

INTERNATIONAL MONETARY FUND



# **Staff Country Reports**

**Cyprus: Report on the Observance of Standards and Codes—  
Fiscal Transparency Module**

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# INTERNATIONAL MONETARY FUND

## CYPRUS

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

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Approved by Mr. Deppler and Mrs. Ter-Minassian

October 14, 2005

#### **EXECUTIVE SUMMARY**

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

**Cyprus has been making major progress in improving fiscal transparency, helped by the government's efforts to strengthen budget management systems and comply with the EU *acquis communautaire*.** As a result, the country now fully meets or even exceeds the code's standards in many areas. Key areas where Cyprus meets the requirements of the code include: (i) well-defined fiscal responsibilities of the branches of government and central bank independence; (ii) a clear legal and administrative framework for fiscal management; (iii) detailed reporting on debt and financial assets of the central government; (iv) clear and well-publicized procurement rules and public sector employment procedures; (v) robust internal control mechanisms and an independent external audit; and (vi) technical independence of the national statistics service. Areas where Cyprus approaches best practice include the timeliness of the budget submission and approval process; a new computerized accounting and reporting system; and the scope and quality of external auditing, including the scrutiny by the house of representatives of the audit reports.

**The momentum of fiscal management reform efforts should be maintained to meet the requirements of the code in additional areas. The main priorities for the near-to-medium term are to:**

- Introduce a proper legal framework for public/private partnerships, and develop adequate monitoring and reporting mechanisms to reflect their fiscal costs, benefits and risks; include information on such partnerships in the budget documents;
- Present a composite budget which integrates all expenditure activities and revenue inflows comprehensively; integrate further extrabudgetary funds in the budget;
- Integrate further the medium-term forecasts and fiscal policy objectives from the stability and convergence program into the annual budget process;
- Develop an effective "open government" strategy;
- Prepare a mid-term budget review report, to be discussed in parliament;
- Publish fiscal data on a timely basis, at regular intervals and according to a preannounced schedule, and using a consistent dissemination format; and
- Encourage outside scrutiny of the macroeconomic and fiscal projections, and the underlying methodology and assumptions.

	Contents	Page
I.	Detailed Description of Practice .....	<a href="#">4</a>
A.	Clarity of Roles and Responsibilities .....	<a href="#">4</a>
B.	Open Budget Preparation, Execution, and Reporting .....	<a href="#">14</a>
C.	Public Availability of Information .....	<a href="#">26</a>
D.	Assurances of Integrity .....	<a href="#">29</a>
II.	IMF Staff Commentary .....	<a href="#">33</a>
Tables		
1.	Dates of Submission of Financial Report and Audit Report.....	<a href="#">23</a>
Boxes		
1.	General Government in Cyprus .....	<a href="#">5</a>
2.	Taxpayers' Legal Rights to Appeals .....	<a href="#">13</a>
3.	The Budget Preparation Calendar .....	<a href="#">14</a>
4.	Budget Preparation Process .....	<a href="#">15</a>
5.	Development Planning .....	<a href="#">17</a>
6.	The FIMAS System .....	<a href="#">20</a>
7.	Program Budgeting .....	<a href="#">25</a>
Appendix Tables		
2.	A Summary Assessment of Practices.....	<a href="#">38</a>
3.	Public Availability of Information—A Summary .....	<a href="#">42</a>

## ABBREVIATIONS

AG	Auditor General
CP	Convergence Program
CDB	Cyprus Development Bank
EBF	Extrabudgetary fund
FIMAS	Financial Information Management Accounting System
GFS	Government Finance Statistics
PAC	Public Accounts Committee
PEM	Public expenditure management
PFM	Public financial management
PPP	Public/Private Partnership
QFAs	Quasi-fiscal Activities
ROSC	Reports on the Observance of Standards and Codes
CP	(Stability and) Convergence Program
SDDS	Special Data Dissemination Standard
SGP	Stability and Growth Pact
TIN	Taxpayer identification number

## **I. DETAILED DESCRIPTION OF PRACTICE<sup>1</sup>**

### **A. Clarity of Roles and Responsibilities**

#### **Definition of Government Activities**

**1. General government is largely defined in line with Government Finance Statistics (GFS) principles, and is for the most part covered in the budget process.** *1.1.1*

The units of general government are listed in Box 1, and they correspond to GFS standards for statistical reporting purposes. The budget process covers all the general government activities except those from the public loans funds and the local authorities. The activities of the public loans funds, but not those from the local authorities, are covered in the government's annual financial report. The commercial activities of general government entities are very limited and are not separately reported. Government activities are clearly distinguished from those of financial and nonfinancial corporations in the private sector. A number of so-called semigovernmental organizations are part of the public sector at large, and they carry out activities that are either mainly commercial in nature—for instance, the electricity authority and the telecommunications authority—or mostly of a nonprofit character—for example, the Human Resources Development Authority and the Cyprus Sport Organization. These organizations have been set up under their own legislation, which also specifies the role of the government in their management and operations, and have their own budget which is approved by the house of representatives. They are covered in the government budget and financial report to the extent they receive grants and loan guarantees or make contributions to the consolidated fund.

**2. The relationships between government and public nonfinancial and financial corporations are mostly clear.** *1.1.4*

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<sup>1</sup> Discussions on fiscal transparency were held in Cyprus during May 17–30. The staff team comprising Messrs. De Broeck (head), Akitoby and Joshi received excellent assistance and cooperation from the authorities. The mission met with the minister of finance and officials from the ministries of finance, health, education, interior, commerce, industry and trade, labor and social insurance; the Auditor-General; the Commissioner of State Aid Control; the ombudsman; officials from the Planning Bureau, Cyprus Agricultural Payments Organization, the Accountant-General's Department, Customs and Excise Department, Inland Revenue Department, Central Bank of Cyprus, Internal Audit Service, Public Administration and Personnel Service, and the Statistical Service; the Parliamentary Committees of Financial and Budgetary Affairs, Public Accounts, Labor and Social Insurance; representatives from the Union of Municipalities, local authorities, Development Bank of Cyprus, telecommunication and electricity authorities; the European Union Delegation (and the EU desk economist for Cyprus), Professor Panos Pashardes of University of Cyprus, as well as with representatives from the Cyprus Chamber of Commerce and Industry, Employers and Industrialist Federation, Ernst & Young, and K.P.M.G.

The government has a majority participation in four nonfinancial corporations, in which it appoints the Board of Directors, and a minority stake in two other such corporations, where it is just represented as a shareholder. With the exception of Cyprus Airways, these are all small companies. The government also owns the bulk of the equity of Cyprus Development Bank (CDB), a relatively small financial institution. The government's equity participation in these seven companies is reported in the annual financial report at book value, and no itemized information is provided on their financial position or dividend payments—most of these companies have not been in a position to pay dividends in recent years. They are the recipient of sizeable government guarantees, which are presented in an itemized way at face value in the annual financial report. State aid to these corporations, notably Cyprus Airways, is now strictly governed by the EU *Acquis Communautaire*.<sup>2</sup> There is currently no active privatization program.

<b>Box 1. General Government in Cyprus</b>	Share of GDP 2004
General government in Cyprus comprises the following :	
<b>Central Government Units Covered by the Budget</b>	36
1. General Public Services, including parliament, president's office, judiciary, 11 ministries, and 12 independent services 2. Auditor General's office 1/	
<b>Central Government Units with Individual Budgets</b>	
3. Public Loans Fund (extrabudgetary fund) 4. Special Funds 2/	
<b>Social security funds (no individual budget)</b>	6
5. Central Holiday Fund 6. Redundancy Fund 7. Social Insurance Fund 8. Unemployment Benefits Fund 9. Social Security Scheme	
<b>Local Government</b>	2
9. 33 Municipalities 10. 549 Communities	
1/ The budget of the Auditor General's office was equivalent to 0.03 percent of GDP 2/ Central government transfers to Special Funds amounted to around 1/3 of GDP	

<sup>2</sup> Following large losses in both 2003 and 2004, Cyprus Airways has adopted a major restructuring plan. The European Commission in early May approved temporary state aid in the form of a 30 million CYP loan guarantee in support of the plan.



**3. The relationship between government and the semigovernmental organizations is in some aspects not clearly defined.**

1.1.5, 2.1.4

The Council of Ministers appoints the Board of Directors of the semigovernment organizations and approves their budget before it is voted by the house of representatives. These organizations are monitored by the line ministries responsible for their sector; most of them receive grants or subsidies and loan guarantees; and both the electricity and telecommunications authorities have made ad hoc payments to the government. Their financial relationship with the government is diverse, reflecting the nature of their activities and the specifics of their enabling legislation, and is not always well-documented. In particular, the arrangements regulating transfers from the electricity and telecommunications authorities to the budget appear ad hoc, while some investment requirements in government securities remain in place for these two authorities. They are also engaged in some limited quasi-fiscal activities (QFAs), including universal service provision requirements. There is no information on the cost of these QFAs in either the government's annual financial report or the annual reports published by these two authorities. In the context of EU accession, and the associated liberalization of the energy and telecommunications sectors, a new regime with independent regulators is being set up while new legislation to give the electricity and telecommunications authorities more autonomy is under preparation.<sup>3</sup>

**Government relations with the private sector**

1.1.5

**4. Government regulation of the nonfinancial private sector is mostly transparent.**

Laws and regulations that govern private sector activity are generally transparent. With the EU *acquis communautaire* now being fully reflected in the national legislation, the scope for using laws and regulations as implicit tax/subsidy mechanisms has been eliminated.<sup>4</sup> At the same time, EU accession has required the private sector to meet a range of additional legal and regulatory requirements that in some cases have not yet been translated in a fully transparent way into national legislation.<sup>5</sup> No systematic assessments are made of the compliance costs and the benefits of new government laws and regulations.

