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FISCAL TRANSPARENCY

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HUNGARY



COMPLIANCE RATINGS

<i>Fiscal transparency</i>	2006	2005	2004	2003
Clarity of roles	●●●●	●●●●	●●●●	--
Availability of information	●●●●	●●●●	●●●●	--
Budget preparation	●●●●	●●●●	●●●●	--
Accountability	●●●●	●●●●	●●●●	--
Score	4.00	4.00	4.00	--

OUTLOOK & COMMENTARY

The need to increase fiscal policy transparency has been highlighted by the political disturbances which followed Prime Minister Gyurcsány's acknowledgement of having hidden the seriousness of the fiscal situation prior to the April 2006 parliamentary elections.

While generally compliant with international best practices in the field of fiscal transparency, Hungary is faced with the challenge of re-establishing fiscal credibility through serious structural reforms. The government's plans to adopt a medium-term budget framework for 2007-10, with expenditure ceilings for each budget chapter, are expected to enhance fiscal policy transparency. The consolidation package contained in the Convergence Programme submitted to the EU in September 2006 is also expected to result in better transparency, stronger political accountability and renewed policy credibility.

The government is currently transitioning to the ESA95-compliant GFSM 2001 accounting system. The Ministry of Finance is working with the IMF and Eurostat to introduce methodological correspondences and considerable progress has already been made.

EXECUTIVE SUMMARY

4.00 Compliance in progress

While Hungary is broadly compliant with international best practices in fiscal policy transparency, recent political events have highlighted the need to enhance accountability and transparent decision-making processes, which could be instrumental in reducing endemic budget deficits. Political credibility has been strained by the difficult fiscal situation and exacerbated by the leakage of Prime Minister Gyurcsány's speech, in which he acknowledged that the government had concealed the seriousness of the fiscal situation prior to the April parliamentary elections. In fact, despite the availability of deficit figures released by the National Bank of Hungary, Prime Minister Gyurcsány repeatedly maintained that the deficit was significantly lower than reality.

Despite its many strengths, Hungary faces significant challenges, mainly related to the necessary implementation of structural reforms to improve the state of public finances, increase growth prospects and secure economic stability. While authorities in the past have mainly relied on ad hoc measures to stabilise public finances, the government has acknowledged the urgency of making efforts towards sustainable consolidation. The Convergence Programme presented to the EU on 1 September 2006 recognises the need to focus on the medium-term and refers to the government plan to adopt a medium-term budget framework with expenditure ceilings for the various budget chapters, which is supposed to guide Budget Bills for the period 2007-10.

In accordance with the Convergence Programme, the government intends to implement a package of short- and long-term reforms to bring extra-budgetary funds into the budget. Some of these extra-budgetary funds are expected to be incorporated into the various budget chapters, while others might be transformed into additional government units. A transition to the ESA95-compliant GFSM 2001 accounting system is underway, and, since 2006, the Ministry of Finance has been working with the IMF and Eurostat to introduce methodological correspondences between the two systems. Considerable progress has been made, and a number of non-budgetary units have already been reclassified as general government entities under the ESA95/GFSM 2001 definition of general government.

The government has started tackling the heavy burden created by a large public sector. Significant shrinking in the size and internal fragmentation of the central government has taken place in 2006, with a reduction in the number of ministries from 14 to 11 and a 20% reduction in the number of employees. The government has also started a consolidation and regional reorganisation of the central administration and its decentralised bodies, entailing a 10% staff cut. This process should be completed by the end of December 2006.

Hungary's overall score is unchanged from last year.

1. CLARITY OF ROLES, RESPONSIBILITIES, AND OBJECTIVES



Compliance in progress

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.

Structure, functions, and responsibilities of government

The relationship between general government and the rest of the economy in Hungary is clearly defined in the legislative framework. The State Treasury (*Magyar Államkincstár*) maintains a continuously updated record of all central level government units (including central budgetary institutions, extra-budgetary funds and social security funds), which are required to sign up in a Registration Book accessible to the public. There are currently 697 central budgetary institutions and 14,419 local government budgetary institutions in Hungary.¹

Sub-national governments exist at the county and municipal level. They are self-governing entities but are heavily dependent on fiscal transfers from the centre. Hungary has 19 counties and, in addition, Budapest enjoys a comparable status as the capital city. Seven administrative regions have been established in line with the requirements of the European Union. The local government sector is highly fragmented with around 3,200 municipalities, more than 2,000 of which have less than 1,000 inhabitants. Attempts to consolidate some of these municipalities to create a number of micro-regions have been frustrated by the existence of a rule requiring a two-thirds majority to approve such potential changes.²

Hungary currently has two definitions of the government for accounting purposes. The *Act XXXVIII:1992 on Public Finances* sets the definition of the legal government, which is composed of the state budget, central government budgetary institutions, extra-budgetary funds, and social security funds and local governments with their budgetary institutions. Eurostat and the IMF -- under ESA95 and GFSM 2001 -- use a broader statistical definition, towards which the administrative system is currently transitioning. A number of non-budgetary units have been reclassified as general government entities under the ESA95/GFSM 2001 definition of general government. They include the State Privatisation and Property Management Company (APV), the National Road Construction Company (NA), the State Debt Management Company (ÁKK), two Participation Management Companies and, as of 2006, the National Road Management Company (ÁAK).³

Public broadcasting corporations, as well as 170 non-profit institutions, public foundations and public non-profit corporations have also been reclassified as government units in line with the ESA95/GFSM 2001 definition. A statistical survey on non-profit institutions performing government functions was conducted in 2003 by the Ministry of Finance (MoF) and the Office of the Prime Minister to determine which of these institutions met the statistical criteria to be classified as government units. Based on this survey, the Hungarian Central Statistical Office (*Központi Statisztikai Hivatal*, HCSO) divides these units into three groups, namely corporations, households, and government sector.⁴

Coordination and management of budgetary activities

Following major problems with budget execution in the early 1990s, a central State Treasury system was set up under the supervision of the MoF in 1996 to manage most revenue and expenditure flows. The purpose of the innovation was to bring a growing deficit under control and manage the problems created by a large number of independent budgetary institutions. The single Treasury account was set up to cover all institutions belonging to the state household, that is, the state budget and extra-budgetary funds, thus reducing unnecessary cash transfers between different government accounts.

The state budget covers all activities of the central government (according to national accounts ESA95, SNA93 and GFSM 2001) and provides normative and other transfers to local governments. In addition, there are six extra-budgetary funds, which constitute part of the state household (but not the state budget), namely the Labour Market Fund, the Central Nuclear Financial Fund, the Research and Technological Innovation Fund, the Flood and Groundwater Protection Indemnity Fund, the Homeland Fund and, as of 2006, the Cultural Fund. The social security funds are the Health Care Fund and the Pension Fund.⁵

In accordance with the Convergence Programme presented in September 2006, the government intends to implement a package of short- and long-term reforms to bring extra-budgetary funds into the budget. Some of these extra-budgetary funds are expected to be incorporated into the various chapters, while others might be transformed into additional government units. The Flood and Groundwater Protection Indemnity Fund is expected to be included in the budget in the short term.⁶ Following the implementation of these reforms, about one third of institutions currently outside the budget are expected to be privatised, terminated or merged into the budget, leading to significant improvements in the fiscal balance as soon as 2007.⁷

