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Czech Republic: Report on Observance of Standards and Codes—Fiscal Transparency Module—Update

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REPORT ON THE OBSERVANCE OF STANDARDS AND CODES
CZECH REPUBLIC—FISCAL TRANSPARENCY MODULE: AN UPDATE
AUGUST 8, 2003

The Report on the Observance of Standards and Codes (ROSC) in fiscal transparency in the Czech Republic was first issued in September 1999 and has been updated annually.[1] This note reports on the developments since the last update in August 2002. For a full description of institutions and practices and IMF staff recommendations, it should be read in conjunction with the original report and its updates.

The original ROSC and its updates concluded that fiscal transparency had increasingly improved in the Czech Republic. At the same time, these assessments highlighted some of the shortcomings in fiscal management, notably those associated with the growing spending outside the State (central government) Budget, the quasi-fiscal activities of government entities, and the inadequate recognition of fiscal risks.

A. Clarity of Roles and Responsibilities

The original ROSC and its updates acknowledged the well-defined roles and responsibilities of the government and their clear separation from those of the private sector, but expressed concern about the growing share of expenditure outside the State Budget, on the basis of which fiscal policy is formulated.

In line with ROSC recommendations, the fiscal coverage has been broadened in recent years, most importantly by including the Czech Consolidation Agency (CKA) and the State Agriculture Intervention Fund in general government data. Since the last update, the newly created Railway Transport Infrastructure Administration (spun from the Czech Railways) has been included in the general government as a central government entity. Reflecting primarily the establishment of new extrabudgetary funds (EBFs), the share of State Budget spending in total general government spending has declined from 63 percent in 2000 to a projected 55 percent in 2003.[2] The shift of expenditures to subnational levels in 2002 following the 2001 public administration reforms and the decentralization of spending power in favor of regional governments also contributed to this trend.

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[1] The original report "Experimental Report on the Observance of Standards and Codes—Czech Republic" and its annual updates are available on the IMF website: www.imf.org/external/np/rosc.asp.

[2] The share of EBFs in total general government spending increased from 2.7 percent in 2000 to 6.9 percent in 2001, following the establishment of two new funds, and is projected to increase further to 8.4 percent in 2003.

The authorities are considering steps to consolidate the budget structure. A review of extrabudgetary funds and entities is being conducted with the aim of liquidating some and consolidating the activities of some others in the State Budget. Notably, the National Property Fund (the main privatization fund) is slated for liquidation in 2005 and the CKA in 2007.

B. Public Availability of Information

The Ministry of Finance (MoF) releases a wealth of information on public finances on its website. This information goes beyond the requirements of the Special Data Dissemination Standard (SDDS). The original ROSC and its updates acknowledged the comprehensiveness of data on the State Budget, but suggested more frequent availability of data on the rest of the general government.

Fiscal information disseminated through the MoF's website includes general government finance data (available in English) on the basis of the IMF's *Government Finance Statistics Manual, 1986* (*GFSM 86*). Preparations are underway to migrate from cash-based *GFSM 86* to accrual-based *GFSM 2001*, which is also compatible with the European System of Accounts, 1995 (*ESA 95*). The planned changes would broaden the coverage of the general government.[3] They would also require harmonization of accounting rules across the government sector. With IMF technical support, bridging tables between the *GFSM 86* and *GFSM 2001* data have already been set up and a specific timeframe for completing the migration has been developed and is being implemented. Aggregate fiscal estimates on the *ESA 95* format are also published in the annual Pre-Accession Economic Program and are available on the MoF website. The *ESA 95* data will be used for policy coordination with the European Union (EU).

There has been little progress in improving the frequency and timeliness of publicly available information on the local governments and EBFs. For these, only annual data are published (but updated quarterly), while information on the State Budget is available monthly. Preparations are being made to begin publishing quarterly general government data on the *ESA 95* format.

[3] The coverage of data on the general government on the basis of *ESA 95* is more comprehensive than those compiled on the basis of *GFSM 86*. *GFSM 86* data exclude CKA, the Agricultural and Forestry Guarantee and Support Fund (PGRLF), the Children and Young People Fund (under liquidation), public universities, and semi-budgetary organizations that receive more than 50 percent support from the State Budget. Cash transfers to these institutions are, however, captured in the *GFSM 86*-based data.

C. Open Budget Preparation, Execution and Reporting

The original ROSC and its updates recognized the transparent budget preparation and execution process, but suggested a better assessment of fiscal risks, particularly those related to contingent liabilities.

The progress, made on several fronts, has been mixed:

- The budget preparation process continues to be transparent and meets international standards. Budget assumptions and projections are routinely discussed with the central bank, local think-tanks and independent experts; forecasts are made public. Also, changes in macroeconomic projections that could have a bearing on the fiscal outcome are openly discussed and are published quarterly by the MoF (*Czech Republic: Macroeconomic Forecast*).