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<sup>3</sup> A regulator for the telecommunications sector, the Office of the Commissioner of Electronic Communications and Postal Regulations is already operating, while the regulator for the electricity sector is being set up.

<sup>4</sup> Notably, Cyprus has recognized the importance of the EU's Code of Conduct on Business Taxation, and is committed not to introduce new tax measures deviating from the Code.

<sup>5</sup> EU "regulations" as adopted by the relevant EU body are directly and uniformly applicable throughout the Union. EU "directives" in contrast have to be implemented by national legislation adopted by the relevant authority in the member state. While such legislation needs to conform to the substance of the directives, it does not have to be uniform among the member states and its drafting can reflect country-specific elements.

5. **The government is making efforts to provide more and better information on the regulatory framework governing the private sector.** A number of ministries—notably the ministry of the interior, which has drawn up a Citizen’s Charter for its departments with a view to providing more information and faster service to the public—and the electricity and telecommunications authorities provide detailed information on the laws and regulations that relate to their activities and have arranged access to various forms in both printable and electronic format. A Foreign Investor Service Centre has been set up to give information, advice and assistance on meeting the regulatory requirements for investment projects in Cyprus. Finally, an information campaign has been organized to raise the awareness of the business community, and the public more generally, of the range of legislative and regulatory changes brought about by EU accession. A 1999 Law codifying the general principles of administrative law specifies that every person has the right to request information about a public action that affects him.<sup>6</sup> But the provision in the 1990 Public Service Law that all written and oral information received by a public officer during the exercise of his duties is in principle confidential remains an impediment to a more open government communication strategy.<sup>7</sup>

#### **Government relations with the central bank and public financial sector**

1.1.4

6. **The central bank is fully independent and does not carry out any fiscal or quasi-fiscal activities.** The central bank became fully independent following the enactment in 2002 of a new Central Bank Law which reflects EU requirements.<sup>8</sup> The central bank has price stability as its objective and is prohibited from providing credit facilities to the government and from purchasing directly government debt instruments. The central bank acts as the government’s banker and financial agent (Articles 50 and 51, Central Bank Law). Services to the government are not compensated and no interest is paid on government deposits, which are substantial (Article 52). The Central Bank Law specifies a profit transfer arrangement according to which—unless the Bank’s General Reserve Fund has fallen below its capital, or unless the Bank’s Board deems that exceptional circumstances need to be invoked—80 percent of net profits are transferred into the consolidated fund. These net profits exclude any revaluation gains or losses.

7. **The single publicly owned financial corporation, Cyprus Development Bank (CDB), currently does not carry out significant QFAs but continues to face some financial pressures as a result of past QFAs.** The government retains a 88 percent stake in CDB, which at the time of its creation in 1963 was envisaged as having the dual role of a business development agency and a financial institution. CDB has over the years greatly

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<sup>6</sup> There are no set procedures for requesting information and no fees are charged except when prescribed by law or regulations.

<sup>7</sup> In a number of cases, the Office of the Ombudsman has helped citizens gain access to information that initially had been denied.

<sup>8</sup> The central bank website is <http://www.centralbank.gov.cy>.

expanded its range of products and services and developed its international activities. It intends to establish commercially oriented corporate banking operations as the second pillar of its activities, while maintaining a core of other operations aimed at business development. In recent years, and in part as a result of past QFAs, the CDB had to write off a large amount of nonperforming loans, with a corresponding major reduction in its net equity and reserves position. The institution has been implementing a strategic business plan, which has been a key factor in its return to profitability (before provisioning) in 2004, and is also envisaging strengthening its capital base. The government has fully guaranteed the loans from the European Investment Bank to the CDB, and in early 2005 recognized as an explicit debt obligations stemming from a mechanism to take on the exchange rate risk associated with CDB's foreign borrowing.

### **Fiscal management relations among the branches of government**

*1.1.2*

8. **The fiscal roles of the executive, legislative and judicial branches are clearly defined in the Constitution and laws.** According to the Constitution, the minister of finance is responsible for the annual preparation of a comprehensive budget. The minister of finance, notably through the Office of the Accountant General, is also responsible for budget execution and reporting at all stages. The Council of Ministers, headed by the president, has the overall responsibility for the financial management of the government. According to the Constitution, the auditor general, appointed by the president, is also part of the public service. The house of representatives has to approve the itemized (by ministry, department, and independent service) expenditures that are not directly charged to the consolidated fund. The house of representatives may approve any expenditure proposed in the draft budget, but may not vote an increased amount or alter its purpose. The judiciary is not directly involved in fiscal matters, but reviews administrative acts and decisions, including in fiscal matters, and handles criminal proceedings against public officers.

### **Fiscal management relations among different levels of government**

*1.1.2*

9. **The responsibilities of different levels of government are well defined, but some of the financing arrangements lack clarity.** Cyprus has six administrative districts that act as intermediate bodies between the central government (ministry of interior) and the local authorities. The latter are composed of 33 municipalities (governed by the 1985 Municipalities Law) covering larger towns and tourist areas, and 549 communities (governed by the 1999 Communities Law) covering sparsely populated rural areas. Both municipalities and communities have responsibilities for such activities as water supply and sewers, road maintenance, and public health protection, with communities having fewer responsibilities and less autonomy. In 2003, the local authorities spent around 1.8 percent of GDP, running a deficit of 0.2 percent of GDP. The central government is covering a large part of the local authorities' investment expenditure and a fraction of their other expenditure through grants, with such grants accounting for more than one third of total spending. There are no clear legal arrangements specifying grant conditions and formulas. The central government also provides guarantees on local borrowing for investment purposes. The local authorities can levy their own taxes and charge fees under the conditions specified in their respective laws. Yearly

budgets, which have separate current and development estimates, are submitted to the ministry of interior and, in the case of municipalities, further to the Council of Ministers. Accounts should be finalized by April 30<sup>th</sup> of the following year and are audited by the auditor general.

## **The legal and administrative framework for budget management**

### **10. The legal framework for management of public funds is overall clear; but it is not very specific.** 1.2.1

The Constitution in its Articles 80–81 spells out the budget preparation and approval calendar and defines the role of the house of representatives in the expenditure approval process. The Constitution also creates the offices of the Accountant General and Auditor General. Article 165 sets up a consolidated fund, while Article 166 lists the expenses that are chargeable directly to this fund. Articles 167 and 168, finally, assign the responsibility for budget preparation and execution to the minister of finance, and provide arrangements for bridging finance and supplementary budgets. Law N112/2002 for the Management of Revenues, Expenditure and of the Accounting System of the Republic contains more detailed provisions complementing those of the Constitution. The Law applies to all ministries, departments and independent offices, as well as to funds not as such included in the budget but under public administration. It gives the finance ministry a central role in fiscal management and covers matters related to budget preparation, approval and execution; the reallocation of resources between heads and subheads; accounting systems and financial reporting; the duties and responsibilities of controlling officers and the accountant general; the ratification of international loan agreements by the house of representatives; and the authority of the minister of finance to extend loan guarantees. The Law does not deal with issues of managing the composition of the public debt, fiscal risk and sustainability, or financing arrangements such as public/private partnerships (PPPs).<sup>9</sup>

### **11. The legal framework for fiscal management mainly focuses on the expenditure side, while tax policy it not well coordinated with overall fiscal management.** 1.2.2

The annual budget preparation process is not used to present and discuss tax policy objectives or changes. Tax policy measures are usually enacted by separate laws adopted throughout the year. This dual process complicates to some degree fiscal management, as within-year tax law changes could affect the relevance of the revenue estimates included in the budget and could result in additional spending pressures that would require the adoption of supplementary budgets.<sup>10</sup> Moreover, it results in a disconnect between revenue and expenditure policies.

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<sup>9</sup> The Planning Bureau in 2000 prepared a note on PPPs, posted at its website.

<sup>10</sup> In analogy with Articles 80 and 167 of the Constitution, which prevent the house of representatives from voting an increase in budgetary expenditure, the house cannot vote changes in the tax legislation that would reduce revenues.

**12. Mechanisms for the coordination and management of budgetary and extrabudgetary activities are well defined.**

1.1.3

Cyprus has 28 special funds, the balances with the Treasury of which are reported in both the budget and the annual financial report. A number of special funds receive government transfers, which are also reported in both documents. The management of the assets of these funds is closely monitored. In addition, a public loans fund governed by the Public Loans Law, Cap. 208, and administered by loan commissioners appointed by the Council of Ministers has been set up. The fund maintains balances with the Treasury, which are shown under the assets and liabilities of the Central Government, and it covers its operating costs from interest on its lending portfolio. It has a number of revolving programs operating under its umbrella, which are geared to providing low-interest loans for development projects in a number of sectors. The fund's activities are governed by specific operating regulations, and they are monitored closely by the ministry of finance and subject to the auditing arrangements for the public sector.

