



STATE AUDIT
OFFICE OF HUNGARY

THESES ON THE REGULATION OF PUBLIC FINANCES

April 2007

Table of Contents

INTRODUCTORY THOUGHTS TO THE THESES ON THE REGULATION OF PUBLIC FINANCES	5
THESES	11
Thesis No. I: The key issue for successfully reforming the public sector is modern regulation of public finances.....	11
Thesis No. II: Regulation of public finances requires major modernisation.....	12
Thesis No. III: Regulation of public finances should be based on internationally accepted principles confirmed by domestic political consensus.....	13
Thesis No. IV: The cornerstone of regulating public finances is accurate specification of public duties	14
Thesis No. V: The new regulation of public finances should distinguish two levels within the state budget.....	14
Thesis No. VI: Regulation of public finances is necessary, which embraces the entire staff and procedure of public fund management.....	15
Thesis No. VII: The new regulation should ensure exercising the budgeting right of the National Assembly and the representative bodies, as well as the responsibility of the executive power.....	16
Thesis No. VIII: Budgetary balance is a fundamental requirement to sustainable development.....	17
Thesis No. IX: The regulation should ensure transparency of collecting and allocating public funds, irrespective of the economic actor performing these.....	18
Thesis No. X: The principle of "value for money" should be ensured on budgeting and allocating public funds	19
Thesis No. XI: Appropriate rules should be applied to economic management and information systems to cater for the conditions of reasonable and economical economic management at the level of institutions.....	20
Thesis No. XII: An important establishment for compliant and successful economic management is a system of internal control.....	21
Thesis No. XIII: Adjustment of the public funds audit system to the new requirements is inevitable	22
Thesis No. XIV: Regulation of public finances should be predictable and relatively stable	22
Thesis No. XV: For predictability of the system of public finances and development of public confidence, the fundamental rules need to be incorporated in the Constitution.....	23

JUSTIFICATION.....	25
For Thesis No. I.....	25
For Thesis No. II.....	26
For Thesis No. III.....	27
For Thesis No. IV.....	31
For Thesis No. V.....	33
For Thesis No. VI.....	34
For Thesis No. VII.....	36
For Thesis No. VIII.....	38
For Thesis No. IX.....	41
For Thesis No. X.....	42
For Thesis No. XI.....	45
For Thesis No. XII.....	48
For Thesis No. XIII.....	50
For Thesis No. XIV.....	50
For Thesis No. XV.....	51

INTRODUCTORY THOUGHTS TO THE THESES ON THE REGULATION OF PUBLIC FINANCES

1. The necessity of a new regulation for public finances

At the time of the regime change, the Republic of Hungary inherited serious internal and external public debts. In the early 1990s, financial instability was further intensified by a dramatic drop in the production and employment levels. The system of state duties built upon full employment was impossible to sustain. As a result of reforms and stringent measures implemented, the country's financial situation consolidated by the mid-90s, and kept improving until 2001. After that, however, the financial balance was broken again. Government overspending seen particularly in the election years only temporarily remedied the conditions of economic growth. By the middle of the decade, unsettled public finances became a hindrance to economic competitiveness, and weakened the foundations of sustainable development. Operating the system of local governments represents a serious risk factor both in terms of financial balance and the absorption of EU funds. All these necessitate a comprehensive re-regulation of public finances.

2. The objectives of the new regulation

Renewing the regulation of public finances serves a dual purpose. The direct goal is to establish rules and institutions and to find technical solutions that render public funds management more transparent, predictable and efficient both at the level of national economy and institutions. The ultimate goal is, however, to improve the internal and external conditions to competitiveness and sustainable development by means of a better system of public finances, financial balance and an increased confidence in it.

3. The role of the State Audit Office in a renewed regulation of public finances

Based on its experience gained through producing audits, opinions on budgetary bills and final accounts, the State Audit Office has tabled multiple proposals for a comprehensive modernisation of regulating public funds management. In order to catalyse the renewal of regulation, the SAO offered to lay the foundations of a new public finance regulation. The SAO was not lead by the intention of extending its audit licences in the process. On the contrary, our experience proved that subsequent auditing tools provide no remedy for public funds leaking for structural reasons or for overspending driven by political intentions. Consequently, more regulation, transparency and predictability need to be added to the entire management of public funds.

Under the foundation work, a number of partial studies have been produced - with the involvement of external experts -, international experience reviewed and professional debates held. The most relevant documents will be subsequently published by the Development and Methodological Institute of the SAO in a dedicated volume of studies. The study summarising the research is accessible at the SAO's home page at www.asz.hu, and it will be made available in a written format as a background to this document to those interested. At the same time, the SAO's initiative role has its boundaries in terms of constitutionality and reason. Then SAO is not licensed to present bills to the National Assembly, but it would not be justified for the SAO to assume the whole process of developing a bill entirely by itself. Consequently, the point we intended to reach in terms of preparing the new regulation was where we no not transgress our scope of authority, but are able to provide palpable and proficient help to establishing a comprehensive legal regulation with a new approach, and are ready to cooperate in producing various regulatory concepts, specific plans for regulation and feasibility studies and impact analyses highly appreciated by us.

4. Justification for presenting the proposal in the form of theses

As an organisation reporting to the National Assembly, the State Audit Office attempted to word its proposals in a way that facilitated direct utilisation in the legislative work as much as possible. Our compilation entitled "Theses on the regulation of public finances" (hereinafter referred to as the "Theses") contains the major principles of the proposed regulation, the breakout points, methods and the justification for the theses organised under points. We intend to offer a facility for the National Assembly to accept the SAO's initial proposals as

the basis of further work - provided they are suitable for support. We hope that the "Theses" will convince all members of the Hungarian National Assembly of the necessity of change, appoint the course of modernisation, and on these bases, the modernisation work on the legal regulation of public finances will accelerate and yield actual results still in this parliamentary cycle. For this reason, we primarily attempted to highlight issues important for political decision-making on formulating the theses, avoiding a too deep and detailed description of professional relations.

The topics have been arranged around working titles. The key notions presented in the title are followed by a brief explanation. An elaborated analysis and our arguments are provided in the Justification. This structure also underlines that we have produced a compilation to find a common denominator – necessary for the consent –, which, instead of closing, is intended to catalyse the work aimed at modernising the regulation of public finances.

5. The subject of regulation for public finances

Very consciously, the "Theses" do not address a renewal of the public finances act only the regulation of public funds. A modern aspect of the state and public sector requires the scope of public finances regulation to be systematically extended to organisations managing public funds outside the state budget. This is how we are able to meet global challenges, European requirements, but this is also what our domestic experience suggests. In the past few years, a global tendency whereby organisations outside the public finances play an increasing role in performing public duties has also evolved in Hungary. Audits performed by the SAO have revealed that the risk of public funds leakage is the highest at the points where the public and private sectors meet. Only a new approach in the regulation can eliminate this risk, where the application of public funds is in the focus of regulation instead of the organisation of public finances. At the same time, the notion of public funds should be construed extensively: all revenues under public law (including waived taxes), contributions to public services, the portion of state assets represented by funds and all revenues from the utilisation of public assets should be deemed as public funds.

6. The two major messages of the “Theses”

The most important message of the ”Theses” is to lay the regulation of public funds management on solid foundations and enforce the principles through the entire regulation. The „Theses” lay down the key principles and outline the courses of regulation along the lines of which these may be enforced. We consider it important to reach a political and societal consensus on the principles.

The second emphatic consideration of the ”Theses” is that modernisation has not left public funds unaffected. The development of information technology requires the key rules of the public funds information system to be formulated also at the level of legislation. Our accession to the European Union and to other international organisation justifies reflecting the standards developed by these organisations for the public sector also in the Hungarian regulation. The technologies of budgeting and economic management have developed. The application of these should be given or even cleared the way in the Hungarian public funds management.

7. Graduality in renewing the regulation for public finances

The renewal of public funds management is probably not possible by passing a single law, or incorporating a few easy-to-implement thoughts of the ”Theses” in the existing regulation. Besides renewing the entire legal regulation, the “Theses” offer proposals for a systematic re-regulation of certain blocks in the public funds management. Certainly, it is not a duty of the SAO to decide whether the legislator should regulate certain blocks in a single law or in various laws. An indispensable requirement is to regulate the financial relations of the central and the local levels in a more stable and transparent way compared to the current state, adjusted to the changes evolving through the distribution of tasks. Ultimately, modernisation may be implemented without modifying the Constitution, but the reform would be complete if a chapter designating a constitutional framework for public funds management was added to the Constitution. Consequently, we make a proposal for the key content elements of the amendment of the Constitution.

In the ”Theses”, we do not initiate establishment of new institutions. To our assessment, institutional solutions are derived from the tasks, and it is primarily the provision of public duties that need modernisation, placing the relevant regulation in the foreground. If the

necessary new state functions are defined, it is reasonable to assess the impact of these on the system of institutions, and to set up optimal institutional conditions.

8. Coordination of the “Theses”

The preparation of the ”Theses” was preceded by broad coordinating discussions, attended by a number of competent politicians and theoretical and practical experts. Dedicated discussions were conducted with the Minister of Finance and his staff, members of the Government, the leaders of parliamentary factions and the relevant parliamentary committees, ex-ministers of finance and presidents of the central bank. The members of the presidency of the Hungarian Economic Society also formed an opinion on the material, departments of financial law of multiple universities.

Everyone pointed out the timeliness and importance of the regulation of public finances laid down in a uniform structure and supported by impact studies. According to the majority opinion, it would be reasonable to add a public finance chapter to the Constitution to serve as the basis of legal regulations, for the stability of regulation. Generally, agreement was reached on the problems and proposals raised in the “Theses”.

We made efforts to consider the proposals and observations received, but the diversity and occasional argumentative nature of these also made us formulate our own stance, basically. Consequently, in the issues we received contradictory opinions, we maintained our earlier professional opinion based on our auditing experience.

Some, for instance, voiced their doubts in respect of whether the duties of the state can be determined accurately and in a normative way. In their opinion, these can be continuously adapted to the changes of life and the financial position of the state. We consistently maintain in this issue that the reform of public finances can only be successfully implemented if at least medium-term stability and predictability is achieved in defining state duties.

9. Further work

In the “Theses”, we did not intend to formulate a detailed regulation concept that could be immediately and directly used for codification. On the contrary – in harmony with the act on legislation and the requirements of quality legislation –, we consider it necessary for a regulation concept and detailed impact studies to precede legislation. In the course of this, in

addition to assessing the general social and economic impacts of a more modern but stricter regulation, particular attention needs to be paid to the institutional and structural changes necessary for new tasks, to establishing the conditions of adoption and that the rules applicable to the central and local levels of public finances should be duly differentiated and harmonised at the same time.

