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Slovak Republic

Report on the Observance of Standards and Codes (ROSC) Fiscal Transparency Module

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July 12, 2002

EXECUTIVE SUMMARY

This report provides an assessment of fiscal transparency practices in the Slovak Republic in relation to the requirements of the IMF *Code of Good Practices on Fiscal Transparency* based on discussions with the authorities and other organizations, the authorities' response to the IMF fiscal transparency questionnaire, and other sources of information. The IMF *Manual on Fiscal Transparency* (http://www.imf.org/external/np/fad/trans/manual/) should be consulted for further explanation of the terms and concepts discussed in this report.

Fiscal management and transparency have improved substantially over the last two years and the Slovak Republic now meets the fiscal transparency code's standards in several areas. Key weaknesses in the coverage of fiscal operations and in budget preparation have been largely addressed; budget preparation is now cast within clearly identified medium-term macroeconomic framework and constraints; and budget execution and reporting have new financial control and internal audit procedures. The information publicly available on public finances has also improved and the integrity of such information is now ensured by clearly defined and independent scrutiny. The authorities' resolve to join the EU has been a key factor in rapidly revising the legislative and regulatory framework. The challenge is now to strengthen administrative capacity to implement effectively the legislative reforms and to ensure that the government maintains a consistent and well-coordinated view of all its fiscal operations.

The staff team identified a number of areas where progress would be needed to meet all the requirements of the code and to move toward best practices. These include: a better definition of the coverage of general government and of the relations between the central and general government and the rest of the public sector; better accounting, classification, and reporting of fiscal operations; further improvement in the quality of fiscal data; and more careful consideration of long-term policy commitments and fiscal risks.

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Abbreviations and Acronyms

COFOG	Classification of Functions of Government
ESA	European System of Accounts
EU	European Union
FPI	Financial Policy Institute
FMA	Financial Market Authority
GFS	Government Finance Statistics
GFSM	Government Finance Statistics Manual
MOF	Ministry of Finance
NBS	National Bank of Slovakia
NFPEs	Nonfinancial public enterprises
NLO	National Labor Office
NPF	National Property Fund
NSO	National Statistics Office
PFIs	Public Financial Institutions
QFAs	Quasi-Fiscal Activities
RONI	Regulatory Office for Network Industries
ROSC	Reports on the Observance of Standards and Codes
SAO	Supreme Audit Office
SDDS	Special Data Dissemination Standard
SFV	Sterednodbý finačný výhl'ad (general government financial outlook)
SGDB	Slovak Guarantee and Development Bank
SHDF	State Housing Development Fund
SNA	System of National Accounts
STA	Slovak Tax Authority

I. INTRODUCTION[1]

1. This draft report provides an assessment of fiscal transparency practices in the Slovak Republic in relation to the requirements of the IMF *Code of Good Practices on Fiscal Transparency.* The assessment has two parts. The first part is a description of practice, prepared by the IMF staff on the basis of discussions with the authorities and their responses to the fiscal transparency questionnaire, and drawing on other available information. The second part is an IMF staff commentary on fiscal transparency in the Slovak Republic.

II. DESCRIPTION OF PRACTICE

A. Clarity of Roles and Responsibilities

2. **The definition of general government follows internationally accepted standards.** The general government encompasses the central government, institutions supported by the state budget, state and extrabudgetary funds, insurance and social security institutions, and regional and local governments (Box 1). The government is currently in the process of revising its statistics to be consistent with the 1995 European System of Accounts (ESA95), and is contemplating the adoption of the *2001 Government Finance Statistics Manual (2001GFSM).* Although significant progress has been made in reducing the number of extrabudgetary funds and integrating their activities into the state budget,[2] a few areas need greater clarification, such as the status of the new State Intervention Agency in Agriculture[3] and the coverage of nonprofit organizations that perform governmental functions.

3. **The roles of executive, legislative, and judicial branches of the government are clearly defined in the constitution;[4] responsibilities between different levels of**

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[1] Discussions on fiscal transparency were held in Bratislava during June 13–20, 2002. The staff team, comprising Messrs. Cangiano (head), Young, and Ms. Zakharova met with officials from the Ministries of Finance, Labor, Privatization, Economy, the National Statistics Office, the National Bank of Slovakia, the National Property Fund, the Public Procurement Office, the Antimonopoly Agency, the Regulatory Organization of Network Industry, the Financial Market Authority, and selected state-owned enterprises and subsidized units. The staff team also met with representatives of entrepreneurs' associations, the EU ambassador in Bratislava, the Slovak Governance Institute, and Transparency International.

[2] The *Act on the Abolition of Some State Funds* came into effect on January 1, 2002, except for provisions pertaining to the State Housing Development Fund that will become effective as of January 1, 2003. The Act dissolved 10 out of 12 extrabudgetary funds; their functions have been absorbed by the relevant state budget chapters.

[3] The Agency was created by transforming the Agricultural Market Regulation Fund. Its main function is to support the production, purchase, and sale of selected agricultural and food products. To this end, it issues regulations, promotes sales and consumption of some products, and exercises supervision over market organisation. Given that its financing sources are partly derived from the state budget, and that its budget is executed according to the 1995 Act on Budgetary Rules, as amended, as a subsidised organisation of the ministry of agriculture, the agency should be included in central government.

[4] The 1992 Constitution is available in English at http://www.government.gov.sk.

government and intergovernmental fiscal relations are clear but still evolving. With respect to the judicial branch, persons, and legal entities are allowed to challenge the legality of administrative actions taken against them by appealing to the courts under the 1964 Code of Civil Procedures, as amended in 2002. The Act on Budgetary Rules specifies the division of responsibilities across different levels of government, budget management procedures, and reporting requirements (Box 2).