**The legal and administrative framework for tax policy and administration**

**13. Taxation<sup>11</sup> has an appropriate legal base, which is comprehensive and reasonably clear.**

1.2.2

The Constitution in its Articles 78 and 87 gives the house of representatives the power to impose taxes.<sup>12</sup> Municipalities and communities have also the right to establish some local taxes (e.g., property taxes) under the conditions of the laws governing their activities. To comply with the EU *acquis* on taxation and customs, the tax system has undergone numerous changes in recent years, creating a temporary period of uncertainty for taxpayers. However, the harmonization with EU standards has overall simplified the tax system and enhanced transparency.

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<sup>11</sup> The tax framework comprises four main taxes, namely the income tax, the VAT, the excise duties, and customs duties. The basic tax laws are (i) for VAT, law N95(I)/2000 as amended; (ii) for customs and excise, customs code law 94(I) of 2004, excise duties law of 2004, EU council regulation 2658/87 as amended, EU council regulation 2913/92, EU commission regulation 2454/93; for direct taxation, the Income Tax Law 118(1) of 2002 and the assessment and collection of taxes law 4/1978 as amended. These laws describe, among others, tax base, tax rates, tax concessions, and the general principles and procedures relating to tax issues.

<sup>12</sup> All tax laws and regulations are published in the official Gazette of the Republic and readily accessible, mostly in Greek, at the ministry of finance's and tax administrations' web sites ([www.mof.gov.cy/gpo](http://www.mof.gov.cy/gpo); [www.mof.gov.cy/mof/customs](http://www.mof.gov.cy/mof/customs); <http://taxisnet.mof.gov.cy>). The major accountant firms in Cyprus provide timely translation in English of most of the tax laws and regulations.

**14. Tax exemptions have been reduced, but no tax expenditures are reported.** 1.1.2

Tax exemptions are based on clear criteria specified in tax laws, with no official discretion.<sup>13</sup> Compliance with EU requirements has resulted in a significant reduction of tax concessions and a close monitoring of all state aid, including fiscal incentives. The Inland Revenue Department prepares estimates of the cost of associated tax expenditures every time that a proposal to change the tax legislation is made. These estimates are reported to the minister of finance and, when a proposal makes it to the parliamentary stage, to the house of representatives. Moreover, an estimate of the impact of fiscal incentives was prepared in the context of the EU negotiations. However, there is no systematic reporting on tax expenditures in the regular budget documents themselves.

**15. Tax and customs administration are clearly defined.** 1.2.2

Taxes are administered by two separate agencies: the Inland Revenue Department and the Department of Customs (also in charge of the VAT and excise tax). While the Inland Revenue Department is organized along functional lines,<sup>14</sup> the Department of Customs is rather based on regional offices reporting to a central administration. There is no unique taxpayer identification number (TIN), but all TINs have a common element in order to secure a link between the various tax departments.<sup>15</sup> Tax officials are subject to the code of conduct for all civil servants under the Public Service Law of 1990. In addition, the Customs Department has recently issued a well-publicized code of ethics, to ensure that its officials maintain high standards in their duties. The Inland Revenue Department continuously offers training to its staff on how to provide information and assistance to taxpayers. Every tax office has a service desk where taxpayers can obtain all relevant forms and information.

**16. Taxpayers' legal rights are well defined.** 1.2.2

Taxpayers' rights are set out in the Constitution and the main basic tax laws. These include the rights to information and effective assistance from tax officials with confidentiality,<sup>16</sup> and

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<sup>13</sup> There is one exception: in cases where an individual is living below the poverty line, the minister of finance can exercise discretion as to whether that person should pay income tax.

<sup>14</sup> The structure is arranged functionally around assessment, collection, audit, and tax enforcement units. International experience suggests that the functional structure permits clear lines of accountability.

<sup>15</sup> This common element is the "Companies Registration Number" for legal entities and the "Identity Card Number" for physical persons.

<sup>16</sup> Tax administrations departments are not allowed to exchange information among themselves or with the social security fund. Disclosure of taxpayers information has also been profoundly affected by the EU *acquis* on administrative co-operation and mutual assistance, which allows EU members to exchange taxpayers' information both automatically and on

(continued...)

the right to appeal tax administration decision (as described in Box 2). To increase taxpayers' general awareness of their rights, the Inland Revenue Department has recently produced a booklet on taxpayers' rights, which assembles various provisions on the subject. Moreover, these rights are posted on the tax administrations' website and spelled out during communication with taxpayers (e.g., on tax returns, assessment raised, and determination letters).

## **Public servants' code of behavior and anti-corruption activity**

*1.2.2*

17. **Public servants are subject to a well-defined code of behavior.** The Constitution in its articles 124–125 creates a public service commission which, among others, has the authority to exercise disciplinary control over public officers. Part VI of the Public Service Law, 1990, specifies the duties, obligations, and rights of public servants, while Part VII contains a detailed disciplinary code, including the procedures for dealing with disciplinary offences and their sanctions. A special ethics code, available to the public, applies to the officers of the Customs Department. Cyprus has a comprehensive legal framework against fraud and corruption. The penal code defines a series of offences of official corruption, such as extortion by public officers, abuse of office, or neglect of official duty. In addition, the Prevention of Corruption Law provides for sanctions to be taken against both public and private corruption. Part VII of the Public Service Law also contains special anticorruption provisions, including a recently introduced obligation for public officers to report in writing acts of corruption and bribery by another officer of which they became aware in the exercise of their duties. Law No. 50 (I) of 2004 requires public office holders to declare their assets and liabilities to an Independent Tribunal comprising a lawyer and an accountant (both from the private sector) and the Secretary of the Council of Ministers. The declaration is prepared upon taking up office and again upon leaving office. All citizens have access to the services of the ombudsman, which acts as another mechanism to ensure integrity in the public service. Moreover, the Council of Ministers in April 2003 set up a coordinating body on corruption. Indications are that acts of corruption and bribery are not widespread and that the procedures to deal with such actions tend to be effective.

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request. Moreover, as of July 1, 2005, the EU has introduced an automatic exchange of information on cross-border interest payments, in compliance with the EU savings tax directive.

## **Box 2. Taxpayers' Legal Rights to Appeals**

Taxpayers' legal rights to appeals are set in the main basic tax laws (internal review process) and in the Constitution (appeal to the supreme court).

### **Internal review process**

The review process varies across tax types.

#### **1) VAT**

If any person disagrees with a decision of the VAT Commissioner (e.g., for imposition of levy, tax assessment) he may file:

(i) *A written objection to the VAT Commissioner*, within 60 days from the date of the notification to this person of a VAT assessment (Article 51A of the Value Added Tax Laws of 2000 through 2004). The appeal must be written and supported by the relevant evidence.

(ii) *A written objection to the minister of finance* within 60 days from the date of the notification to this person of the relevant decision of the VAT Service, provided that the person has paid all the amounts payable by him or has deposited a money deposit to the VAT Commissioner. The Minister examines the legality as well as the substance of the tax dispute (Article 53 of the Value Added Tax Laws of 2000 through 2004).

#### **2) Customs and excise duties**

*A written objection to the Director of Customs*, which every person has the right to submit within a period of sixty days from the date of issue of the decision (Article 112 of the Customs Code Law of 2004).

#### **3) Direct taxes**

A taxpayer can appeal through a two-stage complaint process:

(i) *A written objection to the Director of Inland Revenue*, no later than the end of the month following that in which he was notified of the decision (Article 20 of the Assessment and Collection of taxes Law 4/1978 as amended). The taxpayer does not have to pay the tax liability at this stage, and the tax administration has to respond to his objection within 3 years (a formal response re-activates the 3-year response period). The taxpayer is issued an assessment on the undisputed amount and requested to pay this amount. A revised assessment is issued in full settlement of the objection.

(ii) *Appeal to the tax tribunal*, within 45 days of the date of the commissioner's decision (Article 20 of the Assessment and Collection of taxes Law 4/1978 as amended). Tax tribunals were introduced by an amendment to the assessment and collection of taxes law 4/1978, with effect as of January 2, 2000, to allow an independent administrative body to examine the subject matter of the litigation before appeal to the supreme court.

### **Appeal to the supreme court**

Based on Article 146 of the Constitution, any person may file an appeal to the supreme court against an executory administrative act of inland revenue or customs departments within 75 days from the date of the notification to this person of the relevant act. The supreme court examines only whether the proper procedures were followed, and does not take up the substance of the matter.