The development of the theses of the new public finance regulation by no means suggests that the work currently under way in the Ministry of Finance aimed at modernising the public finance act adopted in 1992 and amended innumerable times since is unnecessary. The two endeavours are not contrary to each other but complement each other. In the theses, the regulation of public assets or potential organisational forms of budgetary institutions are only addressed tangentially, as – to our information – practically complete draft bills are available for these issues. The “Theses” argue for a comprehensive modernisation of public finance regulations. Its specific proposals concerning the system of public finances or the budgetary economic management can, however, be incorporated in the legislation preparatory work currently under way.

Concerning the report on the work carried out in 2006, this “Theses on the regulation of public finances” is delivered to the National Assembly with the offer that the State Audit Office is prepared to participate in the preparation of the new public finance regulation through quality legislation by offering the research base of the Development and Methodological Institution.

Budapest, April 2007

THESES

Thesis No. I: The key issue for successfully reforming the public sector is modern regulation of public finances

The competitiveness of the Hungarian economy considerably depends on the capacity of public institutions and the quality of their operation. The fundamental purpose of public finance reforms is to establish conditions whereby the decision-makers pass responsible decisions on public funds, the rights and obligations of users are unambiguous, and the costs, profits and results of operating and transforming the public sector are clear. A necessary but insufficient condition of institutional reforms – by which we mean the reorganisation of the system of operating rules and organisation – is the modernisation of the conditions of the public sector's economic management. The required solutions

- restore public confidence, facilitating – actual or tacit - social agreements among the fundamental interest groups and various generations;
- ensure the predictability of fundamental institutions (tax system, pension system, social benefits, etc.), social solidarity and equitable sharing of public dues;
- enforce responsible exercising of the budgeting right of the legislature and the local bodies of representation;
- harmonise the tasks and the allocated resources concerning both the governmental levels and the areas of public policies, and
- require the managers and users of public funds to pursue responsible and transparent economic management.

Reasonably, institutional reforms should be represented in the legislation first. Clear legal regulation is the basis of any change in terms of quality. Predictable and enforceable rules of public finances are also considerably weighted in terms of regaining international confidence. The development and passage of laws reflecting the best international practice would demonstrate the existence of consensus in the key issues of public funds regulation within the country, and of sufficient determination to implement the necessary reforms.

The new provisions of law related to public funds should ensure that the legal security for the operation of the public sector is not more risked by political conflicts than to a minimum extent. This is the key issue of authenticity in the current Hungarian economic policy.

Thesis No. II: Regulation of public finances requires major modernisation

There is a need for comprehensive modernisation of the laws mainly passed in the early 1990s, determining the operation of the public sector, including the planning, collection and utilisation of public funds. The legislature and the legislation preparatory staff attempted to adapt to the changing requirements by continuously amending these laws and the related implementation decrees. Due to the innumerable amendments – each justified in itself –, the regulation of the economic management of public funds is complicated even to the law appliers. In many cases, it is not clear which issues to regulate in law and which in decrees. Today, unjustified deviations exist in both directions. Regulation by law calls for extension both in terms of contents and depth compared to the currently effective laws, i.e. multiple regulatory subjects can be and should be transferred from today's decrees to new regulation by law with more current contents. At the same time, we often find provisions of procedural nature stipulated in laws, which could be regulated in decrees as well. A review of regulation with a view to deregulation would also be relevant.

The approach and terminology of the current regulation of public finances is obsolete, and is outdated by development, primarily as a result of our accession to the European Union. International literature, and practice in the wake of it, brought considerable changes in the regulation of public finances in the second half of the 1990s. International organisations adopted a number of financial, “good governance”, auditing, accounting and statistical principles that would be essentially justified to be incorporated in the domestic regulation of public finances, similarly to the leading foreign methods of budgeting and public finance management. Continued use of the proven elements of the domestic regulation is certainly expedient.

Transparency should be added to the structure of public finance regulation. It would be necessary to stipulate the principles of public funds management in law (possibly the Constitution), with an effect applicable to all laws on public finances, laying the foundations of the rules for such laws. Relying on this, the regulation of public finances – according to a

systematic approach – is expediently divided into blocks. (It is not necessary, however, to regulate each block in a separate law; what is more, separation of the various topics would break the uniform logic of regulation.) The recommended blocks of regulation are:

- budgeting and final accounts;
- information management and financial management (commitments, preliminary audits, allocation, payments, cash management, management of obligations and claims, accounting);
- definition of the organisational forms of organisations operated under state budget control, their legal status and rules of economic management (the so-called status issues);
- regulation of balance-related issues of the budget, the system of budgetary responsibility, and
- economic management of public assets.

Thesis No. III: Regulation of public finances should be based on internationally accepted principles confirmed by domestic political consensus

In developed and democratic states and in international organisations, the principles and best practices that should be represented in the modern regulation of the public sector have crystallised. International recommendations can only be actually beneficial if the adoption is confirmed by domestic professional, political and social consensus.

On developing the new regulation, the majority of indispensable principles can be identified using our current knowledge. On regulation, the principles of representation of the people and limited authorisation should be materially applied. We consider it a fundamental principle to ensure broad transparency, directly supported by full compliance with the principles of publicity and controllability. (For example, in addition to current expenditures, the resulting financial commitments and determinations should also be disclosed.) The principles of performance-orientation, foresight and sustainable balance should be enforced in budgeting and economic management. The representation of all these principles can be ensured by actual application of the principles of completeness and specification. These principles need to be complemented by consistent representation of the principle of authenticity.

Thesis No. IV: The cornerstone of regulating public finances is accurate specification of public duties

Public financing becomes uncontrolled and intransparent if the state does not pass a clear-cut decision on specifically which assets and services it wishes to provide itself. Unambiguous assignment of each task to a governmental level is also crucial. Declaring a task as a public duty (state or local governmental duty) is a legal act. Full listing of all state functions and duties cannot be resolved under a single law, and this cannot even be a task of public finance regulation. At the same time, the procedure of defining tasks requires prudent legal regulation. As a consequence of the currently valid constitutional rules, state duties include establishing the internal/external security of the country, ensuring democratic operation of the state organisation, maintaining the institutional guarantees for enforcing fundamental rights. These frameworks also provide the bases of the new regulation. The new law (or the Constitution) should necessarily stipulate

- that public duties may only be allocated by law, concurrently designating the necessary resources and the responsibilities for each task;
- that the minimum scope of public duties should be defined to avoid the prevention of rights stipulated and institutions listed in the Constitution, and
- that the services provided by the state should be available to those affected (entitled), providing equal opportunities.

Catering for public duties obviously incurs public expenses, and raising and distributing the funds necessary for financing public expenses is an privilege and an obligation under public law derived from the Constitution and other provisions of law. Public duties, however, can also be provided by natural persons and/or private enterprises, under contracts and assignments.

Thesis No. V: The new regulation of public finances should distinguish two levels within the state budget

It seems expedient for the new public finance regulation to define central and local levels instead of the two levels and four subsystems defined by the current regulation of public finances. The central level includes the current central budget, the Pension and Health Insurance Fund and the dedicated state funds. The independence of each of the latter funds

needs revision. Special rules may remain applicable to social security and dedicated state funds in the future, too. This, however, does not justify handling these as a separate subsystem.

The second level comprises budgets for local governments (minority self-governments). The financial relations of the two levels need regulation, with special regard to the harmony, predictability and transparency of tasks and resources.

The accepted principles of public funds should be enforced at both levels of public finances, however, the particularities of the two levels should be considered to the utmost on regulation and selecting the methods.

Thesis No. VI: Regulation of public finances is necessary, which embraces the entire staff and procedure of public fund management

The theoretical (transparency, controllability, etc.) and general rules of the new legal regulation should be extended to all entities managing public funds, irrespective of the organisational form and ownership relations. A narrower scope of rules will be valid only for the actors of the public sector (organisations under state budget control and organisations outside state budget control but directly related to the state in terms of foundation and financing). The effect of certain special rules of law will be exclusively applicable to organisations related to public finances and under state budget control.

A fundamental issue in regulation is clear and accurate terminology (public sector, public finances, public funds, etc.). On defining and construing terms, the solutions evolved and accepted in the international practice are applicable. The public finance regulation should specify the notions of governmental sector and public sector. The reason is, on the one hand, that these are indispensable for supplying sufficiently accurate data related to the convergence programme. On the other hand, the way non-governmental organisations of the public sector participate in budgeting, data supply and reporting needs to be defined.

The new regulation should use the broadest notion of public funds as a starting point, regarding all revenues under public law, contributions to public services, the portion of state assets represented by funds and all revenues from the utilisation of assets as public funds.

The regulation that adopts a new approach should embrace all movements of public funds management observing identical principles, i.e. the principles accepted here should be

promoted not only on passing new legislation but also on amending older legislation that cannot be abolished for the time being.

Thesis No. VII: The new regulation should ensure exercising the budgeting right of the National Assembly and the representative bodies, as well as the responsibility of the executive power

The currently valid regulation grants unjustifiably great liberty for the current governments (chapters, institutions) to regroup various appropriations accepted in the budget act, while overloading legislature with a large quantity of unmanageable information.

The purpose of the new regulation is to establish securities in the system of budgeting (the presentation and the acceptance procedure), reporting and settlements that guarantee for the substantial decisions related to the distribution of public funds to be actually passed by the National Assembly and the representative body of local governments. For this reason, the actual decision-making options offered by the current political decision (budget) need to be clarified. The formal political acceptance of previously decided and basically automatic expenses from year to year may just as well deprive political responsibility of its substance as the intransparency of decision preparatory materials. It is important for MPs/representatives to pass decisions only in substantiated situations of decision-making. It requires voting units, i.e. the tasks and appropriations MPs/representatives actually need to pass decisions on, to be adequately defined in budgetary documents. Politics should decide on aggregates that adequately promote political preferences and accountability in terms of implementation, but do not disturb the operability of implementation.

In terms of regulation, flexibility indispensable for reasonable implementation of the budget needs to be ensured, however, the practically unlimited possibility of regrouping appropriations without parliamentary controls should be eliminated. The environment for implementing budgets is rather variable, which requires the conditions for flexible responses. The current regulation of setting up a supplementary budget is easily avoidable, while the rules of procedure are rather complicated and time-consuming, for which reasons the obligation to prepare a supplementary budget does not comply with the intended role. Establishing new, more flexible conditions for budgeting under the National Assembly's control would facilitate better implementation – besides promoting the principle provided in the thesis.