Certain appropriations, such as healthcare and mortgage subsidies, are considered “open-ended budgetary items” and allow spending in excess of the original budgetary allocation. This mechanism is meant to overcome difficulties in estimating precise expenditure figures at the time of budget preparation. It is regulated in a transparent manner and usually has only a minimal impact on the fiscal deficit of the central government. Open-ended budgetary items are defined yearly by the budget and usually include consumer price subsidies for transportation of students, elderly and disabled persons, family and housing subsidies, state guarantees, as well as compensation for individuals and corporate entities in pursuance of government decrees. Consumer price subsidies for transportation are usually classified as open-ended budgetary items to compensate for revenue losses resulting from price preferences guaranteed by the state to certain social groups. However, this appropriation did not exceed its spending limit in 2005 and is not likely to do so in 2006 either.⁸ Any changes to the legal conditions of an entitlement must involve adjustments to the appropriation. This requirement is waived for investment incentives where the open-ended nature of the expenditure item is justified by the importance of the projects for the national economy. The government has plans to implement new rules for open-ended budgetary items, aimed at holding line ministries responsible for meeting targets.⁹

Certain public non-financial institutions -- in areas such as infrastructure, agriculture, housing, foreign trade, and medicine (general practitioners) -- are required to undertake non-commercial activities on behalf of the government. Public financial corporations are engaged in government programmes either by providing subsidised loans (where the interest subsidy is covered by the budgets of the relevant ministries) or through export-import insurance services backed by government counter-guarantees and finances from the budget.¹⁰

Since the early 1990s, expenditure arrangements in Hungary have become more decentralised. Local government institutions provide health, education, utilities and other services and employ 65% of public sector workers.¹¹ However, transfers from central government provide the majority of revenue for local budget institutions, meaning that local authorities are not always or entirely in control of their ability to deliver on these mandated functions.

County and regional development councils are responsible for distributing special subsidies for less developed regions.¹²

The central government has clearly stated its determination not to assist municipalities in financial trouble and borrowing is carefully controlled. Local government bankruptcies are governed by the *Act on Local Government Bankruptcy*, which establishes a formal procedure for managing insolvent sub-national governments. In particular, the amount of liabilities arising from the commitments assumed by a local government cannot exceed the adjusted own revenues of the government (defined as 70% of the own revenue estimates less short-term liabilities such as debt servicing and leasing charges). Liquid credit repaid the same year is exempted from these calculations.¹³ However, according to some commentators, implementation of the *Act on Local Government Bankruptcy* is less strict in practice and a law on supplementary financing of disadvantaged municipalities with external constraints provides an alternative support mechanism, which, however, is often awarded on a political basis.¹⁴

The Convergence Programme presented in September 2006 points out the government plans to facilitate a re-allocation and streamlining of tasks by substantially reducing the amount of normative grants available to local governments, relying on supplementary transfers conditional on their efficient performance of tasks instead. However, some commentators have highlighted the difficulties connected with a possible change in the financing system of local governments, which would require some prior degree of centralisation and, therefore, a two-thirds majority for approval. One possibility is a reform of the local tax system to make more revenues available at the local level.¹⁵

The Hungarian State Treasury is accountable to the minister of finance. All budgetary appropriations, revenues, and expenditures are channelled through the Treasury, which processes the reports and budgets of all budgetary institutions, including three of the six extra-budgetary funds, and manages their accounts, as well as state aid and foreign claims on the state. The Treasury also conducts the financial management of the central budget and compiles the annual final accounts. The Treasury is organisationally made up of two vice presidents and five directorates: implementation of the state budget, economics (public finance aggregation and accounting, regulation), financing (state aid, debt management, financial regulation), information technology, and economic management. In addition, there are 19 county directorates across the country which process the local government budgets and reports and supervise state aid, among other tasks. The Treasury currently has a total staff of just under 4,000.¹⁶

Relations between government and public sector agencies

The National Bank of Hungary (NBH - *Magyar Nemzeti Bank*) is legally defined as an independent central bank. It is not allowed to issue credit to the government and cannot take instructions from government agencies in its management of monetary policy. However, the responsibility for setting the exchange rate regime and the inflation target is shared with the government. In Hungary's highly polarised political debate, the relationship between the government and the NBH has been tense and even confrontational in recent years, although characterised by effective collaboration at the expert level. Following a revision of the NBH Act, the prime minister nominated four new members of the Monetary Council in March 2005. The measure was widely seen as an attempt to influence NBH decisions, although the actual impact of the measure on policy-making appears to have been minimal.¹⁷

While NBH and MoF assumptions about the government's fiscal position differed significantly in recent years, with the NBH taking a much more negative stance, discrepancies between revenue and expenditure projections of these institutions have been significantly reduced in 2006. Following the MoF decision to increase its deficit forecast in line with NBH projections – recognising that certain highway construction projects were not eligible for Public-Private Partnership (PPP) classification – the fiscal forecasts of the two institutions are currently very similar, as shown by the data presented in the latest Convergence Programme and *Inflation Report*.¹⁸ The government deficit figures do not include the outstanding guarantees to the State Railways (*Magyar Államvasutak, MÁV*) and the Budapest Transportation Company (*Budapesti Közlekedési Vállalat, BKV*).¹⁹

The Government Debt Management Agency (*Államadósság Kezelő Központ, ÁKK*) is responsible for the management of the public debt of the central government, the Social Security Fund, and extra-budgetary funds. In addition, it has the legal right to issue state-guaranteed debt, a recent case being an issue by the Student Loan Centre (*Diákhitel Központ, DHK*). ÁKK is a 100% state-owned company whose board of directors is appointed by the MoF and is mainly composed of senior representatives of the ministry. At the MoF's request, the governor of the NBH appoints a permanent representative to the board. He is supplied with all documentation pertaining to debt management but has no voting rights. ÁKK consults with the NBH in formulating its strategy. As of 2004, ÁKK conducts active cash management of the Treasury account. ÁKK has no say in the formulation of fiscal policy. The MoF is responsible for approving ÁKK's annual plan, which is usually accepted with relatively minimal modifications.²⁰

The Hungarian Privatisation and State Holding Company (*Állami Privatizációs és Vagyonkezelő, ÁPV*) is a holding company for remaining government stakes in the corporate sector and in real estate. The Treasury Property Management Authority (*Kincstári Vagyoni Igazgatóság*, a budgetary unit) has specialised responsibility for real estate and non-market type and non-tradable government property. ÁPV is responsible for the sale and management of state equity assets. It can retain a proportion of privatisation receipts for expenditures approved by the parliament, typically the costs of preparing and implementing the privatisation, the rest being remitted to the state budget. It is managed by a government-appointed board of directors and a supervisory board and is legally required to report on its transactions.²¹ The justification for a separate privatisation agency is somewhat questionable at a time when the government portfolio is small and successful privatisations very rare.

Government involvement in the private sector

The privatisation process in Hungary is largely complete. Almost 80% of the economy is in private hands, although the government still retains a presence in some companies with majority private ownership. As of end-2005, ÁPV had stakes in 129 companies (compared to 138 at the beginning of the same year), of which majority stakes could be sold in 97. In addition, ÁPV controls some real estate holdings. At the time of writing, official information on privatisations completed in 2006 has not yet been made public, but is expected to be released in the ÁPV annual report. While most information on privatisation is publicly available, some commentators have pointed out the difficulty inherent in understanding the use made out of revenues derived from privatisation.²²

The most important remaining stakes include 99.95% of MALÉV Hungarian Airlines, whose privatisation was re-launched in September 2006, 25% of the pharmaceutical producer Gedeon Richter, and 50% of the FHB Land Credit and Mortgage Bank (*Földhitel- és Jelzálogbank*). Around 10% of the government stakes in the oil company MOL have been privatised in 2006 and the remaining 1.7% is expected to be privatised within the next twelve months. Much longer-term privatisation prospects might include the Post Office and the State Railways, both of which will require serious restructuring.²³ In some of the remaining cases, the Civil Code makes full privatisation impossible. For example, the ongoing privatisation of Budapest's Ferihegy airport is limited to the right of use based on its sale of the equity of the operating company. Specifically, this privatisation implies a 75-year lease to the British Airport Authority. However, the airport infrastructure is defined as non-tradeable state property. Along with the machinery, it is controlled by the Hungarian Treasury Property Management Authority that operates under the auspices of the MoF.²⁴

