedural manual or other instructions that cover the details of the debt management process, operational controls, and reporting arrangements. These details would include restrictions on such things as the types of instruments that can be used for debt management, risk parameters, and content of a medium-term debt management strategy; the methods for analyzing contingent liabilities and risk of called government guarantees; as well as the usual accounting standards and reporting and auditing requirements. If the legislation does set limits on guaranteed debt, it is critical that the regulations provide clear criteria for consideration and approval of guarantees.

106. Regulations should also define the responsibilities of the debt management unit, whether this structure is located within the ministry of finance, the central bank, or a separate agency. The objectives of the unit should be clearly stated and include minimizing costs of debt servicing while taking

<sup>52</sup>It is recommended that debt management practices follow the IMF (2003b) *Guidelines for Public Debt Management*.

### **Box 6. Authority over Natural Resource Assets and Resource-Related Borrowing**

The government's involvement with natural resources should be clearly established in law, and the power to grant rights to explore, produce, and sell and buy these resources should be well established in laws, regulations, and procedures that cover all stages of resource development. The Guide provides detailed guidance in this area.

Financial asset holdings, including any related to the saving and investment of resource revenues, should be subject to clear rules for disclosure, regardless of which government agency, extrabudgetary fund, or public company holds the assets. They should be considered as part of the overall financial assets of the government, and the assets should be reported on the consolidated government balance sheet if one is maintained.

Rights to borrow for public purposes should be under the authority of one government ministry (usually the ministry of finance). Countries with important natural resources may face additional issues related to control and transparency of financial assets and liabilities because loans may be made with future resource revenue as collateral. The terms of such loans tend to be negotiated and usually are not available to the public, and the authority for such borrowing may not be subject to the usual rules and oversight. Fiscal transparency requires that the legal framework include adequate disclosure and oversight requirements for all borrowing, and that oversight agencies such as the external audit agency be given sufficient authority and capacity to implement the law. These requirements should apply equally to any borrowing or collateralization by the national resource company.

steps to manage associated risks. The head of this unit may be delegated authorization by the minister of finance to manage domestic and external debt. In some countries, such as the United Kingdom and Ireland, the debt management agency has broad powers and independence, and monitoring by the legislature is through ex post scrutiny.

#### **Asset management**

107. For countries that accumulate financial assets through investment of savings, it is critical to have an open and clear asset management strategy.<sup>53</sup> Countries with significant natural resource assets face important issues regarding debt and asset management, as discussed in Box 6. The objectives of savings, such as stabilization or saving for future generations, or other considerations, such as investment abroad to avoid exchange rate appreciation, should be clearly stated. Changes to asset management policy should be clear and publicly available. In addition, the asset management function should be carried out under clear investment guidelines that are issued by the ministry of finance and available to the public. The guidelines should set limits on risk, types of assets, and geographical or currency composition of financial assets. Information should be provided on how asset managers will be held account-

<sup>53</sup> *Norway's* Government Pension Fund–Global is considered a best practice in transparent asset management. Box 6 in the *Guide on Resource Revenue Transparency* provides more details on the asset management guidance, reporting, and auditing of these assets.

able, such as through comparison with a benchmark portfolio. The public should also have information on total financial assets and on the return on investments. The agency or business in charge of asset management should be subject to external audit.

108. Physical assets should be inventoried, and sales and purchases monitored, so that the full stock of physical assets is known at any point in time. Under accrual accounting, the balance sheet would include nonfinancial assets. The valuation of such assets raises some transparency questions, as discussed in Chapter III.



## Open Budget Processes

109. The budget process and the information presented in the budget documentation are central to fiscal transparency. Almost without exception, the annual budget is the government's main instrument for setting fiscal policy. It is the occasion on which the government presents its expenditure proposals and the means by which it will finance them, within the context of explicit statements of its policy intentions. Alongside the formal set of line-item allocations of spending organized by administrative unit, which forms the core of information needed by the legislature to scrutinize and approve spending, the government uses the budget to detail its proposals for revenue collection and borrowing, placed in a historical framework, and explains how these proposals will help achieve its objectives.

110. Information provided at the time of the annual budget should cover all fiscal activities, irrespective of the institutional arrangement under which they take place. Only if such elements as extrabudgetary funds, quasi-fiscal activities, and tax expenditures are included in the budget presentation is it possible to review the full extent to which public resources are allocated according to announced policy objectives and programs. Information should also be readily available on how budgets are prepared and executed, including the role of such documents as budget circulars. The type of information required for fiscal transparency—including functional and economic presentations—is described further in Chapter III; it will be referred to only selectively in this chapter.

111. Although the principles and practices outlined in this chapter are described primarily in the context of the central government, they have parallels for levels of subnational government that have tax powers and expenditure responsibilities, receive or make transfers to the central government, and may themselves have borrowing capacity. Transparency considerations apply in regard both to the need to provide sufficient information to the central government to carry out its responsibilities for determining overall fiscal and macroeconomic policy and to assessing the implications for its own budget and the rest of the public sector to ensure their own public accountability. In

a similar vein, the information provisions documented in Chapter III apply in large measure also to subnational governments.

112. Principles and practices relating to openness of the budget process concern budget preparation, documentation, and presentation, as well as procedures for budget execution, fiscal reporting, and auditing. Many of the OECD *Best Practices for Budget Transparency* apply particularly to this pillar of the Code, and they are referenced here when they extend significantly beyond the good practices described in this pillar.<sup>54</sup>

## Budget Preparation Process

2.1 Budget preparation should follow an established timetable and be guided by well-defined macroeconomic and fiscal policy objectives.

113. The Code includes good practices relating to (1) budget calendar; (2) medium-term framework for the budget; (3) impact of budget measures; (4) fiscal sustainability and fiscal risks; and (5) coordination of budgetary and extrabudgetary activities.

114. Basic requirements under this principle are to ensure that

- realistic budget proposals are presented to the legislature according to a prescribed timetable;
- the likely costs and effects of new expenditure and revenue measures are clearly explained; and
- a consistent multiyear fiscal framework is provided, based on realistic economic assumptions.

### Budget calendar

2.1.1 A budget calendar should be specified and adhered to. Adequate time should be allowed for the draft budget to be considered by the legislature.

115. An important feature of a transparent budget preparation process is the availability of a reliable and publicly available calendar, along with associated procedures, to which the executive rigorously adheres. This helps ensure fair and full access to the budget process. Such provisions do not, however, require the executive to deny itself space for careful deliberation and decision making before making available the full details of its budget proposals for legislative and public consideration. This is particularly important for tax policy changes. But there should be predictability about when the executive's proposals—in either consultative, draft, or final form—will be made public. Normally the draft budget itself should be made public when the executive submits its budget for legislative approval.

116. The OECD best practice guidelines suggest that a pre-budget report should be presented to the legislature and published no later than one month prior to the tabling of the annual budget. This report should state the government's medium-term economic and fiscal intentions, and highlight total revenue,

<sup>54</sup>Readers may also wish to refer to *Guidelines on Public Expenditure Management* at <http://www.imf.org/external/pubs/ft/expend/index.htm> as well as the World Bank *Public Expenditure Management Handbook* at [http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/1998/06/01/000009265\\_3980728144519/Rendered/PDF/multi\\_page.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/1998/06/01/000009265_3980728144519/Rendered/PDF/multi_page.pdf).



expenditure, the deficit or surplus, and debt.<sup>55</sup> Such a report can usefully facilitate legislative and public debate on overall fiscal policy objectives and strategy.

117. Once the draft budget has been formally submitted, the scope of the amendments that the legislature can make varies according to the type of political system. Nevertheless, as a general rule, the detailed budget proposals should be presented to the legislature in sufficient time to allow careful deliberation, including by committees and subcommittees where mandated, before any legal deadlines for adoption of the necessary legislation. The OECD best practice guidelines suggest 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.<sup>56</sup> Where there is a role for subnational governments, the budget preparation calendar for subnational governments should allow adequate time for consultation at the local level and the timely provision of the necessary information for the central government budget process.

## Medium-term framework for the budget

2.1.2 The annual budget should be realistic, and should be prepared and presented within a comprehensive medium-term macroeconomic and fiscal policy framework. Fiscal targets and any fiscal rules should be clearly stated and explained.

118. Although the preparation of the budget has an annual perspective, it is important to place it within broad fiscal policy objectives and the sustainability of fiscal policy over the longer term. At the very least, the budget documentation should indicate how the annual government budget will help achieve the government's broader objectives regarding government or public sector finances, and longer-term deficit and debt targets. Such statements are more helpful if they include quantitative detail on government or public sector finances and the longer-term fiscal outlook. In general, this information should be provided in a background paper that is part of the budget documentation.<sup>57</sup>

### Realistic budgets

119. A range of factors combine to determine whether or not a budget proposal is realistic. Of crucial importance is that the underlying macroeconomic framework be based on a set of mutually consistent assumptions that are plausible, have a reasonable prospect of occurring, and are not prone to bias. This will provide a solid basis for projecting the budgetary cost of statutory obligations such as unemployment and other social benefits. Revenue projections should be realistic in the sense that they should be consistent with recent trends, and the contribution of new measures and/or administrative improvements should be credible (Box 7). The implications of both existing and new policies and programs should be fully reflected, as well as those of any extrabudgetary funds, significant tax expenditures, and quasi-fiscal activities.

<sup>55</sup>In *South Africa*, a Medium-Term Budget Policy Statement is presented to parliament up to four months before budget day. It contains the macroeconomic assumptions, proposed interprovincial allocations, the expected functional classification of expenditure, and the expected split between capital and current spending. For a discussion of the pre-budget consultation phase in *Canada*, see OECD (1999).

<sup>56</sup>Current practice in terms of the amount of time allocated for consideration of the budget by the legislature varies across countries. *Albania* allocates one month, which legislators consider to be too short, but new legislation is under preparation to extend it to at least two months. *Bulgaria*, *Croatia*, and *Indonesia* allow six to eight weeks, whereas *Colombia* and *Cyprus* allocate three months. Most developed countries allow at least three months. The time for consideration by the legislature is protected in many countries by provisions that allow for continued financing in the event that the budget is not adopted prior to the beginning of the fiscal year. <sup>57</sup>In *Hong Kong SAR*, the annual budget documentation provides a clear statement of fiscal policy objectives and medium-term sustainability (see *Hong Kong SAR*, Fiscal ROSC, 1999, paragraph 32). In *Moldova*, a statement of fiscal policy objectives is reflected in both the medium-term expenditure framework and the annual state budget (see *Moldova*, Fiscal ROSC, 2004, paragraph 36).

### Box 7. 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 most recently available period by the estimated tax base. For transparency, it is necessary to disclose how 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 and 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 that 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; this can be particularly useful for forecasting revenue from natural resource extraction. 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, be made available.

**Trend and autocorrelation approach.** It is difficult to link revenue developments in non-tax revenue (derived from specific fees and charges, profits of corporations, or property values) to underlying macroeconomic variables. 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 the underlying trend has been determined should be specified, along with the relevant specific information that influences the forecast.

120. It is particularly important that budgets not be costed on the assumed achievement of optimistic “targets” of the sort that sometimes underpin multi-year development plans. For short- and medium-term macroeconomic policy frameworks, realistic assumptions are required to construct central projections, around which a variety of other scenarios can be formulated as a basis for assessing sensitivity and sustainability.

#### *Medium-term frameworks*

121. It is essential that the annual budget be prepared and presented within a comprehensive and consistent quantitative medium-term macro-

economic framework. In its simplest form, this is often termed a medium-term fiscal outlook, which generally includes unconstrained estimates of the effect of current policies over the medium term. Extending this approach to produce a medium-term fiscal framework (MTFF) requires agreement also on a comprehensive statement of fiscal policy objectives against which fiscal performance can be assessed. In particular, fiscal targets should be specified that are consistent with macroeconomic stability and fiscal sustainability, and they should be embedded within realistic and internally consistent medium-term macroeconomic projections. In this context, it is important that there be a strong interface between the government's national planning or development framework (e.g., Poverty Reduction Strategy Paper (PRSP)) and the medium-term budget.

122. Medium-term budget frameworks (MTBFs) and medium-term expenditure frameworks (MTEFs) take this approach further. These two approaches are variously defined by different institutions and authors. For the purpose of this discussion, an MTBF incorporates projections of expenditures and revenues by individual spending agencies that allocate resources in line with strategic priorities, consistent with the overall MTFF. An MTEF extends the analysis of expenditures further, with more detailed sectoral costing and performance measures (possibly including activity and output-based budgeting). These frameworks include the production of medium-term disaggregated expenditure profiles, including (in more advanced versions) detailed costing and monitorable performance measures at aggregate and sectoral levels.

123. An important advantage of an MTBF 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, inadequate provision is often made for operating and maintenance costs associated with capital expenditures. For countries that are only beginning to develop and implement a medium-term framework, only aggregate forecasts will be feasible in the first stages. They will nonetheless provide a useful starting point for considering medium-term changes in budget policy. Best practice is to publish a comprehensive, rolling medium-term budget framework (covering three to five years) as a central basis of fiscal management.<sup>58</sup> Box 8 describes medium-term budget frameworks in more detail.

124. An MTEF reflects priorities within sectors and accounts for the recurrent cost implications of capital projects. Other key elements would include projections of significant entitlement programs, interest payments, and forward costs of large investment projects. Introducing these into the budget process entails fundamental changes in the way budgets are put together. Countries at different stages of development might consider different models. The implementation of more advanced modalities should go hand in hand with the necessary improvements in administrative capacity. Each stage should build on the preceding one and be in line with the capabilities of the budget system. Because the more advanced versions can become administratively and politically demanding, it is important that enhancements to the framework proceed at a pace consistent with overall capacity.<sup>59</sup>

<sup>58</sup>In *Germany*, the *Law on Budgetary Principles*, for instance, explicitly requires multiyear financial planning by all levels of government (see *Germany*, Fiscal ROSC, 2003, paragraph 50). In *Brazil*, the *Fiscal Responsibility Law* requires a multiyear framework for all levels of government for a three-year period (see *Brazil*, Fiscal ROSC, 2001, Box 1).

<sup>59</sup>A number of countries, including *Brazil*, *Chile*, *Hong Kong SAR*, the *Netherlands*, and *Slovenia*, have integrated a medium-term framework into both the budget process and budget documentation (see *Brazil*, Fiscal ROSC, 2001, paragraph 22; *Chile*, Fiscal ROSC, 2003, paragraph 37; *Hong Kong SAR*, Fiscal ROSC, 2001, paragraph 32; *Netherlands*, Fiscal ROSC, 2006, paragraph 30; *Slovenia*, Fiscal ROSC, 2002, paragraph 19). In *Moldova*, the medium-term framework provides a comprehensive analysis of government finances that covers social insurance funds as well as the central and local governments (see *Moldova*, Fiscal ROSC, 2004, paragraph 33).

### Box 8. Medium-Term Budget Frameworks

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 advanced economies, such as the *United Kingdom* and *Australia*, and by developing and emerging market countries, such as *Chile* and *Brazil*. Experience in these and other countries, however, suggests that stringent conditions have to be fulfilled before the full benefits can be attained.

The key characteristics of a medium-term budget 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
- Hard budget constraints in the form of ministries’ and agencies’ budget appropriations.

The forward estimates process has significant technical advantages for both 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*

125. Medium-term frameworks take on added importance for resource-rich countries. In particular, the framework should reflect the envisaged pace of exploitation of natural resources and the management of resource-related revenues, and these should be consistent with macroeconomic stability and sustainability considerations. Such a framework needs to take into particular account the inherent volatility of resource-related revenue flows and intergenerational issues associated with exhaustible resources.<sup>60</sup>

#### *Fiscal rules and responsibility laws*

126. Fiscal rules are forms of restrictions on fiscal policy (usually in law) at an aggregate level (Box 9). Examples of numerical or stand-alone fiscal rules include requirements to balance the budget, limits placed on borrowing by the central or subnational governments, or limits placed on the pace at which expenditures are permitted to grow. In some cases, public borrowing is restricted to the level of public investment (a “golden rule”) or the fiscal deficit is constrained (e.g., the criteria for fiscal convergence under the

<sup>60</sup>See the *Guide to Resource Revenue Transparency*.

*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.

Experiences to date 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.
- 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 are most likely to be effective in the context of a real, stable, transparent, and well-publicized commitment to fiscal control. In many cases, medium-term budget frameworks must also be based on fundamental institutional improvements, sustained political commitment, an appropriately phased introduction of improved forecasting, rigorous costing of programs, and disciplined budget management.

European Union's *Maastricht Treaty* or the "close to balance" requirement of the European Union's *Stability and Growth Pact*).

127. In general, such rules need to be simple and transparent to serve as effective instruments of communication for government policy objectives.<sup>61</sup> Transparency requires that fiscal rules be clearly defined, with well-specified reporting requirements from the outset such that noncompliance can be easily detected and addressed. The golden rule, for example, can be open to interpretation as to what constitutes public investment and so needs to be defined in terms of budget classification. If an escape clause is included in a rule (e.g., when a departure from the rule is justified by economic conditions), the circumstances in which it applies should be clearly defined. Reporting on performance relative to the rule should also be consistent with other practices of the Code.<sup>62</sup>

128. The credibility of numerical rules and targets depends critically both on the realism of the budget and on the quality of the assessment of fiscal risks and sensitivity analysis. An equally important aspect for transparency concerns the need for a clear strategy in the event that unforeseen circumstances cause actual spending or deficits to breach numerical targets. Various approaches

<sup>61</sup>Indeed, fiscal rules that are poorly designed or inconsistently implemented can undermine fiscal transparency, in part because of the perverse incentives they may provide for one-off measures or creative accounting.

<sup>62</sup>Kopits and Symansky (1998) discuss fiscal rules in detail.

### Box 9. Fiscal Rules, Fiscal Responsibility Laws, and Fiscal Transparency Laws

During the past decade, a number of countries have implemented fiscal rules and fiscal responsibility (or transparency) laws as a mechanism for improving fiscal discipline and policy outcomes. These arrangements generally support fiscal transparency by providing a clear statement as to policy objectives and how these objectives will be achieved, including informing the public of fiscal risks. One function of these laws is to help build support for fiscal consolidation by strengthening the credibility of fiscal policies and by increasing accountability.

#### Stand-Alone Fiscal Rules

Stand-alone fiscal rules seek to enhance the credibility of macroeconomic policies by limiting the scope for discretionary intervention. They encompass provisions such as balanced budget obligations, expenditure limits, and debt limits. Under the *Maastricht Treaty*, for example, countries seeking to adopt the single currency of the European Union agreed to limits on their fiscal deficits and debt, and also accepted limits on central bank borrowing. Most recent rules are supported by some level of transparency standard in the form of appropriate accounting conventions, reporting requirements, and a medium-term macroeconomic framework.