Box 1. Structure of General Government in the Slovak Republic

General government consists of central government, regional and local governments, state and extrabudgetary funds, insurance and social security institutions, and other institutional units.

Central government. It encompasses all central budgetary organizations, 15 line ministries, the National Statistics Office (NSO), and subsidized central budgetary institutions, such as the Supreme Audit Office (SAO), the Anti-Monopoly Office, and the Academy of Science.

Regional and local governments. Starting in January 2002, general government includes eight regional self-governing bodies, in addition to 2,879 municipalities. Regional governments' responsibilities include regional development, territorial planning, secondary education, social assistance, health care, culture, road transport and communication, civil protection, and some international cooperation functions. Municipalities are responsible, among other things, for social assistance, registry offices, some road and communication systems, territorial planning and building permits, environmental protection, primary education, sports, and some health care.

State funds. There are two state funds: the National Property Fund (NPF), which carries out privatization of state-owned enterprises and derives its financing source from privatization receipts; and the Slovak Land Fund, in charge of privatizing state agricultural property and promoting agricultural development.

Extrabudgetary funds. There are two remaining extrabudgetary funds: the State Fund for Decommissioning of Nuclear Facilities and Disposal of Nuclear Waste; and the State Housing Development Fund (SHDF). The Nuclear Fund, which was founded in 1994, is mainly financed by contributions from nuclear facility operators and subsidies from the state budget; its resources are managed by the ministry of economy. At end of 2002, the functions of the SHDF, involving financial support at subsidized interest rates to low-income families and municipalities, will be transferred to the ministry of construction and regional development. The extension of repayable loans will be performed through the Slovak Guarantee and Development Bank.

Insurance and social security institutions. Insurance and social security institutions encompass health insurance agencies, the Social Insurance Agency, and the National Labor Office (NLO).

Other institutional units. These are organizations that receive at least 50 percent of their funding from the central government budget. Starting in January 2002, general government includes *Slovenska Konsolidacna* (recently merged with *Konsolidacna Banka*) that manages nonperforming assets.[5]

4. **Government activities are clearly distinguished from those of public financial institutions (PFIs).** Two public financial institutions, Slovak Guarantee and Development Bank (SGDB) and Export and Import Bank (Eximbank), carry out noncommercial banking

[5] *Slovenska Konsolidacna* (SK) is a state-owned joint stock company receiving repayable financial facilities to assist with the recovery of nonperforming loans. Its resolutions are approved by an independent board.

operations. Under the 1995 Act on State Aid, as amended,[6] the SGDB provides assistance in the form of loans and loan guarantees to small- and medium-size enterprises. Loans are funded by the state budget, but are administered by commercial banks under agency contracts. The SGDB also contributes to repayments of interest on these enterprises' loans. Eximbank's policies are in line with the basic recommendations of the OECD convention for export loans.

Box 2. Fiscal Decentralization in the Slovak Republic

At present, municipalities account for a small share of government activity in the Slovak Republic. Expenditures and revenues are only 8 percent of general government. However, plans for decentralization envisage further significant transfers of responsibilities in health, education, and social assistance to municipalities. In addition, eight regional governments have been established.

Municipalities' financial resources currently consist of: shared taxes (personal, corporate, and road); own-source revenues, mainly property and other local taxes, as well as nontax revenues in the form of fees, fines, permits, and property income from leases; and transfers and grants from the state government. Tax shares are established annually in the state budget. Based on the 2001 draft state final account, shared taxes are 31 percent of municipalities' resources, while transfers and grants from the state budget are 16 percent. Expenditures are for sewage, water, lighting, and the maintenance of local roads, as well as for education, health care, tourism, and regional development. Transfers are earmarked and limits are established in the Act on State Budget; they cover administrative expenditures, except wages; urban public transport; primary school construction; and specific-purpose grants, such as fire protection. Borrowing in excess of a prescribed level of municipalities' own revenue requires approval from the MOF.

Decentralization began on January 1, 2002, with the transfer of the responsibility for maintaining registers of vital statistics. On April 1, responsibilities for culture were transferred. On July 1, 2002, responsibilities for primary education will be transferred to the municipalities and for secondary education to the regions; as well, transfers for competency in some areas of social assistance were transferred. In 2003 and 2004, responsibilities for some areas of health care and transport will be transferred.

For 2002 and 2003, transfers are set out in a decentralization grant. By 2004, the government intends to establish revenue-sharing arrangements for financing local and regional governments. In addition, there will be two new limits on borrowings: one, in terms of debt as a proportion of revenues; and two, in terms of debt service, principal and interest, as a proportion of revenues. These changes will take place in 2005.

The responsibilities of external auditors of municipalities have been expanded to include, in addition to traditional audits for financial compliance, financial management systems. The Financial Control Administration in the MOF will continue to audit compliance on the use of budgetary resources. There are provisions under the amended Act on Budgetary Rules for "recovery regimes" for municipalities and forced receivership, which are applied to municipalities with overdue liabilities. External auditors will be responsible for auditing those activities devolved from the state government.

[6] Amendments to the *Act on State Aid* were adopted in November 2001. In conformity with the EU's *acquis communautaire*, the Act specifies conditions for the provision of state aid to sensitive sectors, to higher territorial units (regions), and to small- and medium-size enterprises.