Government regulation of the private sector complies with the EU's *acquis communautaire* and international best practices. In some instances, there continues to be quasi-fiscal activities through price regulation, although the scale of this diminished significantly in 2003 when electricity and natural gas prices were raised to cost recovery levels. The overall share of regulated prices in the CPI basket was 19.4% in 2003, whereas another 14.6% were controlled through excise duties.²⁵ The only remaining area where prices are controlled by the government is local and long-distance transportation where there are no immediate plans to modify the system. The government has also

subsidised mortgages in recent years. However, the subsidies were capped in response to stronger-than-expected demand.²⁶

A particular problem with the government's involvement in the private sector in 2005 had to do with an attempt to undertake large infrastructure projects through Public-Private Partnerships (PPPs) that were formally outside of the government budget. Following the September 2005 Eurostat decision to reject these projects as PPPs, the government agreed to include them in the budget, which added nearly two percentage points of GDP to the government deficit. The Hungarian government has been pursuing an ambitious investment programme in highways, although the same approach has also been applied – on a much smaller scale – to the construction of student dormitories and prisons. The government plans to double the length of Hungary's 580-kilometer national highway network by 2007 at an estimated cost of some 4.8 billion US dollars.²⁷

Following a wave of restructuring and consolidation, the development of the Hungarian highway infrastructure has since 1999-2000 been the primary responsibility of two distinct state-owned companies (although private companies have also been involved as principal partners on some projects): the National Motorway Company (*Nemzeti Autópálya*, NA) and the State Motorway Management Company (*Állami Autópálya Kezelő, ÁAK*). NA is ultimately responsible for the development and construction of the highway structure. ÁAK, in contrast, is responsible for operating the system. Since it derives its revenues primarily from the private sector (through highway tolls), the Hungarian government was hoping to treat it as a private sector entity and move the highway investment off-budget by having NA transfer the finished, as well as uncompleted, motorways to ÁAK. There is no objection by Eurostat to transferring the completed and uncompleted sections to ÁAK and embedding them into a large project.²⁸

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

Legal framework for budgetary activities

The Constitution places the parliament in charge of approving the government budget and final accounts. The principal legislation governing fiscal activity in Hungary is *Act XXXVIII:1992 on Public Finances*. It covers the central budget institutions, along with off-budget state funds, local governments, and the social security system.²⁹ The *Act C:2000 on Accounting* establishes a unified accounting, auditing, and reporting system for all units of government.³⁰ The *Act LXV:1990 on Local Government* lays down the responsibilities of local governments.

Although it generally conforms to international best practices, Hungarian legislation leaves budgetary entities a certain amount of flexibility in varying and re-allocating their expenditures. While technical suggestions of public bodies (such as the Hungarian State Treasury) on possible amendments to the *Act on Public Finances of 1992* are usually taken into account, some commentators have pointed out that the numerous amendments to the Act (10 between 1992 and 1995; 14 between 1996 and 2000; 24 between 2000 and 2004; etc.) have usually been driven by short-term government interests and have not provided an adequate and stable institutional framework for budgetary decision making. The Constitutional Court has recently ruled that amendments to the *Act on Public Finances*, previously included in annual budget laws, need to be approved separately, in order to allow for proper parliamentary discussion. The latest amendments, adopted in July 2006, have not introduced any major changes in budgetary decision-making, with the exception of quarterly reporting on the implementation of structural reforms and chapter equilibrium reserves.³¹

Legal framework for taxation

Tax procedures are set out in the *Act XCII:2003 on the Order and Regime of Taxation* which establishes the rights and obligations of both taxpayers and tax authorities. It addresses the jurisdiction and competence of tax authorities, the legal consequences of default, and administration procedures. The Act is readily available, as is advice on tax

issues. Issues pertaining to local taxes are covered by the *Act XCI:1990 on Local Government*. Individual taxes typically have their basis in separate pieces of legislation. The customs legislation broadly conforms to EU standards. Tax and customs officials alike are bound by codes of ethics in addition to their standard civil service obligations.³²

Tax administration is the responsibility of the Tax and Financial Control Administration (*Adó- és Pénzügyi Ellenőrzési Hivatal*, APEH), which is an economically independent body of state administration operating under the auspices of the MoF. Its operations are governed by the founding legislation and the *Act on the Order and Regime of Taxation*.³³ While the system is generally professional and efficient, problems are caused by the high tax burden and the fragmented legislation.³⁴ Customs administration is carried out by the Hungarian Customs and Finance Guard (*Vám- és Pénzügyőrség*), which is controlled and supervised by the MoF.³⁵

Ethical standards for public servants

The *Act XXIII:1992 on the Legal Status of Public Servants* is the key legal document that defines the responsibilities and rights of public servants. It includes provisions relating to personal liability, conflicts of interest, remuneration, promotion, and discipline.³⁶

Hungary has a highly professional and relatively well-paid civil service. In spite of this, corruption remains a problem, although it is generally deemed to be less serious than in most other new EU member states. The Transparency International Corruption Perceptions Index in 2006 ranked Hungary 41st of the 163 countries reviewed with a score of 5.2 out of a perfect 10.³⁷ Public perceptions in Hungary see corruption as endemic, with the police, tax and customs authorities most directly affected. Similarly, the use of “gratuities” is par for the course in the health care sector. Attempts by the State Audit Office to assess the importance of corruption suggest that anti-corruption measures, most notably the 2001 anti-corruption strategy, have met with at best partial success. International assessments have pointed out particular problems with the illegal funding of political parties. In 2003, the government launched a “Glass Pockets” programme designed to increase transparency in public life, especially in the financial management and organisational structure of budgetary organisations, and this seems to have had some positive effects.³⁸

2. PUBLIC AVAILABILITY OF INFORMATION

●●●● Compliance in progress

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

Central government operations

Under the *Act on Public Finances of 1992*, the government is required to develop a system of budget information that will “facilitate the planning of the financial processes of the public finance system, the establishment of the targets/quotas of the budget and that will be suitable for the analysis, appraisal and controlling of the realisation of the budget.”³⁹ Moreover, the Act states “the financial statements and the budgetary reports of the system of public finances shall be harmonised with the obligations of provision of statistical data, international governmental financial statistics, and the scheme of national accounts.”⁴⁰

The government, in the run-up to Hungary’s EU accession, committed itself to developing a rolling three-year fiscal programme, initially for the years 2004-6, partially with a view to managing the absorption of EU funds. The framework establishes expenditure targets for the main budget chapters and all future budgets are supposed to be prepared within this framework. However, the project has been fraught with problems. At the moment, the medium-term objectives published in connection with the budget contain only non-binding deficit targets for the following two fiscal years. According to some commentators, such a lack of consistency between medium- and short-term planning has often created problems, resulting in improvised policymaking and weak accountability. However, the government has recently announced its plans to introduce a rolling three-year medium-term fiscal framework with binding expenditure caps and pessimistic budgetary projections, explicitly aimed at underestimating revenues and overestimating expenditures.⁴¹

The Convergence Programme presented in September 2006 mentions that, starting in 2007, the Budget Bill will define expenditure appropriations for the various budget chapters, as well as functional budget targets in nominal terms for three years ahead.⁴² The 2007-10 fiscal programme sets an expenditure limit for each ministry for every year until 2010. However, at the time of writing, it is still to be decided whether parliament will officially adopt these figures through a law or will simply include them as a side explanation. In the first case, their legally binding nature would make it more difficult to exceed expenditure ceiling obligations.⁴³