Recent fiscal rules for many emerging market economies have tended to rely to a greater extent on numerical reference values. *Chile* has implemented a “structural surplus rule” that aims at a cyclically adjusted surplus rule for the central government equal to 1 percent of GDP. Moreover, it is legally mandated that the government explain any deviations in the fiscal outcome from the surplus rule. The rule provides useful ex ante guidance for spending plans; the spending target is used to restrain in-year spending with updated forecasts and steps to cut spending or raise revenues as needed. *Bulgaria* imposes a debt ceiling on gross general government debt as a share of GDP in the *Law on Government Debt*. *Moldova* uses the annual budget law to stipulate nominal limits on external and internal debt that can be taken on during the year, and the *Law on Local Public Finance* requires that subnational budgets be balanced.

#### Fiscal Responsibility Laws

A number of countries have enacted fiscal responsibility laws (FRLs) as permanent institutional devices aimed at promoting fiscal discipline in a credible,

can be taken, including identification of those categories of expenditure that are to be protected and those that can be compressed to maintain targets. Clearly, the contribution of fiscal rules or responsibility laws depends on both political will and a careful development of the details of the framework.

### Impact of budget measures

2.1.3 A description of major expenditure and revenue measures, and their contribution to policy objectives, should be provided. Estimates should also be provided of their current and future budgetary impact and their broader economic implications.

predictable, and transparent manner. Sometimes such laws are referred to as fiscal transparency laws. First adopted by a few industrial countries in the 1990s, FRLs have been implemented more recently in Latin America, Europe, and Asia. FRLs may include procedural rules or numerical rules, or both.

*Procedural fiscal rules* generally aim to enhance transparency, accountability, and fiscal management by defining the attributes and interaction of participants in the budget process. FRLs generally require the government to commit up front to a monitorable fiscal policy strategy, usually for a multiyear period, and to report and publish fiscal outcomes and strategy changes on a routine basis.

The FRLs for *Australia*, *New Zealand*, and the *United Kingdom* place great emphasis on procedures. They outline principles of responsible and transparent fiscal management, reporting requirements, and accountability. In *Australia's* FRL, there are no numerical rules. *New Zealand's Fiscal Responsibility Act* aims to maintain public debt at prudent levels through appropriate operating balances. The *United Kingdom's Code for Fiscal Stability* is supplemented by two numerical rules that are outside of the code itself (the “golden rule,” which bars borrowing to finance current expenditures over the cycle, and the “sustainable investment rule,” requiring that the public sector debt-to-GDP ratio be maintained at prudent levels).

*Numerical fiscal rules* are intended as a permanent constraint on fiscal policy, generally in terms of an indicator of overall fiscal performance. Main types of numerical rules include (i) deficit rules (balanced budget), (ii) debt rules (ceilings), (iii) borrowing rules (*Cyprus* has a prohibition of central bank financing), and (iv) expenditure rules (the *Netherlands* sets ceilings on total expenditure and major subcategories).

Mechanisms to encourage compliance are critical for FRLs. Although some European countries have relied on reputational sanctions for noncompliance, credibility may require additional measures, including institutional sanctions for noncomplying jurisdictions and/or personal sanctions for noncomplying public officials, which are applied automatically when fiscal targets are missed and/or budget procedures not followed. One example of this approach is *Brazil's* FRL.

### **Costing of new revenue and spending programs**

129. Budget discipline requires clear descriptions and careful costing of both continuing government programs and new policy proposals. As part of the budget documentation, countries should always include a statement describing any important fiscal policy changes and their expected effects.<sup>63</sup> These statements should incorporate estimates of the separate impact of each new program on revenue and expenditure for the current year (which sometimes may be particularly dependent on the timing of the policy change or announcement). This will allow a clear picture of the factors that may cause budget outcomes to diverge from planned spending and thus improve

<sup>63</sup>A 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, whereas new policy items are subject to detailed voting processes (see *France*, Fiscal ROSC, 2000, paragraph 13). In the *Netherlands*, the fiscal costs of new policy initiatives are separately identified in the budget process and budget documents (see *Netherlands*, Fiscal ROSC, 2006, paragraph 34).

accountability for fiscal policy implementation. Estimates should also be included of the current and future magnitude and impact of tax expenditures and of the future impact of new initiatives, which may increase once they come fully into play. There may also be issues related to sustainability over the medium term and beyond.

130. It is also important that any discussion of new measures take into account the implications for subnational governments in terms of resource requirements and expenditure responsibilities. Best practice is that the estimated fiscal effects of all proposed central government legislation, including the cost implications for subnational levels of government, be made publicly available.<sup>64</sup>

131. For new revenue measures, it is important that forecasts be consistent with recent trends and realistic assumptions. Moreover, existing policies regarding tax expenditures need to be clearly understood. Several approaches to revenue forecasting are outlined in Box 7. With regard to expenditure measures, rigorous costing is required to distinguish the separate effects of policy changes.

### ***Broader economic implications***

132. New policies, or new measures to promote existing policies, may have varying degrees of effectiveness and may have an impact beyond the particular purpose to which they are directed or the individuals or group to which they are targeted. Reforms aimed at reducing fiscal deficits and improving macro stability, or at enhancing efficiency, may affect different income and social groups differently, and may hurt or benefit vulnerable and low-income groups more than others. It is important for transparency that some assessment of these impacts be included in the budget documentation.

133. Poverty and Social Impact Analysis (PSIA) refers to the analysis of the distributional impact of policies and policy reforms on the welfare of different groups, with a specific emphasis on the poor and vulnerable. Similar analysis can be applied to other effects (such as the environment) and target other parts of the population. Various approaches are available, from the simplest to more complex econometric techniques (Box 10). Good practice would require that budget documentation include at least a simple analysis of the differential impact of new policies and measures.

## **Fiscal sustainability and fiscal risks**

2.1.4 The budget documentation should include an assessment of fiscal sustainability. The main assumptions about economic developments and policies should be realistic and clearly specified, and sensitivity analysis should be presented.

### ***Fiscal sustainability analysis***

134. All countries should provide some indication of the sustainability of fiscal policy, although the depth and methodology with which this information is presented may vary considerably. Fiscal policies are considered

<sup>64</sup>In the *United States*, the Congressional Budget Office (CBO) 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 <http://www.cbo.gov>.



### Box 10. Poverty and Social Impact Analysis

Understanding the impact of policy interventions on different groups is critical to designing effective policy strategies. *Poverty and Social Impact Analysis (PSIA)* refers to the analysis of the distributional impact of policy reforms on the welfare of different groups, with an emphasis on the vulnerable and the poor. PSIA helps to

- analyze links between policy reforms and their impact on poverty or particular social groups;
- explicitly consider trade-offs among reforms on the basis of their distributional impacts;
- enhance the positive impacts of reforms, while minimizing negative impacts;
- identify mitigating measures and risk management systems; and
- assess policy reform risks.

Although there is no single methodological template for analyzing the poverty and social effects of a policy, it is possible to identify key elements important for a good-practice PSIA. Key issues include the identification of

- groups likely to be affected in a positive or negative manner;
- implementation mechanisms for carrying out the reform;
- key transmission channels (employment, prices, access to goods and services, assets, transfers, and taxes);
- assumptions permitting the estimation of the expected magnitude and direction of the impact on key groups; and
- critical risks that could change the expected impact of the reform.

Several definitions of PSIA prevail. The most basic refers simply to instances in which the social consequences of programs are considered, even if only on a qualitative basis. In many cases, however, the term PSIA refers to cases in which analysis is supported by rigorous analytical studies. These can include *incidence analysis*, which generally focuses on the impact of changes in tax and public spending policy on household income or welfare, often using econometric techniques. *Computable general equilibrium models* are sometimes employed to incorporate fundamental links among production structures, incomes of various groups, and the patterns of demand. *Social accounting matrix multiplier models* provide a comprehensive, flexible, and consistent system for organizing a nation's social and national accounts over a period of time.

unsustainable if current policies are likely to lead to a buildup of debt to an excessive level.

135. Judgments about excessive debt, and particularly about excessive debt-to-GDP ratios, can be hard to make.<sup>65</sup> A common approach is to rely on a rule that specifies, for example, that the debt ratio cannot rise or cannot exceed a specific limit. This limit may be affected by the external credibility of a country or its policies or the depth of its debt markets. Assessments of fiscal sustainability have to be made on a country-specific basis, relying on

<sup>65</sup>IMF and World Bank (2005 and 2006).

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.

136. 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.<sup>66</sup> 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 that 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 be distinguished from necessary structural changes.<sup>67</sup>

137. Issues related to medium- and long-term sustainability take on added importance for countries with significant resource-related revenues. Periods of relatively high commodity prices may produce pressure for budget expenditure commitments that cannot be sustained when commodity prices fall back to trend levels or below; and such trends may be particularly difficult to assess. Moreover, issues of fiscal sustainability for such countries need to take into account resource exhaustibility, as well as the inherent volatility of commodity prices.

### ***Realistic assumptions and sensitivity analysis***

138. As noted above, the realism of the assumptions underlying the macroeconomic framework is critical for the realism of the budget as a whole. The assumptions must therefore be accurately presented in the budget documentation and available for scrutiny by outside experts. Assumptions regarding natural resource prices and production should be made transparent. This will reduce the risk of overly optimistic assumptions being chosen for projected growth or inflation that will undermine the integrity of the budget process. In this context, it is important for transparency that the assumptions and data used for the medium-term framework and development of the budget be reflected to the extent possible in any development plan or policy framework paper set out by government (e.g., a PRSP). Moreover, there should be a transparency relationship between the two types of documents, with any differences clearly explained.

139. In terms of fiscal resources, in some countries, the ministry of finance assigns an annual collection target to the tax administration. This undermines the credibility of revenue policies and the transparency of the budget process overall.

140. Issues related to sustainability look at the longer-term profile, whereas sensitivity analysis looks at the sensitivity of short-term fiscal outcomes to various sources of risk. One major risk to the budget pertains to the underlying macroeconomic assumptions. Even when these are realistic and have

<sup>66</sup>The 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.

<sup>67</sup>For 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).

been subject to outside scrutiny, the nevertheless inherent uncertainty can have implications for budget implementation. As such, it is important for policymakers to have a clear understanding of the extent to which plausible variations in macroeconomic variables could exert pressure for the budget to deviate from the envisaged path. Lower-than-anticipated real growth, for example, will result in lower revenues and higher obligations for social welfare programs than allocated in the budget. For this reason, in countries with substantial resource revenue, sensitivity analysis should take into account a plausible range of variability in commodity prices. Current-year expenditures under new programs are notoriously difficult to project, and this uncertainty should also be assessed. In all cases, the realism of the budget is enhanced if it is demonstrated that there are contingency allocations and a set of specified reactions and priorities for the budget in the event that revenues or expenditures diverge from the path envisaged in the budget.

### *Fiscal risks*

141. In addition to variations in key macroeconomic assumptions, it is important to take into account other sources of fiscal risk. Most notable are contingent liabilities. These include not only cases where there is a binding legal contract (explicit guarantees), but cases in which there is the presumption that the government will bear the costs—even in the absence of a specific contract to that effect. Other examples are described in Box 11.

142. Explicit contingent liabilities cover a range of instruments, including government guarantees for loans to public corporations, deposit insurance, and statutory commitments in the form of entitlements (e.g., pensions or social benefits). Indemnities are commitments in which the government assumes specified risks. For example, when a public corporation is privatized, governments sometimes provide an indemnity to the purchaser against specific risks—such as protection from future legal action related to preexisting conditions. The risk that these liabilities might come due and in what magnitude can be assessed to some extent, and this is discussed in Chapter III. Public-private partnership agreements are emerging as an increasingly significant source of contingent liabilities, and are discussed in detail in Chapter I and Chapter III.

143. Loans guaranteed by the government often pose an important source of fiscal risk for public corporations. For many governments, cumulated debts of public corporations, particularly utilities, are a considerable source of risk. When it is clear that the public corporation is unable to bear the repayment obligation, the loan should be counted as part of government debt as an explicit, rather than contingent, liability.

144. The potential fiscal consequences of implicit guarantees may be as large as or larger than those arising from explicit contingent liabilities. For example, even in the absence of explicit deposit insurance, governments may be expected to bail out commercial banks—particularly if this has been the practice in the past. A similar implicit liability may be attached to loans taken out by public corporations and subnational governments, even without government guarantees. It is important that these liabilities be understood, monitored, and,

### Box 11. Contingent Liabilities

Contingent liabilities usually arise from explicit or implicit guarantees, including legal entitlements that commit the government to particular levels of support. A brief typology of likely contingent liabilities includes the following:

#### Explicit Liabilities

- Commercial bank deposit and other balance sheet guarantees
- State insurance programs (crops, flood)
- Loan guarantees (for other levels of government, public corporations)
- Exchange rate guarantees
- Demand/revenue guarantees in public-private partnership contracts
- Underfunded entitlement programs
- Uncalled capital and other potential legal obligations
- Guarantees issued against possible environmental liabilities.

#### Implicit Liabilities

- Banking system bailouts
- Coverage of liabilities of privatized entities
- Investment failure of nonguaranteed pension, employment, and social protection funds
- Environmental and disaster relief
- Debt obligations of subnational governments.

Statements describing the significance and nature of all contingent liabilities should be included in budget documentation, including

- policy purpose of the guarantee program
- total amount of guarantees, classified by sector and duration
- intended beneficiaries
- likelihood that the guarantee will be called.

Best practice is to publish quantitative estimates of the potential fiscal impact of guarantees based on the probability that they will be called.

where possible, quantified. Although natural disasters and the attendant need for aid from the government are generally regarded as unexpected events, in many cases there is a predictable element. A number of environmental events, such as droughts and floods, are recurring, and the risk should be assessed. The likelihood that the government will need to provide emergency or disaster relief is more difficult to quantify. More generally, the reporting requirements outlined in Box 11 are essential for budget transparency.

#### *Budget programs and performance objectives*

145. Transparency and accountability in government require that budget presentations and accounts contain clear statements of the government's

objectives as well as a listing of the items on which money is spent (as in traditional *line-item budgeting*). Results of previous policies should also be evaluated against their stated objectives. 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 in relation to a clearly stated set of objectives.<sup>68</sup> Thus, expenditure on a “public health” program could be linked to the government’s broad aims of promoting preventative health care, and more specific objectives would be given in, say, an anti-malaria 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 following section.<sup>69</sup> 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 programs receiving the support of the international community.<sup>70</sup>

146. Recent efforts in advanced economies have emphasized a need to increase the authority and incentives for line managers to achieve agreed-upon results. A number of countries are developing sophisticated systems of results- (or performance-) oriented budgeting and accounting (Box 12). These efforts are very important for increasing the transparency of strategic and operational choices made through government budgets. Best practice is that transactions be classified by activity or output, and by program or outcome. Detailed financial and nonfinancial information for all outputs and activities and programs and outcomes, together with comparable information for the previous year, should be part of the budget documentation.<sup>71</sup> 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 do, however, place a heavy demand on administrative resources, and may be accorded a lower priority in countries with fewer resources or less-developed institutions. But all countries have the capacity to specify clear objectives for at least the major services provided by the government.

## Coordination of budgetary and extrabudgetary activities

2.1.5 There should be clear mechanisms for the coordination and management of budgetary and extrabudgetary activities within the overall fiscal policy framework.

147. The organization of responsibilities among central ministries (e.g., finance, economy, and planning) and spending ministries is a key issue, as is the way in which they coordinate their work. Countries approach this in different ways. In those countries with a tradition of development or central planning, responsibilities for fiscal management are divided between a finance

<sup>68</sup>The *United States*, through its Planning, Programming, and Budgeting System, represented the leading example in the mid-1960s.

<sup>69</sup>It should be noted that a program classification is conceptually distinct from the GFSM 2001/ Classification of the Functions of Government (COFOG) functional classification, because government program objectives may be served by activities in several functional areas (an anti-malaria 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.

<sup>70</sup>The *Netherlands* introduced program budgeting in 2001 to provide parliament with a more policy-oriented and transparent budget document. The methodology has structured line ministry budgets around strategic objectives and policy areas, and then connected these to performance targets (see *Netherlands*, Fiscal ROSC, 2006, paragraph 48).

<sup>71</sup>Access to detailed work on these issues in the OECD and to individual country sites is provided through the OECD website, [http://www.oecd.org/topic/0,2686,en\\_2649\\_37405\\_1\\_1\\_1\\_1\\_37405,00.html](http://www.oecd.org/topic/0,2686,en_2649_37405_1_1_1_1_37405,00.html).

### Box 12. Performance-Based Budgeting

Performance-based budgeting refers to procedures or mechanisms intended to strengthen links between the funds provided to public sector entities and outputs through the use of formal performance information in resource allocation decision making.<sup>1</sup> Performance-based budgeting encompasses a wide range of different budgeting reforms that differ in the way they measure performance and link results to funding. Parallel objectives of performance budgeting cover improvements in both allocative and managerial efficiency of public expenditure, with the former perhaps predominant in transition and developing countries, and the latter in early reformers (Australia, New Zealand). One underlying theme of these reforms is to permit greater managerial freedom so long as they can produce the desired outputs or outcomes. Various models for performance budgeting include the following:

- Program budgeting (based on planning, programming, and budgeting first implemented in the 1960s)—which allocates funds according to programs rather than line items so that common objectives are considered and funded together.
- Marginal analysis (most well-known example is zero-based budgeting implemented in the United States federal government in 1976)—which decomposes programs into incremental stages (called decision packages), each of which is ranked according to priority so that available funding is assigned to the highest priorities.
- Systems that attempt to link the level of budget funding to performance targets—for example, by providing additional funding conditional upon agencies agreeing to tougher outcome and/or output targets (the United Kingdom Public Service Agreements might be seen as an example of this).
- Formula funding based on expected results and/or costs for delivering those results.
- Budgetary performance incentives that link past performance to future agency funding as a motivator for performance.
- The purchaser-provider model in which agencies are paid “prices” for the results (usually outputs) that they deliver. This model represents a combination of cost-based formula funding and budgetary performance incentives.

<sup>1</sup>Definitions that confine performance budgeting to funding mechanisms designed to provide a clear link between funding and results through the use of formal performance measures are too narrow. Performance information more generally may be the starting point for decisions, or may be used in conjunction with other types of performance information.

ministry (for the current budget) and the economy or planning ministry (for the capital or development budget). Other countries divide responsibilities by making specific ministries or departments responsible for different fiscal management functions (e.g., macrofiscal policy, budgeting, and 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 clearly specified.