5. **The distinction between commercial and noncommercial operations of nonfinancial public enterprises (NFPEs) requires clarification, as these enterprises carry out quasi-fiscal activities.** There are two types of NFPEs: state-owned enterprises; and joint stock companies with government participation.[7] Under the Act on State Aid, NFPEs may be eligible for two types of assistance: direct, in the form of subsidies, transfers, and grants; and indirect, through the use of state loan guarantees and tax relief.[8] NFPEs are neither consolidated in the government's financial statements, nor is the value of the government's investments recorded on its balance sheet. A number of NFPEs run significant losses as a result of quasi-fiscal activities (QFAs). For instance, the Slovak Danube Company and the Slovak Railways incur losses as a result of charging tariffs below cost recovery levels.[9] Slovak Railways covers its liquidity shortfalls by borrowing and rolling over its existing debt, much of which is state-guaranteed. QFAs are also carried out in the electricity sector,[10] where industrial and commercial users cross-subsidize household consumers and the government continues to guarantee the electricity transmission company's borrowing. At present, NFPEs' dividends to the government are determined on an ad hoc basis.

6. **Privatization procedures are generally transparent and subject to scrutiny by the legislature, but some discretionary spending of privatization receipts is permitted.** The repeal in 1999 of a highly restrictive legislation[11] has marked a significant improvement in terms of the clarity and certainty of privatization procedures.[12] While the privatization

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[7] These include some 50 state-owned enterprises and about 200 joint stock companies where the government maintains control. These companies are incorporated under the *Commercial Code* and are subject to the *State Company Act*. An exception is Slovak Railways that is governed by the *Slovak Railway Act*.

[8] The aid is administered by the Agency on State Aid and conforms to EU legislation that requires aid to be in the public interest. The Agency publishes an annual report on its activities, which appears in the *Commercial Bulletin* and on its official web site http://www.usp.sk.

[9] Since the beginning of 2001, the government has taken some steps to restructure the railway company. In particular, passenger and freight railway transport was separated from the railway track, and a Railway Company was created and became operational in January 2002.

[10] Whereas electricity generation and distribution companies are up for partial privatization in 2002, transmission of electricity will remain in government hands. The planned elimination of cross-subsidization in 2003 would be an important step in establishing a transparent tariff-setting mechanism for the electricity sector.

[11] The 1995 legislation prohibited the privatization of 26 companies, classified as natural monopolies, including the gas company, electricity company, the post, telecommunications, and the railway company.

[12] In 2000, the government sold a 51 percent stake in Slovak Telecom to Deutsche Telekom. In 2001, privatization was mainly carried out in the banking sector, which was governed by the strategy for privatization of state banks passed by parliament in May 1999. In March 2002, the government sold a 49 percent stake in the gas utility company, a sale that yielded Sk 130 billion (13 percent of GDP in 2001). The sale of a 49 percent stake in the distribution part of the electricity company is expected to be completed by end 2002. Companies currently slated for privatization include the Postal Bank, remaining Slovak Bus Transport operations, remaining healthcare establishments, water and sewage utilities, and shares in the property of companies in the portfolio of the NPF.

strategy is under the purview of the Ministry for Administration and Privatization of National Property, the NPF conducts the transactions, enforces privatization contracts, and receives privatization proceeds. Although the NPF retains a 51 percent ownership stake in most privatized enterprises, these enterprises are managed by the ministry of economy. Rules for the use of privatization receipts are clearly specified in the 1991 legislation regulating the transfer of state property and in the 2002 Act on State Budget. While the government retains discretion on the use of privatization receipts above budgeted levels, their use has been reported in the state final account.

7. **The Slovak regulatory framework is now fairly clear and open.** Largely reflecting the requirements for EU accession, the regulatory framework has been overhauled with the introduction of a number of new independent regulatory bodies and with the modernization of the entire regulatory legislation. Gas, heating, and electricity industries are now regulated by a newly created Regulatory Office for Network Industries (RONI)[13] that became operational in October 2001. The mandate of RONI includes third-party access, service quality standards, and licensing of new entrants. Effective January 2003, RONI will take over price administration of public utilities from the MOF. The recently implemented Act on Protection of Competition (May 2001) strengthened the role of another independent regulatory agency—the Anti-Monopoly Office—by introducing improved procedures for assessing the degree of market concentration and bringing criteria for assessing merges and acquisitions into line with EU standards. Another important piece of legislation that took effect in January 2002 is the new *Commercial Code* which strengthens minority shareholders' rights. [14] Progress has been also made in simplifying registration of new businesses.

8. **The central bank is independent and does not carry out QFAs.** The 2001 Act on the National Bank of Slovakia (NBS) legislates its independence and lays out the institutional relationship between the monetary and fiscal authorities. The NBS[15] maintains the accounts of all central budgetary institutions and state funds. In addition, the NBS acts as an agent for the MOF in administering the Treasury bill and state bonds primary markets. After providing for reserves, NBS profits are remitted to the state budget. A written agreement between the NBS and the MOF clearly defines the interest rate at which government's deposits are remunerated as well as the prices charged by the NBS for providing the above services to the government. Under the Act on State Budget, the government determines the amount of the NBS remittances to the budget. Since January 2002, the NBS manages the accounts of the

[13] RONI is an independent agency whose six-person council is appointed by the president. Its resolutions are published in the Official Gazette and are available on its website http://www.urso@gov.sk.

[14] Since November 2001, capital markets and the insurance industry have been supervised by the Financial Market Authority (FMA). Under the new laws passed in 2002, the FMA was specifically given wide powers of enquiry and supervision and can now impose a range of remedial measures and penalties to address violation of laws, regulations, and terms and conditions of its permits or licenses.