The Final Report on the Fulfilment of the Budget provides some information on tax expenditures in terms of quantifiable exemption permitted by the personal and corporate income tax laws. Relevant types of state aid provided by the central government are also documented and reported by the State Aid Monitoring Office (*Támogatásokat Vizsgáló Iroda*) within the MoF. Certain information on quasi-fiscal activities, in the form of transport and other subsidies, is also provided.⁴⁴ Not only does the government maintain major explicit subsidies in support of pharmaceutical prices, agriculture, housing, and transportation, but it also maintains implicit subsidies in the same areas, as well as for public utilities, by assuring low-end user prices.⁴⁵ While specific information on quasi-fiscal activities is not compiled in specific separate statistics, undertaking these activities requires parliamentary approval and related information can be retrieved by the public through parliament.⁴⁶

Since 1998, the State Treasury has been managing a National Support Monitoring System (OTMR) aimed at keeping track of subsidies, including ‘subsidies by tenders’. For example, it is in charge of examining criteria established in

Acts and Government Decrees regarding family subsidies (which account for about 10% of government expenditure) and transferring subsidies where these criteria are met. Specifically, the OTMR registers expired taxes and duties debt data of beneficiaries of public aid schemes, excluding them from the opportunity to receive support, should these beneficiaries not have paid their debts. The OTMR provides a useful tool to control aid accumulation and offers detailed statistics of support forms and beneficiaries by regional repartition, thus increasing transparency.⁴⁷

The government has prepared a new system for reporting the value of the financial assets of general government entities, and this has permitted their revaluation on a “fair value” basis or to reflect market prices since 2002. All general government entities are required to compile quarterly and annual accounts providing the opening and closing stocks of their financial assets and liabilities.⁴⁸ However, budget documents rarely provide information on financial liabilities derived from PPPs. For example, while the 2005 budget included some information on PPP liabilities and long-term obligations, no information on these liabilities was included in the 2006 budget, as pointed out by the State Audit Office in its opinion on the 2006 budget.⁴⁹

The periodicity and timeliness of Hungarian fiscal statistics meet, and in some cases exceed, the IMF Special Data Dissemination Standard (SDDS) requirements.⁵⁰ However, some commentators consider fiscal data less than reliable and have expressed their frustration with the continuous retroactive changes in government fiscal data, together with breaks in time series. While these retroactive changes in the figures are sometimes due to methodology changes, users stress that it would be helpful if such changes were somehow anticipated.⁵¹

Public sector operations

The *Act on Public Finances* was amended in 2001 to impose detailed reporting requirements on all economic units engaged in fiscal activities. These include public trust funds, public non-profit companies, ÁPV, and the Hungarian Development Bank (*Magyar Fejlesztési Bank*, MFB). For example, ÁPV is now required to submit monthly reports on cash receipts and expenditures, as well as quarterly balance sheet reports matching those submitted by budgetary entities. Most other entities report on an annual basis, although additional information can be requested on an ad hoc basis. NA, the National Motorway Company, produces quarterly data.⁵² Quarterly reporting on the implementation of structural reforms was introduced by the July 2006 amendments of the *Act on Public Finances*.⁵³

The government’s budget documents now provide comprehensive coverage of general government operations. There is semi-annual budget reporting, which covers all components of the legal government with both a functional (activity-type) and economic classification. Such information is also used for projections for the current budget year and, in the form of indicative projections, for the year following the budget year. The final report analyses any deviations between the budget and the actual outturn and identifies the effect of macroeconomic factors, forecast errors, and policy changes.

Monthly data are now published on the fiscal position of the central government (including social security funds) on the MoF website and in the monthly periodical *Pénzügyi Szemle*, as well as by the Central Statistical Office (HCSO) in its *Monthly Bulletin*.⁵⁴ However, the institutional coverage of the central government on the legal definition does not yet match the GFSM 2001 definition.⁵⁵ The MoF has begun to compile quarterly data on the legal government sector on an ESA95 basis for Eurostat and for internal use. The MoF has further declared its intention to begin compiling quarterly general government statistics on the ESA95-compliant GFSM 2001 standards, which, for the time being, are still compiled and submitted to Eurostat by the HCSO. While the MoF undertakes a variety of studies, only a few publications are available on its website and, according to some commentators, their quality varies greatly.⁵⁶

Under the current definition of labour, the HCSO compiles non-financial account statistics for all sectors (including government) and the NBH compiles financial accounts statistics for all sectors (including government).⁵⁷

A 2003 amendment of the *Act on Public Finances* requires that the government provide a detailed explanation of the difference between fiscal accounts based on the national standards and the ESA95-compliant records sent to Eurostat. The requirement was first applied, retroactively, to the 2002 accounts.⁵⁸ There continue to be some discrepancies in the fiscal and monetary accounts of the general government, although they have diminished in recent years due to the consolidation of the government sector.⁵⁹ The Hungarian Debt Management Office provides some supplementary information to link the two data sets provided by the MoF and the NBH. Local government data are still to be consolidated.⁶⁰

As part of the “Glass Pockets” programme designed to improve transparency, Government Decree 95 of 2003 has identified a comprehensive list of documents pertaining to central government finances, as well as central and sub-national government budgetary institutions, which must be made publicly available.⁶¹ The main amendments introduced by Act XXIV of 2003, the basis of the “Glass Pockets” programme, relate to support and supply contracts between the public and private sectors, increased transparency of the financial management and organisational structure of budgetary organisations, strengthening of the SAO’s role, and tightening of public property management rules.⁶² In order to improve the efficiency of public expenditures and achieve medium-term budgetary expenditure targets, the government has prepared a detailed timetable for the submission of comprehensive legislative amendments aimed at undertaking structural reforms. Under amendments to the Public Finance Act introduced in July 2006, the government is expected to inform the general public every quarter about the implementation of the timetable and the legislative tasks for the subsequent period.⁶³

The activities of ÁPV, while not included in the central government budget, are approved as part of the budget process. Aggregates of government equity holdings are reported in the annual report of ÁPV, and expenditures of the company are reported in an annex to the annual *Report on the Fulfilment of the Budget*.

The regulation and reporting of quasi-fiscal activities has improved. Starting in 2003, the government is formally no longer able to use ÁPV’s privatisation reserves for subsidising government activities, injecting capital into state-owned enterprises, or undertaking other quasi-fiscal activities. In addition to repaying government debt, privatisation receipts can now be used to pre-finance budgeted infrastructure and human resource development projects connected with Hungary’s EU accession.⁶⁴ The quasi-fiscal activities of the MFB have been eliminated and its three main subsidiaries -- NA, ÁAK, and the Student Loan Centre DHK -- were purchased by the central government in December 2002. However, DHK is not covered by the ESA95-compliant general government statistics, as it is classified as a corporate entity.⁶⁵ The government has taken steps to account for quasi-fiscal activities associated with PPPs, but not with public enterprises.⁶⁶

The Hungarian State Treasury maintains an updated website where information on the central government balance, social security funds balance, extra budgetary funds balance, accounting balances, budgetary and closing accounts acts can be found. While information on the website is in Hungarian, an English version of the website is soon to be launched.⁶⁷

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

Debt reporting

As part of its SDDS commitments, Hungary regularly releases data on central government debt that cover the operations of the central budget, extra-budgetary funds and the social funds. This is disaggregated by instrument, maturity, currency, and type of holder. The information is released quarterly within 50 days of the end of the reference quarter. Responsibility for compiling the data lies with the Government Debt Management Agency ÁKK which produces a wide range of high-quality current and historical information on its website and in printed form. In addition to the quarterly report, an annual *Debt Management Report* is published. ÁKK further publishes

information in advance about its debt-financing needs and plans, including an annual *Debt Management Outlook* and an advance calendar for domestic debt auctions.⁶⁸