148. The way in which the budget is defined is also crucial. Although some countries may use the word “budget” simply to cover the estimates related to the *annual appropriation* of funds by the legislature, this concept is incomplete. Similarly, although various kinds of operations set up outside the annual appropriations process may be referred to as *extrabudgetary*, and some extrabudgetary funds (e.g., social security) are handled in a different way from the general funds of government, they should be brought within the budget process so that a comprehensive picture can be constructed of the extent to which all sources of funding and planned outlays are consistent with announced broader policy statements and commitments (Box 13).<sup>72</sup>

149. Although there may be valid reasons for setting up some funds outside the appropriations process, and for earmarking some revenues, excessive use of such arrangements can diminish transparency (as well as reduce fiscal policy control and flexibility).<sup>73</sup> It is therefore important that the activities of extrabudgetary funds be subject to the same discipline as budget appropriations. There should be rules and regulations regarding the accountability of extrabudgetary fund management, and the accounting and auditing of extrabudgetary funds should be compatible with the rest of the budget. Even where resources for extrabudgetary agencies and funds are not appropriated as part of the budget process, it is good practice to report them in the budget *documentation*. For this reason, it is recommended that social security funds be reported, even though the GFSM 2001 allows for them to be classified separately from central government.

150. 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.

151. 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.

152. The use of extrabudgetary funds—including for resource-related revenues—can undermine the transparency and blur the link between fiscal activity and stated policy objectives, particularly when funds are set up with legal authority for their own spending outside the normal budget process. Although the Norwegian Government Pension Fund–Global is considered successful and transparent, this characterization reflects the fact that it is part of a coherent fiscal strategy in a country with a well-established institutional framework, a long

<sup>72</sup>In some cases, extrabudgetary funds are established using earmarked tax or non-tax revenues.

<sup>73</sup>The channeling of earmarked taxes to extrabudgetary funds is common when 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.

### Box 13. Extrabudgetary Activities and Fiscal Transparency<sup>1</sup>

Extrabudgetary activities are transactions of general government entities that are not included in the central or subnational budget appropriation laws. Examples include nonmarket nonprofit institutions (NPIs), financed wholly or partly by government transfers or earmarked revenues; transactions related to commercial activities of government agencies (user fees) that are not included in their budgeted revenue and expenditure; and social security funds, which are declared extrabudgetary on the grounds that these obligations and their financing are seen as a separate and distinct activity. Taken together, these activities often account for a substantial share of fiscal spending.<sup>2</sup> Extrabudgetary funds are usually created by a law stating their purpose, financing, administration, and other arrangements. They may be managed by the ministry of finance, line ministries, or other spending agencies, or they may be completely autonomous.

Extrabudgetary funds can undermine transparency by taking expenditure decisions outside the budget process, distorting resource allocation from the path envisaged in announced policies. Recognizing that many countries have some type of extrabudgetary activity, it is important to make their role in carrying out government policies transparent and subject to the same accountability requirements as other budgeted expenditures. Fiscal transparency requirements are outlined below:

- Extrabudgetary activities should be identified in the annual budget or an annex to the budget, along with a statement of the purpose or policy rationale.
- Fiscal activities financed through extrabudgetary funds should be integrated into the budget process, even if they remain outside budget allocations, to maintain unified control of fiscal policy and avoid problems in expenditure coordination. In general, resources for extrabudgetary funds should be allocated through the budget, and expenditures should be subject to parliamentary approval, even if they remain outside the annual appropriations process.
- The rules and operations of an extrabudgetary fund should be transparent and free from political interference. This requires regular disclosure and reporting of the principles governing the fund.
- Extrabudgetary funds should be subject to audit and should publish financial statements covering all inflows and outflows and, if relevant, the allocation and return on assets.
- Transparency requires that (i) detailed reports of extrabudgetary activity be included in budget documentation and (ii) reporting on extrabudgetary activities follow the same basis as budget reporting (on a gross basis; distinguishing revenue, expenditure, and financing; with expenditure classified by economic, functional, and administrative category).

<sup>1</sup> Allen and Radev (2006).

<sup>2</sup> According to the IMF's 2005 *Government Finance Statistics Yearbook*, in countries with extrabudgetary funds, those funds accounted for up to 44 percent of total central government outlays.



tradition of transparency, and a broad revenue base. Whether or not the extrabudgetary fund has the legal authority for own spending, the legal framework should require that the purpose of spending from these funds be clearly specified and subject to parliamentary scrutiny. Good practice requires that projections of transactions be given to the government as part of the budget process, and accounts giving details of actual spending and fund assets and liabilities be presented along with standard budget reports and accounts to parliament, or preferably as part of the consolidated government accounts.

153. The more general point is that all fiscal activities should be subject to review and priority setting as part of the budget process.<sup>74</sup> 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.<sup>75</sup>

## Procedures for Execution, Monitoring, and Reporting

2.2 There should be clear procedures for budget execution, monitoring, and reporting.

154. The Code includes good practices relating to (1) the accounting system; (2) in-year reporting; (3) supplementary budgets; and (4) the presentation of audited final accounts to parliament.

155. Basic requirements under this principle are to ensure that

- revenues, commitments, payments, and arrears can be tracked effectively; and
- audited final accounts and audit reports are presented to the legislature and published within a year.

## Accounting

2.2.1 The accounting system should provide a reliable basis for tracking revenues, commitments, payments, arrears, liabilities, and assets.

156. Fiscal transparency requires that there be a comprehensive, integrated accounting system that provides a reliable basis for assessing payment arrears. Transparent budget execution relies on having an effective accounting system with comprehensive coverage of fiscal transactions, and having a system of effective internal controls. Even if the accounting system is cash-based, fiscal transparency requires that the system record commitments as well as payments in order to effectively monitor arrears. It is equally important that regardless of the accounting basis, the system should be capable of tracking assets and liabilities and changes thereto (Box 14).

### *The accounting system*

157. Accurate accounting for spending is essential for fiscal transparency. Accounting systems should be based on well-established internal

<sup>74</sup>Or through more extended reviews linked to medium-term budget targets or longer-term sustainability.

<sup>75</sup>The new budget system laws in *Moldova* and *Latvia* go as far as to incorporate former extrabudgetary funds as special funds in the annual budget.

### **Box 14. Fiscal Transparency and International Public Sector Accounting Standards for Financial and Fiscal Reporting**

#### ***Government Finance Statistics Manual 2001 (GFSM 2001)***

The GFSM 2001 is not a financial or accounting standard, but a standard for analytical reporting of fiscal statistics; the GFSM 2001 looks at economic impact rather than accounting entity performance. The revision of the GFSM in 2001 took into account the growing importance of accrual concepts for government accounting and the need to harmonize GFSM 2001 principles with other international statistical systems (notably the *System of National Accounts*) that use accrual concepts. The revision does not require countries to adopt accrual accounts, but instead envisages a staged transition during which countries could adjust data from their cash accounts or use cash balance data where differences between accrual and cash are not substantial.

The Code emphasizes as important that (i) all countries report on financial assets and liabilities, introducing some elements of modified accrual standards, and (ii) all countries aim to have an accounting system that can produce reliable reports on payment arrears and expenditure commitments. Such reports should be produced at a memorandum level by a cash system on a routine basis.

Substantial progress has been made toward the development of accounting and financial reporting standards aimed at improving international comparability of data and increased fiscal transparency. The work of the International Federation of Accountants (IFAC) and the 2001 revision of the GFSM 2001, together with the Code, are important steps in this direction. Although the objectives of these initiatives differ, there are benefits from coordination of work in all three areas.

#### **IFAC-International Public Sector Accounting Standards Board (IPSASB)**

The International Public Sector Accounting Standards Board (IPSASB) functions as an independent standard-setting body under the auspices of the IFAC, with responsibility for developing high-quality accounting standards for use by public sector entities in the preparation of general purpose financial statements.

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

158. Differences in accounting rules used by the government, central bank, and public enterprises can limit consolidation and undermine transparency. It is not uncommon, for example, for a central bank to report on an accrual basis consistent with International Financial Reporting Standards (IFRS), while the government continues to report on a cash basis. Under these circumstances, any revaluation gain reported by a central bank on its foreign reserves following a devaluation would have no counterpart in the form of unrealized losses on foreign liabilities of the government. The government could thus perceive a windfall gain in terms of higher central bank

To this end, by February 2007, the IPSASB had issued 24 accrual accounting standards or IPSASs ([www.ifac.org](http://www.ifac.org)).

For the most part, IPSASs are based on international accounting standards designed for the private sector and modified for applicability to the public sector. Although the IPSASB encourages governments to progress to accrual basis accounting, it has also issued a comprehensive cash basis IPSAS *Financial Reporting Under the Cash Basis of Accounting*. This IPSAS establishes requirements for the preparation and presentation of cash receipts and payments, and includes encouraged disclosures that enhance the cash basis report. A separate study provides guidance for countries making the transition from cash to accrual basis accounting.

Recent IPSASs of interest include disclosure of financial information about the general government sectors, revenue from non-exchange transactions (taxes and transfers), and presentation of budget information in financial statements for both the accrual and cash bases. Ongoing work includes standards for reporting on social policy obligations, service concessions (public-private partnerships), and a conceptual framework for public sector financial reporting.

#### **The Code**

While the Code is consistent with the application of accrual basis accounting, this is not required. It is highly desirable for countries operating on a near-cash basis that disclosure of fiscal activity go beyond a simple cash flow report. A number of requirements of the Code stipulate reporting of data that goes beyond pure cash accounting reporting standards. Some of these are encouraged under the IPSASs on cash accounting as additional disclosures, and others would be adopted in financial statements as a government moves toward an accrual system.

profits, and ignore unrealized losses on its own debt obligations. Similar issues can arise with differences between accounting bases applied by public enterprises and the government. Ideally, accounting standards used by the government, central bank, and public enterprises should be mutually consistent and consistent with the presentation of a consolidated statement.

#### **Bank accounts**

159. Transparency requires routine (normally on a monthly basis) reconciliation of bank statements with government accounting data. For transparency, the minister of finance should have sole authority to open or close bank accounts so that all accounts are documented, and no transactions take place outside the purview of the ministry of finance. A treasury single bank account, supported by a treasury general ledger, is considered best practice because any bank accounts outside the single accounts are swept on a daily basis.

### ***Assessment of arrears***

160. 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 on an accruals basis. Effective government accounting systems should provide enough information to assess the extent of payment or tax arrears.

161. 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 more common in developing countries and countries in transition, for the reasons given in Box 15. This problem can often arise more from poor budget preparation or even policy decisions than from accounting system weaknesses, but a robust accounting system does help to remedy the problem and prevent its recurrence.

162. Fiscal transparency requires that cash accounting reports be supplemented by accounts-based reports of bills due for payment to assess arrears.<sup>76</sup> 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.

163. On the revenue side, governments must also account for taxes and other revenue that has not been received on time.<sup>77</sup> 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 (Box 15). 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.<sup>78</sup>

164. 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.

### ***Coverage of domestic and externally financed transactions***

165. The accounting system should bring all public transactions to account in a timely way, and cover both domestic and externally financed

<sup>76</sup>See more detailed discussion of these issues in Potter and Diamond (1998) and IFAC (2000b).

<sup>77</sup>Because tax revenue is compulsory and unrequited, there are more difficulties in establishing recognition points to establish tax liability than on the expenditure side. IFAC (2000b) 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).

<sup>78</sup>Although 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 15. 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 a check or payment order.

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 financing arrangements. For example, expenditure may be debited directly from 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*

166. 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 failing is that assets thereby created or acquired are not recorded in a way that helps to identify long-term operations, capital depreciation, 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.

### ***Resource-related revenues***

167. Resource revenues should be accounted for under the same system and rules as other revenue and expenditure, with the accounting system based on a well-established internal control system. Best practice is provided by an accounting system that allows accounting and reporting on both an accrual and cash basis. In particular resource sectors, such as oil, the existing accounting and internal control framework may not be sufficient. In these cases it may be necessary to establish specific verification and reconciliation mechanisms and institutions to improve transparency in the flows of resource-related revenue.

### **In-year reports**

2.2.2 A timely midyear report on budget developments should be presented to the legislature. More frequent updates, which should be at least quarterly, should be published.

168. Effective fiscal management depends on timely, reliable, within-year information on the government's fiscal position. The midyear budget report should contain a comprehensive analysis of budget implementation, including comparisons for all major revenue, expenditure, and financing items with midyear figures for the preceding year and midyear estimates for the budget. Any other government decisions or other circumstances that may have a material effect on the budget should be disclosed to the legislature. There should also be an updated forecast of the budget outcome for the current fiscal year, identifying the main factors causing a discrepancy between the budget and the expected budget outcome (e.g., changed economic assumptions, new policies, contingencies, and changes in the timing of revenue or expenditure).

169. It is a key requirement of fiscal transparency that this report be presented to the legislature within three months of midyear. This is consistent with establishing accountability for appropriate responses to changing economic or fiscal circumstances, and is critical for fiscal transparency. More frequent updates should also be published during the fiscal year. These should be at least quarterly; best practice is to publish monthly reports within the following month.

170. The OECD best practice guidelines suggest that the midyear report be presented to the legislature within six weeks of the end of the midyear. General Data Dissemination System (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), as discussed under principle 3.3.

## Supplementary budgets

2.2.3 Supplementary revenue and expenditure proposals during the fiscal year should be presented to the legislature in a manner consistent with the original budget presentation.

171. 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*. All these practices tend to reduce transparency, in terms of both aggregate control and strategic priority setting.

172. Supplementary budgets 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 before spending.

173. Fiscal transparency requires that any changes to the budget during the fiscal year that require legislative approval be evaluated with the same intensity as the annual budget, and that the approved supplemental budget be published with a summary of the key changes. Countries vary in the latitude that the executive may be given to change expenditure from one area to another. The legislative framework for fiscal management—often the budget system law—should clearly define the limits on the executive to make changes in the budget during the fiscal year, and define those changes that require legislative approval through a supplemental budget. As noted in the discussion on budget realism, ideally changes to the budget should be minimal for the budget to be seen as a genuine statement of spending and borrowing plans. Where supplementary budgets are used—even frequently—it is essential for transparency that the changes be clearly placed within the context of the budget and the stated policy objectives.

174. 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 appropriations 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.

## Audited accounts

2.2.4 Audited final accounts and audit reports, including reconciliation with the approved budget, should be presented to the legislature and published within a year.

175. The year-end report allows the government to demonstrate key results achieved and to outline a comprehensive overview of the government's finan-

cial assets and liabilities, and contingent liabilities. It should explain any deviation from compliance with the level of revenue and expenditures authorized by the legislature in the budget. It should, if possible, also include performance information that demonstrates how the originally articulated targets have achieved actual results. Ideally, the year-end report should provide explicit reconciliations to previous budget documents.

176. The coverage of final accounts and their timing should be specified in the budget law. The final accounts should explain any deviations from the budget as adopted by the legislature; they should be reconciled in detail with budget appropriations and a summary table showing the major causes of deviation from the original appropriations; 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 be presented to the legislature within six months of the end of the fiscal year.<sup>79</sup>

<sup>79</sup>As examples, audited final accounts are available within four months of the end of the fiscal year in *Moldova*, five months in the *Netherlands*, and nine months in *Bulgaria*.





## Public Availability of Information

177. Making fiscal information available to the public is a defining characteristic of fiscal transparency.<sup>80</sup> Principles and practices in this regard concern the provision of comprehensive information on fiscal activity and government objectives and the presentation of such information in a way that facilitates policy analysis and promotes accountability.

178. A cornerstone for ensuring the timely and uniform availability of fiscal information is that it can be readily accessed free of charge on the Internet.

### Provision of Comprehensive Information on Fiscal Activity and Government Objectives

3.1 The public should be provided with comprehensive information on past, current, and projected fiscal activity and on major fiscal risks.

179. The Code includes good practices relating to (1) the coverage of budget documentation; (2) past, present, and future performance information; (3) fiscal risks, quasi-fiscal activities, tax expenditures, and contingent liabilities; (4) identification of revenue sources; (5) debt and financial assets; (6) subnational government and public corporations; and (7) long-term reports.

180. Basic requirements under this principle are to ensure that

- the budget documentation covers all budgetary and extrabudgetary activities of the central government, the fiscal position of subnational governments, and the finances of public corporations; and
- information published on the central government includes details of its debt, significant financial and natural resource assets, nondebt liabilities, and contingent liabilities.

#### Coverage of budget documentation

3.1.1 The budget documentation, including the final accounts, and other published fiscal reports should cover all budgetary and extrabudgetary activities of the central government.

<sup>80</sup>For countries with a language that is not in widespread international usage, and particularly for such countries seeking access to international capital markets, it is useful if fiscal and other economic information is translated, if possible simultaneously, into an international language.

181. It is a requirement of fiscal transparency that information about all fiscal activity undertaken by or for the central government be included within the budget documentation. Reports should encompass detailed statements for all budgetary and extrabudgetary activities, such as autonomous central government agencies, and the consolidated fiscal position of the central government.<sup>81</sup> The level of detail used to describe any specific element of expenditure or revenue may vary according to the size and importance of the activity, but not the institutional arrangement under which it is managed.<sup>82</sup>

182. Table 1 provides a typology for the set of fiscal reports that comprise the standard budget documentation and the other principal supporting material provided during the course of the fiscal year. Standard *budget documentation* is grouped into four main categories. The “*annual budget presentation*,” which is centered on the detailed appropriations accounts for authorization by the legislature, provides the main vehicle for the government to set out the principal objectives and parameters of its fiscal and macroeconomic policies. These are fleshed out in the “*budget supporting documents*,” which explain the background to the government’s proposals, set out the major fiscal risks, and provide details of all the extrabudgetary activities that have fiscal implications. To assess progress through the year and identify the need for any midcourse corrections, “*within-year budget reports*” can be used to compare outturns with the original projections. As soon as possible after the end of the fiscal year, “*final accounts*” should be audited and submitted to the legislature with the auditors’ report. In addition, governments are increasingly issuing other financial reports to provide additional information on the financial position and performance of government consistent with the budget presentation,<sup>83</sup> together with reports on a GFSM 2001 basis.

183. Classification issues are discussed in more detail under practice 3.2.2. The relationship between financial, fiscal, and GFSM 2001 reporting is covered in Box 14.

## Past, present, and future fiscal performance information

3.1.2 Information comparable to that in the annual budget should be provided for the outturns of at least the two preceding fiscal years, together with forecasts and sensitivity analysis for the main budget aggregates for at least two years following the budget.