[15] See also the central bank website at http://www.nbs.sk/INDEXA.HTM.

newly established self-governing regions and, from July 2002, it will also keep the accounts of subsidiary organizations established by the regions.

9. **Government equity holdings appear to be extensive.** At present, the government's involvement in the nonfinancial sector, mainly energy and transportation, is extensive but expected to decline, guided by an active privatization program over the next two years. In the financial sector, government holds majority equity in the Investment and Development Bank and in the Bank of Slovakia, both in the last stages of privatization.[16] All banks are obliged to publish the information on their shareholder structure (including government participation) within thirty days of the end of each calendar quarter. Government's equity holdings are recorded at face value in the Commercial Registry, which is available for public scrutiny, but are not listed in the state final account.

10. **The legislative and administrative framework for fiscal management is clearly defined and the legal framework for expenditures is comprehensive.** The constitution identifies the responsibility of parliament to approve the budget and final accounts and defines the roles and duties of the SAO. The basic legal and administrative framework on the use of public funds is established by the Act on Budgetary Rules, as well as by the Act on State Budget for the relevant fiscal year. Public funds can only be spent by law; the MOF has effective power over budget management; and the rules for the use of contingencies and reserves spending are well defined in the law. Expenditure is clearly regulated by the *Handbook for Drafting the State Budget, State Funds Budget, and Municipal Budget,* and the *Provision of the Ministry of Finance on the Budget Classification*. The legal framework is aimed primarily at financial compliance, with no explicit reference to effectiveness or performance. The Act on Budgetary Rules does not yet allow for supplementary budgets.[17]

11. **Mechanisms for the coordination and management of budget and extrabudgetary activities are well defined.** The budget is subdivided in chapters; ministers and heads of other central budgetary units act as chapter administrators. Except for some mandatory limits on wages and capital spending, appropriations can be shifted within the same chapter provided its limit is not exceeded. Chapter limits can be adjusted up to 10 percent subject to MOF approval and provided the deficit is not increased. Rules for provisional budget are clearly defined. Although appropriations lapse at the end of the fiscal year, the Minister of Finance may approve carryovers in exceptional cases. Most of the operations of extrabudgetary funds are conducted through the government accounts held at the NBS. Budgetary and extrabudgetary institutions' own revenues—donations, fees, and charges—are deposited in commercial banks, even though their use has to transit through the government accounts held at the NBS.

[16] After privatization of these banks is completed, the only government holding in the banking sector will be a 10 percent equity share in the Slovak Savings Bank, with the Austrian Erste Bank remaining the majority holder.

[17] Effective September 2002, the Act on Budgetary Rules will allow for this possibility.

12. **The legislative basis for taxation and administrative procedures is clear and is, for the most part, observed in practice.** Tax laws define tax liabilities with respect to income, property, indirect, and road taxes and fees.[18] The 1998 Act on Customs Duty governs the administration of customs duties. The MOF publishes guidelines on compliance with tax legislation in its *Financial Bulletin*. According to the 1992 Income Tax Act, no institution, including tax administration, has the power to grant tax concessions. However, the ministry of economy can grant tax incentives, subject to approval by cabinet and the Agency on State Aid, only if they conform with the Act on State Aid. Tax concessions are also provided for in the 2002 Investment Incentives Act. Tax offsets are not permitted, except for those allowed under the 1992 Act on Administration of Taxes and Levies (Art. 63). Tax authorities have an obligation to observe the rights and legally protected interests of taxpayers, and taxpayers have a legal right to file a complaint with a tax authority, the MOF, or with the courts on the legality of an action taken by the tax authority. Tax administration has an internal audit unit and is externally audited by the SAO.

13. **Rights and responsibilities for the public and civil service are clearly regulated under the new civil service and public service acts.** These acts also provide for a *Code of Ethics*. The SAO, financial auditors, as well as tax and customs administrations have separate codes of conduct. The Code of Ethics for customs officers, in particular, was adopted early this year, as a measure envisioned in the government's 2000 Plan for the Fight Against Corruption.

B. Public Availability of Information

14. **The budget documents contain a comprehensive coverage of central and general government operations.** There are five budget documents, comprising the state budget, three supplementary documents on detailed government operations and other components of general government, and the *Medium-Term Financial Outlook* or SFV.[19] As well, in the past

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[18] Tax and customs administrations legislation has been substantially revised over the last year in conformity with the EU's *acquis communautaire*. Under the taxation chapter, closed on March 21, 2002, a Tax Investigations Office and a Large Taxpayer Unit are being established; tax confidentiality provisions specifying requirements for the disclosure of information to relevant authorities of another state and provisions pertaining to international assistance and cooperation procedures have been strengthened.

[19] The *State Budget* includes, in addition to the law itself, an explanation of the annual budget law describing its main policies, objectives, and priorities, an administrative (by chapter) classification of spending, details on reserves and earmarked funds, transfers to municipalities, a schedule of maturing debt, and background on the economic outlook. The Annex to the State Budget contains details on revenues, expenditures by chapter, limits on capital expenditures, a schedule for payments of loan guarantees, detailed spending by function, transfers to municipalities, limits on employment and wages by budget chapter, and transfers to subsidized budgetary institutions. The *Expenditures of Budgetary Chapters Prepared with Program Budgeting* provides details on expenditures by budget chapters and on the utilization of the transfers to subsidized budgetary institutions. The *Budgets of Other Elements of the Public Finance* contains details on the operations of the other components of general government, including state funds, social security funds, municipalities, and privatization funds; summary information is also presented for nonconsolidated general government. The SFV presents information on consolidated general government and government bodies outside central government. All these documents are available at the MOF website http://www.finance.gov.sk/.

year the government also published a summary overview report, the *State Budget of the Slovak Republic 2002*; this document, however, is not distributed outside of government. The state budget contains fiscal aggregates for the preceding fiscal year, the current budget year, and the following year. The main macroeconomic assumptions underlying the budget are disclosed in the budget documentation presented to parliament and to the public.