ÁKK compiles its debt statistics both at face and at market value. Foreign debt is converted into forint using the official exchange rate. In contrast, the financial accounts compiled by the National Bank are based on market price valuations.⁶⁹

Advance release calendars

In accordance with its commitment to the IMF SDDS, Hungary produces advance release calendars across the range of fiscal data that it releases under the provisions of the SDDS. The calendars typically give one quarter ahead notice of publication and can be accessed either through the IMF website or via a range of MoF publications. Statistics released outside of the regular schedule are not announced beforehand.⁷⁰ The Hungarian State Treasury website includes an advance publication calendar in Hungarian, which announces expected dates of publication for data related to state budget execution. An English version of this calendar is expected to be available on the website soon.⁷¹

3. OPEN BUDGET PREPARATION, EXECUTION, AND REPORTING

●●●● Compliance in progress

Fiscal policy objectives, macroeconomic framework, and risks

Fiscal policy objectives

Hungary has an open budget process, in which the budget bill and the closing accounts are discussed by parliament, together with the opinion expressed by the State Audit Office.⁷² The fiscal year is the calendar year, with the budget bill typically submitted to the parliament by late September for final voting by late December. Hungary has made good progress in placing its budgetary process within a broader macroeconomic framework, in identifying the objectives of fiscal policy and detailing possible risks. Since 1997, the government has submitted a report to parliament on the expected impact of the budget bill together with information on expected fiscal activity for the following two years.⁷³ The annual budget documents clearly identify fiscal policy objectives.

The *Act on Public Finances* allows the government to present a supplementary budget in the event of significant changes in the economic outlook. Given the cumbersome process involved, resorting to supplementary budgets is quite rare: the last supplementary budget was in fact approved in 1995.⁷⁴ Problems are still created by the fact that, since 2002, additional spending is possible without parliamentary approval and additional appropriations, provided that the deficit does not exceed the budgeted amount by more than 5% of total expenditure. Under an amendment to the *Act on Public Finances* in the 2005 draft budget, the Budget Act shall be amended by parliament if the deficit exceeds the budgeted expenditures of the sub-divisions of the central government -- central budget, social security funds, and extra-budgetary funds -- by more than 2.5%. A supplementary budget is needed when the overshoot exceeds 5%. At the moment, the Budget Act for each year explicitly identifies line items, which can be modified without parliamentary approval. However, overall expenditure control has become tighter with transfers within the budget of a given item now increasingly the only source of flexibility.⁷⁵

As a non-eurozone member of the EU, Hungary is required to prepare annual convergence reports that, among other things, require the government to identify medium-term fiscal policy objectives, even though these tend to be quite broad and general. It is likely that this commitment will enhance longer-term fiscal planning in the country. However, problems are still caused by relatively frequent revisions of the targets. Some commentators have highlighted that, unlike previous Convergence Programmes, the one presented by the government in September 2006 starts from realistic data and indicative projections for 2011 and, however general they might be, it suggests structural reforms in the education, healthcare and public administration sectors.⁷⁶

Macroeconomic framework

The MoF published its basic macroeconomic model in 2001.⁷⁷ The current forecasting framework is not publicly available, although the analytical staff of the MoF are generally recognised to be well qualified. There is some frustration on the part of market participants with the chequered track record of the ministry's projections of the budget deficit in recent years. The budget documents do not explicitly consider different macroeconomic scenarios, although the Convergence Programme does.⁷⁸ There is a possibility that budget documents from 2007 onwards will include different macroeconomic scenarios, based on those contained in the 2006 Convergence Programme.⁷⁹

Fiscal risks

The budget documents do not formally quantify fiscal risks, although the medium-term budget framework is used to assess alternative budget scenarios with some discussion of risks.⁸⁰ In compliance with the *Act on Public Finances*, the report on the fulfilment of the annual budget includes comprehensive statements on outstanding government guarantees. The MoF undertakes the internal sectoral risk analyses. Although the budget contains no evaluation of state guarantees, provisions are made for guarantees that are expected to be called. The provisions cover the outstanding guarantees of the National Development Bank and the Foreign Trade Bank, as well as guarantees issued to exporters and small and medium-sized companies. The total amount of the loans is around 5-6% of GDP. In the recent past, the provisions made have been far in excess of the guarantees called. The parliament annually places a legally binding limit on guarantees and any issued in excess of this level require additional parliamentary approval. The government is allowed to charge a guarantee fee of up to 0.5% of the guaranteed amount. Each individual guarantee is reported to the State Audit Office (SAO). The SAO has called on the government to pay greater attention to revenue risks in its budget documentation.⁸¹

The government has adopted a strategy of managing fiscal risks by establishing special reserves in the budget. However, the implementation of the programme has been incomplete. For example, a reserve was to be created for the Social Security Fund but this has not been done to date. The general reserve under the *Act on Public Finances* has a legal minimum of 0.5% of total expenditures. It is used for unexpected events but can also be used as compensation for revenue loss. As a consequence of overshooting the deficit targets, a new safety reserve of 100 billion forint (0.7% of GDP) was introduced in 2005. While special reserves accounted for 85 billion forint in 2005, the amount was only around 61 billion in 2006, following the introduction of serious restrictions concerning certain expenditures in the chapters.⁸² The funds are at present created for one year at a time and any unspent funds (in net terms) are not carried over to the next fiscal year. Any unspent amounts have to date been used to meet fiscal targets.⁸³ The Public Finance Act amendment introduced in July 2006 stipulates the need for each ministry to establish a 3% chapter equilibrium reserve as a systemic reserve. The government will allow the use of such reserve, to be determined by law, only if the chapter expenditures and revenues, as well as the general government processes, all develop as originally envisaged. Reserves are expected to reach 1% of GDP by 2009.⁸⁴

ÁKK has a risk-management strategy for government debt. About 99.9% of foreign currency debt is currently in euros. The Agency issues a quarterly risk management report. ÁKK has tended to be more risk-averse than the MoF, taking a fairly cautious stance on foreign currency borrowing which the ministry favours on cost grounds.⁸⁵ Some observers have expressed concern that the fiscal difficulties of Hungary might at some point lead investors to substantially reassess their attitudes towards Hungarian government debt.

Fiscal sustainability

The medium-term budget frameworks contain some discussion of fiscal sustainability. In connection with the 1999 pension reform, projections were made of the long-term implications of the fiscal situation. In general, however, fiscal sustainability has become a sensitive issue in Hungary's current excessive deficit situation. Unlike the previous ones, the Convergence Programme presented in September 2006 classifies mandatory fully funded pension funds outside the general government sector, thus making data on budget deficit and public debt reach higher levels. Although Eurostat ruled in September 2004 that the fully funded pension pillar could be recorded inside the general government sector until March 2007, the Government decided to present these figures in advance.⁸⁶

Hungary remains committed to joining the euro-zone, which in turn presupposes sustained efforts to bring the fiscal situation under control. However, the risk remains that inability to enforce fiscal discipline will lead to membership being continuously delayed. Even under a more optimistic scenario, it is not clear that the government's convergence plans are sufficient to put government finances on a sufficiently healthy footing for when monetary autonomy is surrendered to the European Central Bank. The government's de facto target appears to be the

minimum acceptable 3% of GDP public sector deficit, rather than an overall fiscal balance. Some discussion of structural reform, as well as medium-term sensitivity analysis of government finances, is contained in the Convergence Programme.⁸⁷

Budget presentation

Data reporting

The Hungarian budget covers the budgetary central government, social security funds, and the extra-budgetary funds. Data on the general government in compliance with the ESA95 standards are provided in a special chapter attached to the general explanation of the budget bill and the final accounts bill.