184. For a more complete picture of the current fiscal position, information on past fiscal performance should be presented in the annual budget presentation on the same classifications as the budget and reinforced elsewhere in the budget documentation.<sup>84</sup>

185. Original and revised budget estimates for at least the two preceding years 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). Forecasts for at least the two years beyond the budget year should also be included, using realistic assumptions about macroeconomic pros-

<sup>81</sup>For example, *Canada* covers (at the federal level) all budgetary and extrabudgetary funds in the budget, and *France* has incorporated many funds previously treated as extrabudgetary in the budget (see *Canada*, Fiscal ROSC, 2002, paragraph 18; and *France*, Fiscal ROSC, 2000, paragraph 9).

<sup>82</sup>For example, in *Greece*, pensions and health care establishments—which are not covered by the budget—were estimated to account for about 36 percent of general government expenditure in 2004 (see *Greece*, Fiscal ROSC, 2006, Box 1).

<sup>83</sup>Where the government budgets on an accrual basis, as in *Australia*, *New Zealand*, and *France*, these financial reports also fulfill the function of reporting on compliance with budget appropriations. In other countries (e.g., the *United States*), *accrual reporting* is separate from budgeting, which is mainly on a cash basis.

<sup>84</sup>A good example is *Chile*, where the Budget Directorate publishes comprehensive information and databases related to the public sector at <http://www.dipres.cl>.

Table 1. Budget Documentation and Other Fiscal Reports

	Report/ Document	Comment	Relationship to GFSM 2001
Budget Documentation	The annual budget presentation	Includes detailed projections of revenues, expenditures, balances, and borrowing; proposed fiscal measures; and appropriations accounts containing details of the expenditure authorized or to be authorized by the legislature through a budget (appropriations) law. Transactions are generally classified by administrative unit and item of expenditure.	GFSM 2001 is not universally applied, but use of GFSM 2001 facilitates compilation of national accounts and fiscal reports.
	Budget supporting documents	Includes various statements (e.g., providing details of extrabudgetary funds, autonomous agencies, quasi-fiscal activities, and fiscal risks) and background papers (e.g., on the fiscal and economic outlook).	GFSM 2001 presentation of the <i>overall balance</i> is preferred, and should be reconciled with the presentation in the annual budget.
	Within-year budget reports	Reports on fiscal outturns produced on a monthly or (at least) a quarterly basis using budgetary and extrabudgetary accounts and including debt.	An administrative presentation (as in the annual budget) is common, but a GFSM 2001 summary is preferred for monitoring fiscal developments.
	Final accounts	Final audited accounts are presented to the legislature at year's end to provide assurance of regularity and consistency with appropriations.	As for the annual budget, a GFSM 2001 summary is rarely provided.
Other Reports	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-IPSASB has also developed reporting standards applicable to <i>cash accounting</i> (see IFAC, 2000a).	A GFSM 2001 summary is rarely provided but, in some countries, financial reports meet a number of analytical needs, including GFSM 2001 reporting.
	GFSM 2001 reports	Reports that provide analytical information on government finances in GFSM 2001 format. Such reports can be generated from data compiled for one of the above reports, but because accrual accounting is adopted by GFSM 2001 and applied more widely in government, classification in all fiscal reports is likely to converge.	

pects and consistent with stated policy objectives over the medium term.<sup>85</sup> Providing aggregate fiscal projections for 5–10 years ahead in the budget documentation is best practice.<sup>86</sup> The information should include both main fiscal aggregates and more detailed information on subaggregates (item of expenditure, function, and, where available, program or output).

186. 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 (see practice 4.1.3).

<sup>85</sup>In *Chile*, the budget documentation for 2006 shows information for the main fiscal aggregates for four years prior to the budget and projections for three years following the budget. The draft *Budget Law* includes final execution figures for the four previous years for ministries and programs, with as much disaggregation as in the budget. The government's General Control Agency (*Contraloría General de la República*) annual statements include a comparison with the relevant budget. The *Public Finance Statistics Yearbook* includes consolidated figures for central government, general government, and the nonfinancial public sector for the previous nine years. Since 2000, as required by Chile's fiscal responsibility law, the documents accompanying the budget have included a financial projection of the fiscal macro aggregates of budgetary central government for three years following the budget (see *Chile*, Fiscal ROSC-Update, 2003, paragraph 30).

<sup>86</sup>Medium-term fiscal forecasts are discussed in more detail in Chapter II.

<sup>87</sup>A special case that falls outside the usual definition of tax expenditure occurs where government or public corporations 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.

### Fiscal risks, tax expenditures, contingent liabilities, and quasi-fiscal activities

3.1.3 Statements describing the nature and fiscal significance of central government tax expenditures, contingent liabilities, and quasi-fiscal activities should be part of the budget documentation, together with an assessment of all other major fiscal risks.

#### Tax expenditures

187. Tax expenditures are revenues forgone as a result of selective provisions in the tax code. They may 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 used in place of explicit expenditure programs. They can also be targeted to specific types of spending or to specific categories of individuals, families, or firms according to their wealth, income, or spending patterns or other characteristics. In many tax systems, tax expenditures can be significant relative to the total tax revenue. An important difference compared with expenditure programs is that tax expenditures do not require formal annual approval by the legislature (though some may be subject to sunset clauses); they remain in effect as long as the tax law is unchanged, and are therefore not subject to the same regular degree of scrutiny as actual expenditure. A proliferation of tax expenditures can therefore result in a serious loss of transparency.

188. A statement of the main central government tax expenditures should be required as part of the budget or related fiscal documentation, indicating the public policy purpose of each provision, its duration, and the intended beneficiaries. Except in particularly complex cases, major tax expenditures should be quantified.<sup>87</sup> Ideally, the estimated results of previous tax expenditures compared with their policy purposes should also be presented so that their effectiveness can be assessed relative to expenditure provisions.

189. Providing the estimated costs of all tax expenditures in the budget documentation is included in the OECD best practice guidelines, which also

### Box 16. Tax Expenditure Reporting

*Germany* and the *United States* were the first countries to report tax expenditure information, in the late 1960s, and the practice has now extended to most OECD countries, many emerging markets, such as *Brazil*, and developing countries.

In *Germany*, tax expenditures are reported as part of a “subsidy report” to the federal legislature and are subject to scrutiny by the Federal Court of Audit. Most states provide similar subsidy reports to state legislatures. The reports include both direct expenditure and tax expenditures. 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. 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). 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).

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.<sup>88</sup> A number of OECD countries regularly publish estimates of tax expenditures. Box 16 provides information on selected country practices.

### Contingent liabilities

190. It is a requirement of fiscal transparency that national levels of government report publicly on the nature and significance of their contingent liabilities. As explained in Chapter II, contingent liabilities are costs that the government will have to pay if a particular event occurs. They are therefore not yet recognized as liabilities.<sup>89</sup> They include explicit or implicit government guarantees, including uncalled capital and other potential legal obligations.

191. Contingent liabilities complicate fiscal management because of the inherent uncertainty about their fiscal impact. In many countries, guarantees have proliferated, resulting in a large “hidden deficit” that is not reported.<sup>90</sup> (See Box 11.)

192. A statement should be included in budget documentation indicating the public policy purpose of each provision giving rise to a central government contingent liability, its duration, and the intended beneficiaries.<sup>91</sup> Major contingencies should be quantified except in extreme cases where quantification is not possible. Disclosure of contingent liabilities in the annual budget, the midyear report to the legislature, and the final accounts is included in the OECD best practice guidelines. These contingent liabilities should be classified by major category, and information on the past calls on the government

<sup>88</sup>The 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 and 1996; and Government of Canada, *Tax Expenditures and Evaluations 2000*, at [http://www.fin.gc.ca/toce/2000/taxexp\\_e.html](http://www.fin.gc.ca/toce/2000/taxexp_e.html)).

<sup>89</sup>More precisely, IFAC-IPSASB 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 corporation; 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.”

<sup>90</sup>See Polackova (1999).

<sup>91</sup>Disclosure of contingent liabilities should be included in a broader statement of fiscal risks. Reporting on contingent liabilities will require development of an underlying information system for recording them.

### Box 17. Reporting of Guarantees

Irrespective of the basis of accounting, information on guarantees should be disclosed in the budget documents, within-year fiscal reports, and year-end financial statements. Guarantees ideally should be reported in a fuller *Statement of Contingent Liabilities* that is part of the budget documentation and accompanies financial statements, with updates provided in fiscal reports.

A common core of information should be disclosed annually for each guarantee or guarantee program:

- A brief description of its nature, intended purpose, beneficiaries, and expected duration;
- The government's gross financial exposure and, where feasible, an estimate of the likely fiscal cost of called guarantees;
- Payments made, reimbursements, recoveries, financial claims established against beneficiaries, and any waivers of such claims; and
- Guarantee fees or other revenue received.

In addition, budget documents should provide

- an indication of the allowance made in the budget for expected calls on guarantees, and its form (e.g., an appropriation, a contingency); and
- a forecast and explanation of the total new guarantees issued in the budget year.

During the year, details of new guarantees issued should be published (e.g., in the *Government Gazette*) as they are issued. Within-year fiscal reports should indicate new guarantees issued during the period, payments made on called guarantees, and the status of claims on beneficiaries, and update the forecast of new guarantees to be issued in the budget year and the estimate of the likely fiscal cost of called guarantees.

Finally, a reconciliation of the change in the stock of public debt between the start and the end of the year should be provided, showing separately that part of the change attributable to the assumption of debt arising from called guarantees.

<sup>92</sup>The *Czech Republic* is 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 *Czech Republic*, Fiscal ROSC, 2000, Box 2).

<sup>93</sup>Section 7.6 of the *Code of Good Practice in Transparency in Monetary and Financial Policies* requires that, where there are deposit insurance guarantees, information on the nature, operating procedures, financing, and performance of such arrangements be publicly disclosed.

<sup>94</sup>Where there is a portfolio of similar contingent liabilities, such as a large portfolio of loan guarantees with similar characteristics (e.g., in the housing or agriculture sectors), there may be sufficient reliable historical data on loan loss experience to allow a more reliable estimate of the expected cost of the guarantee program to be made. This estimate might then be appropriated as expenditure in the budget.

<sup>95</sup>Supplementary disclosure is also possible under cash accounting, as recommended in the IFAC Exposure Draft 9 (2000a).

to meet contingent liabilities should be disclosed.<sup>92, 93</sup> For guarantees, reporting and valuation details are shown in Boxes 17 and 18.

193. Under cash accounting, contingent liabilities will be recognized only if and when the contingent event actually occurs and a payment is made. Thus, whereas a loan by government will be recorded 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 provides an incentive for governments to arrange for an activity to be financed by a government-guaranteed loan rather than to take responsibility for it as 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.<sup>94</sup> They would instead be disclosed in supplementary statements.<sup>95</sup>

### Box 18. Contingent Liabilities: Valuation and Balance Sheet Treatment

#### Valuation

The main accounting and reporting challenge of contingent liabilities is to determine the value of government guarantees. For example, in *Chile*, the government needs to assess the value of the minimum income and exchange rate guarantees that it offers in the context of public-private partnership arrangements. It uses Monte Carlo simulation analysis to estimate the value of its contingent liabilities resulting from minimum revenue guarantees and revenue sharing and the Black Scholes options pricing formula to estimate the value of its exchange rate guarantees. These estimates are reported in the *Report on Public Finances*, which is part of the annual budget documentation. The details for these techniques are described in Irwin (2003) and Arthur Anderson (2000).

#### Balance Sheet Treatment

Under cash accounting, guarantees are recorded in the fiscal accounts only when a covered contingency occurs and payment is made, and this may be the only point at which the existence of the guarantee becomes apparent. Under accrual accounting, it is necessary to judge whether a guarantee should be treated as a liability. Under international standards, it is judged as a liability only when there is more than a 50 percent probability that payment will be made, and that a reasonable estimate can be made. Where a reasonably reliable estimate can be made of the expected cost of called guarantees, governments that prepare budgets, fiscal reports, and financial statements on an accrual basis should recognize the expected cost as a liability at the time the guarantee is issued.

#### Quasi-fiscal activities

194. There are a number of reasons it is important to identify and report information on quasi-fiscal activities and, where possible, to quantify them. First, the existence of substantial quasi-fiscal activities complicates the design of fiscal policy. It reduces the relevance of the budget balance as an indicator of the government's financial position and means that the reported magnitude of government revenue and expenditure does not provide a good indication of the actual size of government. Nondisclosure of QFAs may increase incentives to move fiscal activities outside government to make the fiscal position look better than it is. Second, quasi-fiscal activities can generate implicit contingent liabilities. If, for instance, a public financial corporation guarantees a loan without a commercial justification and a default on the loan could materially impair its profitability and future viability, it might ultimately require a capital injection from the government. Third, because quasi-fiscal activities often have redistributive effects, their impact should be subject to public scrutiny. Fourth, they impede the process of effective and flexible prioritization of government activities, and they make it harder to measure whether resources have been used efficiently and effectively. Different types of quasi-fiscal activities are detailed in Box 19.

### Box 19. Types of Quasi-Fiscal Activity

#### Operations related to the financial system

Subsidized lending  
Under-remunerated reserve requirements  
Credit ceilings  
Rescue operations

#### Operations related to the exchange and trade systems

Multiple exchange rates  
Import deposits  
Deposits on foreign asset purchases  
Exchange rate guarantees  
Subsidized exchange risk insurance  
Nontariff barriers

#### 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

<sup>96</sup>In 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).

<sup>97</sup>In addition, when sterilization is undertaken for monetary purposes (and hence is not a quasi-fiscal activity), it is important that its financial implications be reported separately in the central bank's annual report.

<sup>98</sup>There is also typically a time lag between the time a quasi-fiscal activity occurs and affects the central bank's profit and loss account, and when central bank profit is transferred to the central government.

<sup>99</sup>In 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.

<sup>100</sup>Significant 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).

195. Reporting quasi-fiscal activities is, however, complex, and raises a number of issues. In the case of nonfinancial public corporations, for example, many subsidies may be implicit, and their financial and distributive impact may be obscured by other overlapping (and sometimes offsetting) measures. 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.

196. The quasi-fiscal activities of the central bank may also be difficult to identify and quantify. 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.<sup>96</sup> Even then, the implications of individual activities for resource allocation in the economy, fiscal risks, or the government's prioritization of policies are not transparent.

197. From the standpoint of assessing financial transparency, a number of consequences follow:

- 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.<sup>97,98</sup>
- 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.<sup>99</sup>
- In some cases, the central bank engages in such extensive quasi-fiscal activities that it experiences a loss, but central bank losses are not reported as expenditure of the central government.<sup>100</sup>



### Box 20. 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 corporation of providing social services). Others, however, are more difficult to quantify. 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 corporation*

A state-owned bank provides a loan of US\$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 US\$1 million and US\$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 US\$1.25 million.

*Example 2: A multiple exchange rate*

The central bank operates a special appreciated exchange rate of 2.75 local currency units (LCUs) to the dollar for mineral exports, and of 2 LCUs to the dollar for imports of a staple foodstuff. The central exchange rate is 3 LCUs to the dollar, entailing a tax on mineral exports and a subsidy on food imports. If total mineral exports are US\$3 billion and total food imports are US\$300 million, the central bank makes a profit of LCU 450 million. The effects of the quasi-fiscal activity can be estimated and reported as follows:

Quasi-fiscal tax on mineral exports = Market value of foreign currency receipts less local currency provided = LCU 9 billion less LCU 8.25 billion = LCU 750 million.

Quasi-fiscal subsidy to food imports = Market value of foreign currency provided less local currency receipts = LCU 900 million less LCU 600 million = LCU 300 million.

- 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.<sup>101</sup> 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.

198. Statements on quasi-fiscal activities should be included in the budget documentation, indicating, at a minimum, the public policy purpose of each quasi-fiscal activity, its duration, and the intended beneficiaries. Statements on quasi-fiscal activities could be compiled by the central ministry responsible for the budget on the basis of information provided by public sector agencies undertaking quasi-fiscal activities, including the central bank.<sup>102</sup> The annual reports of individual public corporations should also indicate the noncommercial services that the government requires them to provide, and public financial corporations should disclose any connected lending to other government-owned agencies, including any nonperforming loans. The annual

<sup>101</sup>Such 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. When rediscounting is provided at below-market interest rates, however, the interest rate subsidy should be regarded as a quasi-fiscal activity. Similarly, unremunerated (or under-remunerated) reserve requirements, which can impose a significant tax on financial corporations where interest rates are high, should be regarded as a quasi-fiscal activity.

<sup>102</sup> The *Code of Good Practices on Transparency in Monetary and Financial Policies* provides a basis for the provision of such information by the central bank.

report of the central bank should indicate any nonmonetary policy activities it conducts on behalf of the government.

199. 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<sup>103</sup> and, where possible, major quasi-fiscal activities should be quantified. However, although it is often possible to provide an indication of the order of magnitude of fiscal effects, as illustrated in Box 20, precise quantification may be difficult, particularly if there are contingent liabilities involved, as in a loan guarantee.<sup>104</sup> If an estimate is provided, its basis should also be indicated.

200. 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, 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.<sup>105</sup>

201. 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.

<sup>103</sup>For 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 non-financial public corporation might include at least some indication of the divergence between the price charged and a price based on full cost recovery.

<sup>104</sup>See Mackenzie and Stella (1996) for a detailed discussion of issues in estimating the size of quasi-fiscal activities.

<sup>105</sup>*Chile*, Fiscal ROSC-Update, 2005, paragraph 7, notes that “The Report on the Public Finances (which accompanies the submission of the budget to congress) included chapters on contingent liabilities from 2003. The chapters on contingent liabilities include annual projections of the cost of minimum pension guarantees, and estimates of the present value of the expected fiscal costs of the future operation of all of the public-private partnerships (‘concessions’) which were in place as of the date of publication. The reports include a brief description of the methodology used for making this calculation.”

### **Assessment of fiscal risks**

202. Budget documentation should clearly indicate the major risks to the fiscal estimates being presented. These risks can usefully be gathered together into a single “statement of fiscal risk,” which constitutes best practice, covering the elements outlined in Box 21. Crucial components are the sensitivity of estimates to varying economic assumptions, and contingent liabilities.

### **Identification of revenue sources**

3.1.4 Receipts from all major revenue sources, including resource-related activities and foreign assistance, should be separately identified in the annual budget presentation.

203. Documentation should enable the identification of both the collection agency (for example, the tax or customs agency, or local government agencies) and the source of the revenue (for example, income tax, social contributions, or grants) according to GFSM 2001 classification (Table 2) or some other international standard classification.