## B. Open Budget Preparation, Execution, and Reporting

### The budget preparation process: clarity and consistency of process and presentation

#### 18. The annual budget process is open but the presentation lacks overall consistency with international standards. 3.2.1

By law, the fiscal year in Cyprus corresponds to the calendar year, while Article 167 of the Constitution places the responsibility for the preparation of the comprehensive budget on the minister of finance. Under Article 81 of the Constitution, the budget then has to be introduced in the house of representatives at least three months before the commencement of the financial year, i.e., by September 30 of each year, and it is to be voted upon by the House not later than December 31 of each year (Box 3). Accordingly, the ministry of finance issues the budget circular by end-March. The budget circular outlines the various parameters for budget preparation for the guidance of the line ministries. A separate, parallel circular is issued by the planning bureau for the development expenditure part of the budget, within the ambit of a five year strategic development plan drawn up by the planning bureau for the development portion of the budget (Box 4). The budget is presented on a line item basis, making it difficult to obtain a consolidated view of the outcomes of programs and policies. Although the budget and accounts classification are consistent and mainly based on an administrative classification and also a basic economic classification is presented, the presentation is not consolidated or the classification based on either the GFS 1986 or the GFS 2001/ESA-95 methodology. The existing classification does not allow an evaluation of programs and objectives nor does it facilitate a transparent analysis of changes in expenditure patterns over time.

**Box 3. The Budget Preparation Calendar**

Due dates	Activities	Legal basis
The fiscal year is set on a calendar-year basis by the Constitution. The main steps in the process are as follows:		
End-March 1/	Budget circular issued to ministries detailing the basic parameters	Administrative instructions of the finance ministry and planning bureau
20 May	Line ministries submit budget proposals to ministry of finance	Administrative instructions of the finance ministry and planning bureau
June to late September	Budget discussion between line ministries and ministry of finance	Administrative instructions of the finance ministry and planning bureau
Early September	Submission to the Council of Ministers for discussion and approval	
30 September	Ministry of finance submits budget proposals approved by the Council of Ministers to the house of representatives	Art. 81 of the Constitution
October to December	Discussion of the proposed budget in the Policy & Budget Committee and in plenary session; budget approval	The Rules of Procedures of the House of Representatives
1 January (next year)	Commencement of budget approved by the house of representatives	Art. 81 of the Constitution

1/ In May 2005 for the 2006 budget.

#### **Box 4. Budget Preparation Process**

Until 1998, the government presented four separate budgets—the ordinary budget, the development budget, the Special Relief Fund for the Displaced and Affected persons and the Defense Fund. By order No. 48.868 of December 16, 1998, the Council of Ministers approved the consolidation of all four budgets, although the presentation is still in two separate sections for the ordinary and the development budget.

The budget circulars of the ministry of finance (ordinary expenditure category) and the planning bureau (development expenditure category) specify the date for submission by the line ministries of their proposals to the ministry of finance (e.g., May 20, 2005 for the 2006 budget) and the planning bureau (e.g., May 14, 2005 for the 2006 budget), and the date when the ministry of finance, in turn, has to submit the combined budget documents to the house of representatives. The budget circulars also detail the parameters for the preparation of budget estimates as based on the country's Convergence Program. It also identifies various budgetary cuts to be made—for instance, the budget circular No.13.23.002 issued in May 2005, specifies that a 20 percent cut be made in overtime allowances, while the increase in current expenditures is capped at 2 percent; the rate of increase was limited to 6 percent for development expenditure and to 2½ percent for social benefits. However, no reference to estimated revenue inflows is made at this stage, and so no clear linkages are established between the spending plans and the expected revenue inflows in the forthcoming budget year.

All investment programs and projects are described in the explanatory memorandum accompanying the development expenditures part of the budget. However, the nature of the information provided and the absence of program classification make it difficult to monitor progress in project implementation. A limited number of expenditure subheads in the budget's development part are marked with a dagger (+), indicating that expenditure cannot be incurred until full details of the project have been provided to the planning bureau and an "Authority to incur Expenditure" has been obtained from the minister of finance. The final approval for de-dagging rests with the minister of finance upon advice from the planning bureau.

Dagging is applied when implementing line ministries have not provided adequate project information by the time the budget is submitted to the house of representatives or when more time is needed to analyze and evaluate the project (in case of new project proposals). Dagging is also used as a mechanism to monitor monthly cash flows of large projects, in which case cash releases are made after periodic implementation reviews in the course of the year. However, problems remain in integrating operating costs of projects into the ordinary budget at the termination of the project's implementation stage, when the related maintenance and operations costs have to be integrated into the ordinary budget.

#### **The macroeconomic framework and policy basis for the budget**

**19. The deficit/net borrowing of general government is the main indicator of the fiscal position, and the general government balance is monitored during the year.** 3.2.3

The deficit/net borrowing of general government is determined in accordance with the provisions of the Excessive Deficit Procedure and the ESA-95 guidelines, and targets are set with a view of meeting the Maastricht deficit and debt criteria, controlling the public debt

more generally and ensuring the long term sustainability of the social security funds.<sup>17, 18</sup> The government monitors the general government balance/net borrowing consistently (on a quarterly basis), and also tracks such indicators as the general government primary and structural balances (in the context of the semi-annual fiscal notifications to the European Commission) and the balance of the consolidated central government (monthly). The deficits of municipalities and communities are not systematically monitored. While the size of the local sector deficit is small at present, it is seen as potentially growing over time as the increase in own revenues and grants may not keep pace with growing expenditure pressures. Besides the ministry of finance, the central bank also monitors and analyses the current fiscal position and the institutional and structural changes in the budget through its recently created fiscal department, which follows the common guidelines of the ECB. The central bank makes fiscal projections in April and October each year and produces fiscal data on both the consolidated central and the general government using information provided by the ministry of finance and the statistical service.

**20. Budget forecasts and underlying macroeconomic assumptions are linked to the Convergence Program (CP) prepared in the context of EU fiscal surveillance, but they not clearly presented in the budget documents.** 3.1.3

Through budget circulars, the ministry of finance and the planning bureau indicate to the line ministries the broad policy guidelines for the budget formulation for the coming year with regard to the recurrent and the development items in the budget, respectively. While a general review of macroeconomic policies is available in the finance minister's budget speech and the accompanying report on economic developments, and a broad consensus exists on the macroeconomic goals, the budget remains essentially based on an incremental budgeting mechanism for expenditure items and only a consolidated revenue forecast based on existing tax policies is prepared. A short document summarizing the economic developments in the previous year and the prospects for the coming year is prepared by the planning bureau and

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<sup>17</sup> Council Regulation (EC) No. 3605/93 of 22 November 1993 on the application of the Protocol on the excessive deficit procedure, as amended; and Opinion of the E.U. Economic and Financial Committee on the content and format of Stability and Convergence Programmes (2001 code of conduct). For the purpose of reporting under the excessive deficit procedure, "government deficit" is the balancing item "net borrowing/net lending" of general government, including streams of interest payments resulting from swaps arrangements and forward rate arrangements.

<sup>18</sup> Reporting according to the ESA-95 standards requires that data on the general government sector also cover the so-called non-market public institutional units, defined as production units the sales of which cover less than 50% of production costs. The school committees, the University of Cyprus, and the Cyprus Tourism, Theatre, and Sports Organizations fall under this criterion. Their activities are fully covered in the fiscal data prepared by the statistical service Cystat and transmitted to the EU institutions, but only aggregate information on funding provided by the central government is included in the budget documents.

the ministry of finance each year. This document discusses broadly the international and national economic developments including details of the inflation rate and the fiscal deficit and presents a brief sectoral analysis. The “Economic Developments and Prospects” document is published shortly before the finance minister’s speech on the budget and is available to the press and the general public. Despite being derived from the CP and following the latter’s objectives,<sup>19</sup> neither this document nor the strategic development plan (Box 5) are linked clearly and explicitly to the CP. This would be possible with little effort, since the medium-term projections and targets discussed in these two documents are fully consistent with the CP. The planning bureau also issues a longer “Economic Outlook” report and accompanying “Economic and Social Indicators,” which offer an assessment of macroeconomic and sectoral developments in Cyprus. The “Economic Outlook” makes extensive references to the international economic environment and also presents short-term forecasts.

### **Box 5. Development Planning**

The planning bureau is the government agency responsible for the country’s development policy. The bureau prepares a medium-term development plan in close cooperation with all ministries, departments, and agencies involved. The development plan reflects the government’s medium-term development priorities, and relates only to the development portion of the budget.

The strategic development plan in principle is prepared for a five-year period (the Strategic Development Plan 2004–06 is for three years only, instead of five, to converge with EU requirements). The plan discusses the development programs of the government and the main semigovernment organizations, and assesses the major schemes proposed by the various line ministries. The first part of the document is devoted to a discussion of the overall development strategy, and includes sections on recent economic developments and the current economic situation, the broad development strategy and the medium-term macroeconomic framework. The second part, which takes up the larger portion of the document, presents in general terms the priorities and strategies in the various development areas and the associated projects. There is no discussion, however, linking these projects to their future operating costs, underlying economic developments or future revenue inflows.