15. **The publication of fiscal information is prescribed by the Act on Budgetary Rules and by the Act on Free Access to Information**. The general public can obtain the data in the monthly *Bulletin of the Statistical Office of the Slovak Republic*. An advance release calendar is available on the NSO website http://www.statistics.sk and gives one-quarter-ahead notice of approximate release dates; precise release dates are made available no later than one week prior to their dissemination. The general public is informed of the calendar in a notice in the MOF's *Quarterly Review of the Public Finances of the Slovak Republic*. Monthly data on central government operations are available four weeks after the end of the calendar month; quarterly data on central government debt within 13 weeks after the end of the reference quarter; and annual data on general government operations within 26 weeks after the end of the reference year. The data on central government operations cover only budgetary central government and exclude state funds. There is no commentary on fiscal developments accompanying the release of these data or in the NSO's monthly bulletin.

16. **The Act on Budgetary Rules stipulates that the accounting and classification conventions used in the state budget accounts are applied across government, including state funds, municipalities, and self-governing regions.** Beginning in 2003, accounting and classification will also be applied uniformly to the NLO, social security and health insurance institutions, the NPF, and the Slovak Land Fund. The MOF prescribes budget accounting and classification. In practice, government uses the IMF's 1986 GFS classification of government accounts. The budget documents, SFV, and state final account all use the GFS classification.

17. **Defense, security, and police expenditures are shown as a separate category of expenditures in the budget documents.** Certain categories of spending, such as the intelligence service, are secret but aggregate data are published. Defense expenditures are currently equivalent to about 1.9 percent of GDP and are scheduled to rise to 2 percent of GDP by 2006, as part of the government's program for preparing for NATO membership.[20]

18. **Loan guarantees are clearly reported in the budget documents and monitored by the MOF, but liquidation of called guarantees has not always been subject to formal appropriation.** Guarantees are reported in the budget documents by lender, currency, and maturity for a period of up to ten years. They are also identified in aggregate in the quarterly report on central government debt. Twice a year the MOF produces a *Report on Loans with State Guarantees Disbursement* where it analyses risks of guarantees being called. The Act

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[20] Detailed information on defense spending and defense policy is available in English on the ministry's of defense website, http://www.mod.gov.sk, and on the website of the Slovak mission to NATO, http://www.nato.int/pfp/sk/slovakia1.htm.

on Budgetary Rules specifies the conditions under which guarantees can be granted and limits to their issuance, although these limits can be changed in the Act on State Budget.[21] The MOF is the only agency authorized to provide state guarantees. To meet increased calls on loan guarantees—currently about 15 percent to 20 percent of issued guarantees on an annual basis—the state budget provides a "reserve." However, in the last two years government liabilities arising from called guarantees have been assumed by the NPF and liquidated by using a portion of privatization receipts. The estimates of these liabilities have been presented in the 2002 budget. There is no recognition of other contingencies such as the liabilities of public enterprises, pending or threatened litigation, or environmental degradation.

19. **Estimates of tax expenditures and quasi-fiscal activities (QFAs) are neither published nor identified in budget documents.** Some limited information is however available or compiled internally. For instance, the Agency on State Aid reports each year on its website http://www.spu.sk all the forms of direct and indirect assistance as defined under the Act on State Aid, including relief from taxes and penalties. The railway companies internally estimate the costs of carrying out QFAs.

20. **Data on gross debt and financial assets for central government and most of general government are reported in the state final account.** Data on central government debt are also published in the *Quarterly Review of Slovak Republic Public Finances* and on the MOF's and IMF's website as part of the SDDS requirements.[22] In both cases, the data are summary figures on external debt and marketable debt owed to domestic banks and nonbanks, by short-term and long-term maturities. Summary information on general government debt is also contained in the SFV. More detailed information on the composition of state debt by instrument is internally compiled at the MOF, but not published. Financial assets do not include tax arrears. The government does not publish a debt management strategy or a debt management report. Financial assets, including accounts receivable, are reported at face value and published annually within six months after the close of the fiscal year. Financial liabilities include loans for balance of payments support, state bonds, treasury bills, foreign loans, and domestic commercial bank credits. As noted earlier (paragraph 9), government's equity holdings are not reported in the state final account.

C. Open Budget Preparation, Execution, and Reporting

21. **The budget preparation process is fairly open and clearly documented.** The budget calendar is governed by the requirements of the Act on Budgetary Rules. The budget

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[21] While this may result in undue discretion in the issuance of guarantees on a yearly basis, a draft public debt law is addressing this issue by setting an overall cap in nominal terms on the outstanding stock of government guarantees.

[22] The Slovak Republic subscribes to the IMF Special Data Dissemination Standard (SDDS) and meets all dissemination standards with respect to coverage, periodicity, and timeliness of the requisite fiscal data. The data are available in Slovak and English on the MOF website http://www.finance.gov.sk.

envelope, along with its key underlying macroeconomic indicators, is discussed and approved by cabinet by end-April; budget guidelines are issued by the MOF in May; chapters' budgets are discussed between June and mid-August; a draft budget is presented to cabinet by September 30, and to parliament by October 15. Since 2000, a medium-term financial outlook prepared by the MOF Financial Policy Institute (FPI) is an integral part of the budget process. The SFV, which is updated on a rolling annual basis, contains summary information on consolidated general government for a six-year period: the preceding two years, the budget or anticipated outturn for the current year, the draft budget for the immediate following year, and forecasts for the following two years. It consists of revenue and expenditure forecasts at a fairly high-level of aggregation by economic classification. Revenue and expenditure forecasts are based on historical trends and include projected impact of main policy changes. The SFV is presented to the government and parliament at the end of April and updated in the fall.