204. Additional source classifications are required in some countries depending on the structure of revenue and the government level at which it is collected. In cases where oil or other natural resource revenues are a significant part of total revenue, these should be separately identified. Such revenues may come from income taxes, levies, royalties, bonuses, profit-sharing arrangements, or transfers from public corporations, or other sources, such

### Box 21. Statement of Fiscal Risks

A statement should be provided with the annual budget giving sensitivity analyses and an overview of all other 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:

**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 percentage point increase or decrease in the assumed rate of GDP growth or inflation or the level of interest rates or the exchange rate, or specific fluctuations in import and export prices, resource revenues, or the timing of relevant events such as privatization or investment projects, from the assumptions 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).

**Contingent liabilities**—these may include guarantees, indemnities, and warranties; uncalled capital (e.g., in international financial institutions); and litigation against the government.

**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.

**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.

as exploration licenses (including for mining, oil, fishing, etc.) and export taxes. In classifying revenues more generally, “other revenues” should be disaggregated to identify such separate items as interest, dividends, withdrawals from income of public corporations, property income, rents, and royalties. Income derived from sales of assets, goods and services, including incomes from licenses, concessions, or privatizations, should be detailed.<sup>106</sup>

205. Grants should be included in the reporting of revenues, according to GFSM 2001 classifications, with supporting information in the form of a fiscal operational statement and distinctions between current and capital. Best practice requires full information on donors, broken down by sectors and programs.

206. An accounting system that allows accounting and reporting on both an accrual and cash basis represents best practice. Information on an accrual basis, which may be limited for some revenue sources, should reflect a realistic assessment of collection rates, including the likelihood of noncompliance. In cases where one level of government collects revenue on behalf of another

<sup>106</sup>To assist in the interpretation of overall revenue trends it is helpful to identify any revenue items that reflect specific one-time events, such as asset sales, granting of major resource concessions, or receipts of unusually large foreign grants.

**Table 2. Revenue Classification (GFSM 2001)**

<b>1</b>	<b>Revenue</b>
<b>11</b>	<b>Taxes</b>
111	Taxes on income, profits, and capital gains
112	Taxes on payroll and workforce
113	Taxes on property
114	Taxes on goods and services
115	Taxes on international trade and transactions
116	Other taxes
<b>12</b>	<b>Social contributions</b>
121	Social security contributions
122	Other social contributions
<b>13</b>	<b>Grants</b>
131	From foreign governments
132	From international organizations
133	From other general government units
<b>14</b>	<b>Other revenue</b>
141	Property income
142	Sales of goods and services
143	Fines, penalties, and forfeits
145	Miscellaneous and unidentified revenue

government level, it should be identified as the source of revenue, and the transfer of that revenue should be clearly observable in the budget and other fiscal reports.

### Debt and financial assets

3.1.5 The central government should publish information on the level and composition of its debt and financial assets, significant nondebt liabilities (including pension rights, guarantee exposure, and other contractual obligations), and natural resource assets.

#### *Reporting of debt*

207. Full information on the level and composition of the government's debt and financial assets provides a sound foundation on which to develop fiscal sustainability analysis. Best practice in providing information on liabilities and financial assets is the publication of a *government balance sheet* as part of the budget documentation. As indicated in Box 22, a number of complex issues need to be addressed in preparing a government balance sheet. Where a government balance sheet is published, it should ideally cover nonfinancial assets of government as well as financial liabilities and assets. However, where nonfinancial assets are not covered, a register of nonfinancial assets should be maintained and a listing of nonfinancial assets, as well as of nondebt liabilities, should be provided in the budget documentation.

208. 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 or financial assets are significant, quarterly reporting should

### Box 22. Government Balance Sheets: Some Issues

With respect to reporting balance sheet information, best practice is to publish with the annual budget and final accounts a full balance sheet showing all liabilities and all financial and nonfinancial assets of the central government.

Governments generally have significant liabilities other than government 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 with the previous year and an explanation of the main reasons for the change. Other liabilities include other accounts payable, such as accrued but not yet paid salaries and wages, transfer payments payable, and so forth.<sup>1</sup>

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 the government will be responsible for a future liability. Examples include multiyear 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. Some countries adopt *modified accrual accounting*, which expenses physical assets at the time of purchase; 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, falls well short of providing all relevant information on government resources and obligations. For example, according to the GFSM 2001, obligations under accident compensation schemes and environmental liabilities are not required in the balance sheet. Furthermore, 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.<sup>2</sup> Long-range projections on government receipts and outlays are also provided in this context.

<sup>1</sup>For a discussion of the definition and recognition of liabilities of governments, see IFAC (2000b).

<sup>2</sup>For 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.whitehouse.gov/omb/budget>.

be an objective. 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 Special Data Dissemination Standard (SDDS) requirement that the central government debt be reported quarterly, with a lag of a quarter, including government-guaranteed debt (as a memorandum item).<sup>107</sup> 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, disclosing both principal and interest. Projected repayments of short-term debt should always be reported on a quarterly basis.

209. Reporting should cover the comprehensive debt of central government, including securities, loans, and deposits.<sup>108</sup> 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),<sup>109</sup> 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 GFSM 2001; or OECD, 1988). Information should also be provided on any sinking funds established for debt amortization. The government's debt report should identify any direct and indirect collateralization of future resource revenue, for instance through precommitment of production to lenders. All government contractual risk and obligations arising from resource-related debt should be disclosed.

210. Debt should be broken down by remaining maturity, and classified as short-term (less than 12 months), medium-term, or long-term.<sup>110</sup> 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 and other debt management operations should be disclosed.

211. Debt should be reported in gross terms. For the GFSM 2001, valuation at both nominal value and market value is required when discrepancies are large.

### ***Reporting of financial assets***

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

213. Financial assets consist of financial claims that entitle the government to receive one or more payments from a debtor, as well as monetary gold and special drawing rights. Financial assets to be reported include cash and cash equivalents; other monetary assets, such as gold and investments; and loans and advances.<sup>111</sup> Additional breakdowns should be provided within each category of financial asset. 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

<sup>107</sup>The OECD best practice guidelines suggest that debt should be reported with a lag of one month.

<sup>108</sup>The reporting standards for debt set out here are based on those in the GDDS and SDDS (<http://dsbb.imf.org/Applications/web/gdds/gddshome>). For a discussion of issues in the reporting of government debt and financial assets, see IFAC (2000b).

<sup>109</sup>Indexed debt is debt 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).

<sup>110</sup>Where remaining maturity is not available, original maturity may be reported.

<sup>111</sup>Cash and cash equivalents cover cash on hand, demand deposits, and short-term highly liquid investments readily convertible to cash.

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.

214. 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.

215. 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.

216. 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.

### ***Significant nondebt liabilities***

217. Governments have significant liabilities beyond debt, which may have important implications for fiscal sustainability. The disclosure of information about the potential cost of unfunded public pension funds, and government guarantees and other contractual obligations (such as commitments under PPPs), is an important element of fiscal transparency.

### ***Unfunded public pension funds***

218. Both employees' pension schemes and social insurance programs may involve substantial liabilities to the government. Current and former government employees' post-retirement benefits are contractual obligations and may be large relative to the current and future financial capacity of the government. Fiscal documentation should include actuarial estimates of both accrued net pension liabilities to date and future net retirement benefit obligations (the latter in both net present value and cash flow terms). Both civil servant and military pensions should be covered as well as retiree health insurance benefits, and the amounts involved may be substantial at both the national and subnational levels. Social insurance programs may also have significant fiscal implications, which should be reported by the fiscal authorities under alternative demographic and economic scenarios—particularly given the effects of aging populations that now affect most industrial countries and are becoming increasingly significant in middle-income countries.

219. Accurate reporting is critical for both defined-benefit and defined-contribution pension plans. For defined-benefit plans it is important to provide an accurate assessment not only of the size of current pension obligations for the budget, but also of the accrued liabilities to date, the actuarial balance, and long-

term cash flow projections. Even under defined-contribution plans, there may be some implicit obligation for the government to ensure the pension reaches some minimum level.

220. In the GFSM 2001, unfunded public pension schemes for employees are treated as a contractual liability. Receipts of contributions and issuance of securities to finance benefits are considered an increase in liabilities, and payment of benefits is considered a reduction in liabilities. There are different approaches regarding reporting. Whereas the GFSM 2001 recommends reporting them in the government accounts, other institutions, such as Eurostat, recommend including them in supplementary accounts.

221. OECD's Best Practices for Budget Transparency specify that employee pension obligations be disclosed in the budget, the midyear report, and the year-end report, treating employee pension obligations as the difference between accrued benefits arising from past service and the contributions that the government has made toward these benefits. Actuarially sound projections of the burden of social insurance programs are presented as part of the budget documentation in a number of countries, including the United States.

#### *Government guarantees and other contractual obligations*

222. Uncertainty related to the fiscal implications of government guarantees makes the disclosure of government guarantees a good fiscal transparency practice.<sup>112</sup> Such guarantees should be disclosed as part of the contingent liabilities report included in the budget, and further information in debt reports will improve scrutiny. Valuation of guarantees raises many substantive issues (see Box 18).

223. Because the main fiscal implications of public-private partnership are guarantees, they should all be identified, detailed, and disclosed in the debt reports (as memorandum items). Additional commitments related to PPPs should be described and quantified if possible.

224. There are several other kind of liabilities that may imply claims on the government. Among them are financial derivatives, arrears, and different kinds of contingent contracts. Environmental clean-up operations following natural resource extraction might also impose future fiscal costs, particularly in the case of defaults by resource companies. Financial derivatives may include swaps, options, or futures issued or bought by the government linked to an underlying financial index, commodity prices, or exchange rate, for example. Major categories of arrears should be separately identified. Finally, other contingent contracts (beyond guarantees and PPP potential claims) can arise from letters of credit, lines of credit, indemnities against unforeseen tax liabilities arising in government contracts with other units, and damages or legal claims against the government in pending court cases.

#### *Natural resource assets*

225. Reporting of natural resource assets' worth should follow the recommendations of the *Guide on Resource Revenue Transparency*. A detailed annual report should estimate the value of the natural nonagricultural resources that

<sup>112</sup>Guarantees are used to support private and other government levels to avoid risk; for example, loan guarantees for the private or public sector; other financial guarantees such as trade and exchange rate guarantees; income, profit, and rate of return guarantees; and minimum pension guarantees. Generally these risks have costs, if they materialize, for the government; therefore, it is recommended that they be carefully controlled.



represent significant or potentially significant government revenue, including hydrocarbons, minerals, timber, and other resources. Resource revenue forecasts should, as far as possible, be consistent with these value estimates.

226. The complexities and difficulties in estimating the value of resource assets are considerable and extremely sensitive to the choice of definitions and parameters. Where international standards exist, the *Guide on Resource Revenue Transparency* suggests that these should be adopted and the methodology published. The reports should try to detail the volume of the reserves, short-term value (based on current prices), and long-term value (based on specified assumptions about long-term prices and extraction rates). A field-by-field estimation is recommended whenever possible.<sup>113</sup>

## Subnational governments and public corporations

3.1.6 The budget documentation should report the fiscal position of subnational governments and the finances of public corporations.

### *Subnational governments*

227. Ex post information should be provided on the fiscal position of subnational government and the consolidated position of general government. This can be done through national accounts-based reports, provided these reflect actual budget outturns for the various parts of general government.<sup>114</sup> The consolidation of the subnational government position is particularly informative when subnational levels of government have significant tax powers, expenditure responsibilities, and/or borrowing capacity, and/or they receive sizable transfers from central government. 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 corporations under their control.

228. Best practice is that reliable information on the general government should be published within six months of the year's end, disclosing central, consolidated, and subnational governments (state and local). Countries differ in how they fulfill this commitment. For example, in some countries, comprehensive fiscal data are compiled by all levels of government using a uniform classification, and a consolidated general government financial position is presented with the annual central government budget. In other countries, with subnational levels of government that are independent fiscal agencies, they observe the same standard of fiscal transparency as the central government.<sup>115</sup>

229. Ideally, quarterly or midyear budget reports should cover the general government fiscal position and provide a basis for assessing whether or not broader fiscal targets that provide context for the budget can be achieved. It is recognized, however, that frequently there are problems in providing budget data for subnational levels of government at the time the central government budget is presented or at fixed points during the fiscal year. 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

<sup>113</sup>The methodologies and criteria used for the reserve estimation and other assumption should be clearly explained.

<sup>114</sup>In 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 governments.

<sup>115</sup>*Australia* provides a further example that broadly combines both of those approaches. 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 presentations 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.

be practical limitations to collecting budget data on a timely basis where the structure of subnational levels of government is quite complex or where the budget and accounting classifications are not standard across governments.

### **Public corporations**

230. Although many public corporations operate on a largely commercial basis, the financial position of public corporations can materially affect the overall macroeconomic environment, and their financial obligations may fall on the central government in the event that they run persistent losses or accumulate excessive debt. Many also conduct extensive quasi-fiscal activities outside the budget, which are not captured in the conventional measure of the overall general government balance. In addition to the other transparency requirements falling on public corporations (including the dissemination of independently audited financial statements shortly after the end of each financial year), it is therefore important that information be included in the budget documentation on their finances, including operating balances in a degree of detail that allows a proper evaluation of fiscal risks.

### **Long-term reports**

3.1.7 The government should publish a periodic report on long-term public finances.

231. Long-term projections on fiscal variables in some countries have become more relevant as a consequence of such issues as aging populations, limited natural resources, and the potential impact of climate change. Fiscal sustainability in advanced economies may increasingly depend on the timely adoption of measures to address future obligations for pension payments and social spending on behalf of an increasing proportion of elderly people. Transparency will improve the understanding of the future costs of current policy decisions, help manage risks, increase support for sound macroeconomic policy within the government, and assist credibility in financial markets. Evidence of efficient allocation of fiscal resources to ensure adequate financing and infrastructure investment should reduce private sector uncertainty.<sup>116</sup>

232. The OECD best practice guidelines suggest that a long-term report (10–40 year projection) assessing the sustainability of current fiscal policies 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 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.<sup>117</sup> Furthermore, other long-term effects should be consid-

<sup>116</sup>Based on Ulla (2006).

<sup>117</sup>See Chand and Jaeger (1996). Also, the *United States* budget 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 50 years beyond the current year. 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 outlays of the Social Security, Medicare, and Medicaid 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 the Economic Assumptions and Analyses section in the *Analytical Perspectives* publication at <http://www.whitehouse.gov/omb/budget>).

ered and included in the projections, such as fiscal implications of natural resource depletion, trade or technology changes that may affect the economy (for example, in countries with significant agricultural exports, inclusion of the country in free trade areas, or effects of biotechnology in agricultural exports), or climate change.

233. An alternative way 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.<sup>118</sup>

234. It is important to go beyond a medium-term framework (fiscal, budget, expenditure) to assess the implications of existing policies over the longer term, where additional variables often come into play. Many industrialized countries will, for example, experience a substantial increase in the share of elderly in the population, implying that current revenue and expenditure policies that may be evaluated as sustainable over the near and medium term are not sustainable over the longer term. Extending the time horizon is more complicated than simply adding years to the projections. Instead, the focus of sustainability assessments needs to be broadened so that “policy makers and the public are in a position to gauge the size of the fiscal gap to which the government is exposed.”<sup>119</sup>

235. Longer-term projections are prone to additional uncertainty, some of which stems from the interaction between policies, economic variables, and demographics. Sharply different burdens for different generations for the same policy commitment need to be articulated. The realism of the underlying assumptions and appropriate range of sensitivity analysis also take on an added importance for transparency. It is also critical for long-term projections to cover the full range of fiscal activity, including tax expenditures, extrabudgetary funds, and contingent liabilities.

236. Although most industrialized countries have incorporated a medium-term budget or economic framework into the budget process, this generally extends only about four to six years. The integration of longer-term issues—such as changes in demographics—into the budget process is less common.

237. *Australia*, *New Zealand* (Box 23), the *United Kingdom*, and the *United States* are among the few countries that have taken a considered approach to long-term issues. In late 2002, the United Kingdom Treasury issued the first *Long Term Public Finance Report*, which provides a comprehensive analysis of long-term economic and demographic developments and their impact on public finances. Australia’s *Charter of Budget Honesty* requires that the medium-term fiscal strategy be supplemented by a longer-term 40-year intergenerational report to assess the longer-term sustainability of current government policies, including the fiscal and financial implications of demographic change.<sup>120</sup> In the United States, long-term issues enter the budget process on an ad hoc basis. While the budget is set within a 5-year framework, 75-year projections are normally included in the stewardship section of *Analytical*

<sup>118</sup>The *United Kingdom* budget regularly contains information on generational accounts (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/budget>). To assess the sustainability and intergenerational impact of fiscal policy, the Code requires the government to publish illustrative long-term fiscal projections covering a period of at least 10 years. In practice, a 30-year horizon has been adopted.

<sup>119</sup>Heller (2003).

<sup>120</sup>Treasury of the Commonwealth of Australia, *Intergenerational Report 2002–03*, Budget Paper No. 5.

### Box 23. Budget Law and Fiscal Transparency: Country Examples

#### New Zealand

*New Zealand's Fiscal Responsibility Act* of 1994 is a benchmark piece of legislation that sets legal standards for transparency of fiscal policy and reporting and holds the government formally responsible to the public for its fiscal performance.

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. It 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;
- disclose the impact of fiscal decisions over a three-year forecasting period in regular “economic and fiscal updates;”
- present all financial information according to generally accepted accounting principles. 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
- 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 pre-election economic and fiscal update to be published between 42 and 14 days before any general election, projections of fiscal trends over at least a 10-year period, and statements of the government’s commitments and specific fiscal risks, including contingent liabilities. (See <http://www.treasury.govt.nz/publications>.)

#### Australia and the United Kingdom

*Australia's Charter of Budget Honesty* and the *United Kingdom's Code for Fiscal Stability* are similar in principle to New Zealand’s *Fiscal Responsibility Act*. Partly because of Australia’s 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, whereas others are new requirements.

*Perspectives*, which include projections for social insurance programs that are generally considered to be extrabudgetary. In February 2006, the European Union published the first “Long-Term Sustainability of Public Finances in the European Union” report, as part of regular budgetary surveillance. Critical assumptions included the continuation of current policy, population projections provided by Eurostat, and specified macroeconomic projections.

## Presentation of Information

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

238. The Code includes good practices related to (1) citizens’ guides; (2) reporting criteria; (3) fiscal indicators; and (4) reporting of budget program objectives.

239. Basic requirements under this principle are to ensure that

- the main proposals and economic background to the budget are explained clearly to the general public;
- revenue, expenditure, and financing are reported on a gross basis and expenditure is classified by economic, functional, and administrative category; and
- results of central government programs are presented to the legislature.