## **Medium-term planning and analysis of fiscal risks**

**21. A statement on medium-term fiscal policy objectives is included in the budget documents as part of the minister of finance’s speech, but fiscal sustainability issues and risks are not covered as such.**

*3.1.1*

Under the CP, a medium-term projection is prepared as part of the fiscal policy planning and budgeting exercise, and forecasts of the main economic aggregates, including the parameters affecting the social security fund and health expenditure, are prepared. The ministry of finance examines the impact of policies on the budget balance and also estimates the general

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<sup>19</sup> A low deficit, fiscal sustainability, and a defined GDP growth and fiscal consolidation path.

government overall, primary and structural balances in the context of the CP.<sup>20</sup> The 2005 budget was in line with the goals set in the December 2004 CP, and the CP preparation calendar is now broadly aligned with the budget preparation calendar, which could facilitate their further integration (see Box 3 above).<sup>21</sup>

**22. Fiscal rules are used in the budget process.**

3.1.2

The government in June 2002 adopted the basic fiscal rule of zero borrowing from the central bank, which is also enshrined in the central bank law. Since EU accession, the government follows the requirements of the Stability and Growth Pact (SGP), combined with quantitative limits on the growth of most current expenditures beyond 3 percent, and for capital expenditure beyond 4 percent.<sup>22</sup> There is an understanding that the local levels of government have to present a balanced budget to the ministry of the interior.

**23. Estimates of new initiatives and ongoing costs of government policies are not clearly distinguished in the budget documents.**

3.1.4

The finance minister's budget speech discusses the new initiatives for the forthcoming year in brief. However, the budget documents<sup>23</sup> present expenditures on a line item basis without clearly distinguishing between ongoing costs of activities and the costs of any new spending proposals introduced in that year's budget, although some detail is provided in the explanatory memoranda to the budget for development projects. Development program estimates are based on studies to assess the need for a new service and the attendant costs for its implementation over the life time of a scheme. However, the implementation of development programs, currently at 70 percent to 80 percent, points towards a need for more effective monitoring.

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<sup>20</sup> The "December 2004 Update of the Convergence Programme of Cyprus" was approved by the European Commission on February 16, 2005. It covers a T+4 year medium-term policy objective, medium-term expenditure and revenue tables, general government debt, primary balance targets and a long-term sustainability analysis of public finance under different scenarios and with a sensitivity analysis.

<sup>21</sup> Cyprus' first CP was published at the time of EU accession, in May 2004. Following the update in December 2004, its preparation calendar is now guided by the 2001 code of conduct (see footnote 17 above). According to the code, CP submissions should take place shortly after the budget presentation to the house of representatives, in between mid-October and end-November.

<sup>22</sup> Special provisions introduced the following specific expenditure limits: no increase for grants to semigovernmental organizations; containment of defense outlays to CYP 70 million annually; and containment of the rate of increase of current transfers (pensions, monetary allowances) to the rate of inflation.

<sup>23</sup> The budget documents include the text of the law to provide for the budget for the year in question and accordingly are published in the official gazette.

**24. The sensitivity of budget estimates to changes in economic variables is assessed but fiscal risks are not discussed with the budget** 3.1.5

The finance minister's budget speech to the house of representatives refers broadly to the economic variables and the general economic situation in the country and their impact on the budget, but a more in-depth analysis is only offered in the CP. The response to cost overruns or revenue shortfalls in the past has been to resort to a supplementary budget, with 14 supplementary estimates presented to the House in 2003, totaling CYP 431 million, equivalent to 6.7 percent of GDP.<sup>24</sup> This practice has since been controlled and only four supplementary or amending budgets were sent to the House in 2004, amounting to CYP 63 million or 0.9 percent of GDP. The budget documents do not indicate contingent liabilities, nor are these assessed in the context of certain large infrastructure projects, where the government is either a guarantor or a majority owner. However, the financial report does include a statement on outstanding guarantees given by the government.

**Clarity of control of budget execution**

**25. Basic accounting and internal control procedures are in place but the new accounting system's full potential still remains to be exploited.** 3.3.1

The Accountant General has issued detailed financial and accounting regulations to guide Heads of Departments and Independent Services and accounts officers in the maintenance of accounts. The government has recently set up a financial information management accounting system (FIMAS) in the treasury. The system appears to have the capacity to monitor expenditures on a monthly basis and on a program basis, although the program functionality does not seem to have been used, possibly because of lack of program budgeting at the line ministry level. The system also has the capacity to check payments against budget allocations and record commitments (Box 6). In combination with strict payment authorization procedures, this ensures strong ex ante control. The system can also be used for preparing the budget documents, and the 2004 budget documents were the first to be prepared using the FIMAS system. However, the system is relatively recent, having been set up in 2003 and becoming operational in 2004, and occasional reporting discrepancies have been noticed in line ministries. The government operates a single account called the government general account, and all revenues deposited in private banks are deposited into it within two days of collection. Transfer delays are watched by the Treasury and a system exists to collect interest on delayed payments into the government general account. The Central Bank of Cyprus

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<sup>24</sup> Additionally under Section 4(1) of the Budget Law, the Council of Ministers may authorize *virement* under any subhead or head of expenditure against equivalent savings, subject to certain criteria. The minister of finance is also authorized by the Council of Ministers by their decision No. 3727, dated March 19, 1964, to vire by use of special warrants provided they are laid in the House as provided under Section 4(2) of the Budget Law.

provides the Treasury daily balances on the government general account. Although bank reconciliation is carried out, it takes place only monthly and end-year reports do not provide any information on discrepancies between monetary and fiscal data. There is no formal process to ensure consistency between the monetary survey reports on commercial bank credit to government and the government data on the financing of the deficit.

### **Box 6. The FIMAS System**

The FIMAS system is based on a 10 digit code supported by a further 10 digit analysis and a 10 digit transaction code, which allows generation of about 250 standard reports and a further number of customized reports at any hierarchical level, including on payments and commitments. FIMAS has a general ledger; includes expenditure control, budget preparation, costing and reporting modules; and maintains a database of outstanding government liabilities.

FIMAS could be used to strengthen commitment control. Clauses 11 & 12 of the Law for the Management of Revenues, Expenditures and of Accounting Systems of the Republic and Other Related Matters makes the controlling officers personally liable for ensuring that expenditures do not exceed allocations. In addition, Law No. 112 (1)/2002 makes the incurrence of any expenditure in excess of approvals a criminal offence. The government has also issued instructions (*Order No. 1568 of December 23, 2003, Paragraph 3.1.5 and Articles 73 and 74 of the Finance and Accounting Instructions issued by the accountant general*) to ensure recording of commitments. However, the large number of supplementary budgets and extensive use of special warrants, while preventing the build-up of payment arrears, suggest that the current commitment control system in place does not yet ex ante ensure a hard budget constraint.

Other functionalities offered by FIMAS could be developed as well. Considering the lack of program budgeting, absence of regular feedback reports to line ministries on their performance, and inadequate analysis of expenditures, the full potential of FIMAS does not seem to have been realized yet. The system covers all national and EU funds except those directly paid to citizens in the area of agriculture (channeled through the Cyprus Agricultural Payments Organization) but not local authorities or semigovernment organizations. While the consolidated central government budget and accounts classifications are uniform, they are not uniformly used at other levels of government. Steps are, however, being taken to implement reporting based on IPSAS standards—although full accrual recording still remains a challenge. No data on nonfinancial assets of the government is available but a policy paper is now under preparation to set up a reporting system and generate data through FIMAS. Project modules of FIMAS that provide capacity for program and project monitoring are being developed.

While it is envisaged to present the 2004 accounts with a full set of notes on accounting policies, consolidation of accounts still remains a problem. FIMAS does not have the capacity to generate transaction-based data on tax arrears although this can be interfaced through the tax service system. Detailed loan register and government guarantee registries are maintained, and work on a computerized system to provide details of loans and government guarantees is now underway and is expected to be completed by year-end.

The accountant general provides FIMAS-based information to the statistical service and every account code is allotted an ESA-95 code to enable generation of data on government statistics for the EU Commission, Eurostat, and the ECB in ESA-95 format. However, the generation of data on a cash basis remains the main methodology, and the statistical service uses data from external sources, such as trade statistics, to prepare information on an accrual basis, the ESA-95 accounting standard.

**26. Financial management practices are in a number of respects not well coordinated.**

*3.3.1, 2.1.4*

While there is a well established concept of cash planning on an annual and monthly basis, the frequent resort to supplementary budgets and special warrants to meet expenditure overflows and lack of comprehensive mid-term reporting indicate a need for greater coordination of financial management practices. However, the budget and fiscal control and investment and finance directorates of the ministry of finance closely coordinate cash management and debt issuance, with the latter deciding on the debt characteristics and issuance timing on the basis of information on the amount of net financing needs regularly provided by the former.

**27. Internal audit is not yet fully effective but a new internal audit service is expected to bring further improvements in this area.**

*3.3.3*

The government has recently set up an internal audit service, an independent agency to conduct internal audit. This agency currently uses treasury staff on secondment until new staff is recruited, a process currently underway. Under Article 6 of the internal audit Act (No.114 (I)/2003), the commissioner of internal audit submits annual reports to an Internal Audit Board<sup>25</sup> (set up under Article 14 of the Act) by end-June. However, these reports are not public documents. In 2004, the internal audit service audited nine EU preaccession funds and only one ministry, and it plans to undertake another five or six follow-up audits in 2005, based on an agreed action plan. The internal audit staff is guided by an internal audit manual based on international audit standards. However, the new internal audit mechanism will reach its full potential only once the entire staff complement is in place.