Another important means of providing parliamentary control over the executive power is the acceptance of the final accounts. The National Assembly can exercise its jurisdiction materially if the structure of the final accounts is bound to be identical with the structure of the accepted budget. It is worth considering assigning legal consequences to the non-acceptance of the final accounts – except in a period of government change.

Emphasizing the responsibility of executive power in general raises the issue of legal consequences. Intentional or negligent violation of rules related to public funds currently incurs sanctions under labour law and – in particular cases – criminal law. The proposed new public finance regulation that lays down the general principles of public funds management (transparency, completeness and specification) not only in general but also in specific provisions, may represent great progress in this field. With the existence of specific provisions, the responsibility under labour law or criminal law can be construed for those violating the rules of publicity, completeness or authenticity intentionally or through negligence.

Thesis No. VIII: Budgetary balance is a fundamental requirement to sustainable development

In the current situation of public finances, the challenges of budgetary equilibrium and financial stability (sustainability) are placed in the foreground. Foreign experience shows that – in case of adequate political intentions – adoption of a rule-based budget and/or involvement of independent institutions may present a solution. The convergence programme or the criteria applicable to the Euro zone define the requirements of equilibrium applicable to the entire public sector. In order to comply with these, it is reasonable to stipulate the rules that ensure budgetary equilibrium and sustainability in law for each level of public finances. These rules are to be confirmed by procedural rules aimed at nipping overspending in the bud. Such a requirement may be, for instance, that a financial impact study is required to be submitted with any act affecting the budget, indicating the extra financing requirement of the act and the related resources. On budgeting, appropriate reserves need to be generated to handle risks endangering the equilibrium, and financial sanctions need to be applied if the expense appropriations are exceeded.

However, a public finance equilibrium, i.e. a sustainable budget, is a necessary but insufficient condition to the country's actual objective, i.e. sustainable development. A

budgetary equilibrium cannot be ensured through overtaxation or curtailments risking the provision of fundamental state duties, even in the medium term. The efforts made to reach a budgetary equilibrium may not jeopardise the competitiveness of the economy, the welfare of the population either on the revenue or on the expenditure side, but it is the sharing of public dues and public expenditures that are precisely aimed at reinforcing these. This requirement again confirms a necessity for a comprehensive public finance regulation by emphasizing that commitments made for public expenditures and waiving public revenues should be assumed considering the principles described above.

Thesis No. IX: The regulation should ensure transparency of collecting and allocating public funds, irrespective of the economic actor performing these

Transparency is an important value of public finance systems. When implemented, it contributes to restoring public confidence, reducing losses derived from various irregularities, and may improve financial discipline. Transparency may significantly reduce the costs of handling public debt. In providing state duties, an increasing role is assigned to organisations in the non-governmental sector. For public-private partnership to be fruitful for the public, all users of public funds need to be accountable. Transparency is ensured by an adequately organised information system, and the publicity of processes and decisions. Information should be available to an appropriate depth and with contents specified in international standards – i.e. also in compliance with administrative, economic and functional classifications.

As a result of transparency, risks intrinsic to the whole and various parts of public finance should become known. An important condition of revealing these is for the state accounting to demonstrate the change in the financial standing of the sector, the off-balance sheet risks and the risks related to tasks provided outside the public finance. (These include various state receivables, conditional and contingent liabilities and receivables from and liabilities to business organisations owned by the state/local governments.)

Another important requirement is transparency of the financial legal system. The regulation of public finance should contain securities for the stability of legal provisions affecting both the revenue and the expenditure sides, and, if any changes are necessary, the transparency of those.

Publicity, at the same time, is also a security for political competition to be materially promoted on elections. This would also be the purpose of a statutory report issued – with pre-defined contents – prior to elections, which would explain compliance with the government programme and, in connection with that, the situation of the budget, with special respect to any future risks thereof.

Disclosing the details of public assets management may not be limited by the protection of business secrets. At the same time, it needs careful deliberation what should and what can be disclosed of public finances, in order to avoid premature disclosure of data (on public procurements or debt financing, for instance) weakening the business position of the state.

Thesis No. X: The principle of "value for money" should be ensured on budgeting and allocating public funds

The principle of performance orientation can be promoted in public finance regulation by enforcing the principle of "value for money" for economic management – from budgeting to providing specific services. This means that each forint of the budget should be used effectively and efficiently.

In the current practice of budgeting, performance-orientation is not promoted: instead of the actual resource requirements of each task, budgeting takes the evolved situation as a starting point, and the central allocation of resources is not based on performance requirements. This is what programme-based budgeting would change.

A significant and increasing part of expenses should be planned based on the relevant programmes. The system of programmes consists of major programmes, programmes and sub-programmes. According to international experience, the central budget of a country contains 30-40 major programmes in general. The programmes within each major programme would be the voting units for decisions on the budget. The programmes may be permanent or temporary ones. Typical cases of temporary programmes are capital expenditures, but these could also be programmes of transition to a programme-based budget. The voting and the decision-making procedure are different in case of the two programme types. It is recommended that a programme-based budget is adopted for EU funding programmes and mostly ministries with "chapter managed appropriations", as a first step.

The remaining balance of budgetary expenses are to be planned in an institution-centred way, starting from the resource requirements of maintaining apparently necessary capacities, which are not necessarily identical to baseline budgeting.

An opportune field for using programme-based budgeting is the system of local governments where experimental projects have been staged since the mid-1990s. At the same time, the introduction of new budgeting methods for local governments requires a differentiated approach and in certain cases longer time.

Subsequent to budgeting and in the course of economic management, performance orientation can be promoted by assigning performance indicators to the application of budgetary appropriation, and monitoring compliance with these at the levels of organisation, sector and government.

Thesis No. XI: Appropriate rules should be applied to economic management and information systems to cater for the conditions of reasonable and economical economic management at the level of institutions

Performance orientation needs to be ensured even at the fundamental levels of implementing budgets, i.e. with budgetary institutions. Depending on the nature of public duties, regulation should define the legal status and rules of economic management of organisations under state budget control in a differentiated way. For budgetary organisations performing public services a flexible environment of economic management needs to be created, which – without prejudice to the principles described above – does not diminish their competitiveness compared to enterprises performing similar services.

The modern budgeting methods outlined in the previous section should be complemented by the creation of institutional conditions suitable for performance measuring. What is necessary for this is that the information systems of budgetary organisations provide better service to the heads of these organisations and supervisory (steering) bodies. An important condition to adopting programme-based budgeting is transition to the modified (partial) accrual accounting. The preparation of this presumes a thorough professional discussion and focussed work.

The greatest shortcoming of the current information management is that it does not apply a systematic approach in managing the accounting and statistical information generated in the

public sector, nor the information systems. Today, institutions are required to supply an excessive quantity of details, unutilised.

Budgetary institutions use a somewhat modified version of accounting developed for companies. Development of a state accounting system seems necessary, which is better adapted in terms of approach to the peculiarities of budgetary management, and provides a better service in response to the management information requirements of the government and local governments. By consistent promotion of international standards applicable to the governmental sector, such a regulation can be developed. In the course of this, particular attention needs to be paid to a complex reflection of financial risks in the public sector and of changes in the public assets. The current practice of disclosing the accounting issues regulated by law for the competitive sector only in government decrees for budgetary institutions cannot be maintained. This is justified to be regulated by law instead.

Thesis No. XII: An important establishment for compliant and successful economic management is a system of internal control

The internal control system for public finance includes the objectives, guidelines, operating procedures and rules set up by the management of the respective organisation. Without operating this control mechanism, it is not possible to make the organisation ensure economical, effective and efficient implementation of its mission and various efforts, operation in line with the relevant legislation and internal rules, protection of the organisation's assets and information, the appropriate quality of the accounting information system, reliable and timely annual financial reporting, avoidance and investigation of faults and frauds. An important function of the renewed regulation is to cater for this area, which is also neglected by the current regulation, in a way that reflects its significance and complies with the international standards. The notion and significance of internal control mechanisms need to be incorporated in the new regulation, and it should be declared that the elements and structure of internal control systems to be set up at the level of each institution – relatively independently – should comply with the international standards. The basic requirements related to the independent internal control function within the internal control system are justified to be laid down in law. Parallel to this, the current regulation by decree should be eliminated.

Thesis No. XIII: Adjustment of the public funds audit system to the new requirements is inevitable

Auditing is a priority function of public funds management. On specifying the new regulation, the audit system needs significant improvement. The workload shared by organisations providing internal audit functions needs to be specified in a clear and unified structure (Hungarian State Treasury, organisations performing audits related to the EU funds, supervisory audits and organisations performing internal institutional audits). It is particularly important to promote the principles of effectiveness, efficiency and economy over the whole audit system. Concerning the changing functions, it needs to be indicated that an increasing emphasis is placed on compliance with the professional requirements of the plans and the performance evaluation of each area, in addition to traditional compliance auditing.

A changing role of external audits and a broadening scope of tasks represent an international tendency. The SAO's audit licences need no extension, but the changes of the whole public finance regulation may justify further specification of these. Audits performed by the State Audit Office increasingly focus on revealing the financial and operating risks in public finances, and the advisory role performed for the legislature is growing.

Audit capability is necessary not only for financial but also for professional reasons. Enforcing various controls derived from the peculiarities of specialized duties is a task of specialised audits. The activities of these also need to be made more coordinated.

Modern democracies set up adequate audit facilities also for civil organisations. Instead of replacing them, these supplement the audit facilities of state organisations. In order to enforce a targeted spending of public funds, the controlling role of publicity is worth utilising.

Thesis No. XIV: Regulation of public finances should be predictable and relatively stable

On regulating public finances, the requirement of long-term predictability and social acceptance of the state's behaviour, as well as public confidence in new solutions are attached key significance for the participants of the economy. For this reason, the stability of regulation and the avoidance of frequent modifications are particularly important for legislation on public funds. Predictability includes: careful preparation of laws (impact studies, social coordination, consideration of local government specialities), creating harmony

among various blocks of the law, and specifying the effective dates of laws in a way that leaves sufficient time for preparing for the application thereof. The proposed regulation of public finance adopts a completely new approach, new methods and techniques compared to the domestic practice in the systems of budgeting, final accounts, state accounting, auditing and financial control. For this reason, providing as much as years between the acceptance and putting in to force of new rules may be justified, or a phased enforcing of new provisions. An important requirement is that implementation decrees are known subsequent to announcing new legal rules but well before they come into force, including the requirement that sufficient time is also available for local governments to create their own implementation decrees.