22. **Annual budget presentation is primarily focused on macroeconomic constraints.** The budget is presented according to the 1986 GFS. For the purpose of monitoring the *Stability and Growth Pact* criteria on deficits and debt, GFS data are transformed to ESA95 conventions.[23] The notification or reconciliation is published annually by Eurostat in the fall but is not part of the budget documents nor is widely distributed. For the first time, the 2002 budget was prepared with a focus on a functional (COFOG) classification of expenditures.

23. **The overall balance of central government is the key fiscal indicator.** The general government balance is also monitored during the year and is receiving increasing attention. The budget and the medium-term financial outlook present primary and current balances. Although all the quantitative information is available, sustainability issues are only discussed in a qualitative fashion. As a requirement for EU accession, the FPI has started preparing cyclically adjusted budget balances and sensitivity analysis for revenue forecasts.

24. **A statement on medium-term fiscal policy objectives is included in the budget documents.** The medium-term financial outlook and program budgeting are the two key tools the authorities believe will assist them in the gradual transition to multiyear budgeting. Four chapters have been presented on a program basis. Objectives and priorities are clearly stated, although the focus remains on the state budget.

25. **Government priorities and main objectives are clearly stated in the *Report on the State Budget*, but performance analysis is limited.** Estimates of new initiatives are clearly distinguished in budget preparation but not in the budget documents. Alternative scenarios are not prepared and main fiscal risks are not disclosed in the budget. The 2002 state budget presents a few estimates of the budgetary costs of reducing income taxes and increasing public pensions. Long-term scenarios (up to 40 years) are occasionally prepared for specific

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[23] Principal adjustments are to convert revenues and expenditures to an accruals basis (mainly interest payments), to exclude financial transactions, and to include the activities of *Slovenska Konsolidacna*.

sectors.[24] However, there is no systematic analysis on long-run implications of ongoing policies, nor of government commitments.

26. **Internal control procedures mainly focus on formal compliance with existing legislation.** The Act on Financial Control and Internal Audit, effective January 2002, lays down the basic rules, objectives, and methods; and outlines the duties of public administration authorities in control of public funds. The act also enhances the role of the MOF as the central authority in the area of financial control and internal audit. Within its responsibilities, the MOF guides and submits summary reports on financial control and internal audit findings to the Slovak government. Penalties are imposed for unauthorized use of public resources. The MOF is also responsible for the professional training of financial controllers and internal auditors, and cooperates with the SAO and the relevant EU institutions.

27. **The accounting system is capable of producing complete and accurate in-year reports on central government budget outturns.** Reports on general government finances tend to be less timely and accurate. Line ministries, state budget funds, and municipalities transmit accounting data to the MOF with a considerable delay (45 days after the end of a quarter). Most general government units have double-entry accounts for receivables and accounts due for payment. The only exception is taxes where there is no accounting for tax assessments; they are only maintained by tax type and by taxpayer in a separate record that contains updated data on tax arrears. The existing accounting system, together with information on tax arrears and on invoices, allows for reports on a wider basis than that of cash. However, whereas information on tax arrears is presented in the state final account, expenditure arrears (currently about SKK10 billion) are compiled only for internal purposes.

28. **Public procurement has been strengthened**. A new Public Procurement Office was established in 2000 as the central state administration body in the field of public and license procurement. Its main competencies include, among others, publication of the *Public Procurement Bulletin*, maintenance of the list of entrepreneurs, and supervision of professional qualifications in public procurement. The office covers contracts whose value is above a threshold of SKK 1 million. In order to fully comply with EU requirements, public procurement rules should apply to public utilities that are currently outside of the mandate of the Public Procurement Office.

29. **Slovak labor legislation has been fully harmonized with EU practice with the adoption of the new Labor Code, Civil Service Act, and Public Service Act in 2002.** The new Labor Code integrates diverse labor market legislation implemented during the past decade into a single law. The Civil Service Act governs, in a comprehensive manner, legal

[24] For instance, the following studies were prepared in 2000 and 2001: *Strategy of Social Security Reform in the Slovak Republic*, which includes a section on "Financing of Pension Schemes in 1996–2015 with Outlook to 2040;" and the *Long-Term Tendencies in Selected Spheres of Slovak Society Until 2015*, prepared by the Forecast Institute of the Slovak Academy of Sciences and discussed at the State Economic Board in June 2000; and the *Draft National Strategy for Sustainable Development*.

relations between civil servants and the state, and lays down conditions for performance of the civil service. It also introduces the concept of civil service employment. The Public Service Act establishes employment relationships based on contractual principles.

30. **Although there is no legal statutory protection, in practice tax administration is independent from political interference.** The Director General of the Slovak Tax Authority (STA) is appointed by, and accountable to, the Minister of Finance. STA is responsible for the uniform application of tax regulations; it also proposes amendments to these regulations, determines the number and organization of tax offices, and formulates strategies for tax administration development. The Customs Directorate is headed by the Director General, also appointed by the Minister of Finance. It coordinates the customs offices, carries out tasks set in international agreements on the control of illegal exports and imports, and ensures observance of customs regulations.