**28. Procurement rules and practices are clear and well publicized.**

*3.3.2*

Procurement rules, codified in a new procurement law, Law 101/2003, are clear and well publicized. All government tenders over 5000 CYP are publicly tendered, in compliance with the EU directive in this area.<sup>26</sup> All tenders are publicized in the official gazette, a weekly publication issued each Friday. The tenders are also put on the website of the government<sup>27</sup> or the relevant bodies such as the telecommunications authority (which avails itself of some special procedures under the procurement Law 100/2003 for entities operating in the utilities sector) or the electricity authority. The procurement rules are within the EU accession norms as the national legislation was harmonized in 2003 and is followed in practice. This is further ensured through several regulations issued in 2003 and 2004 on the award of public contracts,

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<sup>25</sup> The minister of finance, two other ministers, the accountant general, and a person with experience in internal audit, who is not a civil servant, comprise this Board.

<sup>26</sup> Directive 2004/18/EC of March 31, 2004 of the European Parliament and of the Council on the coordination of procedures for the award of public works contracts, public supply contracts, and public service contracts.

<sup>27</sup> [www.mof.gov.cy/gpo](http://www.mof.gov.cy/gpo).



including those for local authorities, public enterprises and other entities operating in various infrastructure sectors.

**29. Civil service employment procedures are clear and well understood.** 3.3.2

The Public Service Law and the Public Service (emoluments, allowances and other benefits to public officers) Regulations specify the rules governing recruitment, employment, promotion, and pay procedures. With the number of employees in the broad public sector service amounting to over 46,000, almost 16,000 of which with civil servant status, employment procedures and remuneration conditions are clear and well understood.<sup>28</sup> Government employees are appointed by a Constitutionally created Public Service Commission which fills all permanent public service posts. The Commission's members are appointed by the president for a fixed term of six years, to ensure their independence. The Public Service Law and the Public Service Regulations are well defined with clear criteria for competitive recruitment and promotion. The salary scales of public employees are well specified and posted on the web. In fact, in Cyprus public servants in nonmanagerial positions are paid wages that are significantly above private sector rates.<sup>29</sup> However, promotions are time bound and seniority based, limiting incentives for performance. The government is now in the process of undertaking public service reform by extending the retirement age from 60 to 63, and considering a new performance appraisal system for the public service.

**Clarity of internal control and independence of tax administration**

**30. Tax administration's internal monitoring and control mechanisms have been strengthened.** 3.3.3

Tax and customs administrations' operational capacity has been strengthened in the run-up to EU accession, notably through a modern information technology system, leading to reduced fraud opportunities, better information sharing, and improved audit operations. Moreover, mechanisms to ensure accountability have been strengthened. These include improved internal audit systems in the inland revenue and customs administrations, frequent audits by both the Internal Audit Office and the Auditor General Office. On specific tax matters, tax officials are allowed to issue advance rulings, which the courts consider binding on the concerned tax departments.

**31. The national tax and customs administration are administratively under the ministry of finance but operate independently.** 3.3.4

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<sup>28</sup> Other employment categories in the broad public sector include the educational service, police, fire service and military personnel, and craftsmen and laborers. In addition, the semigovernment organizations employ around 12,400 staff.

<sup>29</sup> Gross salaries and allowances of higher civil servants range from CYP 7,708 p.a. to CYP 46,418 p.a. at the level of the general director of a ministry.

The Inland Revenue and Customs Departments directly report to the ministry of finance, and their operational budgets are determined through annual appropriations under the budget law. They are not allowed to retain a share of the revenue collected for staff bonuses or any administrative expenditure. Inland revenue and customs administrations are carried out on the basis of constant and close cooperation with the ministry of finance. While tax officials have no specific legal protection from political interference, they are appointed, like other civil servants, by the public service commission, an independent body, which fosters impartiality. The 1999 Law on the General Principles of Administrative Law provides additional safeguards in this regard.

### Accounting and reporting on budget execution

#### 32. FIMAS is capable of producing accurate in-year reports on the consolidated central government budget outturn, including defense expenditures. 3.3.1

The accounting system can generate accurate and timely in-year reports in various forms, including monthly fiscal reports and reports on outstanding payment obligations—although not in GFS format. Vouchers are input into the system online by the line ministries, which maintain their own database. This information is then transferred at the end of the day to the central system in the Treasury, checks are issued and the data is consolidated for the generation of fiscal reports. The accounting classification is entirely consistent with the budget classification, and the accounting system is also used to generate the budget documents. Article 81 of the Constitution mandates the submission of the final accounts to the house of representatives within three months from the end of the financial year. In practice, however, the timeliness of reports has been and remains an area of concern, in that the 2004 reports have tended to be submitted to the finance minister with significant delays (Table 1).

Table 1. Dates of Submission of Financial Report and Audit Report

Sl. No	Financial Year	Date accountant general's finalized accounts submitted to: 1/		Date of submission of auditor general's report to the president
		Ministry of Finance	By MoF to house of representatives	
1	1999	4 April, 2001	27 September, 2001	20 November, 2000
2	2000	30 August, 2001	5 November, 2001	22 November, 2001
3	2001	23 September, 2002	12 February, 2003	22 November, 2002
4	2002	2 February, 2004	7 July, 2004	21 November, 2003
5	2003	26 November, 2004	12 December, 2004	25 November, 2004

Source: Ministry of finance.

1/ The auditor general starts the audit of the accounts before the date on which the accountant general submits the finalized accounts to the ministry of finance. However, with the new FIMAS this synchronization problem is expected to be resolved.

**33. Fiscal reporting covers all of the consolidated central government.** 3.3.1, 2.1.1., 3.2.4

The government's budget displays allocations to all ministries and independent services paid out of the consolidated fund, the development expenditure, the estimates of expenditures to be met from the loan commissions, and transfers to special and extrabudgetary funds, semigovernment organizations and local authorities. The budget execution is reported by the accountant general in monthly reports ("abstracts") and the finalized annual accounts. The presentation of the data in the annual financial report is based on the budget classification. As prescribed in the Law for the Management of Revenues, Expenditure and of the Accounting system of the Republic of 2002, Section 13, the annual financial report covers not only the budget but also the receipts and expenditures of the other public funds (but not the local authorities).<sup>30</sup> However, some expenditures on services provided across government bodies are double counted but netted against compensation for these services in the accounts of the providing body. Financial reporting is now under review to ensure compliance under IPSAS. Data on the consolidated general government are prepared by the statistical service in accordance with the ESA-95 standards and published on a quarterly and annual basis on the service's website.

**34. The legislature does not receive in-year reports on budget outturn, and does not undertake a mid-year review.** 3.4.1

Although the FIMAS system has the capacity to do so, no formal mid-year reports are generated using FIMAS or in any other format. Neither does the house of representatives undertake a mid-term review of budget execution. The house formally only receives the annual financial report, but it has access, as has the public, to the monthly and quarterly fiscal statistical information on the websites of the budget and fiscal control directorate and the statistical service (see below).

**35. Audited final accounts are normally available within twelve months of the end of the fiscal year** 3.4.2

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<sup>30</sup> The Financial Report, to be submitted by the Accountant General within three months after the end of each year, as provided by Article 81 of the Constitution, contains the receipts and payments account and statement of assets and liabilities, details of budget implementation by ministry and independent services, as well as a statement of supplementary budget appropriations approved during the year, and detailed information on special warrants issued. It also includes statements showing public debt, outstanding balances of loans and guarantees granted by government, amounts of various funds administered by government, outstanding balances in public corporations and international organizations. Lower levels of government and semigovernment organizations are not included, except for the transfers they receive. There is no reporting on the QFAs of semigovernment organizations and government-controlled companies.

Under Article 116 of the Constitution, the auditor general (AG) is to annually audit<sup>31</sup> the final accounts of the government and submit her report to the president, who transmits it to the house of representatives. The AG also audits the accounts of statutory bodies, local authorities, special funds and other agencies (see below). The accounts of statutory bodies are submitted to the House by June 15 of each year, with no reported delays, but submission of the accounts of municipalities are usually delayed.<sup>32</sup>

## **Results-oriented budgeting and reporting**

### **36. The objectives and expected results from government activities are discussed only in general terms.**

3.2.2, 3.4.2

The broad objectives of government policies are discussed only in the finance minister's budget speech and briefly in the planning bureau's strategic development plan (for development programs only). Detailed policy or program objectives are not discussed nor are program outcomes evaluated. However, the annual "Economic Outlook" report issued by the Planning Bureau includes a short evaluation of progress achieved toward meeting the overall objectives of the medium-term development plan, notably its macro-economic targets and broad sectoral objectives. Moreover, the new FIMAS modules under development (see Box 6 above) will allow the introduction of a program budgeting concept and the reporting of expenditures on such basis (Box 7).

#### **Box 7. Program Budgeting**

The lack of a formal medium term budget framework and analysis has prevented the government from developing a strategic plan for the line ministries; as a consequence, the budget exercise relies mainly on incremental budgeting practices. Even for the development expenditure part of the budget, no detailed medium-term risk analysis or estimation of the revenue stream is made, leading to a partial analysis of the fiscal impact of the projects. The budget at present, therefore, cannot relate objectives and results of government activity to expenditures, but merely indicates line ministry requirements in terms of line item budgets. The implementation of development programs, currently at around 70 percent to 80 percent, also indicates a need for more effective monitoring of program objectives. The new FIMAS has the capacity to develop the functionality to help track expenditures on a program basis.

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<sup>31</sup> No calendar is specified.