Establishing – or maybe codifying – a practice whereby at least a year’s preparation time is provided for completely new rules applicable to public finance (including the adoption of new tax types) between announcing and putting into force.

Thesis No. XV: For predictability of the system of public finances and development of public confidence, the fundamental rules need to be incorporated in the Constitution

If no majority is available on this in the National Assembly, the regulation of public finances by law may be implemented without changing the Constitution. The regulation, however, would be complete, and would best serve the financial security of citizens and increase the confidence of actors in the money market if constitutional guarantees were set up to enforce the major principles of public finance (e.g. authorisation of people’s representation, transparency, completeness, specification, sustainability).

Such a guarantee would be, among others, to require a budget to be produced for each calendar year, and the implementation thereof to be accounted for under the final accounts within a period defined in the Constitution; equilibrium to be ensured between the expenditure and revenue sides of the budget to be prepared following the new approach; in addition, to budget for the required financial cover to provide each state duty.

The Constitution should indicate the function of final accounts: settlement by the government, and in case of acceptance, release from the obligation of implementing the budget. Bills on budgeting and final accounts may exclusively be tabled by the government, and these bills may not contain amendments to other laws.

The Constitution should define the notion and exact contents of sharing public dues – more accurately than currently –, detailing each form of sharing public dues: the persons and their organisations are required to contribute to covering the expenses of common needs based on their participation in the economic traffic, their revenue and financial statuses, activities, in line with their ability to bear burdens, especially with taxes, duties, contributions, customs and the consumer contributions payable for public services used (collectively referred to as: public dues).

In addition, the supreme law should provide for a situation where the National Assembly has not created the budget act for the next year in due time. In such cases, the government should immediately submit a bill on transitional economic management to the National Assembly. Such a law loses effect on the day the new budget act comes into force, and on the date defined in the Constitution at the latest. Until the law on transitional economic management is created, or if that law has lost effect before the new budget act was put in to force, the government is authorised to collect the revenues under the relevant legislation and to perform the proportionate expenditures within the expense appropriations of the previous year's central budget.

JUSTIFICATION

For Thesis No. I

Successful implementation of reforms affecting the public sector and, as a result, better operation of the whole public sector is unthinkable without material modification to the public finance system. The system of public finance can be considered as the circulation system of the public sector, which facilitates the implementation of objectives in terms of strategy, politics and policies. This system provides for the resources necessary for operating the government and implementing the goals, a distribution of resources among the various governmental levels and areas in proportion to tasks, reducing unjustified differences in income among social groups, regions, towns, economic sectors, appropriate motivation of and control over participants implementing policies, as well as managing financial risks of government activities.

There are permanent conflicts among participants of the public sector (politicians deciding on the application of public funds, competent implementing apparatuses, various sectors and public administration levels), due to the nature of things. The system of public finance has a key role in transforming these into positive energies. Today, performance-oriented budgeting, a presentation of actual decision-making options are absent, settlements of public funds are deficient, as is an adequate system of institutions for settlements related to the application thereof.

The most salient feature is a lack of legal security, caused by the state not only as the legislator but also as a law applier, or even at times as a market actor. A number of provisions of law affecting the operation of the public sector are not observed by state organisations either. The main reasons for an absence of law-abiding behaviour are intransparency of the legislation, lack of a financial background for the requirements formulated for the laws of the relevant profession and permanent changes to the legislation. Violations of law deriving from intentional and negligent behaviours can be investigated by the current control system only on an occasional basis. The corruption situation is not improving, what is more, it seems to be deteriorating. This is dangerous because it causes a direct loss of growth through leakage of a significant portion of resources, on the one hand. This danger is intensified by the influx of EU funds. On the other hand, it is detected that foreign economic actors adapt to the situation here, and this affects the circle and behaviour of future investors.

For Thesis No. II

The Public Finance Act (PFA) and its implementation decrees, as well as the laws regulating certain elements of the public finance need a thorough revision. We only point out a few of the anomalies well known in professional circles. The key implementation decrees to the PFA regulate a number of issues (e.g. reporting obligations, requirements for controls) that are specified in laws for the competitive sector.

It is not only the principles of regulation through decrees and through laws respectively that are unclarified, but a number of contradictions can be found in the legal rules governing the public sector. For the legal regulation of organisations performing public duties, the fundamental legislation, the PFA and Act No. IV of 1959 on the Civil Code (hereinafter referred to as the CC) and the so-called sectoral laws are out of line with one another, generating considerable gaps and loopholes in regulation. The CC mentions budgetary organisations (section 36 of the CC) between legal entities [paragraph (3) of section 28 of the CC]. The notion of budgetary organisations is defined in section 87 of the PFA. On these grounds, budgetary organisations include, for example, kindergartens, schools, universities, ministries, the prosecutor's office, etc. Obviously, important differences should be expressed here in terms of being subjects of law. Sectoral laws (e.g. Act LXXIX of 1993 on school education, Act CXXXIX of 2005 on higher education – hereinafter referred to as the higher education act –, Act XXXI of 1997 on the protection of children and on custodian management, etc.) use different concepts for institutions. For example, the higher education act terms institutions of higher education as legal entities. Further contradiction is derived from the fact that economic entities (i.e. bound to keep accounts) under point 1 of paragraph (1) of section 3 of Act C of 2000 on accounting (hereinafter referred to as the accounting act) are entrepreneurs, organisations of public finance, other organisations, the Central Bank of Hungary, and health care, social care and educational institutions founded by these or by natural persons. Consequently, this rule blends the notions of institutions and their maintainers. Furthermore, this chaos has tax implications, too, considering that a number of human services enjoy exemption from VAT on objective grounds, and the revenues of institutions and maintainers are difficult to separate.

It cannot be maintained that accounting solutions applicable to budgetary organisations and deviant from the Accounting Act are not published in law: major provisions related to the settlement of public funds, reporting on the financial standing of units managing public funds

and the substantiation of economic decisions on the application of public funds require regulation by law.

Based on the experience of the State Audit Office, we consider the presentation of various budgetary documents (budget bill, final accounts) to be outdated, and the settlement obligation and the publicity of executive power to be defective.

In this situation, the regulatory work aimed at amending the PFA and preparing new legislation may bring progress in this situation. The reasonable division into blocks can be implemented using various legal and professional solutions. Options of a legal solution mean raising the question of how many provisions of law regulate the broad issue of budgetary management. We believe there are multiple potential combinations. On our part, we emphasize that a criterion for solutions potentially suitable from this aspect is a systemic approach. A natural requirement is constitutionality – explained under another point.

For Thesis No. III

A few principles of public finance regulation are a consequence of the democratic nature of the state. On formulating other principles, the documents of multiple international organisations may be considered as the basis, as these organisations have in the past 10-15 years declared and compared a number of principles of “good governance” with the practice prevailing in certain countries. It is important for the new regulation to reflect the spirit of international standards.

Such standards are the government finance statistics (GFS) developed by the International Monetary Fund in the field of statistics, and ESA 95 applied for Eurostat settlements. In the area of accounting, the principles applied to the public sector by the International Federation of Accountants (IFAC), and the international public sector accounting standards (IPSAS). In terms of external controlling of the public sector, mention must be made of the guidelines and standards of the International Organisation of Supreme Audit Institutions (INTOSAI), while in terms of internal control systems, COSO that records the general principles thereof and the COBIT standards that record any IT implications, as well as the internal auditing standards of the Institute of Internal Auditors (IIA).

The principle of representation of the people is derived from our democratic form of state, which states that the application of public funds should be decided by those that have received political authorisation to do so and are responsible for it towards their voters. Enforcement of this principle presumes that the elected representatives are able to exercise these rights substantially, and at the same time, they should be accountable on elections for exercising this right. Promoting this principle is so important that a thesis is dedicated to it.

The principle of limited authorisation comprises three elements. On the one hand, the government (the executive body of local government) is under an obligation of execution compliant with the accepted budget, which is a preliminary authorisation. On the other hand, the authorisation of the executive power has a definite term, which is typically one year. The third element is that earlier decisions and other determinations have a significant impact on revenues and expenses represented in the budgets for the relevant year. Neither economic management in public finance, nor the various processes can, however, be linked to the closure of budget years. “Life” goes on after the start/end date of each budget year. The promotion of this principle is able to ensure transition between the principle of representation of the people and reasonable operation, if budgeting and implementation are able to handle this conflict. The principle of limited authorisation is a source of real conflicts, as the continuity of economic management and the enforcement of adjustment claims derived from environmental and other factors is difficult.

Transparency in the present state of affairs is a value that needs to be represented at multiple points in the laws governing public funds management as a goal to be met. Transparency is justly expected by each actor that establishes a relationship with public finance. The necessity and possibility of enforcing this principle are formulated as independent theses.

Promotion of the principle of publicity is an important peculiarity in the operating frameworks for the rule of law. For public funds, no direct ownership control is in place, and market consumers’ control is only indirectly present. At elections, it is publicity, in addition to the authorised political bodies, that represents the greatest deterring force in terms of avoiding all kinds of irresponsible economic management, political manipulation and crimes (including corruption).

Today's technological facilities represent almost unlimited potentials for publicity. This principle should be promoted over the whole system of information management, and the "toleration" of publicity should be made mandatory for organisations performing public duties but not operated under the state budget control.

The principle of controllability means that control mechanisms used to prevent improper use, inexpedient and uneconomical spending of public funds should be present in each phase of defining tasks, allocation of funds (irrespective of the legal status of the user of public funds), as well as reporting on and settlement of application.

The principle of financial substantiation means that the political preferences should be expressed in the financial plans produced observing the relevant rules, which are at the same time legally accountable. This principle also means that political decisions are passed through a feasibility filter. The process of planning and accepting the budget may be the "technological" and procedural curbs to a one-sided representation of political considerations. The rule-based budgeting practice, i.e. the application of various rules requiring efforts to reach budgetary equilibrium reinforces the promotion of this principle. The budget is at the same time a means of political communication with voters, economic actors, with lenders and investors among them.

Substantial representation of the principle of foresight would be an aim of methodological renewal of budgeting. In the past one and a half decades, the reflex action of surviving financial crisis management has caused considerable and quantifiable damage to the country. In the present budgetary process, hardly any role has been assigned to modern budgeting techniques. The traditional (incremental) budgeting practice not based on performance (a breakdown of resources, if you like) is unsuitable to lay the foundations of structural changes to expenses to an extent necessary for substantial changes, or to finance new tasks adequately, to forecast the future consequences of long-term decisions on expenses, and to enforce the requirements of efficiency and results related to spending. The promotion of this principle requires a strategic approach to be adopted in each area of public policies.