The budgeting process involves medium-term planning. A two-year framework was used in 2001-2 to match the political cycle and to strengthen the role of medium-term planning by making the second-year projections into actual appropriations. The approach was, however, abandoned by the new Socialist-led government in the 2003 budget due to transitional difficulties in the face of changing macroeconomic circumstances and the desire for better harmonisation with EU standards. The *Act on Public Finances* allows the authorities to choose between a one-year and a two-year framework.⁸⁸

Hungary produces and disseminates a comprehensive range of budgetary information, facilitating analysis and promoting accountability. The MoF disseminates information from the Treasury accounts, social security funds and extra-budgetary funds, and from local governments. While there is no complete description of the methodology through which all the data are compiled, the methodology for compiling data on the operations of the central government has been developed to adhere to the GFSM system. The data classified in this manner differ slightly from the GFSM 1986 methodology, in that repayments of loans are included in revenue and gross lending is counted as expenditure. Data released in accordance with Hungary's commitment to the SDDS, however, are compiled so as to comply with GFSM methodology.⁸⁹

The current accounting system combines elements of cash and accrual-based methodologies. However, budget preparation and reporting are based on GFSM 1986-compliant cash-based model. A transition to the ESA95-compliant GFSM 2001 system is underway, although no formal framework for the transition has been adopted. In 2006, the IMF and Eurostat started working on a project to introduce methodological correspondences between ESA95 and GFSM 2001 data. MoF officials are involved in the elaboration of such a conversion methodology.⁹⁰ Considerable progress has been made, with the compilation of intermediate fiscal statistics and the dissemination of metadata being the key remaining problems.⁹¹ At the moment, accrual estimates are made for taxes, social contributions, interest, certain kinds of property income, normative transfers to enterprises and social transfers, wages, employer contributions to social security and labour market funds, and the use of goods and services. These typically involve time adjustments to cash data using accrual interest calculations by ÁKK.⁹²

Budget execution and monitoring

The management of fiscal flows is to a high degree centralised at the State Treasury, which makes all disbursements on the basis of authorisation by the central budget, the social security funds, and the extra-budgetary funds. Entities such as ÁPV operate outside of the Treasury system and have separate accounts either at the National Bank or at commercial banks.⁹³ Local government accounts are also managed independently of the State Treasury.

Certain revenue and expenditure appropriations belonging to the budget chapters are amended during the year or at year-end to grant some flexibility to the government in the execution of the budget. While some of these

amendments become necessary to cope with the lack of proper planning, they do not negatively affect transparency, as they have a sound legal background and are followed very closely by the Treasury once they are introduced. Specifically, the *Act on State Household* defines the right to amend appropriations and the yearly state budget identifies the appropriations to be amended by the parliament, government or various ministries.⁹⁴

During the budget year, the MoF publishes monthly budget monitoring reports, which are currently prepared at the central government level. They are available on the MoF website within one month of the end of any given calendar month. The reports are then sent to the State Audit Office, the Government Control Office, and several parliamentary committees.⁹⁵ The monthly execution data use a national classification and provides only summary data. Revenue and expenditure streams are not classified in either economic or functional terms. However, the annual execution data do comply with the GFSM 1986 classification guidelines.⁹⁶

Local governments prepare semi-annual and annual reports, as well as “quick reports” each quarter. The reports cover all their revenues and expenditures, including subsidies from the central government. Financial committees are required to comment on the semi-annual and annual execution reports. They further monitor revenues and changes in assets of the municipalities, as well as examine the reasons for borrowing and their economic basis. Findings are reported to the municipal council, which can, if necessary, refer them to the State Audit Office.⁹⁷

Each budgetary organisation is required to have its own internal control unit. In October 2001, a new Central Harmonisation Unit (*Ellenőrzési Rendszer Fejlesztési Főosztály*, CHU) was created as an independent budgetary body under the direct supervision of the minister of finance in compliance with the *Act on Public Finances*, which places the minister in charge of the development, regulation, co-ordination, and harmonisation of the public internal financial control system. Under the *Act on Public Finances*, the minister of finance is required to implement the standards and norms of internal audit and to assess its quality through compliance tests.

The Treasury checks spending requests from budgetary organisations in advance. The government in 2003 adopted a new decree designed to enhance the internal audit of budgetary organisations. Under the provisions of the decree, financial and performance audits can be conducted in line with international best practices. Internal auditors, who must meet high professional qualification standards, are granted functional and organisational independence. Summaries of all independent audits are submitted to the MoF on an annual basis. The ministry then compiles them into a comprehensive report on the quality of financial management and internal controls, which in turn is submitted to the government. Under the new regulations, budgetary entities have to establish financial management and control procedures, as well as undertaking regular risk assessment of their activities. All financial decisions have to be properly documented for audit purposes.⁹⁸

The Government Control Office (*Kormányzati Ellenőrzési Hivatal*, GCO), which is under the control of the Office of the Prime Minister, was established in 1993 as a body responsible for special internal audit tasks in compliance with the Government Decree No. 70/2004 (IV.15). The government decides what tasks the Office should undertake and the prime minister has the right to make requests. An annual plan is presented to the government, which approves it by issuing a decree. Some *ad hoc* audits are undertaken but they seldom number more than two a year and do not tend to be very extensive. The remit of operations, with the exception of EU funds, focuses on institutions closely connected with the government. The GCO has the right to audit extra-budgetary funds and state-owned enterprises but does so only very infrequently. The State Audit Office and the GCO operate separately from each other and the GCO cannot duplicate work undertaken or planned by the SAO unless expressly required to do so by the government. In order to avoid duplication, the two institutions exchange their annual audit plans.⁹⁹

GCO investigates the impact of expenditure or revenue collection, financial control, and the management of budgetary institutions and extra-budgetary funds. The GCO was made the national control authority for EU funds in 2003 and the control and audit of such funds has become its primary responsibility. It is eventually expected to account for 90% of the GCO's workload, compared to the current 50%. On-the-spot checks of different categories

of funds are conducted in 5-15% of the cases. It is further able to review the effectiveness of control at various levels of government. All audits are conducted in accordance with the Institute of Internal Auditors (IIA) Standards. The main focus of the work is on legal and regulatory compliance. The reports are submitted to the heads of the relevant departments and not made public. In cases of impropriates, reports are made to the government and/or the relevant ministries, which are then responsible for taking corrective measures.¹⁰⁰

The GCO is fully financed by the government and currently has a staff of 166. As an internal government agency, the GCO does not have formal requirements to publish its findings. The work plans of the GCO are approved by the prime minister.¹⁰¹ According to some commentators, the GCO does not have a high degree of credibility, as its tasks are highly politicised. A Government Decree was approved in 2004 to reduce GCO politicisation, determining clearer rules and audit standards for its activity.¹⁰²

Accounting basis

The *Act on Public Finances* stipulates that accounting of budgetary receipts and expenditures shall be on a cash basis, in accordance with GFSM 1986. Hungary is currently transitioning to ESA95 and GFSM 2001-compliant accrual-based system.