<sup>32</sup> Financial audit of Statutory Bodies Laws of 1983 and 1984 (No. 40/83 and 73/84); and Municipal laws 1985 to 1987, and Communities Law No.86(1)/99.

## C. Public Availability of Information

### The coverage and quality of budget documents

2.1.1

37. **The budget documents cover most consolidated central government fiscal operations, including defense expenditures.**<sup>33</sup> The annual budget documents provide comprehensive information on the consolidated central government expenditure and revenue, presented under the headings of constitutional powers, constitutional services, independent government services, and ministries. More specifically, on expenditure, it contains estimates of ordinary expenditure directly chargeable to the consolidated fund as defined by Article 166 of the Constitution; and estimates of other ordinary and development expenditures, laid before the house of representatives for adoption. Defense expenditures are identified and reported in the same format as the other expenditure heads.

38. **Operations of the local government, semigovernment organizations, and extrabudgetary funds are outside the scope of the budget documents.** While the central government budget includes the transfers to or from local authorities, semigovernment organizations, and special and extrabudgetary funds, these entities' own revenue and expenditures are not part of the annual budget. For semigovernment organizations, a separate budget is prepared and submitted to the house of representatives for approval.

### Past and forecast fiscal data in the budget

2.1.2

39. **The budget discloses the fiscal outturns for one year prior to the budget and forecasts for the new budget year.**<sup>34</sup> The summary and detailed tables in the budget statement cover only the budget outturn for the previous year, the current year's appropriations, and the proposed appropriations for next year. Moreover, the status of last year's outturn data (e.g., provisional and unaudited, final and audited) is not disclosed. While forecasts of key budgetary aggregates for the two years following the budget are not provided in the annual budget, the CP does contain medium-term information on some main budget aggregates.

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<sup>33</sup> The budget documents comprise: (i) the budget law; (ii) the budget speech; (iii) "Summary of Revenue;" (iv) "Summary of Charges and Expenditure by Head;" (v) "Details of Revenue;" (vi) "Details of Expenditure and Charges on Consolidated Fund;" (vii) "Statement of Assets and Liabilities;" (viii) "Salary Scales;" (ix) "Creation of New Posts;" (x) "Abolition of Existing Posts;" and (xi) "Officers in Control of Revenue and Expenditure Votes." The 2005 budget law and the accompanying documents are available on the website [www.mof.gov.cy/mof](http://www.mof.gov.cy/mof).

<sup>34</sup> According to the Fiscal Transparency Code, good practice consist in dissemination of data on the outturns of the two preceding fiscal years, together with forecasts of key budget aggregates for the two years following the budget.

## **Budget treatment of off-budget fiscal activity**

**40. Statements on contingent liabilities are not included in the budget documents, but such liabilities are partially covered in the financial report.** 2.1.3

The accountant general maintains an official register of government-guaranteed debt, and a statement of outstanding guarantees is included in the annual financial report. Summary projections for pension expenditures over the longer term are included in the CP documents, for the monitoring of government's commitments under the SGP. Information on fiscal risks related to pending judicial decision is not disclosed. As regards PPPs, a comprehensive registry is not maintained at the ministry of finance, nor are the potential fiscal risks of these contracts disclosed in budget documents.<sup>35</sup>

**41. Estimates of tax expenditures are not contained in the budget neither are the costs of quasi-fiscal activities.** 2.1.3, 3.2.4

The tax code gives rise to a fair amount of deductions and exemptions.<sup>36</sup> None of the tax expenditures related to exemptions have been published. The far-reaching liberalization during the past few years has led to a drastic reduction in QFAs. However, the extent and risk of QFAs remain nonnegligible, as some semigovernment agencies and government-controlled companies continue to engage in such activities. There is no reporting of the cost of these quasi-fiscal activities.

**Publication of data on the government balance, revenue and expenditure and on debt and financial assets** (see also Appendix II) 2.1.1, 2.1.4

**42. Information on the government balance, revenue and expenditure is available from a range of sources.** Consolidated accounts of the central government and social security funds are prepared on a cash basis and made available by the Budget and Fiscal Control Directorate on the ministry of finance's website ([www.mof.gov.cy](http://www.mof.gov.cy)), on a monthly, quarterly and annual basis. More detailed information on these consolidated accounts is included in the annual financial report, which is a priced publication available from the government printing office. The statistical service, Cystat, publishes accounts of the general government on an ESA-95/national accounts basis with a quarterly and annual frequency on its website ([www.mof.gov.cy/mof/cystat](http://www.mof.gov.cy/mof/cystat)). Both the coverage (consolidated central versus general government) and methodology (cash versus accrual) of these two datasets are

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<sup>35</sup> The government is in the final stages of reaching an agreement for a major PPP project to upgrade the Larnaca and Paphos airports.

<sup>36</sup> See for example, the summary of deductions and exemptions in "Cyprus Tax Facts 2005," available at <http://www.deloitte.com/cy>.

different.<sup>37</sup> The central bank in the statistical sections of its regularly published Monetary Policy Report (released on average eight times a year at [www.centralbank.gov.cy](http://www.centralbank.gov.cy)) reproduces a summary of the most recent public finance data as released by either the Budget and Fiscal Control Directorate of the ministry of finance (for example, in the May 2005 Monetary Policy Report) or the statistical service (for example, in the July 2005 Report). The European Commission, in its semi-annual General Government Data publication, and Eurostat, through access to an electronic database, also make available the general government data in ESA-95 format prepared by Cystat.

**43. Information on gross public debt and financial assets is published.** The ministry of finance prepares quarterly and annual data on the level and composition of general government debt, including its external component, for the purpose of EU fiscal surveillance. In the context of the EU's semiannual fiscal notification procedure, the annual changes in the stock of general government debt are reconciled with the net borrowing of general government on a national accounts (ESA-95) basis.<sup>38</sup> General government debt data are compiled in accordance with ESA-95 standards, and are transmitted to Eurostat and the ECB and also provided to the major rating agencies. The Budget and Fiscal Control Directorate of the ministry of finance and the statistical service provide detailed and comprehensive data on the government debt on their websites. The statistical service, the Cypriot Stock Exchange, the European Central Bank, Eurostat, and the EU Commission, all publish selected government debt data on Cyprus on their websites.<sup>39</sup> The central bank publishes detailed information on the government's external financing program, and data on government securities auctions and repos and reverse repo transactions. Moreover, a statement on

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<sup>37</sup> In line with ESA-95 standards (see also footnote 18), the general government as defined by Cystat comprises all government departments, the social security fund, the municipalities and local community boards, the University of Cyprus, the school committees and a number of semigovernment organizations (Cyprus Tourism Organization, Cyprus Theatre Organization, Cyprus Sports Organization). The statistical service publishes quarterly and annual fiscal data for the general government according to ESA-95 standards.

<sup>38</sup> Available on the website:

[http://europa.eu.int/comm/economy\\_finance/about/activities/sgp/natnot\\_en.htm](http://europa.eu.int/comm/economy_finance/about/activities/sgp/natnot_en.htm).

<sup>39</sup> Cystat makes available annual data on the debt of the consolidated general government. The Cypriot Stock Exchange publishes data on the outstanding amount of treasury bills and development stocks and the (very limited) secondary market transactions in development stocks. The EU Commission publishes the debt data submitted in the context of the fiscal notification. The ECB publishes such data in its annual report on "Bond Markets and Long-Term Interest Rates in non-Euro Area Member States of the European Union and in Accession Countries" (most recent issue released in November, 2004). Eurostat, finally, provides electronic access to debt data on a time series basis and has also conducted a more detailed survey on the structure of government in EU members, the results of which are summarized in Eurostat's Statistics in Focus, Economy and Finance, 2/2005, January 2005.

government financial assets and liabilities is published annually in the budget (which is available on the web) and the annual financial report (which is for sale at the government printing office). Assets are broken down into cash and short-term deposits, advances and debit balances, and inventories, and liabilities into special funds with treasury, central bank of Cyprus—government general account—deposits and credit balances, domestic treasury bills, and foreign treasury bills. Loans extended by public funds and government shareholdings are not included in the balance sheet, but shown as a footnote to the balance sheet. A detailed statement of public debt is included in the financial report. This statement indicates particulars of each domestic or external debt, the year it was raised, amount, details of discount, the net amount, the amount repaid or redeemed, balance outstanding, interest rate, sinking fund amounts and remarks on details.

### **Commitment to timely publication of fiscal data**

2.2.1, 2.2.2

44. **Legal commitments for regular publication of fiscal data have been made, but advance release data calendars are not announced.** The timeliness of published fiscal data is not adequate. While the Constitution, Article 81, mandates the submission to parliament of the final accounts within three months from the end of the financial year, in practice, the submission tends to run behind schedule. Consolidated central government accounts prepared on a cash basis are published on the ministry of finance's website ([www.mof.gov.cy](http://www.mof.gov.cy)) on a monthly, quarterly and annual basis, albeit with a lag of a few months. The quarterly public finance data prepared by the statistical service ([www.mof.gov.cy/mof/cystat](http://www.mof.gov.cy/mof/cystat)) are submitted to the EU and made public within three months.<sup>40</sup> No advance release date calendars for fiscal reporting to the public are available, but the statistical service updates a release calendar every Friday, containing the dates and content of the following week's statistical releases. Cyprus has not yet subscribed to the Special Data Dissemination Standard (SDDS).