### Citizens’ guide

3.2.1 A clear and simple summary guide to the budget should be widely distributed at the time of the annual budget.

240. In addition to the detailed material on the budget, which is essential for effective analysis and scrutiny by the legislature and informed public, the government should publish a “citizens’ guide” to explain the main features of the budget in a form that is objective, reliable, relevant, and easy to understand. Written in plain and accessible language, the guide should summarize recent economic developments, explain the main objectives of the budget, list the main changes and/or new policies proposed, and show how revenue is to be raised, spending is to be allocated, and financing achieved.

### Reporting criteria

3.2.2 Fiscal data should be reported on a gross basis, distinguishing revenue, expenditure, and financing, with expenditure classified by economic, functional, and administrative category.

241. Budget transactions need to be able to be 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. An important feature is that spending is recorded in gross terms so that the full extent of government activity can be properly established. This requires that user fees and charges, such as those used by some clinics and hospitals to offset directly the costs of health care, be recorded separately as government revenue even though they are not remitted to the treasury.

### ***Comprehensiveness and compatibility with the GFSM 2001***

242. The data classification system should comprehensively cover the broadly defined budget. The data classification system should also be compatible with GFSM 2001 standards for data classification in the sense that distinctions at a transaction level should permit generation of GFSM 2001-consistent reports.<sup>121</sup> A classification by administrative category is important for internal control purposes. Classifications and subclassifications should be consistent with the analytical distinctions in the current GFSM 2001.<sup>122</sup> However, it should be emphasized that the GFSM 2001 is a reporting standard for fiscal statistics and not an accounting or financial reporting standard. The differences are discussed in Box 14 (Chapter II). Aside from providing an analytical framework that facilitates assessment of the aggregate impact of government transactions on the economy, the GFSM 2001 provides a widely accepted standard for an *economic classification* of revenue and expenditure and adopts the UN COFOG<sup>123</sup> 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.

243. It is important that all military spending be recorded and reported under the defense function, including that which is financed by off-budget or commercial revenue sources. Although 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, however, warrant a somewhat different approach to auditing the details of military spending.

### ***Consistency with administrative accountability***

244. The classification system should also allow clear tracking 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 these

<sup>121</sup>See Table 1 for a discussion of the relationship between GFSM 2001 classification and various types of fiscal reporting.

<sup>122</sup>Although the GFSM 2001 is not the only fiscal statistical reporting standard (the SNA and ESA provide alternatives that are close in concept), the current GFSM 2001 provides the most generally accepted international point of reference for purposes of classification of fiscal statistics.

<sup>123</sup>See <http://unstats.un.org/unsd/cr/family2.asp?Cl=4>.

countries are changing their classification system to promote administrative accountability.<sup>124</sup>

## Fiscal indicators

3.2.3 The overall balance and gross debt of the general government, or their accrual equivalents, should be standard summary indicators of the government fiscal position. They should be supplemented, where appropriate, by other fiscal indicators, such as the primary balance, the public sector balance, and net debt.

### *The overall balance*

245. The overall balance<sup>125</sup> of general government is a widely used reference point for fiscal policy analysis. Measured in cash terms, it provides a succinct indication of the impact of fiscal policy on aggregate demand: a larger deficit, for instance, generally suggests a more expansionary fiscal policy. The overall balance 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”). Analysis of the size of the deficit or surplus and its components, as well as the sources of deficit financing (or “below-the-line” transactions), will also be relevant in assessing the implications of fiscal policy for the economy (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). Generally speaking, under the GFSM 2001, the net lending/borrowing balance may be considered as the accrual equivalent of the overall balance.

246. Although it is generally useful for analysis of the fiscal position to start from an assessment of the overall general government balance, there are some qualifications to this. First, for practical or constitutional reasons, in many countries the standard measure of the fiscal position is the overall balance of central government rather than general government. This may reflect the degree of autonomy of subnational governments or the lack of availability of consistent data. Second, where the financial positions of some public corporations can have macroeconomic effects or are directly affected by central government decisions, the central or general government balance should be supplemented by a measure of the broader public sector balance or its GFSM 2001 accrual equivalents or by indicators that consolidate with general government the financial position of those public corporations that present fiscal risks.

247. Third, where the overall balance measure has acknowledged shortcomings, supplementary information on alternative balance measures should be provided to meet particular policy needs. For example, the primary balance (overall balance excluding net interest payments) should be routinely reported for countries with substantial public debt or deteriorating debt dynamics. When there is high inflation, the operational balance (the overall balance minus the part of debt service that compensates debt holders for

<sup>124</sup>*Belarus*, Fiscal ROSC, 2004, paragraph 22, indicates that data on economic classification are compiled monthly for the republican government and quarterly for consolidated general government. The budget classification is broadly compatible with the GFSM 2001, with the exception of some parts of the functional classification. Privatization receipts were treated as revenue prior to 2003.

<sup>125</sup>In the GFSM 1986, the overall balance (or the overall deficit/surplus) is defined, on a cash basis, as total revenue and grants minus expenditure and lending minus repayments. An alternative definition of the GFSM 1986 overall balance may exclude some transactions in assets and liabilities (e.g., privatization proceeds) and classify them below the line. In the GFSM 2001, the “overall cash surplus/deficit” is defined as total revenue (including grants) minus expense minus transactions in nonfinancial assets; all transactions in financial assets (including “lending and repayments”) and liabilities are shown below the line. An alternative definition of the GFSM 2001 cash surplus/deficit and accrual net lending/borrowing is the “overall fiscal balance,” which allows for the reclassification of some transactions in assets and liabilities for public policy purposes (e.g., subsidies in the form of loans are shown as expenses, while proceeds from privatization—including fixed asset sales—are shown as financing).

inflation) is often also reported.<sup>126</sup> 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 fiscal policy stance. There are also circumstances under which it might be appropriate to show supplementary measures of the overall balance, which exclude certain highly variable items. For countries with large and volatile revenues from oil, for instance, changes in the non-oil fiscal balance provide a useful indication of the implications of the fiscal stance for domestic demand.<sup>127</sup>

248. In addition to the need for such supplementary measures, a further concern about the overall balance is that it is a cash-based indicator that 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 lending.<sup>128</sup> 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. In cases of significant levels of the two activities described, an augmented balance, which includes these effects, should be reported in addition to the overall balance.

249. In an integrated government *accounting system*, under accrual or modified accrual accounting, it would be necessary to reconcile debt transactions with operating accounts. Under cash accounting, IFAC recommends that the disclosure of assets and liabilities 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.

250. Another point of contention is the appropriate way to treat grants. In both the GFSM 1986 and the current GFSM 2001, grants are treated as “above-the-line” or deficit-reducing receipts. However, because 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. Because below-the-line information is generally less available to the public, fiscal transparency is enhanced by considering grants above the line. To indicate potential issues related to these receipts, in countries with large grant inflows it is common to identify the overall balance, both inclusive and exclusive of grants.

251. Many of these issues will be addressed by adopting an accrual basis for fiscal reporting because it fully and properly reflects changes in government assets and liabilities. Although many countries will continue to use a cash overall balance for some time, the GFSM 2001 recommends an accrual basis for

<sup>126</sup>See Tanzi, Bléjer, and Teijeiro (1993) and Davis, Ossowski, and Fedelino (2003).

<sup>127</sup>The various concepts of the fiscal balance are discussed in Bléjer and Cheasty (1993).

<sup>128</sup>See Mackenzie (1998) and the GFSM 2001.



recording 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 accrual or modified accrual accounting schemes.<sup>129</sup> 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 GFSM 2001 fiscal reports, the overall balance should be reported in budget and accounting reports with an analytical table showing its derivation from budget data. Publishing both accrual and cash-basis indicators is best practice.

### Reporting of budget program objectives

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

252. A statement of the objectives of major budget programs should be reported, if possible supported by the use of quantified social indicators. 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's end. Comparative information should be provided for at least a few previous fiscal years. OECD best practices call for this assessment to be independently audited and presented to the legislature within six months of the end of the fiscal year.

## Timely Publication

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

253. The Code includes good practices relating to (1) legal obligations to publish timely data and (2) release calendars.

254. A basic requirement under this principle is to ensure that there is a legal obligation to publish timely fiscal information.

### Legal obligation to publish timely data

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

255. Fiscal transparency is grounded in the accessibility of a wide range of timely information to the public in a predictable and timely manner. Confidence that such practices will be pursued requires a clear legal obligation on the government. Exercising discretion to determine whether, when, in what detail, or

<sup>129</sup>See *Australia*, Fiscal ROSC, 1999; and *United Kingdom*, Fiscal ROSC, 1999.

### Box 24. Freedom of Information Acts

Freedom of information acts provide public access to government records and information that facilitates discussion of public policies and provides for greater accountability of government. This increased public oversight provides stronger incentives for government to perform well and makes it more difficult for governments to conceal poor decisions, wrongdoing, or other problems. Not only can closer observation by the public help to guard against abuses, mismanagement, and corruption, but it can also help governments by instilling greater public trust and support for difficult decisions.

More than 50 countries worldwide, including developed and emerging markets, have adopted comprehensive freedom of information acts (FOIAs) to facilitate public access to records held by government institutions, and more than half of these have been adopted in the past 10–15 years. In addition, many countries in South America, Asia, Europe, and Africa (mainly British Commonwealth countries) are currently considering adoption of FOIAs. However, in some countries freedom of information laws exist in name only because they actually restrict access to government records.

#### Common Features

The basic feature of all FOIAs is the ability of individuals to request information from any public authority, but the definitions of what may be requested vary. Newer laws tend to define information more broadly. The right to request belongs to citizens and usually to permanent residents and corporations in the country. Many countries now allow anyone in the world to request information.

Another common feature of FOIAs is a requirement for government agencies to routinely release certain types of information, such as organizational structure, functions, rules, and annual reports. Some FOIAs require the information be posted on the Internet.

#### Coverage

FOIAs generally apply to nearly all government entities, including local and regional levels of government. Sometimes these laws also extend to nongovernmental organizations that receive public funding and companies that carry out projects or provide services funded by the government. In some cases governments

to whom to release fiscal information damages the credibility of both the government and the information itself, because governments will often be tempted 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.

256. Posting fiscal information free of charge on the Internet has become an essential element in ensuring that access to information is uniform and timely. Even in countries with low levels of public usage, making material available on the Internet permits other media and informal dissemination methods to function more effectively. Official gazettes and other publications of record should be posted on an easily identifiable and accessible website as soon as they are completed. Such actions should complement rather than

have created commissions to decide certain policies, and these commissions are not bound by the FOIAs.

All FOIAs have some types of exemptions. Many exempt certain government institutions, including courts; legislatures; and those that provide defense, international relations, and intelligence services. It is common in parliamentary systems for documents submitted to the cabinet for decision and records of cabinet meetings to be exempt. Other common exemptions cover individual privacy, commercial confidentiality, law enforcement, other information received in confidence, and internal discussions. Most laws require the government to demonstrate that release of information will be harmful before it can be withheld from the public. Some countries balance this against the benefit of public knowledge and can require information to be released if the benefit is considered to outweigh the harm. This provision is often applied to reveal wrongdoing or corruption, or to prevent harm to individuals or the environment.

#### **Enforcement and Appeals**

The passage of an FOIA is only the beginning. It is the implementing regulations that will determine whether the public does in fact have access to information. A broad application of exemptions, requirements such as proof of legal interest, long delays in providing information, and excessive fees can prevent the use of the law to acquire information. Also, if independent oversight bodies are not given adequate resources, the appeals process can be very slow.

FOIAs are commonly enforced through oversight bodies as well as administrative reviews. Many countries have created external monitors such as an ombudsman, review panels, or information commissioners that can be asked to review a decision to withhold information. Although they can be influential, they often do not have the power to issue a binding decision. The final level of appeal in almost all countries is to the national courts, which can make binding decisions. In some countries the courts are the only point of external review.

For further information, see <http://www.freedominfo.org>; [http://www.freedominfo.org/documents/global\\_survey2004.pdf](http://www.freedominfo.org/documents/global_survey2004.pdf); [http://www.privacyinternational.org/index.shtml?cmd\[342\]\[\]=c-1-Freedom+of+Information&als\[theme\]=Freedom%20of%20Information&conds\[1\]\[category.....\]=Freedom%20of%20Information](http://www.privacyinternational.org/index.shtml?cmd[342][]=c-1-Freedom+of+Information&als[theme]=Freedom%20of%20Information&conds[1][category.....]=Freedom%20of%20Information).

substitute for traditional methods of dissemination, such as hard copy publication and direct release to the press and other media.

257. The GDDS and SDDS guides note that the timeliness of data (i.e., the amount of time between the end of a reference period—or a reference date—and dissemination of the data) reflects many factors, including some that are related to institutional arrangements, such as the preparation of accompanying commentary and printing. They provide guidance on appropriate objectives for the timeliness of categories of fiscal data, noting also the importance of not compromising other aspects of data quality.

258. The legal obligation of governments to publish fiscal information is a requirement of fiscal transparency. Best practice is that the law require publication of a wide range of fiscal information (including official policy papers),

### Box 25. Fiscal Transparency and Data Dissemination Standards

The Code and the Manual generally reflect the standards for coverage, periodicity, and timeliness of data dissemination set by the Special Data Dissemination Standard (SDDS) and the General Data Dissemination System (GDDS). Standards under the SDDS generally correspond to best practice. In areas outside the coverage of SDDS and GDDS, such as dissemination through budget documentation and published audited final accounts, and issues of greater emphasis such as contingent liabilities, the Code sets its own standards. The relevant SDDS/GDDS standards are set out in the table below.

Fiscal Sector	SDDS	GDDS
<b>Central government operations</b>		
Coverage	A	A
Periodicity	Monthly	Quarterly
Timeliness	1 month	1 quarter
<b>Central government debt</b>		
Coverage	B	B
Periodicity	Quarterly	Annual—quarterly encouraged
Timeliness	1 quarter	1–2 quarters
<b>General government/public sector operations</b>		
Coverage	C	C
Periodicity	Annual	Annual
Timeliness	2 quarters	2–3 quarters

A All central government units and extrabudgetary funds, showing revenues, expenses, deficits, surplus, and main components of deficit or surplus and financing; disclosure of interest payments is encouraged.

B Liabilities of all central government and extrabudgetary funds, disaggregated by maturity, and either by residency (foreign/domestic) or by currency;<sup>1</sup> guaranteed debt (as relevant); quarterly debt service projections encouraged under SDDS.

C All central government units, extrabudgetary funds, state and local government, if any, and social security funds. If the public sector, then general government plus public nonfinancial corporations.

<sup>1</sup>For fiscal transparency, the currency breakdown is more relevant because it allows measurement of the potential impact of variation in the exchange rate.

<sup>130</sup>The 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 ombudsperson—an office independent of the executive that receives and investigates complaints of misadministration—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.

with clearly specified and justified exceptions. Examples of national legislation representing best practice in setting clear standards for fiscal reporting are discussed in Box 23. The various fiscal reports issued in connection with the budget are described in Table 1.

259. Some countries also have freedom of information legislation that requires government agencies to make available to the public on request any information they hold (Box 24), 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 case of nondisclosure.<sup>130</sup>

The SDDS and GDDS also include other dimensions relevant to fiscal transparency, including

**Access by the public.** The SDDS calls for providing the public, including market participants, ready and equal access to the data. Countries subscribing to the SDDS are to

- *disseminate in advance release calendars for the data; and*
- *release the data to all interested parties simultaneously.*

**Integrity.** Noting that confidence in the statistics ultimately becomes a matter of confidence in the objectivity and professionalism of the agency producing the statistics, and that transparency of practices and procedures is a key factor in creating this confidence, the SDDS requires subscribing countries to

- *disseminate the terms and conditions under which official statistics are produced, including those relating to the confidentiality of individually identifiable information;*
- *identify internal government access to data before release;*
- *identify ministerial commentary on the occasion of statistical releases; and*
- *provide information about revision and advance notice of major changes in methodology.*

**Quality.** A set of standards that deals with the coverage, periodicity, and timeliness of data must also address the quality of statistics. Although quality is difficult to judge, monitorable proxies, designed to focus on information the user needs to judge quality, can be useful. The SDDS requires subscribing countries to

- *disseminate documentation on methodology and sources used in preparing statistics; and*
- *disseminate component detail, reconciliations with related data, and statistical frameworks that support statistical cross-checks and provide assurance of reasonableness.*

## Release calendars

3.3.2 Advance release calendars for fiscal information should be announced and adhered to.

### *The timing of publication*

260. In line with the GDDS and SDDS (Box 25), advance release calendars should be announced for the year ahead showing at a minimum release dates for annual reports and a range of dates for more frequent reports.<sup>131</sup> 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 per-

<sup>131</sup>Release 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.

son responsible for providing the latest information about the likely release date. Governments should make a commitment to release fiscal reports and data simultaneously to all interested parties. Best practice is represented by the more demanding requirements of the SDDS.<sup>132</sup> 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.

<sup>132</sup>For discussion of advance release calendars, see IMF (1996 and 1998a).

# IV

## Assurances of Integrity

261. It is essential for fiscal transparency that fiscal data reported to the government meet basic criteria that attest to their quality, and that mechanisms be in place that provide assurances to the legislature and the public about data integrity. Internal oversight mechanisms are necessary for the conduct of public officials, public service employment, internal audit, procurement, purchases and sales of public assets, and national revenue administration. External oversight mechanisms also provide assurances through an independent national audit body, a national statistical body, and engagement with external independent experts.

### Data Quality Standards

4.1 Fiscal data should meet accepted data quality standards.<sup>133</sup>

262. The Code includes good practices relating to (1) realism of budget data, (2) accounting standards, and (3) data consistency and reconciliation.

263. Basic requirements under this principle are to ensure that

- accounting policies meet generally accepted accounting standards;
- final accounts are fully reconciled with budget appropriations, and fiscal aggregate outcomes are compared with previous forecasts; and
- countries subscribe to the GDDS if they are not able to adhere to the SDDS.

#### Realism of budget data

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

264. It is important that budget estimates and forecasts take into account all the information available at the time of presentation, including the lat-

<sup>133</sup>An in-depth treatment of this issue is found in the IMF's July 2003 Data Quality Assessment Framework and Data Quality Program, at <http://www.imf.org/external/np/sta/dsbb/2003/eng/dqaf.htm>.

<sup>134</sup>*Netherlands*, Fiscal ROSC, 2006, paragraph 60, indicates that budget data are reliable and the variance between budgeted and actual outturn is disclosed to the public, giving reasons for variation.