The principle of sustainability and equilibrium means that the sharing of public dues is equitable, predictable, and expenses are unaffected by interest groups in pursuit of contributions and narrow-minded political interest. It is very important that sustainability is ensured through agreements between various types of economic actors (employers,

employees), and between various generations – “visible” or “invisible” socio-economic agreements, for example social contracts between generations. Ensuring equilibrium does not necessarily mean specific rules for results but more general requirements such as a requirement of budget surplus for the primary items of the central budget, i.e. equilibrium between social security funds and the current budget of local governments (golden rule), banning social security funds and other state-owned funds to borrow loans, and regulating local governments borrowing capital investment loans and liquidity loans.

Firstly, the principle of completeness means that each actor should give a fully detailed account on the public funds used. The various financial statements should be produced under the principle of gross settlement. In addition to subsidies from the budgets, the fees paid for public services also constitute public funds, and the application of these should be accounted for just like revenues from utilising state assets. Uncollected public funds (tax allowances and exemptions) and outstanding receivables should be disclosed. The principle of completeness is also important to be emphasized because off-budget liabilities have significantly increased in terms of public financial systems, and so have off-balance sheet items, mostly future liabilities, represented in the state budget. The principle of completeness is implemented if these items are properly reflected in the government statistics and reporting systems.

Using the principle of specification means that spending, the actual budgeting process and the financial situation are available for decision-makers and taxpayers to study. The principle of specification can be overused. This is the situation today when presentations make it hard to see the woods for the trees. The principle of specification requires concurrent representation of administrative, economic and functional presentation – and with clear compatibility. For an administrative presentation, an important issue is the degree of aggregation, and the definition of adequate voting units.

The principle of authenticity means that the items represented on both the revenue and the expense sides within the public finance system signify actual resources and spending related to actual rendering of public duties. The current practice of public finance settlement represents a significant tax content under the various expenses, which prevents the promotion of this principle.

For Thesis No. IV

Neither public finance, nor expense budgeting are imaginable without clarification of the duties the state is supposed to provide. Today, neither the Constitution, nor other legislation explains the notion of state duties. Certain activities have been designated – as state duties –, e.g. by specifying government duties, but not no taxation of state duties is found in the provisions of law.

What the PFA also stipulates is only that the state provides state duties of public finance fully or partially through budgetary organisations, or directly or indirectly ensures full or partial financial cover for providing them. In terms of contents, all the law lays down is that the contents and requirements of state duties should be stipulated in dedicated laws. The PFA returns to the issue in a part that addresses budgetary organisations, stating that budgetary organisations shall comply with their state duties specified in provisions of law, resolutions and deeds of foundation serving the common social needs, and under an obligation to carry out and provide duties. Globalisation and EU membership levy further duties on the country, which are important to be clarified because central financing is also associated with providing these.

The maintenance and protection of market economy is a continuously emerging constitutional duty of the state; in addition to this, the traditional functions remain. There are duties that should be complied with by all states in all times. Such duties derive mostly from the definition of state purposes, certain fundamental rights and international commitments. For other duties, it is up to the state itself to decide to what extent it wishes to intervene in providing duties, and whether to provide it by itself or transfer them to local governments as public duties. In the latter case, the legislator should cater for the economic conditions of providing local government duties specified in the law by way of adequate sources of its own revenue and state subsidy proportionate to the particular duty, however, the Constitution contains no further stipulations concerning the method of determining the sources of its own revenue and state subsidy, as well as the volumes and the proportions thereof. In this way, the National Assembly is free to pass decisions on how it caters for the financial cover of the duties stipulated by law. The financial cover necessary for the mandatory duties of local governments is ensured by the National Assembly through a complex system of sources of own income and central budgetary subsidies – as specified by the law, the Local Governments

Act, the law on local taxes, the sectoral laws stipulating statutory duties, as well as in the budget act¹.

On establishing a new regulation, it may be justified to investigate whether it is possible and expedient to record public duties in law. There are numerous arguments for and against. An argument for it is that awareness of them would considerably facilitate both economic and social stability. An argument against it may be high variability, for which reason revision and clarification of these is only conceivable in the medium term. Resolution of this task would be considerably facilitated if in-depth social discussions were conducted in broad circles, and the lessons learnt were summarised in a “social contract”.

On establishing public dues, the legislator has a wide space for deliberation. Great freedom is available for selecting an economic source as a starting point for sharing public dues, and for designating the object of public duties accordingly². The Constitution does not stipulate income and assets as mandatory or potential objects to be used as the basis of sharing public dues, but stipulates that the sharing of public dues should be adjusted to the circumstances of income and assets, in a proportionate manner³.

In the current system of budget management, budgeting is fundamentally based on existing appropriations (baseline), and financing is built around those. The process and the final results are good indicators of rigid structures. Despite frequent voicing of priorities, the public finance expenses of the past 15 years reveal that the changes in appropriations in the key areas – apart from minor fluctuations, and impacts of ad-hoc measures – practically only follow the variations of inflation from year to year. Examining the internal proportions within expenditure appropriation in a functional framework, no substantial changes are seen either in terms of proportions.

Means of providing for public duties:

- the (central, local governmental) budget as the financial basis, on the one hand, which is used to collect revenues due to the public finance and to cover the relevant expenses payable;

¹ Rulings No. 48/2001. (IX. 22.) and No. 2/1997. (I. 22.) of the Constitutional Court.

² Resolution passed by the Constitutional Court in case No. 620/B/1992

³ Resolution passed in case No. 448/B/1994

- on the other hand, the (central, local governmental) property base, which may be used as a source of public duties, and the changes of which are important index numbers of the operation of the state.

The regulation of the method of performing public duties should extend to the following:

- the collection system of public revenues, the authorisation and responsibility of participants,
- the forms of providing for public services;
- the cases of public services produced by the respective users;
- the cases of “external” use of public services;
- the forms of financial “treatments” of public duties;
- for care organised on an insurance basis;
- normative subsidies;
- operating support systems through invitations to tender;
- onerous supports. **For Thesis No. V**

We consider it an important element of the new regulation to replace the current over-segmented public finance (the four sub-systems, unclear relations of responsibility among them) with a two-level system. The budgetary rights assigned to the central level are exercised by the National Assembly. This is where the current central budget, the two social security funds and – after desirable “profile cleanings” – the dedicated funds would be transferred. It is a technical and political issue which one of today’s state funds is justified to be maintained independently. As a principle of regulation, it is acceptable that operation as a dedicated fund is acceptable for certain tasks (pensions, nuclear safety, etc.). The existence of dedicated funds is contrary to the principles of unity; accordingly, application of such a solution requires special reasoning. For independent funds, however, formulation of special budgetary rules is justified. The regulation of financial management of the two large social security funds needs to be handled integrally with the reforms of health care and the pension system.

The second level is the level of local governments. It is reasonable to establish rules of economic management and organisation so flexible as to facilitate harmonisation of expected changes in the systems of local governments.

Separation of these two levels provides a facility to apply regulations valid for each participant of public finances and for the levels separately, more consistently than today. An important element of particular rules are the solutions resulting from the constitutional position of local governments and connections to the central level rules. The *de jure* constitutional independence of local governments are in reality significantly restricted by the laws applicable to the sector, which, by requiring maximalist and unfeasible requirements, force local governments to violate the law on a continuous basis. The constitutional independence of local governments is breached and their rational economic management is prevented by the fact that the legal titles, allocation mechanisms and real value of state contributions related to their statutory duties are changing hectically, subordinated to the current short-term fiscal goals. In this situation, the state itself provides a *de facto* exemption of compliance with the requirement of local responsible economic management. Financial relations between the central and local levels need more reliable and transparent regulation compared to the current situation. Various techniques of these are possible; we designate two important courses. On the one hand, the legal titles of state contributions need to be considerably reduced, and the segmentation of these on sectoral principles needs to be prevented. On the other hand, state subsidies need to be fixed to some macro-economical variable – a good background to this are budgetary rules –, ensuring predictability and fiscal political space.

For Thesis No. VI

The provisions of law determining the operation of the public sector may be arranged in the following groups: (1) revenue laws, (2) professional or sectoral laws, (3) laws governing the distribution of tasks between governmental levels, and conditions thereof, (4) laws recording the rules related to the various implications of budgetary economic management and to the application of public funds, (5) laws related to annual budgets and final accounts. The public sector operates as determined by all these groups of legislation. Significant inconsistency is seen among these types of legislation, and the institutions of budgetary stability are absent.

A quality breakthrough in modernising the whole legal environment may be represented by the establishment of the new public finance regulation. As an additional element, special legislation guaranteeing the sustainability and stability of the budget has appeared in the practice of developed countries (particularly the EU member states), which serve the purpose of complying with the rules of budgetary results accepted by the *acquis* and the international

financial markets. The latter ones – relying on the tripartite system of interest harmonisation – govern cooperation and self-restriction of economic actors (employers, employees, government), the various levels and subsystems within the government (e.g. pension insurance funds, regional governments, etc.) in order to maintain budgetary stability. On legislation, localisation of similar institutional solution is worth considering in Hungary, too.

It may not be a task of public finance regulation to define the exact set of public duties, but the notions of public duties and the related state responsibilities need to be distinguished from the specific implementation of duties, as an important theoretical base. In terms of public duties, duties of public authorities (which may only be provided by a state actor) and the regulated public services need distinction. The latter one may be provided by a non-governmental actor, as well – under adequate circumstances. In the field of performing public duties, references need to be made to the fact that the government may be a provider or buyer of public services, but it is also possible to represent government responsibility in supports granted in the form of transfers. The standards and protocols related to the public services provided and/or purchased by the government are disclosed in separate provisions of law and sectoral laws. As an expectation for sectoral laws, the regulation of public finances should require the parameters of various public services and public service providers need to be defined in a way also construable from the aspect of financing requirements. Consequently, statutory requirements specific to industries⁴ and sectors⁵ may be necessary.

Regulation of public finances generally governs economic management of public funds, particularly the rules of public finance (governmental sector), and the legal status of the actors operating in the public sector. By virtue of its nature, it should have a structure and contents that do not require frequent modifications and further specification. To actors not under state budget control but performing public duties and using public funds (public utility companies, not-for-profit organisations, private actors cooperating on a partnership basis) the determined parts of the law should be applicable.

The new regulation of public finances should extend to the following issues of budgetary economic management:

⁴ In this respect, professional stances need to be tried in discussion.

⁵ The most important ones here are the specialities applicable to local governments and pension insurance.