31. **The legislature undertakes quarterly reviews of budget performance**. However, this year for the first time the MOF, with a view to identify risks inherent in the state budget, has prepared a document on *Risks of Noncompliance with the Revenue and Expenditure Targets of the State Budget and Other Components of the General Government in 2002*, which was approved by cabinet in April.

32. **The audited final accounts are available within six months of the end of the fiscal year, as stipulated in the Act on Budgetary Rules**. This act specifies the minimum content of state final account, which must contain an evaluation of the state budget, as well as of the budgets and financial statements of state funds, municipalities, and social security institutions. The state final account contains the statement of the government's financial assets and liabilities, and detailed information on state activities. The act also requires that the government prepare summary outturns for the whole public administration as an appendix to the state final account. The SAO audits the government's financial statements, and the results of its audits and any reservations with respect to the financial statements are included in the SAO's annual report to parliament.

D. Assurances of Integrity

33. **Budget data are relatively reliable, but there have been differences between budget estimates and outturns.** In the past two years, the differences between estimated total revenues and expenditures and actual budget outturns have been significant, reaching 15 percent to 20 percent in 2000–01. These differences, which partly reflect the inclusion of budgetary units' own revenues and associated spending as well as changes in the macroeconomic environment, are disclosed to the legislature. However, a full explanation of these differences is not provided, either in the state budget or in the state final account.

34. **The department of accounting of the MOF prescribes a chart of accounts for all budgetary entities.** The state budget, state budget funds, and municipal budgets are all compiled and presented on a cash basis, as well as the transactions of the social security and privatization funds. The MOF is responsible for informing relevant departments about any changes to accounting standards. Any such changes must be published as an amendment to

the Act on Accounting or an MOF decree. However, a statement of accounting policy is not included in the state budget or in the state final account.

35. **The MOF and NBS data are reconciled on a quarterly basis, but discrepancies tend to emerge.** Fiscal reporting is relatively comprehensive. Discrepancies between MOF accounting data and NBS financing data are due to differences in accounting methods, classification and coverage of general government, and balances of budgetary and extrabudgetary institutions and organizations' deposits with commercial banks.[25] At present, the NBS on the one hand, and the MOF and NSO on the other, do not share an agreed upon list of units covered in the general government. While data on balance sheets are available in the state final account for most units of general government, there is no reconciliation between net debt or net worth and data on deficits.

36. **Independent auditors carry out external audit.** The SAO is established in the constitution as an independent body reporting to parliament, responsible for auditing the management of budgetary resources, state property, property rights, and state claims. Its mandate covers effectiveness or value-for-money audits, as well as financial compliance; it is also responsible for auditing the state final account. The office undertakes its own audits and audits requested by parliament. The chairman of the SAO is elected by parliament in a secret ballot. Its auditors are granted access to premises, records, and documents as required, and can impose fines on those who refuse to provide access. The SAO is required to report to parliament at least annually; in practice it reports quarterly (also on its website at http://www.controll.gov.sk/).

37. **The SAO's mandate and independence were recently strengthened by amendments to the constitution and the 1993 Act on the Supreme Audit Office.** The new legislation grants the SAO with a greater financial independence; it now draws up its own budget, which is submitted to parliament for consideration before being sent to the MOF.[26] The term of the chairman was increased from five to seven years (renewable once). In addition, the SAO's mandate was expanded to cover state budget and extrabudgetary funds, including the NPF, SHDF, and EU and other project funds. The SAO now meets the requirements and principles of the Lima Declaration on guidelines for independent external audit. The SAO also audits state-owned enterprises, where the government has at least a 34 percent interest.

38. **Various bodies are responsible for follow-up on external audit, including cabinet and parliament.** If the SAO identifies defects as a result of its audits, the defects are first reported to the audited entity for remedial action. If a satisfactory remedy has not been undertaken, the SAO chairman brings the issue to the attention of the prime minister. If an agreement is not reached, the chairman may appeal to parliament. The audited entities are to

[25] While the NBS reports on the basis of the bank coding criteria, the quarterly reports of the ministries and state funds are classified in terms of the economic codes, given in the classification manual.

[26] In practice, it is considered by the Committee on Budget, Finance, and Currency.

report back on remedial action taken. In the event that remedies are still not forthcoming, the government is to be informed with further appeal to parliament.

39. **External scrutiny of macroeconomic models and assumptions is permitted and encouraged.** The MOF actively supports the use of external macroeconomic and fiscal forecasts. There are formal institutional arrangements with the Institute of Informatics and Statistics, managed by the NSO, and the Academy of Sciences' Institute of Slovak and World Economy to scrutinize MOF macroeconomic models and assumptions. The MOF draws on expertise of a private company, Economic Consulting, to prepare alternative forecasts of medium-term macroeconomic and fiscal developments. The medium-term macroeconomic framework is posted on the MOF website after parliamentary approval of the state budget.

40. **The national statistics office is given legislative assurance of independence.** The 2001 Act on State Statistics gives the NSO technical independence for the compilation of national statistics. The head of the NSO is appointed by the president for five years, with possibility of renewal for a second term. The Slovak Republic's fulfillment of the IMF SDDS requirements provides further assurance of statistical integrity.