Procurement and employment

Hungary has a central public procurement system which is regulated by the *Act CXXIX:2003 on Public Procurement*, which replaced an earlier act from 1995. The Act conforms to international best practices and is fully EU-compliant.¹⁰³ Procurement is managed by the Public Procurement Office (*Központi Szolgáltatási Főigazgatóság*). The public procurement legislation does not apply to non-financial public enterprises and certain agencies, which nonetheless engage in fiscal activities.¹⁰⁴

The government's "Glass Pockets" programme requires the publication of all contracts involving the expenditure of public funds and the management of public property worth more than five million forint. All operations using public resources, whether conducted by state agencies or private companies, can now be audited by the State Audit Office irrespective of their value.¹⁰⁵

The process of civil service recruitment has a clear basis in law and matches EU standards. Recruitment is conducted through a competitive process and positions are filled in accordance with the qualifications required for them. New recruits are required to pass a civil service examination. Personal connections and political considerations result in some efficiency losses but these are not sufficient to fundamentally distort the process. Civil servants are governed by the *Act XXIII:1992 on the Legal Status of Civil Servants* and the *Code of Ethics for Civil Servants*. Annual reviews of staff performance, comparing previously agreed tasks with outcomes, are conducted on the basis of the *Act on the Legal Status of Civil Servants*. Outside assessments of staff performance are conducted periodically at government agencies, including the MoF.¹⁰⁶

Fiscal reporting

The *Act on Public Finances* stipulates that the central government, social security funds, extra-budgetary funds, and sub-national governments must present their final accounts to the parliament within eight months of the end of the year.¹⁰⁷ In addition, the MoF produces regular updates on fiscal activity.

Hungary subscribes to the IMF SDDS, and meets its standards for coverage, periodicity and timeliness of reporting central and local government data. For central government activity, this means monthly data releases, within one month of the reference month. General government data are released annually, with a timeliness of six months after

the end of the reference year. There is an advance release calendar giving one-quarter advance notice of precise release dates. Data are compiled from Treasury accounting records of actual out-turns, but are nonetheless considered provisional, subject to the eventual approval of parliament.¹⁰⁸

The *Act on Public Finances* requires the government to provide the legislature with a *Report on the Fulfilment of the Annual Budget*. The Act also requires that the authorities present final accounts for central government to parliament within eight months of the end of the fiscal year. In addition, Hungary's monthly bulletins on the budget are accompanied by a ministerial commentary that addresses unanticipated deviations in the data. The information presented in this way is subject to the scrutiny of the SAO. The process of reconciling budget proposals with programme results is well developed.¹⁰⁹

4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●●●● Compliance in progress

Data quality standards

As a SDDS subscriber, Hungary broadly meets the IMF standards for the quality, coverage, and timeliness of its fiscal data. The data are typically presented in a GFSM 1986-compliant format and only the classification of some extra-budgetary institutions in the general government represents a deviation from international best practices. The classification of data conforms to the 1993 *System of National Accounts*. Sound statistical techniques are used and source data are validated with other administrative records, even if similar assessments are not conducted for the outputs. Only minor discrepancies remain between above the line and below the line items and revisions practices are generally known. However, the IMF has noted the need to improve metadata accessibility.¹¹⁰ The government is currently transitioning to the ESA95-compliant GFSM 2001 system, although no formal framework for the transition has been adopted yet. In 2006 the MoF began working together with the IMF and Eurostat to introduce methodological correspondences between ESA95 and GFSM 2001 data.¹¹¹

Independent scrutiny of fiscal information

Independent Audit

The status of the State Audit Office is enshrined in the Hungarian Constitution, which defines it as the “financial and economic audit organisation of the parliament.”¹¹² Its precise responsibilities are laid down by the *Act XXXVIII:1998 on the State Audit Office*.¹¹³ It is an independent state entity accountable solely to the parliament, which elects its president and two vice presidents for a period of 12 years. These individuals can only be removed in the face of professional misconduct or conflict of interest. Independence was further enhanced in 2004 through the establishment of a separate budget for the SAO.¹¹⁴ There are plans to comply with the June 2006 IMF recommendations to further strengthen the role of the SAO or establish another independent body reporting to parliament. However, according to some commentators, efforts to increase the powers of the SAO are constrained by the lack of strong political will to do so.¹¹⁵

Parliamentary approval is not required for the SAO’s work plan, although the president does typically discuss it with the parliament. The annual plans are typically based on a medium-term plan, although *ad hoc* audits can also be conducted when deemed necessary. The SAO also submits an annual report to parliament, detailing its activities and the implementation of its recommendations by the government. The SAO is generally regarded as one of the most efficient and professional state agencies in Hungary and almost all of its recommendations are generally accepted and acted upon by the government. However, the structure and content of the central budget and final accounts, the inventory of state properties (excluding business activities), the strict regulations on the obligation to introduce supplementary budgets, as well as the introduction of accrual accounting remain issues of contention between the SAO and the government.¹¹⁶ The European Commission in its 2003 *Comprehensive Monitoring Report* noted that “The State Audit Office is functionally and operationally independent, its staff is adequate and well trained and its audit services satisfactorily cover all public and EU funds.”¹¹⁷

The SAO is required by law to form an opinion on the government’s budget proposal, which is submitted to the parliament and debated simultaneously with the budget bill. Occasionally, the government’s lack of timeliness in

submitting the budget proposal to the SAO creates problems, as forming an opinion on the proposal is made difficult by the lack of information regarding official assumptions.¹¹⁸ Both the minister of finance and the SAO president have to give speeches at the opening of the session. Similarly, the *Act on Public Finances* stipulate that the central government, social security funds, extra-budgetary funds, and sub-national governments must present their final accounts to the State Audit Office within six months of the end of the year.¹¹⁹ The procedure adopted for the budget bill is also applied to the final accounts. The SAO can comment on any aspect of the budget proposals except for the government's policy positions. The issues addressed typically cover compliance with laws and decrees (including EU requirements), consistency with the government's economic policy, the nature of appropriations, and the quality of projections. The SAO highlights areas where it sees a discrepancy of more than 5% between the government's projects and the SAO's own estimates based on previous experience. The report on the final accounts includes comments on the presentation and the planning methods, and reviews the estimates used. In order to formalise the process, the SAO has frequently advocated the adoption of a special act on the state household.¹²⁰

The SAO criticised the 2006 budget proposal, arguing that spending was underplanned and no specific basis was given for some of the revenue items.

The SAO can further follow the use of EU funds in Hungary. The remit of regular *ex post* audit also covers extra-budgetary funds, social security funds, and the use of state transfers by sub-national governments. All SAO findings are published and submitted to parliament.¹²¹ In addition, the audit plans of the Office are available on the website.¹²² The quality of audit has tended to be lower and its remit less comprehensive in the fragmented sub-national sector. The largest cities are audited on an annual basis, but a special sampling system exists for the smaller municipalities. All municipalities are audited at least once every four years and have control committees that are required to report on their budget implementation to the municipal council. The largest towns, municipalities with expenditures of more than 300 million forint, and municipalities with outstanding loans also have to engage an outside independent auditor to review their balance sheets, surplus cash statements, and profit and loss accounts. The findings of such audits are published.¹²³ In order to achieve more responsible and effective financial planning at the local level, the government intends to reform the municipal system and strengthen monitoring of their activities. The SAO is expected to appoint an external auditor, which, however, will carry out an audit program chosen by the SAO. The government also has plans to strengthen internal audit of local authorities and is exploring the possibility of including clear provisions on the responsibility for this task, to be subordinated to mayor and municipality financial committee control, in the municipalities law.¹²⁴