- the legal status of organisations pursuing budgetary economic management and the rights and obligations of non-budgetary economic organisations using public funds;
- the methods applicable on budgeting, the contents of a budgetary document, the requirements of format and contents for reports on implementation;
- establishing a few fundamental rules to ensure budgetary equilibrium;
- rules for the procedure of accepting the budget;
- the procedure of commitment, remittance, enforcement;
- the procedure of supplying funds;
- issues of funding a budgetary deficit, handling public debt, and management of state receivables;
- management of information (accounting and statistics, IT);
- the procedures of reporting and settlements;
- internal control mechanisms of public finances;
- auditing.

For Thesis No. VII

The requirement of actually exercising the budgetary right of the National Assembly and the bodies of representation may be met with paying maximum attention to the previously discussed authorisation to represent the people, restricted authorisation, and the principles of completeness, specification and controllability. Attention is called here to the significance of decision preparatory documents, the associated professional requirements and the accountability of the executive power.

The currently effective regulation has granted unjustifiably great liberty to the executive levels – for over ten years – in terms of regrouping the various appropriations adopted in the budget act, while the proposed and accepted budget acts in their current forms are unsuitable for political bodies to reorganise fiscal processes through substantial decisions. In terms of settlement, the voting units are incorrectly designated, and, as a result, even decision-makers are frequently in no position to pass decisions. In many cases, the administrative, economic and functional presentations of budget items are incompatible. Off-budget risks directly or indirectly affecting public finances are represented unpredictably in the accounting. Without addressing this problem, the propagation of solutions relying on partnership with the private sector will add to the intransparency of public finances.

A key requirement to implementing the principle of representation of the people is that material changes to the appropriation may only be performed by an elected political body. In

the presentation of the budget, it needs to be positively represented that the current decision-maker has a restricted opportunity to pass decisions not only in terms of time but also in terms of contents related to revenues and expenses. A key issue is to make the establishment of adequate voting units⁶ the basis of budgetary decisions. Politics should pass decisions on aggregates that appropriately ensure promotion of political preferences (e.g. improving the role of prevention in health care, increase administrative capacities necessary to absorb EU funds, etc.), render implementation of these accountable (death rates for the leading causes of death decrease, and the necessity and costs of curing such diseases also decreases) and do not disturb the operativeness of implementation. (The budget appropriations related to prevention need not be approved line by line.)

In the presentation of the budget document, the following requirements should be complied with. On the revenue side, revenues under public law (and the amounts of tax allowances and exemptions as information items) should be presented separately. Separated from revenues under public law, the utilisation fees should be presented, detached from revenues from property utilisation. Revenues should be presented in an identical structure and in the format of projections for two years – beyond the relevant year – (next to valid tax rates and tariffs), and the actual figures should be presented for two years retrospectively. In terms of expenses, the gross accounting policies should be observed, the figures of the previous two years and the commitments for the next two years need to be presented. Expenditure appropriations should be displayed in administrative and economic structures, where, in case of institutional budgets, the institution is the chapter (e.g. the National Assembly), and organisational basic units are the subchapters; in programme-based budgets, the major programmes and programmes correspond to chapters and subchapters.

The budget act should present the debts, financial instruments, reserves, ordinary and contingent future liabilities of the state and local governments as information items.

On implementing the budget, the Minister of Finance should report to the competent committee of the National Assembly in monthly reports submitted on the 15th working day of the month following the relevant month. The structure of this should be suitable for

⁶ A voting unit is the smallest unit of a budgetary decision, which contains expected results and expenditure ceilings in both textual and numerical formats. In other words, it is an obligation to perform duties, which contains a specific description of the task, the outputs of performing the task, the necessary physical resources,

comparison with the corresponding periods. The other periodical report is the six-monthly report to be produced until 31 July, and sent to the National Assembly.

Final accounts are a report on the utilisation of appropriations for the budgetary year; for this reason, it is a fundamental requirement to produce it in a structure complying with the budget act. The final accounts should contain an itemised account of compliance or non-compliance with the effective financial rules. Such rules under ESA' 95 are for deficit and public debt, and the budget policy rule detailed in thesis No. VIII. Violation of rules partly depends on factors that cannot be influenced in advance by budgetary decisions (for example, interest rate dynamics, changes of exchange rates). A solution for factors that cannot be influenced could be provisioning and freezing certain authorised expenses.

For submitting the final accounts and the associated decision, two solutions are eligible. According to one, the modern public finance information system (based on the Treasury's accounting and account management practice) facilitates submission of a to-the-point final accounts document following a new approach in April following the relevant year. In this way, the final accounts can be used as the basis of the next year's budgeting, and the National Assembly is able to pass a decision concerning the government's responsibility in terms of implementation within a short time.

In case of the other solution, much more thorough and more detailed final accounts would be produced, for which auditing by the state audit office would also take a longer time. For this reason, the final accounts could be discussed in the National Assembly in the second year following the relevant year. Although this facilitates release of the government from implementation at a later date, it causes no major disturbance in budgeting, as the budgeting is not built on the final accounts. We consider the arguments in favour the second solution to be stronger.

For Thesis No. VIII

In line with international requirements (convergence and stability) and practice, it is necessary for the system of rules for public finance to contain budgetary rules, too. The negative impacts of overspending, demand for a stable national (or regional) currency and the financial

inputs (headcount, classification, the amount of physical capital in a given case), and finally, the feasible expenditure ceiling.

vulnerability of national economies have led an increasing number of countries to a recognition that budget policy should be forced among pre-defined (strict) rules, i.e. a rule-based budgetary policy should be pursued. Rules are basically used for two aims:

- to stop budgetary overspending, and
- to create space for an anti-cyclic budgetary policy.

These two aims are interrelated to a certain extent. On the one hand, because budgetary overspending and the rigid rules restricting it eliminate the possibility of implementing an anti-cyclic budgetary policy. On the other hand, budgetary overspending is often caused by the fact that the commitments assumed in “good” years can only be complied with by the state in “bad” years through indebtedness.

Budgetary rules are often not formulated alone but as a part of a comprehensive economic (adjustment) package. They are varied in terms of legal forms. In certain cases, the budgetary rules are recorded in countries’ constitutions. More frequent is regulation in other laws, for instance, in a comprehensive law on finance. There are examples where the law establishes the major principles only, while the rules of procedure that ensure the desired results are detailed in lower level legislation. Rules may be applicable to the country’s central budget or to budgets within the country (e.g. provinces).

In terms of contents, budgetary rules may be classified in three groups:

- rules designating targets;
- procedural rules;
- rules specifying sanctions and correction mechanisms for a case targets are frustrated.

Rules designating targets in various countries are used to stipulate a level of deficit (surplus) in the current budget, and to define the maximum proportion of public debts.

Procedural rules may be the provisions that stipulate substantiation and transparency of budgeting, and disclosing authentic information on budgetary processes. In addition, provisions of law require equalisation funds or reserves to be generated in a number of countries – particularly where the indicators of national economy show significant fluctuation.

In case budgetary targets are frustrated, various replenishing and other corrective measures may be enforced. Particularly typical are these rules of cases when the budgetary limits of units within a country are exceeded.

The budgetary rules are apparently the most efficient when stipulated in high level legislation. Experience, however, is contradictory. The rules recorded in the Constitution and in laws are often too simplified, rigid and hard to change. Compliance with such generates serious losses at times, on the one hand. On the other hand, such rules motivate certain governments to apply creative accounting and various tricks to eliminate the restrictions deemed irrational. And this is what leads to even more serious problems, loss of credit, covert indebtedness. Consequently, – according to certain opinions – it is expedient for the current government to record and publish the budgetary rules they intend to follow, and keep to them.

A development of recent years is that the financial risks incurred by the local governmental sector has an increasing role among the factors jeopardising stability. Handling these by adequate rules, re-regulating the conditions of borrowing and other long-term commitments is a task that cannot wait. On these grounds, the following types of budgetary provisions should be reasonably incorporated in the new regulation:

It may be required for the central level, for instance:

- mandatory equilibrium of off-budget funds, no borrowing is permitted;
- the debt service of central budgetary debts and the reduction of public debt should be financed from the primary budgetary surplus;
- liquidation of assets or concession revenues should be used to repay public debt;
- guarantees and guarantees granted by the Government should be limited.

It is reasonable to record for local levels, for example:

- there is no passage between the current and accumulation budgets, and the current budget cannot generate a deficit (golden rule);
- local governments may borrow liquidity and capital investment loans (the upper limit of indebtedness should be restricted – following adequate modelling –, subject to financial

capacity), and guarantees and accounts payable should be considered when calculating the loan portfolio;

- liquidation of assets or concession revenues should be used to repay local government debts.

These rules – also ensuring adequate flexibility – are capable of guaranteeing long-term sustainability of the entire budget. The accountability of these sustainability rules are ensured by the clear rules of financial management, as necessary conditions. In addition, a more transparent and stable regulation of sharing public dues is necessary for welfare systems and developments affecting multiple generations to enforce this principle, compared to the current one. Another guarantee for sustainability is for the economic actors to comply with the implicit and explicit rules of sharing public dues, and also apply self-restriction on enforcing their business interests.

For Thesis No. IX

A starting condition of promoting transparency is the clarity of the system of rules and the legal environment. Setting up the recommended new regulation – to our conviction – would represent major progress in this field. Based on clear and traceable regulation, transparency of collecting and applying public funds can be enforced, irrespective of the economic actor performing them. Enforcement of this is particularly important when – in harmony with international trends – the significance of performing public duties based on various partnerships increases in Hungary, too.

Based on the relevant document of the International Monetary Fund, the promotion of transparency is ensured by

- unambiguous definition of tasks and scopes of authority;
- wide accessibility of the generated information;
- publicity of preparing, implementing and reporting on the budget;
- fair economic management.

It is important to emphasize that practical accountability of this requirement may be implemented by way of identical structures of budgets and reports.

The transparency of the budgeting process and the document ensures accountability of the governing power, which is a fundamental condition of fair competition among political parties. This principle is fully enforced if the accepted budgets are implemented. Any processes deviating from the budgets in any direction question the trustworthiness of governments.

For Thesis No. X

Many of the countries ahead of us have proved that performance requirements towards the whole public sector, its branches and individual actors result in a surplus. Especially important is the adoption of the principle of performance orientation as early as on budgeting, because this element of economic management decisively determines the other processes of economic management. On planning appropriations, the purpose of the recommended expense, the method of achieving the goal, the proposed resources and justification for the expense amount should be presented. Performance indicators should be widely used for designating and calling to account for goals. In case of changing appropriations, the same requirement should be enforced.