- The progress made in 2001–02 toward transparent and rule-based assumption of contingent liabilities was reversed in 2003. Following the significant tightening of rules for issuing government guarantees in 2001 (including the requirement of separate parliamentary approval for each guarantee[4]), only one new guarantee was issued in 2001, and three in 2002. But, in 2003, a general guarantee was granted (on the basis of the Act 77/2002 on the Czech Railways) to the Railway Transport Infrastructure Administration up to annual limits to be set by the government. On the positive front, in an effort to provide a better assessment of future fiscal risks, the 2003 draft budget documentation included, for the first time, a three-year projection of the maximum call on state guarantees.[5]

- In 2001, the MoF provided the OECD with detailed estimates of tax expenditures in the Czech Republic, which were subsequently published (see *OECD Economic Surveys: Czech Republic, 2001*). Since then, no attempt has been made to update these estimates.

- In June 2003, as a part of a broader fiscal reform package, the government approved, in principle, a three-year fiscal framework in order to provide a medium-term perspective to fiscal policy and facilitate the absorption of EU funds following the Czech Republic's accession in 2004. The 2004 budget will be cast within this framework that hinges on three components: (i) a rolling three-year State Budget; (ii) medium-term deficit targets based on general government coverage; and (iii) annual ceilings on the total expenditure of the State Budget and the state EBFs. The

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[4] See the July 2001 ROSC update for details.

[5] The projections represent the worst case scenario of across-the-board default on government guaranteed loans.

medium-term framework should strengthen budget planning, control, and execution. Moreover, although there is no formal requirement for performance budgeting in this framework, the intention is to introduce "performance indicators" in the State Budget from 2005 to guide "value-for-money" audits.

D. Independent Assurances of Integrity

The Supreme Audit Office (SAO) conducts high quality and transparent audits of the State Budget and the state EBFs—a fact recognized by the ROSC. There were procedural changes in 2003 in auditing local government finances.

The SAO audits and provides financial control over the State Budget and the state EBFs. It also audits public institutions to the extent that they receive funds from the State Budget. It further monitors and audits the use of foreign loans and grants, activities supported by state guarantees, and public tenders. However, the SAO is not empowered to audit those state organizations and institutions that are established under the commercial code, even though they are fully owned by the state (e.g., the Czech Railways and the PGRLF).

The SAO conducts compliance audits, combined with financial and performance audits. In order to strengthen its financial and performance audits, the SAO is establishing separate specialized divisions, and is enhancing its audit capacity and staff quality. The audit reports are published in SAO's quarterly Bulletin and are posted on its website (www.nku.cz) in Czech.

At the subnational level, until end-2002, municipalities could opt for commercial audits at their own expense or audits by district offices free of charge. From 2003, following the abolition of district offices, municipalities with a population of less than 5,000 (some 6,250 of 6,500 municipalities) can opt for commercial audits (and pay for it) or audits by regional governments free of charge. Those with a population of more than 5,000 would be audited by commercial auditors at their own expense. The audit reports will be submitted to the municipal councils and will be published.

Similarly, until end-2002, the 14 regional governments, established in 2001, could opt for auditing by the MoF free of charge or by commercial auditors at their own expense. From 2003, they will be audited by commercial auditors, and the audit reports will be submitted to the regional councils and made public.

In 2002, the MoF issued a decree setting out the procedures and requirements for auditing the accounts of municipalities and regions. The MoF monitors the final audited accounts of all local governments.

E. IMF Staff Commentary

The Czech authorities made further progress last year in improving fiscal transparency that was already high by international standards. Particularly welcome are measures already taken, or being implemented, to broaden the coverage of general government data; move to the *GFSM 2001* accrual basis reporting; improve reporting on fiscal risks, including those arising from contingent liabilities; strengthen the medium-term budget framework; and gradually increase the scope of performance budgeting. However, greater effort is needed to improve the public availability of fiscal data outside of the State Budget and to maintain regular tax expenditure reports. The extension of a general government guarantee in 2003, after significantly tightening the procedures in 2001, weakened efforts to make the assumption of contingent liabilities transparent and rule-based.

As regards auditing and financial controls, the SAO continues to maintain high-quality scrutiny over the flow and use of public funds. There are, however, still a number of important fully or partially state-owned enterprises that are outside the purview of the SAO. At the subnational level, the effectiveness of the new arrangement to audit local government finances is yet to be tested. Ensuring appropriate standards for audit and fiscal discipline at the subnational level is critical in light of the removal of all restrictions on borrowing and the fact that local governments are subject to the so-called "small budgetary rules" which are generally less stringent than those applied to the State Budget and the state EBFs.