<sup>135</sup>“Accounting policies are the specific principles, bases, conventions, rules, and practices adopted by an entity in preparing and presenting financial statements” (see IFAC’s 2003 glossary of defined terms at <http://www.ifac.org/publicsector>). The accounting basis may differ between budget documents and financial reports, as it does for example in the *United States*. Some countries have moved to accrual budgeting through a transitional period of reporting on an accrual basis, while still budgeting on a cash basis.

<sup>136</sup>For instance, international public sector accounting standards (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.fasab.gov>).

<sup>137</sup>For 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; that is, accrual accounting. GAAP is the responsibility of the New Zealand Accounting Standards Review Board (<http://www.asrb.co.nz>), a body independent of the government that establishes accounting standards for the private and public sectors.

est projections for the economic outlook and the most recent evidence on spending, revenue, and financing.<sup>134</sup> In updating the budget estimates during the year, it can at times prove difficult to determine whether discrepancies between the original projections and the trends implied by the latest outturn information reflect deviations in the macroeconomic assumptions or in the forecasting parameters, such as execution rates for investment or collection rates for taxes. Judgment must be exercised about the relative quality of the different sources of information and reconciliations made between conflicting data items. When major revisions are made to budget estimates, explanations should be provided to ensure the integrity of the forecasting process. The effects of any changes in policy commitments should also be clearly distinguished.

## Accounting standards

4.1.2 The annual budget and final accounts should indicate the accounting basis used in the compilation and presentation of fiscal data. Generally accepted accounting standards should be followed.

265. Fiscal transparency requires that the accounting policies<sup>135</sup> that are being followed be referenced and that generally accepted accounting standards be met.<sup>136</sup> 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). In-year reports should be prepared using the same accounting basis as the original budget. Advance notice should be given of any significant planned changes in accounting policies or practices. Best practice involves mechanisms for setting standards for government accounting and financial reporting that are open and independent of government.<sup>137</sup>

266. The IFAC-IPSASB has developed prescriptive standards and some associated descriptive guidance on existing government accounting practice (see Box 14).

## Data consistency and reconciliation

4.1.3 Data in fiscal reports should be internally consistent and reconciled with relevant data from other sources. Major revisions of historical fiscal data and any changes to data classification should be explained.

## Internal consistency

267. A precondition of the reliability of all fiscal reports as identified in Table 1 is that they be based on internally consistent data. Cross-checks of internal consistency of fiscal data should be undertaken and the effectiveness of these procedures reported. The security of data should also be ensured.



268. Fiscal transparency requires that final accounts be fully reconciled with budget appropriations, and that each be reconciled with GFSM 2001 reports. The former provides assurance that all relevant accounts are covered by GFSM 2001 reports. GFSM 2001 reports should be compiled parallel to budget reports, and should be actively used in the process of formulating and evaluating fiscal policy. 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.

269. A background paper should be included with the budget documentation that analyzes the differences between forecasts of the main fiscal aggregates made in previous budgets and relevant outturn information. In particular, differences between previous fiscal forecasts and outturns should be broken down into divergences owing to macroeconomic factors that affected forecasts of revenues or expenditures, such as those related to income support, and those that reflected other factors, including unexpected changes in the demand for public services, natural or other types of calamities, wars, or civil conflict. 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**

270. Reconciliation should be undertaken between fiscal data and related nonfiscal data, primarily monetary data but also balance of payments and national accounts data.<sup>138</sup> There should be rigorous reconciliation of fiscal and monetary data, and where reconciliation processes are weak, this fact should be brought to public attention (e.g., in audit reports) in a timely manner. The overall balance measured as the difference between revenue and expenditure should be reconciled with financing data as reported both by the government and by its counterparts—the central bank, the rest of the banking system, and other domestic and external lenders. Data on government financing 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.

271. One way for countries to signal a commitment to improving the quality of fiscal data is to participate in the GDDS. A key purpose of the GDDS is to help countries develop their statistical systems so that they can reach a stage at which they will be able to disseminate timely and reliable data to the public on a regular basis. This is necessary for countries that are not participating in the SDDS. 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, preparing metadata<sup>139</sup> describing current practices in the production and dissemination of official statistics, and announcing plans for short- and long-term improvements in these practices.

<sup>138</sup>In *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 Annex IV, Sample C, in Carson (2001).

<sup>139</sup>Documentation on concepts, scope, classifications, basis of recording, data sources, and statistical techniques is available, and differences from internationally accepted standards, guidelines, or good practices are annotated. Levels of detail are adapted to the needs of the intended audience.

### Box 26. Data Quality Framework: Main Dimensions

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

272. The IMF has produced a generic Data Quality Assessment Framework (DQAF).<sup>140</sup> It covers the various quality aspects of data dissemination collection, processing, and dissemination under the IMF's DQAF umbrella. A specific application for fiscal data has been developed that is consistent with the revised GFSM 2001. The DQAF 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 nonexperts 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*<sup>141</sup> and the SDDS and GDDS.

<sup>140</sup>See detailed information by the IMF's Statistics Department, at the Data Quality Reference Site.

<sup>141</sup>See <http://unstats.un.org/unsd/goodprac/bpabout.asp>.

273. A summary of the generic DQAF is presented in Box 26. The framework follows a cascading structure that flows from the identified prerequisites of data quality and the main dimensions that have been identified as critical constituents of data quality. 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 26). The DQAF recognizes that the quality of an individual data set is intrinsically bound with that of the institution producing it.

### ***Historical consistency***

274. Major revisions to historical fiscal data should be explained. Assurance should also be provided as to the consistency of quality over time. For instance, where aggregate fiscal data are presented in the budget documentation for prior years, it should be clear whether there have been changes in classification and whether the numbers are provisional or final. Any changes to the classification and treatment of transactions should be accompanied by a reconciliation between the old and new presentation of historical data. Reasons for the changes and their approximate fiscal consequences should also be explained. Revisions to fiscal data should follow a regular, established, and published schedule.

## **Oversight**

4.2. Fiscal activities should be subject to effective internal oversight and safeguards.

275. The Code includes good practices relating to (1) ethical standards, (2) employment procedures, (3) procurement regulations, (4) purchases and sales of assets, (5) internal audit systems, and (6) national revenue administration.

276. Basic requirements under this principle are to ensure that

- standards for procurement, financial transactions involving the public sector, and the ethical behavior of public servants are clear, publicly accessible, and observed; and
- internal audit procedures are clear and observed.

### **Ethical standards**

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

277. The government should have effective institutional arrangements to promote public sector values, and a code of ethics or guidelines for the appropriate conduct of public officials, which should be clear, accessible, and publicly available. This is often supported by arrangements to enlist

public servants in support of these ethical standards in their departments or ministries.

278. 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. Some aspects of such a code could be included in the budget and tax legislation; other aspects may need separate policy, legislation, or regulations. The United Nations' *International Code of Conduct for Public Officials*,<sup>142</sup> which is summarized in Box 27, provides a basis for implementing a standard of ethics and for strengthening an existing standard.<sup>143</sup> Best practices for the Principles for Managing Ethics in the Public Sector should be observed.<sup>144</sup> 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 wrongdoing, political commitment, and the active promotion of ethical conduct. The *Observatory on Ethics Codes and Codes of Conduct in OECD Countries*<sup>145</sup> provides examples of recent codes of conduct and ethics codes.

279. Although a code of conduct is an important component in supporting integrity relating to fiscal matters, its mere existence is not sufficient. Accompanying the code should be an active promotion and education program to increase dialogue and understanding of the appropriate public sector values and ethics. In an expanding number of countries, governments have one or more independent ombudsperson functions to provide an avenue for public officials to come forward, in a safe environment, to raise concerns about perceived wrongdoing. These functions have the mandate to investigate cases and suggest remedial action. In addition, some countries have adopted legal and institutional mechanisms to ensure the ethical behavior of public officials.<sup>146</sup> Further, comprehensive employee surveys are often conducted in order to obtain feedback on matters of integrity, morale, and workplace well-being.

## Employment procedures

4.2.2 Public sector employment procedures and conditions should be documented and accessible to interested parties.

280. Selection based on merit is the foundation for a competent, professional, nonpartisan public service. Application of merit principles<sup>147</sup> in public employment should be clear. Procedures governing recruitment and promotion within the public service should be clearly specified and accessible. Conditions of employment should be published. Vacancies should be advertised and filled through competition, with clearly defined and fair selection criteria, which should be merit based.

281. In a number of advanced, and some developing, economies, significant powers related to employment conditions are being delegated to selected agencies. These agencies are allowed to set their own recruitment policies and to determine pay (within varying limits) outside the general scope of a public service central employer authority. This is the case in a

<sup>142</sup>See <http://www.un.org/ga/documents/gares51/gar51-59.htm>.

<sup>143</sup>INTOSAI has published the *INTOSAI Code of Ethics for Auditors in the Public Sector*. See <http://www.intosai.org>.

<sup>144</sup>See <http://www.oecd.org>.

<sup>145</sup>See [http://www.oecd.org/document/12/0,2340,en\\_2649\\_201185\\_35532108\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/12/0,2340,en_2649_201185_35532108_1_1_1_1,00.html). Countries included are *Australia, Brazil, Canada, Greece, Italy, Korea, New Zealand, Poland, Spain*, the *United Kingdom*, and the *United States*.

<sup>146</sup>Some countries have set up independent bodies or commissions that play a watchdog role for the observance of the code of conduct and some also report to the legislature.

<sup>147</sup>The merit principle is commonly understood to require that appointments be made in a non-partisan fashion with a selection process that is free from political party affiliation and bureaucratic relationships, and that they be based on competence and ability to do the job. See <http://www.hrtoolkit.gov.bc.ca>.

### Box 27. Code of Conduct for Public Officials

The *International Code of Conduct for Public Officials*, adopted by the United Nations on December 12, 1996, takes as its starting point that a public official is in a position of trust, implying a duty to act in the public interest. It includes the following provisions:

- 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.
- 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.

number of revenue authorities in developing countries, which are now freed from the restrictions of the civil service code. One motivation has been the perception that corrupt practices, and particularly the incentive for collusion with taxpayers, can be reduced by pay flexibility that allows well-trained revenue administrators to receive salaries higher than elsewhere in the civil service, buttressed by stringent codes of conduct. Clarity and openness of human resource procedures, including conditions of employment, are core requirements.

## Procurement regulations

4.2.3 Procurement regulations, meeting international standards, should be accessible and observed in practice.

282. Arrangements for contracting goods and services, particularly where large contracts are involved, must be undertaken in an open and publicly accessible manner in order 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. The strict observance of procurement regulations is a prerequisite for a robust procurement system.<sup>148</sup>

283. Appropriate and transparent 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.<sup>149</sup> 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.<sup>150</sup> Some countries developed a procurement law based on the United Nations Commission on

<sup>148</sup>An important resource is the methodology for measuring and monitoring procurement performance in the public sector set out by the OECD and World Bank (see [http://www.oecd.org/document/29/0,2340,en\\_2649\\_19101395\\_34337309\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/29/0,2340,en_2649_19101395_34337309_1_1_1_1,00.html)).

<sup>149</sup>*Hungary*, Fiscal ROSC, 2007, paragraph 29, provides a good example of meeting international procurement best practices through the “Glass Pockets” initiative, which was launched in mid-2003. Among its elements are increased State Audit Office powers of scrutiny and audit, a requirement that key players in public corporations declare their assets, and an increase in information on contracts available to the public.

<sup>150</sup>Guidelines on public procurement are available through the OECD website, which outlines relevant legislation under multilateral trade arrangements such as the World Trade Organization’s *Government Procurement Agreement* (<http://www.jurisint.org/pub/06/en/doc/30.htm>) and the European Union’s *Procurement Directives* (<http://formby.wiganmbc.gov.uk/pub/bsu/eudirect.htm>), which set legal obligations for national systems and practices.

International Trade Law (UNCITRAL) *Model Law on Procurement of Goods, Construction, and Services*.<sup>151</sup>

### Purchases and sales of assets

4.2.4 Purchases and sales of public assets should be undertaken in an open manner, and major transactions should be separately identified.

284. The purchase and sale of assets and liabilities, through privatization and other means, should be conducted in an open manner.<sup>152</sup> Decision-making processes, using standardized regulations, should clearly allow for scrutiny. Transparency concerns arise particularly over the manner in which public corporations are privatized. All aspects of the process should be governed by sound marketing considerations, including the need for open tendering and contracts and the manner in which concessions are granted. Purchases and sales of all public assets should be open to independent audit (e.g., by a national audit body) to ensure that the transactions are 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). INTOSAI has published *Guidelines on Best Practice for the Audit of Privatizations*.<sup>153</sup>

285. The sale of assets may sometimes obscure the underlying fiscal position. It is important therefore to identify one-off transactions fully in the reporting framework and to make clear their impact on the fiscal balance.

### Internal audit systems

4.2.5 Government activities and finances should be internally audited, and audit procedures should be open to review.

286. From a fiscal transparency viewpoint, one objective for the internal control environment is to develop and maintain reliable financial data and to disclose the data in a timely manner. INTOSAI has identified objectives of internal control systems: to promote orderly, economical, efficient, and effective operations; to safeguard resources against loss owing 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. 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 28. Internal control systems in all countries should embrace INTOSAI guidelines.

287. One important component of internal control systems is internal audit. Effective internal audit by government agencies is one of the first lines of defense against misuse and/or mismanagement of public funds.<sup>154</sup>

<sup>151</sup>See [http://www.uncitral.org/uncitral/en/uncitral\\_texts/procurement\\_infrastructure/1994Model.html](http://www.uncitral.org/uncitral/en/uncitral_texts/procurement_infrastructure/1994Model.html).

<sup>152</sup>See practice 3.1.4 in regard to reporting requirements for major revenue items.

<sup>153</sup>See <http://www.intosai.org>.

<sup>154</sup>Internal audit is defined 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).

### Box 28. INTOSAI Guidelines for Internal Control Standards

The International Organization of Supreme Audit Institutions (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 provides 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 divided among individuals.
- Competent supervision is to be provided to ensure that 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.

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 ensured 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 be open to review by external auditors. Further, the independence of internal audit from day-to-day management ensures objectivity of its evaluations. Standards of internal audit should be consistent with international standards, such as those of the Institute of Internal Auditors (IIA).<sup>155</sup> The IIA has a comprehensive set of standards for the practice of internal auditing, attribute standards, and performance.

288. Internal audit systems are intended to provide assurance that management's objectives are being achieved.<sup>156</sup> They provide management with objective assessments about the design and operation of management practices and "objective assurance on the adequacy and functioning of an

<sup>155</sup><http://www.theiaa.org>.

<sup>156</sup>Under this broad definition, internal audit covers administrative controls (procedures governing decision-making processes) and accounting controls (procedures governing the reliability of financial records).

organization's risk management, control, and governance processes."<sup>157</sup> Internal audit contributes to a continuous management improvement and accountability program.<sup>158</sup> Responsibility for internal audit therefore rests with the head of each individual government agency. However, a central government agency might be assigned responsibility for developing a government-wide standard approach to internal audit. In some countries, the internal audit reports are also made available to the national audit body.

### National revenue administration

4.2.6 The national revenue administration should be legally protected from political direction, ensure taxpayers' rights, and report regularly to the public on its activities.

#### *Independence of national revenue administrations*

289. The legislation that sets up national revenue administrations should provide for their independence to ensure fair and impartial treatment, free from political intervention. For this reason, heads of revenue administrations should be appointed by law and be given some statutory protection against removal from office and political direction in interpreting revenue laws. The statutory appointment of revenue commissioners with clearly specified powers over interpretation of tax, customs, and any other revenue collection laws and regulations is one approach that helps provide the assurance of integrity.

290. The tax collection process should also be open, and to this end revenue collection agencies should provide timely annual reports to the legislature on their activities and results. These reports provide details of actions being taken to improve compliance with tax laws, as well as cover performance data such as actual collections relative to the budget.

291. Equally important aspects of transparency in revenue collection legislation and regulations and their administration are the openness to review administrative decisions and the extent to which government is obliged to make taxpayers aware of their rights. See practice 1.2.2 for a discussion of taxpayer rights.

## Scrutiny of Fiscal Information

4.3 Fiscal information should be externally scrutinized.

292. The Code includes good practices relating to (1) a national audit body, (2) audit reports and follow-up mechanisms, (3) independent assessments of forecasts and assumptions, and (4) independence of data verification.

293. Basic requirements under this principle are to ensure that a national audit body, which is independent of the executive, provides timely reports (at

<sup>157</sup>See <http://www.oag-bvg.gc.ca/domino/other.nsf/html/01pac05e.html>.

<sup>158</sup>*Canada*, Fiscal ROSC 2002, paragraph 31, outlines internal audit policy, standards, and management.



a minimum on an annual basis) for the legislature and public on the financial integrity of government accounts.

## National audit body

4.3.1 Public finances and policies should be subject to scrutiny by a national audit body or an equivalent organization that is independent of the executive.

294. A national audit body should be set up under law. National audit bodies, also known as supreme audit institutions (SAIs), can only “accomplish their tasks objectively and effectively, if they are independent of the audited entity and are protected against outside influence.”<sup>159</sup> 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,<sup>160</sup> 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. INTOSAI’s *Lima Declaration of Guidelines on Auditing Pillars* provides a comprehensive list of all goals and issues relating to government auditing (see Box 29).

295. Standards of external audit practice should be consistent with international standards, such as those set by INTOSAI, which are described in Box 29. 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. It is therefore best practice that a national audit body or equivalent organization report to the legislature and the public on all public financial management matters relating to the integrity and transparency of fiscal policy. Ideally, there should be an external audit of the government’s performance on budget programs.

296. 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.

297. 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

<sup>159</sup>*Lima Declaration*, Section 5.1; see <http://www.intosai.org>.

<sup>160</sup>For *Iran*, the Supreme Audit Court (SAC) audits the accounts of spending agencies and reports to parliament on implementation of the government budget. The SAC derives its authority from the *Supreme Audit Court Act*, is independent of the executive, and reports to parliament. Its jurisdiction extends to “all the ministries, government institutions, and companies as well as other organizations that draw, in any way, on the general Budget” (Article 55 of the Constitution). The SAC enjoys independence in financial and administrative affairs (see *Iran*, Fiscal ROSC, 2002, paragraph 46).

### Box 29. INTOSAI Lima Declaration and Auditing Standards

#### Lima Declaration of Guidelines on Auditing Pillars

The chief aim of the *Lima Declaration* is to call for independent government auditing. Adopted by the IXth Congress of the International Organization of Supreme Audit Institutions (INTOSAI) in October 1977, it identifies the following critical features of the powers and functioning of a supreme audit institution (SAI):

**Independence:** should be established by constitution for the SAI and its members, and include the financing of its activities.