The practice of the domestic budgeting process needs comprehensive renewal. The current baseline budgeting is unsuitable both for enforcing performance requirements and for laying the foundations of the necessary structural changes. The current practice of residue planning conveys unilateral fiscal considerations towards the actors within the sector, who use adequate techniques for formally adapting to these restrictions, but are incapable of substantially renewing their economic management. There is no alternative to pursuing the goals of financial equilibrium, however, without these changes, the re-generation of equilibrium problems is necessary.

Performance orientation is ensured by a requirement to apply the practice of programme-based budgeting to specified areas of expenses, to monitor the implementation of the budget, and to institutionalise performance auditing.

The expense side budgeting needs to be performed in two major groups. A part of expenses continues to be planned in an institution-centred way, using the resource requirement for maintaining the capacities seen as necessary. In the new regulation of public finance, we

recommend these to be termed as institutional⁷ budgeting. Typically, this principle is applicable to organisations of public authorities, i.e. state organs, administrative, judicial, defence areas, as well as law enforcement. Performing duties here may only be exceptionally assigned to an organisation outside the central budgetary control. The voting unit in this case is an institution. For institutions, a few basic and characteristic natural input details (headcount, office space, number of pieces of equipment, etc.) are also used as the basis of the appropriation. Budgetary decisions here apply to the recognition of justifying planned resources. Planning these capacities does not necessarily mean budgeting from the baseline. It is possible that, on using various due diligence processes, a particular capacity can be provided through a different combination of resources, and it is also conceivable to produce an expense item for a new task by way of zero-based budgeting. The point is that no accountability for the quantity of specific services (e.g. number of convicts) and impacts (e.g. a reduced number of robberies) is possible. On amending sectoral laws – e.g. if the technical parameters of prisons are intended to be changed – a financial impact study may be based on the projected resource parameters. In the circle of institutional budgeting, elementary budgets are produced by the organisations that implement the particular economic management.

In order to improve performance orientation, it is desirable to budget a significant portion of expenses as programme-based, and this proportion – due to improving extent of preparation – should grow in the course of years. When using programme-based budgeting, another issue to be decided is the legal status of the organisation that performs the tasks, given that off-budget organisations may also be suitable to carry out programmes financed from public funds.

Programmes may be permanent or temporary. For permanent programmes, some expenditure appropriations may be determined as a result of earlier decisions, which are not voted on. Accordingly, the budgeting document will contain appropriations disclosed for information purposes, appropriations mandatory as a result of earlier determination, and (free) appropriations subject to actual decisions. This is where the principle of attaching a financial impact study to the acceptance of each law on providing sectoral services is enforced. In the possession of this, the political body is able to exercise its budgetary rights – not only associated with the acceptance of the annual budget act. The structure of programme-based budgets is shown in the table below:

⁷ An institution is not an organisation. An institution (e.g. police) may consist of multiple budgetary institutions and organisations pursuing independent economic management.

Structure of programme-based budgets

	Major programme	Programme	Sub-programme
Type	Government functions	Voting units	Measures
Decision-maker	National Assembly	National Assembly/ or representative body of local governments	Government/ or representative body of local governments
Responsibility	Cabinet minister or a delegate	Undersecretary or a delegate	Institution head or delegate
Approximate number of items	30-40	200-300	1500-2000
Example 1	Education	Higher education	Determine an admission limit for each field of education
Example 2	Environmental protection	Sewage treatment	Construction of a sewage treatment plant
			Increasing fines
Example 3	Education	Public education	Funding normative state contributions by teaching job
			Development of local government participation

Placing the budget on performance bases requires a new approach in reporting on implementation. An important function of reporting is to present the performance situation, in addition to calling to account. For the units under the practice of programme-based budget, diachronic and synchronic reporting is distinguished. The former is adjusted to the life cycle of the programme (capital expenditure, government action), i.e. is aimed at presenting the results thereof. Synchronous reporting represents monitoring mentioned above, periodical reports and final accounts. In the area operated under the system of institutional budgeting,

only synchronic (monitoring and final accounts) reporting is necessary. The final account document consists of a numerical financial report and a report on the implementation.

It is our conviction that the later transition to the new budgeting methodology, the slighter the chance for parallel policy reforms to achieve their actual goals.

For Thesis No. XI

The framework of reasonable and economical financial management of budgetary institutions is defined, among others, by a regulation on the legal statuses of such institutions. In our opinion, the general regulation of the legal status of organisations pursuing budgetary management – within the frameworks of the system of public finance – and a special regulation of organisations performing public duties is an issue where a solution that considers multiple options is eligible. This subject is rather complicated.

What is important is the promotion of the requirements of accountability, performance and transparency associated with the application of public funds.

Another condition of efficient economic management is an adequate information system. The information system (whether statistical or accounting) should always be set up in line with pre-defined decision points, given that it is provider of the specific practice of economic management. At the same time, up-to-date practice requires a well-built and organised information system. Macro and mezzo level information satisfies interests outside the executive actors operating in the public sector, primarily towards taxpayers, the political bodies representing them, international organisations, lenders, investors, etc.

In terms of regulation, a clear-cut distinction of macro, mezo and micro implications of the information system is necessary. May we note that the organisation of information management is closely related to the specific regulation of legal status and economic management status of the economic organisation.⁸ Incorporation into the national account system represents macro, while micro is the financial reporting system for each actor pursuing economic management under the state budget control. The level of mezo is the fund that represents an independent unit of decision-making.

⁸ For instance, two markedly different concepts are around concerning what licences basic budgetary units (currently: budgetary organisations) should hold related to the assets they use.

The first area of information management is accounting. This includes the rules of bookkeeping, the reporting system and the accounting policy (e.g. evaluation principles for assets and liabilities, consolidation methods, etc.). Accounting information is generated at a micro level, in the elementary reports. Information applicable at the mezo and macro levels are gained through consolidation. While the accounting act is in line with the rules of the European community, the accounting system of budgetary institutions – particularly as regards the peculiarities of the government sector – does not fully reflect the internationally accepted principles in any of the areas of bookkeeping, reporting system and the accounting policy. In the course of upgrading, which is indispensable for this reason, an aspect for the new practice should be not to contradict international expectations - if any -, to support the enforcement of principles specified in law, and not to incur unnecessary expenses⁹.

Actually, a state accounting system would be necessary, which would embrace the complete operating and economic management procedures of public finance, and is not restricted to accounting contents in the narrow sense. The information issues necessary for settlements and reporting, the contents of the accounts and the types of necessary reports should be regulated by the law in detail. What it means is that the provisions deviating from the accounting act and specified in the accounting systems of organisations pursuing economic management under state budget control should be incorporated into the law regulating budgetary economic management. Certainly, detailed rules could continue to be set up by a government decree.

At the level of organisations pursuing economic management under state budget control, the modified (partial) accrual basis of accounting¹⁰ would be expedient to follow. To our assessment, it would provide for performance measuring and the enforcement of all the principles explained above.

A number of solutions are available internationally; in-depth study of international experience and the analysis of domestic experience would assist setting up the cash basis and accrual basis of accounting. A decision would be passed after a detailed cost-benefit analysis is performed. The peculiarities of the domestic public finance should be regarded in any way. Such a factor is, for instance, the broad ownership licences of local governments - unique

⁹ In the current situation, the producing and aggregating (not consolidating) of elementary budget reports occupies considerable resources and produces unusable information.

¹⁰ International literature and practice show various ways to construe of this notion. A specific solution may be developed as a result of further debates.

even in international comparison. On transition, each implication should be handled carefully. The handling of amortisation deserves special attention. Considerable variances are seen in the international practice in this respect. Transition to any form of the accrual basis of accounting takes – according to experience – a minimum of 4-5 years. This incurs significant personnel and transaction expenses. Prior to passing specific decisions, a cost-benefit analysis should be produced, which may be used to select the optimal solution. There are examples of phased transitions, and different ways of adoption over the various segments of public finance. It seems expedient to start with local governments. The nature of sectoral economic management, the relatively high level of independence, the extensive capital market relationships and the risks incurred by it represent one group of our reasons. The standard of local government assets registration and valuation is by far superior over treasury assets. This aspect facilitates adoption.

The chart of accounts should be considerably simplified and changed in terms of structure. The main characteristics of the new chart of accounts is worth being specified in law, with the details left to the relevant government decrees to regulate. State accounting should strive to present changes in assets, whereby representing the full property at actual value makes no sense. The contents of the accounting report consolidated to elementary and mezo levels are different from the reporting procedure applicable to the business sector. We recommend that it should consist of a statement of assets change, the balance sheet and a property register. Partial accrual-based accounting also means – among others – that we do not intend to represent each element of the state property at the adequate value. It would be unnecessary for non-negotiable components of the property. The principle of completeness, however, requires registration and representation of these. Producing an aggregated statement of assets and liabilities (see the statements disclosed annually of the local government sector) is misleading as it evokes an illusion that this is in line with the general accounting principles.

Maybe the most important issue of state accounting policy is the principles of consolidation. A function of this (see the principle of completeness) is to provide for the whole system to present the levels of public finance, the elementary reports and a collective financial standing of entities performing duties outside the state budget control, as well as the financial risks for the entire system. In the course of consolidation, the financial risks derived from off-budget organisations, avals and guarantees should be presented at a central level. Consolidation may be performed in terms of individual local governments as well.

Another issue of accounting policy is the handling and appraisal of off-balance sheet items. This includes tax allowances, outstanding receivables, avals, guarantees, obligations under labour law (severance payments), obligations to repay EU funds, etc.

Another area of information management is government statistics. In this respect, a it is necessary to lay down in the law the use of international standards (ESA'95 and the new GFS), and the regulation of the scope, procedure of and responsibility for gathering data in the governmental sector, structuring and publication of the mass of information gained through data gathering, and the fact that these are for public interest, made public and accessible free of charge. The professional standard and elements of responsibility for the government statistical system should be regulated by law.

An area of information management that needs regulation is the quality of information systems (hardware and software) supporting the previous items and other aspects of performing public duties. Specific IT capacities need to be ordered for the implementation of public duties, connections and security of these need regulation, etc. the operating rules of the various information and IT systems (information and other systems for taxes and customs management, health care, pensions, treasury, local governmental and public finance) the method of connecting these (public finance data warehouse), and the internet publicity of information obtained from these systems. A conceivable solution is to establish a separate and independent data warehouse at the level of local governments.