III. IMF Staff Commentary

41. **Over the last two years, the Slovak authorities have taken important steps toward improving fiscal management and transparency.** The authorities' resolve to join the EU has been a key factor in rapidly revising the legislative and regulatory framework. Starting with the passage in 2000 of the Act on Free Information and amendments to the constitution to the recent establishment of a number of independent regulatory bodies, transparency has improved in virtually every aspect of the economic activity in the Slovak Republic; its legislation has been largely brought in line with EU requirements.[27] The challenge is now to implement the legislative reforms effectively, and to ensure that the government maintains a consistent and well-coordinated view of all its fiscal operations. To this end, strengthening administrative capacity to absorb and manage all the changes will be a priority.

42. **The Slovak Republic meets the requirements of the fiscal transparency code in several areas.** Key weaknesses in the coverage of fiscal operations and in budget preparation have been largely addressed. Budget preparation is now cast against a clearly identified medium-term macroeconomic framework and constraints. Budget execution and reporting have now started to use new financial control and internal audit procedures. The quantity, and to large extent the quality, of information publicly available on public finances has also

[27] As of June, 26 of the 30 chapters have been provisionally closed. The chapter dealing with financial and budgetary provisions remains open, largely because of measures required to strengthen administrative capacity to manage EU resources. The Slovak Republic fulfills political and democratic criteria. Important steps were taken to strengthen judicial independence and further progress was obtained in the fight against corruption, notably in translating and implementing the government's *Plan for the Fight Against Corruption* into concrete actions. The November 2001 Regular Report from the European Commission on Progress Towards Accession referred to the Slovak Republic, for the first time, as a functioning market economy which should be able to cope with the competitive pressures of the EU single market.

improved substantially. The integrity of such information is now ensured by clearly defined and independent scrutiny. The Slovak Republic certainly meets all the basic requirements of fiscal transparency. If implementation of new legislation is effectively followed through, there is an opportunity to rapidly move toward best practices.

43. **Further progress is needed in a number of areas to meet all the requirements of the fiscal transparency code.** These include the need for a better definition of the coverage of general government and of the relations between the central and general government and the rest of the public sector; accounting, classification, and reporting of fiscal operations; further improvement in the quality of fiscal data and in the transparency of budget management; and more careful consideration of long-term policy commitments and fiscal risks.

44. **The coverage of general government and relations between central and general governments and the rest of the public sector** could be strengthened by the following.

- First and foremost, the government should revisit the definitions of central and general government to ensure that they effectively comply with ESA95. The State Intervention Agency in Agriculture should be included within the central government, and the coverage of nonprofit organizations that perform government functions should be revisited.

- Key tax sharing agreements between the central government and the regions and municipalities should be established by a transparent formula defined in legislation, rather than left to the discretion of the central government in the annual state budget.

- Financial relations with state-owned enterprises should be clarified by establishing an ex ante dividend policy or a predetermined rate of returns on assets in the budget documentation, and not left to ex post, often arbitrary, policy decisions.

- As privatization continues, the government should develop a view of its core functions and clearly distinguish its noncommercial and commercial activities. Some subsidized central government institutions could be transformed into state-owned joint stock companies to clarify their governance structure.

- The mandate of the NPF should be clarified as to the management of privatized enterprises (which is currently executed by the ministry of economy), since it holds their equity on its balance sheets.

- Government's equity holdings should be listed in the state final account, in addition to the commercial registry, and recorded in its balance sheets at market values.

45. **Accounting, classification, and reporting of fiscal operations** will certainly benefit from the establishment of a state treasury. Some of the following measures should be taken even before it becomes operational, while other measures should indeed be integral part of developing the state treasury.

- The government should publish its annual summary overview report, the *State Budget of the Slovak Republic.*

- A clear and detailed explanation of the differences between budget estimates and actual outturns should be provided both in the state budget documents and in the state final account.

- The reconciliation with ESA95 figures as notified to Eurostat should also be part of the above documents.

- Information on the costs of providing state aid via tax measures, as well as carrying out QFAs, should be compiled and published in budget documents and could later become basis for more extensive reports on tax expenditures and QFAs.

- Available detailed information on composition of state debt by instrument should be published. Similar information should be extended to the general government. Net debt and data on deficits should be reconciled in the state final account.

- The government should develop a plan to progressively adopt accrual accounting in line with ESA95 and the 2001 GFSM. A statement of accounting policy should be included in the state budget and in the state final account. Expenditure arrears should be reported as a memorandum item in the state final account.

46. To improve **the quality of fiscal data and transparency of budget management,** the following measures should be adopted.

- The MOF, the NSO, and the NBS should draw up a uniform and consistent list of institutions that fall under the definition of the general government for the purpose of both fiscal accounting and the monetary survey.

- Moreover, and as a matter of some urgency, government institutions' deposits with commercial banks should be reviewed to ensure full compliance with existing regulations and to strengthen budget execution and reporting.

- The SAO's mandate should include the audit of all enterprises with government participation, not only those with a state interest of at least 34 percent.

- Commercial public enterprises should be audited by the private sector in addition to the SAO.

- The Act on Budgetary Rules should adopt provisions regulating supplementary budgets and the carryover of appropriations from one fiscal year to the next.

47. Budget documents should better reflect **long-term policy commitments and fiscal risks.**

- Given that most of the necessary quantitative information is already available in budget documents, a more rigorous sustainability analysis of the existing policy commitments, as well as of the implications of new commitments, should become a mainstay of future budget documents.

- Contingent liabilities, other than government guarantees, should be reported. These include the liabilities of public enterprises, pending or threatened legislation, and environmental degradation. The MOF's *Report on Loans with State Guarantees Disbursement* should become integral part of the budget documents and made publicly available. Similar reports should be developed on other contingent liabilities.

- As soon as the Debt and Liquidity Management Agency is operational, its first task should be developing and publishing a document outlining the government's debt management strategy.