The Office maintains high quality information services, in many areas also in English, reporting on its own activities and on conditions of fiscal transparency and data integrity. Annual reports submitted to parliament are made available to the public, through the SAO website, on the same day of submission, although they are only available in Hungarian. SAO summary reports are also available in English.¹²⁵ The SAO has typically conducted financial compliance audits, but is currently expanding its remit to include performance auditing of government activity. This topic is still being researched, but the government has plans to introduce performance indicators for certain public services.¹²⁶ The SAO now has a separate division for performance audits that applies international best practices in its work. This division undertook 46 performance audits in 2005.¹²⁷ Comprehensive audits of government agencies are typically undertaken once every four or five years. In the event of any irregularities, the audited entity has to prepare a compliance plan. The SAO verifies compliance within a year. However, the SAO's position as an institution accountable to the parliament means that its primary response to improprieties is to refer the information to the parliament, which then has to decide on corrective action. Instances of fraud are reported also to the police. The SAO has a total staff of around 650, of whom some 200 work in the 20 branch offices. It has been able to maintain its staffing levels even in the face of general budget cuts across the government.¹²⁸

The extra-budgetary funds and Health Care and Pension Funds are also required to be audited by other, independent external auditors. The SAO's work in these instances focuses mainly on compliance.¹²⁹

In connection with the “Glass Pockets” programme launched in 2003, the SAO has been empowered to audit the operations of private companies involved in public procurement, as well as all other activities involving the use of public resources. In addition, the protection of trade secrets can no longer be applied to any information pertaining to government budgets at any level, to public property, and to EU-related expenditures.¹³⁰ However, the publication of these data cannot involve revealing privileged information (know-how, special methods), which could jeopardise the business activity itself.

National Statistics Agency

The Hungarian Central Statistical office (HCSO) is an operationally independent state agency under the supervision of the government. The prime minister appoints the HCSO president and his deputy for a once-renewable six-year term. The HCSO is responsible for the production and publication of all official data pertaining to the socio-economic and demographic situation of the country. The Office employs 800 staff in its headquarters and a further 900 in its seven regional branches.¹³¹ The material and human resources are generally deemed adequate for fulfilling the statutory responsibilities, although budget pressures have made it difficult to increase data collection or the use of surveys in recent years.

The status of the HCSO is enshrined in the *Act XLVI:1993 on Statistics*, according to which it can request state agencies who are parties to the Official Statistical Service to provide information about their activities, and in the implementation of the National Statistical Data Collection Programme, which is established under a yearly government decree. The Act further imposes the responsibility of annual reporting to the parliament and the government. Any natural or legal person is obliged to supply the data requested by any organ of the Official Statistical Service.¹³²

The main sources of fiscal information within the Official Statistical Service are the MoF, the State Treasury, the Social Security Fund, and the Tax Office. Sub-national governments report through the MoF, whereas reporting by the Social Security Fund is done separately on a quarterly basis. Most fiscal data are accepted as obtained from the Treasury system and assembled by the MoF. Data from the Tax Office and wage data are cross-checked. However, in general, there are relatively few tools for quality control in the fiscal sphere.

The development of statistical methodology and norms in Hungary is the responsibility of a tripartite working group (headed by the HCSO but also including the MoF and the NBH), which is responsible for financial statistics, including general government debt. The operations of the group are governed by a written cooperation agreement with rules. The group meets regularly and the decisions, as well as the positions of the different parties, are recorded in minutes. The group is deemed to have made considerable progress in improving the quality of official statistics in Hungary. Among other things, the group is responsible for establishing the statistical definition of general government and has reclassified some 200 units, mainly small ones, as government units.

The HCSO is responsible for converting fiscal statistics from the national methodology to an ESA95-compliant form and for providing data to Eurostat. The MoF primary data are based on cash accounting, although a gradual transition to an accrual-based system is envisaged. In some areas, Hungary uses time-adjusted cash data, which is permitted by the EU. The legal definition of general government in Hungary is not exactly identical to the statistical definition, the main difference having to do with some corporations, such as the Privatisation Agency, NA, and public media corporations (Press, Radio, TV) which cover less than 50% of their costs through sales.

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during visits to Hungary between 16 and 20 October 2006:

Ministry of Finance

16 October 2006

Balázs Romhányi	Deputy Head of Department	Directorate of Fiscal and Financial Policy Affairs
Gizella Csonka László Szabó	Chief Advisor, Deputy Head Counsellor	Directorate of Fiscal and Financial Policy Affairs Division for Government Budget and Fiscal Policies

National Bank of Hungary

17 October 2006

András Kármán Klára Pintér	Deputy Head of Department Senior Economist	Financial Analysis Department Financial Analysis Department
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20 October 2006

István Hamecz	Director	Economics and Monetary Policy Directorate
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ADDITIONAL INTERVIEWS

17 October 2006

Gábor Pósch	Economist, Counsellor	State Audit Office
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18 October 2006

László Seregdi	Deputy Managing Director	Hungarian Financial Supervisory Authority Economics, Risk Assessment and Regulatory Directorate
Zsolt Wieland	Lawyer	Hungarian Financial Supervisory Authority Capital and Money Markets Issuance
Györgyi Joó Tóth	Head of Unit	Hungarian State Treasury International Department
Zsuzsanna Balogh	Advisor	Hungarian State Treasury Treasury Commissioner Office

19 October 2006

Dora Gyorffy
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Central European University
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NOTES

- ¹ Interviews conducted in Budapest, 16-20 October 2006.
- ² Interviews conducted in Budapest, 16-20 October 2006.
- ³ Interviews conducted in Budapest, 16-20 October 2006.
- ⁴ Interviews conducted in Budapest, 16-20 October 2006.
- ⁵ Interviews conducted in Budapest, 16-20 October 2006.
- ⁶ Interviews conducted in Budapest, 16-20 October 2006.
- ⁷ Interviews conducted in Budapest, 16-20 October 2006.
- ⁸ Interviews conducted in Budapest, 16-20 October 2006.
- ⁹ “Hungary: 2006 Article IV Consultation – Staff Report; Staff Supplement; and Public Information Notice on the Executive Board Discussion,” IMF, October 2006, p.23.
- ¹⁰ Interviews conducted in Budapest, 16-20 October 2006.
- ¹¹ Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.
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- ¹³ “Report on the Observance of Standards and Codes: Hungary: Fiscal Transparency,” Washington, D.C.: International Monetary Fund – Fiscal Affairs Department, 18 April 2001, p. 3; www.imf.org/external/np/rosc/hun/fiscal.htm
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- ¹⁵ “Convergence Programme of Hungary 2005-2009,” 2006, p. 39.
- ¹⁶ *The Organisational Structure and the Main Responsibilities of the Hungarian State Treasury*, 2 March 2005, a presentation provided by the State Treasury.
- ¹⁷ Interviews conducted in Budapest, 16-20 October 2006.
- ¹⁸ Interviews conducted in Budapest, 16-20 October 2006.
- ¹⁹ Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.
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- ²² Interviews conducted in Budapest, 16-20 October 2006.
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- ²⁴ Interviews conducted in Budapest, 16-20 October 2006.
- ²⁵ “Hungary: Report on the Observance of Standards and Codes—Fiscal Transparency Module—Update,” 2004, p. 2; “Hungary: 2004 Article IV Consultation—Staff Report; Staff Supplement; and Public Information Notice on the Executive Board Discussion,” *IMF Country Report No 04/145*, May 2004, p. 13; Joanna Kołodziej, “Ceny kontrolowane w wybranych krajach Europy Środkowo-Wschodniej oraz w Unii Europejskiej,” *Bank i Kredyt*, August 2004, p. 79.
- ²⁶ Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.
- ²⁷ Marton Dunai, “Hungary Faces Budget Crossroads – Highway-Building Push Lures Firms, but Huge Costs Threaten Plan to Join Euro,” *Wall Street Journal Europe*, 1 November 2005.
- ²⁸ Dunai, “Hungary Faces Budget Crossroads.”
- ²⁹ Act on Public Finances 1992, Article 1.
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