For Thesis No. XII

The practical implementation of the requirement of performance driven and controllable operation depends, apart from the modernity of planning, primarily on the quality of internal control. By internal control we mean both the system whereby the economic management of government/local governments, ministries, and the associated institutions (appropriations, funds) are being run, and the control arrangements within the individual budgetary institutions. Upgrading internal control systems has become an issue of key significance for several international organisations over the last few years. During that period they specified the most important standards in conjunction with internal control, and created numerous relevant standards. Some international organisations even stipulate the existence of an appropriate internal control mechanism in the agencies cooperating in using the funds as a condition to the disbursement of aids and loans. Using financial resources from the EU's

common budget is conditional upon the minimum requirement that the national organisations receiving the funds should have an internal control mechanism compliant with the standards set by the EU. Despite these international tendencies domestic legislation fails to handle the issue in accordance with its weight. There are hardly any standards of internal control in governmental and local governmental systems, and the individual institutions have excessive freedom in designing their own internal control system without a detailed central requirement. However, some progress has been made over the past few years in some technical issues (e.g. risk analysis). While internal control systems are under-regulated, there is excessive emphasis on the internal audit system, which, in our best judgement, is positively over-regulated.

The full enforcement of the principle of controllability as discussed above does not, in its initial phase, mean the strengthening of external and internal audit functions, instead, it means that control mechanisms aimed at preventing the ineffective, inefficient, and uneconomical allocation of public funds should be in place in each phase of the definition of duties, allocation of funds (regardless of the legal status of the entity using the public funds) and reporting on and accounting for such funds. It is only by building on such internal mechanisms that post-facto internal and external audit functions can be defined better and more specifically. The role of independent internal audit is to ensure that internal control mechanisms are adequate, and that operational risks are identified.

Besides creating the organisational conditions of internal controls it is necessary to elaborate a system of performance indicators that follow the process of spending the funds from the moment of planning through the implementation phase all the way to reporting/accounting. Performance indicators open an opportunity of monitoring financial and/or professional processes and of controlling functions at an organisational level, branch level or government level, which also enables interference if necessary.

Upgrading regulation requires the enactment of the key sections of the present legislation of statutory regulations and government decrees, and bringing the concepts and solutions in line with international standards (COSO and COBIT).

Both budgeting and on-going performance evaluation would suppose a management information system that is well founded, based on data immediately derivable from accounting and reporting information, but is clearly more than just that. Prescribing compliance with the practice of programme-based budgeting could trigger significant

progress in this area. Before selecting the possible solutions, it is necessary to study best international practice, and the embedding of these in their own systems, and their legislative environment. As regards the management information system, it is sufficient to prescribe its mere existence so that the legislator empowers the government agency concerned or the local government to create it through a decree.

For Thesis No. XIII

The regulation related to auditing public funds should also be reconsidered. Based on various INTOSAI documents, the principles of external auditing in the governmental sector need regulation. For internal audits, the standards of the Institute of Internal Auditors (IIA) are justified for use. On re-regulating the audit system of the public sector, the triple requirement of effectiveness, efficiency and economy is deemed necessary. Audit performed on an effectiveness basis facilitates public funds to be spent in a compliant and expedient way, reduces the financial and operating risks of the public sector, and contributes to the promotion of transparency. It is not indifferent, however, what resources and cost relations were used and met to achieve results. We consider it desirable to enforce the requirement of effectiveness beside better utilisation of existing capacities and cost-efficient solutions. It is important to define the various auditing organisations, and the distribution of work among them. A reference should be made of the facts that an important role is assigned to professional audits besides financial audits, and that cooperation between financial and professional auditing organisations is necessary.

For local governments and state funds, the current form of private audits – not denying the importance of its role – needs reconsideration, and a closed system of these should be established. The auditing system of the local public finance level should be regulated cautiously – in line with the peculiarities.

The relations and successiveness, etc. of independent internal and external audits should be regulated in line with the INTOSAI standards.

For Thesis No. XIV

Under Paragraph (1) of Section 2 of the Constitution, the Republic of Hungary is a constitutional state. The rulings of the Constitutional Court have elaborated on the contents of this provision, lending special import to the requirement of legal safety. In terms of legislation, this implies a stable and predictable legal system. These principles enjoy special

priority when it comes to observing the rules of public finances since it is essential that general trust towards the state, in its capacity as legislature, be demonstrated not only by domestic players but also those in the world arena – international organisations, foreign states and business operations or individual citizens as well.

Thus, statutory procedures should be installed to establish legal guarantees for a predictable and stable regulation of public finances. Hence, when the new regulation on public finances enters into force, it should, in addition to introducing the reader to the language of the new legislative items, allow for ways to:

- train those enforcing the law, to apply new regulations (including standardised further education courses on the new piece of legislation, if necessary, clarification of any and all problems concerning construal of the legislation, printing and procuring data-entry forms necessary to implement the legislation, provide all human and material resources needed for a smooth implementation);
- help individuals and organisations affected, to decide how they can best adapt to the provisions of the regulation, and what actions they should take in order to be voluntarily compliant.

When preparing to implement a new piece of legislation, the law does not and cannot generally rule as to what “lead time” should be necessarily allowed between promulgating and enacting legislation. This is to be adjudicated on a case-by-case basis, in the initial phases of writing legislation, considering the contained provisions’ nature, volume, as well as other factors influencing the preparation for enforcement – or for voluntary compliance. This is a duty of organisations that are active in drafting as well as those writing legislation.

In general terms, it is safe to say that when it comes to pieces of legislation that cover certain areas of social relations for the very first time, ones that generate new obligations, laws that enhance existing obligations, or ones that deprive or limit rights, should enjoy a longer lead time for preparation, in order for this process to be in accordance with the Constitution.

For Thesis No. XV

Our currently effective Constitution lacks systematic regulation of public finance. By public finance we mean regulation of sharing public dues, the definition of the levels within public finance, regulation of the elaboration, acceptance, accounting for and reporting on

implementation and auditing budgets for these levels, definition of the types of organisations managed under the state budget, regulating the establishment, economic management and auditing thereof, utilisation of public funds outside public finance, as well as the management of state property, and regulating the audits of such management. The supreme law only contains sporadic provisions to these subjects, and if so, generally in the form of summary declarations. Accordingly, the chapter on the National assembly provides for the obligation to approve the state budget and final accounts, for changing the country's socio-economic plan; the obligation to share public dues is found in the chapter on fundamental rights and obligations; the general provisions stipulate that state property is national property, and also the statutory economic management for companies and economic organisations owned by the state; and a short chapter is dedicated to the State Audit Office and the National Bank of Hungary. A definition for the major content elements of the budget and final accounts is absent, similarly to a regulation on the preparation and acceptance thereof, and a description of the connection between them.

In addition to those mentioned above, regulation of public funds in the Constitution is justified by important contents-related reasons.

Citizens have the right to financial security; for this reason, predictable regulation is required at the level of the Constitution; constitutional rules that ensure sustainable development of the economy, prevent over-indebtedness of the state and implement relative equilibrium in public finances in order to protect the rights and interests of the new generations. The actual right of the National Assembly to define the budget should be restored, as the budget currently does not satisfactorily contain the actual key points of decision-making, and grants too large space to the government to pass actual decisions. The major principles of creating the budget should be represented at the level of the Constitution.

Based on all these, the fundamental rules applicable to public finance, sharing of public dues and, by virtue of its key importance, the central budget and the final accounts are reasonably included in the chapter on public finance to be incorporated in the Constitution as new additions.

This requirement is also supported by domestic and international relations of constitutional law. In the constitutions of EU member states, a detailed regulation of public finance is available, almost with no exception. The concepts and drafts for a constitution produced in

Hungary during the past fifteen years have all included a relevant chapter on the constitution. The program of the government formed in May 2006 identifies a new public finance chapter that complements the currently effective constitution. Our proposal may also facilitate implementation of this part of the government programme.

The detailed contents of the rules on public finance have been discussed in connection with the theses on the public finance law. What we consider important to emphasize is that we do not recommend requiring at a constitutional level whether a budget act needs to be passed each year, and whether multi-year or rolling budgeting would be expedient. This should be regulated by law – in line with the selected solution of economic policy. The point is to determine the budget for each calendar year in the form of a law, and the government should account for implementation within a period defined in the Constitution, in the form of final accounts.

A new rule in the Constitution would indicate the function of final accounts: in case of giving an account that is accepted, exemption from the obligation to implement the budget. In addition, it is to be considered to assign legal consequences to non-acceptance of the final accounts (e.g. that the government is to resign, or the voting on the final accounts should at the same time be a vote of confidence). The use of this rule is not expedient in a case when a new government gives an account on the former government's performance. An issue to be decided is whether to accept final accounts by law or a resolution of the National Assembly.

The Constitution would also contain a stipulation that bills on the budget and final account may only be submitted by the government and no-one else. It means, on the one hand, that individual government organisations cannot be authorised by law to submit their own budgets under the principle of unity of the budget, only to their unchanged budget proposal to be incorporated in the budget bil. On the other hand, the head of government, the committees and the MPs are not allowed to submit such bills, they may only express their stances in the form of amendment motions.

A consequence of resolutions passed by the Constitutional Court is that budget and final accounts bills may contain no amendments to other laws.

Provisions on sharing public dues would specify the exact contents of this notion. The rules would embrace all forms of sharing public dues, and would determine its function. An important element of the regulation would be a contribution corresponding to the capacity of

the individual to bear burdens to cover common needs, because this expresses the principle that no-one can be forced to prevent their own subsistence based on sharing public dues.

In terms of significance, the central budget stands out in the system of public finance, which gives rise to the applicability of some special rules. Accordingly, to begin with, the requirement whereby cover for the state duties and other obligations specified in the Constitution and in laws should be provided. The budget should be detailed enough to facilitate establishment of whether this provision has been complied with.

Ensuring sustainability of public finance equilibrium is important to prevent any increase in state indebtedness. This principle may only be deviated from in emergencies. The detailed rules should be incorporated in legislation.

The rule to create an indemnity act would also be a new element of the Constitution. In the law on transitional economy, the National Assembly authorises the government to collect the revenues and comply with the expenses specified therein.

The Constitution would certainly contain the laws required to be passed to ensure implementation of the provisions of the supreme law (laws regulating the forms of public dues payment obligation, the subjects, the basis and rate of the payment obligation, the laws regulating exemptions and allowances, and the laws specifying the rules of preparing and implementing the central budget and the budgets of local governments, of ensuring equilibrium, of producing the final accounts, of state accounting, of establishing economic organisations managing under the budget, and the financial management thereof, of the method, conditions of exercising ownership rights related to state properties, and the rules of state audits).

In addition to those proposed above, the public finance chapter of a new constitution could embrace the rules applicable to the State Audit Office and the National Bank of Hungary and to budgeting, which are also specified in the current Constitution; however, re-regulation of these subjects is not indispensable in order to provide constitutional substantiation for the public finance law.