**Relationship to parliament, government, and the administration:** should be clearly specified in the constitution.

**Powers of supreme audit institution:** should include power of investigation, enforcement of findings, and the use of the SAI's expert opinions; regulation for accounting procedures should be agreed to with the SAI.

**Audit methods, audit staff, and freedom to establish international exchange of experiences:** should have the capacity and independence to self-determine its working program, methods of recruitment, and training of its staff.

**Reporting:** should be empowered to report its findings to parliament and to the public.

#### Auditing Standards

**Basic principles:** 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; they should avoid conflicts of interest; and they must exercise due care and concern in complying with INTOSAI or other specific auditing standards.

**Field standards:** auditors should plan the audits properly, and design procedures for the completion of regularity audits 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; a regularity audit should provide assurance that the budget and accounts are complete and valid; and the work of the audit staff should be properly supervised.

**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).

Source: <http://www.intosai.org>.

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.

### Audit reports and follow-up mechanisms

4.3.2 The national audit body or equivalent organization should submit all reports, including its annual report, to the legislature and publish them. Mechanisms should be in place to monitor follow-up actions.

298. The *Lima Declaration* guidelines call for SAIs to be laid out in the constitution, and for their independence to be protected by a supreme court. 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 ensure independence. The practice, in a number of countries, of the chief auditor being appointed by and reporting to the president or prime minister imperils the independence of the institution.

299. The chief auditor should report directly to the legislature.<sup>161</sup> 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. The SAI should report to the legislature on at least an annual basis. Some countries currently fall short of meeting this requirement of fiscal transparency because 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.

300. One area in which external audit reports are often not published is 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 nonmilitary authority, and that the results of the audit be presented to a legislative body, such as a public accounts committee.<sup>162</sup>

301. 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.<sup>163</sup> Transparent follow-up to external audits is an important feature that promotes concrete action for improvement.

302. 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 is 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

<sup>161</sup>In *India*, an independent Comptroller and Auditor General (CAG) Reports only to the parliament. It should also be noted that state governments have their own accountants-general working under the comptroller, and auditors-general who provide audit reports directly to state legislatures (see *India*, Fiscal ROSC, 2001, paragraph 26).

<sup>162</sup>In *Pakistan*, for instance, defense appropriation accounts are provided to the Public Accounts Committee, but circulation of the documents is restricted for security reasons (see *Pakistan*, Fiscal ROSC, 2000, paragraph 30).

<sup>163</sup>In *India* (Fiscal ROSC 2001, paragraph 26), the CAG's reports are tabled in the central and state legislatures and are reviewed by their respective Public Accounts Committees and Committees on Public Undertakings. Ministries are subsequently required to submit "Action Taken Notes" to the respective committee via the CAG.

<sup>164</sup>The OECD best practice guidelines go further by requiring that each fiscal report contain a statement of responsibility by the finance minister and the senior official responsible for producing the report.

<sup>165</sup>The Bank of Norway regularly publishes its internal staff macroeconomic forecasts. The Swedish Riksbank publishes macroeconomic forecasts sanctioned by its policymaking body.

<sup>166</sup>In *South Africa*, a set of macroeconomic assumptions are included in the medium term budget policy statement (MTBPS), and the budget submitted to parliament is based on a further update of the macroeconomic framework.

<sup>167</sup>See main conclusions of EU Survey on Independent Fiscal Institutions: Public Finances in EMU, No. 3, 2006 ([http://ec.europa.eu/economy\\_finance/publications/european\\_economy/public\\_finances2006\\_en.htm](http://ec.europa.eu/economy_finance/publications/european_economy/public_finances2006_en.htm)).

<sup>168</sup>In *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. In *Chile*, the government uses macroeconomic forecasts provided by a committee composed of independent experts.

<sup>169</sup>In *Canada*, the federal government prepares its fiscal projections on the basis of average private sector economic forecasts, a prudence factor for economic risks, and a contingency reserve to cover risks from forecasting inaccuracies and unpredictable events (see *Canada*, Fiscal ROSC, 2002, paragraph 34).

### Box 30. The UN *Fundamental Principles of Official Statistics*

The following features of the UN *Fundamental Principles of Official Statistics* 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.
- Statistical agencies are to be entitled to comment on the erroneous interpretation and misuse of statistics.

Source: <http://unstats.un.org/unsd/goodprac/bpabout.asp>.

purview. It is important that the national audit body be given full access to all necessary records, documents, and personnel. Legislative requirements to this effect assist in obtaining the cooperation of audited agencies.

### Independent assessments of forecasts and assumptions

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

303. A number of steps are necessary to facilitate independent assessment of budget forecasts. Inclusion with the budget forecasts of a statement specifying 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.<sup>164</sup> 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 by the citizenry and specialists alike. Regular publication by the central bank or statistical or economic agencies 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.<sup>165</sup> Working methods and assumptions used in producing fiscal and macroeconomic forecasts should be made publicly available at the time the annual budget is presented to the legislature, and preferably sometime in advance of budget presentation. Advance presentation allows time for policymakers, independent forecasters and analysts, the financial press, and the general media to scrutinize and comment on the robustness of the macroeconomic forecasts.<sup>166</sup>

304. Best practice is that institutional mechanisms be established to provide the public with independent assurance that fiscal and macroeconomic forecasts are of high quality.<sup>167</sup> This could include making the fiscal and macroeconomic models available to outside experts.<sup>168</sup> The macroeconomic assumptions used in the budget could also be drawn from those produced by private sector forecasters.<sup>169</sup> Some countries have formal

quality reviews by experts that are made public. Others give an independent public agency the task of critiquing and reporting on the quality of forecasts.<sup>170</sup>

### Independence of data verification

4.3.4 A national statistical body should be provided with the institutional independence to verify the quality of fiscal data.

305. The national statistics agency or other equivalent office should be protected by legislation that grants it technical independence in the verification of the compilation and publication of official statistics.<sup>171</sup> To enhance the integrity of fiscal and other statistics, national statistical agencies can 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.

306. In addition, terms and conditions under which fiscal 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* (Box 30) and by meeting the standards for data integrity contained in the SDDS/GDDS.

307. 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. Where expertise does not exist within a national statistics agency to perform quality checks of fiscal data, countries are encouraged to seek external assistance.

<sup>170</sup>In the *United States*, the budget documents clearly present budget forecasts and disclose all major macroeconomic assumptions (see *United States*, Fiscal ROSC, 2003, paragraph 49). External scrutiny of macroeconomic models and assumptions is encouraged, in particular because the executive and legislative branches of the government each develop their own independent forecasts. There is no formal external scrutiny of the models used. In addition, the United States has many private macroeconomic forecasters who provide a further check on government forecasting. The track record of the CBO in forecasting real economic growth has generally been superior to the average of the private forecasters over the almost 30 years since the creation of the CBO. The executive branch forecasts have been similarly accurate over this same period.

<sup>171</sup>In a number of countries, including several Latin American countries, fiscal data are produced and disseminated by the central bank rather than by the national statistics office.

<sup>172</sup>The *Fundamental Principles of Official Statistics* were adopted by the United Nations in a special session in 1994. The principles are intended to guide producers of official statistics in fulfilling their obligations and to inform users of statistics of what they should expect.

# Appendix

## Summary Table of Principles and Basic Requirements of Fiscal Transparency

Principles	Basic Requirements
<b>Clarity of Roles and Responsibilities</b>	
<p>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.</p>	<ul style="list-style-type: none"> <li>• A published institutional table clearly shows the structure of the public sector, identifying all government entities by level of government, and identifying all public corporations.</li> <li>• The extent and purpose of all quasi-fiscal activities is explained.</li> <li>• Revenue and responsibilities are clearly assigned between different levels of government.</li> </ul>
<p>1.2 There should be a clear and open legal, regulatory, and administrative framework for fiscal management.</p>	<ul style="list-style-type: none"> <li>• No public funds can be spent without publicly available evidence of appropriation by the legislature.</li> <li>• Revenue collection is governed by clear and easily accessible laws and regulations.</li> </ul>
<b>Open Budget Processes</b>	
<p>2.1 Budget preparation should follow an established timetable and be guided by well-defined macroeconomic and fiscal policy objectives.</p>	<ul style="list-style-type: none"> <li>• Realistic draft budget proposals are presented to the legislature according to a prescribed timetable.</li> <li>• The likely costs and effects of new expenditure and revenue measures are clearly explained.</li> <li>• A consistent multiyear fiscal framework is provided, based on realistic economic assumptions.</li> </ul>
<p>2.2 There should be clear procedures for budget execution, monitoring, and reporting.</p>	<ul style="list-style-type: none"> <li>• Revenues, commitments, payments, and arrears can be tracked effectively.</li> <li>• Audited final accounts and audit reports are presented to the legislature and published within a year.</li> </ul>

**Summary Table of Principles and Basic Requirements of Fiscal Transparency  
(concluded)**

Principles	Basic Requirements
<b>Public Availability of Information</b>	
3.1 The public should be provided with comprehensive information on past, current, and projected fiscal activity, and on major fiscal risks.	<ul style="list-style-type: none"> <li>• The budget documentation covers all budgetary and extrabudgetary activities of the central government, the fiscal position of subnational government, and the finances of public corporations.</li> <li>• Information published on the central government includes details of its debt, significant financial and natural resource assets and nondebt liabilities, and contingent liabilities.</li> </ul>
3.2 Fiscal information should be presented in a way that facilitates policy analysis and promotes accountability.	<ul style="list-style-type: none"> <li>• The main proposals and economic background to the budget are explained clearly to the general public.</li> <li>• Revenue, expenditure, and financing are reported on a gross basis, and expenditure is classified by economic, functional, and administrative category.</li> <li>• Results of central government programs are presented to the legislature.</li> </ul>
3.3 A commitment should be made to the timely publication of fiscal information.	<ul style="list-style-type: none"> <li>• There is a legal obligation to publish timely information.</li> </ul>
<b>Assurances of Integrity</b>	
4.1 Fiscal data should meet accepted data quality standards.	<ul style="list-style-type: none"> <li>• Accounting policies meet generally accepted accounting standards.</li> <li>• Final accounts are fully reconciled with budget appropriations and fiscal aggregate outcomes are compared with previous forecasts.</li> <li>• Countries subscribe to the GDDS if they are not able to adhere to the SDDS.</li> </ul>
4.2 Fiscal activities should be subject to effective internal oversight and safeguards.	<ul style="list-style-type: none"> <li>• Standards for procurement, financial transactions involving the public sector, and the ethical behavior of public servants are clear, publicly accessible, and observed.</li> <li>• Internal audit procedures are clear.</li> </ul>
4.3 Fiscal information should be externally scrutinized.	<ul style="list-style-type: none"> <li>• A national audit body, which is independent of the executive, provides timely reports (at a minimum on an annual basis) for the legislature and public on the financial integrity of government accounts.</li> </ul>

# Glossary

**Accounting basis:** Defined in IFAC (2000b) 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.

**Advance release date calendar:** A calendar that indicates the dates on which regular publications will be available to the public. Hence, the public will know in advance when certain statistics or data will be available.

**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:** 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 an appropriation.

**Assets:** Any economic resource controlled by an entity as a result of *past* transactions or events and from which future economic benefits may be obtained. Types of financial assets include cash, deposits, loans, bonds, shares and other equities, financial derivatives, and accounts receivable. Examples of nonfinancial assets include buildings, machinery, equipment, inventories, valuables, land, subsoil mineral deposits, and leases.

**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.

**Budget calendar:** A calendar indicating the key dates in the process of preparing and approving the budget. These would include the date the budget circular is issued, time period for discussing estimates with the ministries and departments, the date the executive budget is submitted to the legislature, legislative review including dates for budget hearings, and the date the budget appropriations bill should be passed by the legislature. There may be other important steps in the process, which varies by country.

**Budget documentation:** The annual budget presentation and the budget-supporting documents, including but not limited to background to policy proposals and discussion of fiscal risks, within-year budget reports for monitoring budget execution, and the final accounts.

**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 whose timing and amount 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.

**Corruption (political):** The misuse by government or political officials of their governmental powers and resources for illegitimate, usually secret, private gain.

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

**Economic classification:** The GFSM 2001 refers specifically to a “classification of expenditure by the nature of transaction, that is, whether required or unrequited, for current or capital purposes, kind of goods or services obtained, and sector or subsector receiving transactions” (IMF, 2001, p. 325). It is generally used to identify the nature and economic effects of government operations. Though not formally described as “economic” in the GFSM 2001, the classification of revenue into current (tax and non-tax), capital, and grants serves a similar purpose.

**Extrabudgetary activities:** 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 *extrabudgetary funds* (such as social security funds) set up under separate legislation that may or may not have a separate annual appropriation. Other examples include commodity funds that use proceeds of commodity aid, specific kinds of revenue for earmarked specific purposes not included in the annual budget, or any other use of public funds that is not appropriated.

**Fiscal sustainability:** A set of policies is sustainable if a borrower is expected to be able to continue servicing its debt without an unrealistically large future correction to the balance of income and expenditure.

**Fiscal transparency:** Openness toward the public at large about government structure and functions, fiscal policy intentions, public sector accounts, and projections. It involves ready access to reliable, comprehensive, timely, understandable, and internationally comparable information on government activities so that the electorate and financial markets can accurately assess the government’s financial position and the true costs and benefits of government activities, including their present and future economic and social implications (Kopits and Craig, 1998, p. 1).

**Functional classification:** The GFSM 2001 refers specifically to the COFOG, which is the international 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 extrabudgetary funds, including social security funds at each level of government; and
- (c) all nonmarket nonprofit institutions that are controlled and financed mainly by government units.

The general government sector can be defined as all the public institutional units that are nonmarket producers. It does not include public corporations, which are market producers, even when all the equity of such corporations is owned by government units.

**Generally accepted accounting principles or U.S. GAAP:** The accounting rules used to prepare financial statements for publicly traded companies and many private companies in the United States. Generally accepted accounting principles for local and state governments operate under a different set of assumptions, principles, and constraints, as determined by the Governmental Accounting Standards Board. Currently, the Financial Accounting Standards Board sets accounting principles for the profession. The U.S. GAAP provisions differ somewhat from International Financial Reporting Standards, though efforts are under way to reconcile the differences.

**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 range of years. 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.

**Governance:** The process by which decisions are made and implemented (or not implemented). Within government, governance is the process by which public institutions conduct public affairs and manage public resources. *Good governance* refers to the management of government in a manner that is essentially free of abuse and corruption, and with due regard for the rule of law.

**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's 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 guarantee:** The most common type is a *government-guaranteed loan*, which requires the government to repay any amount outstanding amount on

a loan in the event of default. In some contracts with a public or private sector entity, the government may provide a revenue or demand guarantee that requires the government to make up the difference if revenue or quantity demanded is below the guaranteed level. Similarly, contracts may also have exchange rate or price guarantees.

**Gross debt:** Debt consists of all liabilities that require payment or payments of interest and/or principal by the debtor to the creditor at a date or dates in the future. Thus, all liabilities in the government finance statistics (GFS) system are debt, except for shares and other equity and financial derivatives. *Net debt* includes the stocks of all financial liabilities minus the corresponding financial assets.

**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.

**International Financial Reporting Standards (IFRS):** A set of accounting standards. Currently they are issued by the International Accounting Standards Board (IASB). Many of the standards forming part of IFRS are known by the older name of *International Accounting Standards* (<http://www.iasb.org/Home.htm>).

**Liability:** An obligation of an entity arising from past transactions or events, the settlement of which results in the transfer or use of assets, provision of services, or other yielding of economic benefits in the future.

**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 (MTBF):** 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 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 potential 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.

**National resource company (NRC):** A nonfinancial public corporation (state-owned enterprise) that is involved in the exploration, extraction, processing, or sale of minerals or oil.

**Net/gross operating balance:** The net operating balance equals revenue minus expense. The gross operating balance equals revenue minus expense other than consumption of fixed capital.

**Net lending/borrowing:** Equals net operating balance minus the net acquisition of nonfinancial assets. Net lending/borrowing is also equal to the net acquisition of financial assets minus the net incurrence of liabilities. See Box 4.1 in the GFSM 2001 for definitions of other important fiscal policy measures.

**Net worth:** Total assets less total liabilities at the end of an accounting period. See Table 4.4: The Balance Sheet in the GFSM 2001. Certain analyses are focused on only the financial assets of the general government sector rather than its total assets. As a result, *net financial worth* is defined as total financial assets less total liabilities.

**Nondebt liabilities:** Includes unfunded pension obligations, exposure to government guarantees, and arrears (obligatory payments that are not made by the due date), and other contractual obligations. For example, a contract permitting a firm to set up a mine may explicitly or implicitly obligate the government to pay for the cleanup costs when the mine is abandoned.

**Nonmarket nonprofit institution (NPI):** A legal or social entity created for the purpose of producing nonmarket goods and services, but whose status does not permit them to be a source of income, profit, or other financial gain for the units that establish, control, and mainly finance them. It is a nonmarket producer if *the majority of its output is not sold at an economically significant price*.

**Nonmarket output:** Goods and services that are not sold at an economically significant price. *Economically significant prices* are prices that have a significant influence on the amount producers are willing to supply or on the amounts purchasers wish to purchase. See Annex 2 of the *GFS Manual 2001 Companion Material: Coverage and Sectorization of the Public Sector* (<http://www.imf.org/external/pubs/ft/gfs/manual/comp.htm>).

**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 effects 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 GFSM 1986 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 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. Because 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 corporation:** A legal entity that is owned or controlled by the government and that produces goods or services for sale in the market at economically significant prices. All corporations are members of the nonfinancial corporations sector or financial corporations sector.

**Public-private partnership (PPP):** An arrangement whereby the private sector provides infrastructure assets and services that traditionally have been provided by government, such as hospitals, schools, prisons, roads, bridges, tunnels, railways, and water and sanitation plants. Cases where the private operator has some responsibility for asset maintenance and improvement are

also described as *concessions*. Although there is no clear agreement on what does or does not constitute a PPP, it should involve the transfer of risk from the government to the private sector.

**Public sector:** A classification drawn from sectors and subsectors of the SNA classification consisting of general government and nonfinancial and financial public corporations. It includes all entities that are either owned or controlled by government.

**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 corporations.

**Quasi-fiscal activities (QFAs):** Activities undertaken by financial and nonfinancial public corporations, and sometimes by the private sector, at the direction of the government, 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 a public corporation.

**Sensitivity analysis:** A “what-if” type of analysis to determine the sensitivity of the outcomes to changes in parameters. If a small change in a parameter results in relatively large changes in the outcomes, the outcomes are said to be sensitive to that parameter.

**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 that, because the government policy objectives could be achieved alternatively through a subsidy or other direct outlays, are 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.

**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, 2000b*), 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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