## **D. Assurances of Integrity**

### **Integrity of data processes**

45. **Budget data are moderately reliable, and the variance between budgeted and actual outturn of main fiscal aggregates is only disclosed in the financial report.** 4.1.1

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<sup>40</sup> Commission Regulation (EC) No. 264/2000 of February 3, 2000 with respect to short-term public finance statistics and Regulation (EC) No. 1221/2002 of the European Parliament and of the Council of June 10, 2002 require quarterly government revenue and expenditure data to be submitted to the EU Commission/Eurostat no later than three months after the end of the reference quarter.



Over the past few years, the frequent recourse to supplementary budgets<sup>41</sup> and widespread use of special warrants have pointed to weaknesses in fiscal projections and management, thereby suggesting that budget appropriations tend not to reflect fully accurately recent spending trends, underlying macroeconomic developments, and well-defined policy commitments. In particular, the disconnection between tax policy changes and the annual budget makes the revenue estimates prone to deviations from actual collections. The variance between budgeted and actual outturn of main fiscal aggregates is not disclosed nor analyzed in the budget documentation, but a comparison for the year reported on is presented in the annual financial report. The ministry of finance has also prepared a comparison of the successive forecasts in the Pre-Accession Economic Programs and the CP with outcomes.<sup>42</sup> During 2001–04, the largest variance between the budgeted and outturn data for total revenue and expenditure was plus 11 percent in 2004 and minus 13.3 percent in 2002.

**46. Statements on accounting policy are not included in the budget and final accounts documents.**

4.1.2

The accounting<sup>43</sup> standard for budget transactions is the cash-basis, but this is not indicated in the financial report or the budget documents. The 2004 financial report is expected to include a full set of notes on the accounting policy.

**47. The processes of accounts reconciliation and fiscal reporting are partially effective.**

4.1.3

Departments' own subsidiary accounts are reconciled online with the Treasury's information in FIMAS, for revenue, expenditure, and other financial transactions. Accounting reports are also reconciled with bank accounts on a monthly basis. In the financial report, budget outturns are reconciled with budget appropriations, and the variances are provided. This process is facilitated by the full correspondence between the budget classification and the account classification. However, there is no formal process for ensuring consistency between aggregate fiscal data for the government and the government's position based on the monetary accounts. Moreover, year-end reports do not provide any information on discrepancies between government ledger records and bank accounts.

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<sup>41</sup> The number of supplementary budgets passed over the past three years amounted to 15 in 2002, 14 in 2003, and 4 in 2004.

<sup>42</sup> Summary results are available in the 2005 IMF Staff Report on the Article IV Consultation, available at <http://www.imf.org> (Country report 05/117).

<sup>43</sup> The administrative responsibility for setting accounting policies lies with the Accounting and Financial Services Directorates of the Treasury.

## **Independent oversight**

### **48. The external audit function and its independence from the executive branch are enshrined in the Constitution.**

4.2.1

Pursuant to Article 115 of the Constitution, the president appoints the AG as head of the supreme audit office, with independence from the executive, legislative, and judiciary powers. The Constitution also prescribes that the AG cannot be retired or removed from office “except on the like grounds and in like manner as a judge of the High Court.” The AG audits all public sector bodies with the exception of government-controlled companies. The external audit office, by virtue of the Constitution, has full access to information in carrying out its duties. The legal requirement of provision of evidence and information to the AG was further strengthened in 2002.<sup>44</sup> The AG submits an annual report to the president, who, by virtue of Article 116(4) of the Constitution, transmits it to the house of representatives. The Constitution, however, does not prescribe any deadline for the submission of the AG’s report.<sup>45</sup> The AG’s report on the Financial Report of the Accountant General is discussed at length by the Public Accounts Committee of the house of representatives and is available on the AG’s website. The report’s section on the ministry of defense is submitted in two parts—one part being available to the public and the other part discussed only with the Parliamentary Committee for Defense. Compliance with the AG recommendations is monitored through reporting on the follow-up actions taken by the audits as widely commented on in the media. The external audit office is staffed with officials holding professional and academic qualifications. The office formally does not enjoy full financial independence, because the executive branch must approve its budget before submission to the parliament.<sup>46</sup>

### **49. The audit office’s mandate is broad.**

4.2.1

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<sup>44</sup>According to Law 113(I) of December 7, 2002 on the provision of information to the AG, “the Auditor General has the power to request evidence and information from auditees in any form and any person who refuses to give the required information or who gives false or inaccurate evidence and information or incites any person to withhold or cover up evidence and information is perpetrating an offense and is liable, if found guilty, to a fine of £1000 and/or imprisonment of up to one year.”

<sup>45</sup>The AG’s annual reports are usually submitted to the president toward the end of October or November for the previous financial year.

<sup>46</sup> The AG indicated that, in practice, her budget had always been approved as submitted.

By virtue of the Constitution, Article 116, and under specific laws,<sup>47</sup> the AG is responsible for the audit of government accounts, statutory bodies, special funds, and local authorities. The scope of the public external auditing, however, does not cover state-controlled companies, which are audited by private firms. In addition to the annual financial audit, the AG is empowered to conduct special audits (e.g., value for money) or any other audit required. In carrying out her duties, the auditor general follows the International Organization of Supreme Audit Institutions Standards and the International Standards on Auditing.

**50. The legislature discusses external audit reports, and holds the executive accountable for follow-ups.**

4.2.1

The Public Accounts Committee (PAC) of the house of representatives has the primary responsibility for examining the annual report of the AG. While there is no specific legal or constitutional basis for the rights and powers of the PAC, the house's standing orders have granted the PAC the rights to request evidence and information from any person. The PAC hearings are open to the press, and external audit reports are made available to the public on the audit office's website ([www.audit.gov.cy](http://www.audit.gov.cy)). Submissions from independent experts and the private sector are invited during hearings on specialized expenditure issues. Follow-up on audits findings is left to the executive, while the AG herself reviews systematically in subsequent annual reports the corrective measures taken on previous audit findings. However, the follow-up itself is not systematic, as the same deficiencies are sometimes identified in subsequent years. The AG's report is also sent to the attorney general, if criminal offences are uncovered during audits.

**51. External scrutiny of fiscal forecasts is hampered by the lack of access to underlying macroeconomic models and assumptions.**

4.2.2

With the exception of assessments by the EU and the IMF in the context of their surveillance activities, no external scrutiny of the fiscal forecasts and underlying macroeconomic assumptions is available. External scrutiny and public debate is hampered by the lack of information on the methodological basis of the macroeconomic and fiscal forecasts.<sup>48</sup> The central bank does not publish detailed quantitative macroeconomic forecasts or provide information on the models generating them.

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<sup>47</sup> Financial Audit of Statutory Bodies Laws of 1983 and 1984 provide that the AG must audit annually the financial statement of semigovernment organizations that are statutory bodies. The audit report, together with the audited accounts must be submitted to the house of representatives by June 15. Similarly, Municipalities Laws 1985 to 1997, and Local Authorities Law no. 86(I)/99 also require municipalities and local communities, respectively, to prepare financial statements and submit it to the AG for audit.

<sup>48</sup> The Economics Research Centre of the University of Cyprus has, however, assisted the ministry of finance in preparing structural fiscal balance estimates for Cyprus (as published in the Research Centre's Economic Policy Paper No. 03-04, May 2004).

**52. The national statistics service is given legislative assurance of technical autonomy.**

4.2.3

The Statistics Law of 2000, Article 15(I), states that the statistical service, Cystat, “maintains its autonomy in technical matters and has exclusive responsibility for the choice of methodology, technique, definitions and procedures for the realization of the program of statistical activities.” In compliance with the EU acquis on statistics, Cyprus has enshrined in its legislation the fundamental statistics principles of impartiality, reliability, transparency, and confidentiality of individual data. The statistical law also provides for a statistical council,<sup>49</sup> which advises on the preparation and implementation of statistical programs. The statistical service is set up as a department of the ministry of finance and reports to the minister of finance, while cooperating with the central bank, line ministries, and other government agencies in the production of statistics.

## **II. IMF STAFF COMMENTARY**

**53. Cyprus has been making major progress in improving fiscal transparency in recent years.** This progress results from efforts motivated by both the government’s objective to strengthen the budget management system and the need to meet EU accession requirements. While substantial benefits from these efforts have already materialized, they have not yet come to full fruition. In particular, the potential offered by the recently implemented FIMAS has not yet been fully exploited. Moreover, the full impact of the EU requirements with regard to market liberalization and state aid will have to await some further legal and regulatory changes that are expected to further increase the transparency in the financial relationship between the government and the publicly owned electricity and telecommunications enterprises and other government-controlled companies.

**54. Notable measures have been taken and substantial improvements achieved in the fiscal transparency area in recent years.** In tandem with the preparation for EU accession, important legal and regulatory steps were taken to raise the financial and operational independence of the electricity and telecommunications authorities and the two largest government-controlled companies. EU accession also added to the incentives to create a new, independent internal audit office, and adopt a transparent legal framework and procedures for procurement and a new statistics law enshrining the technical independence of the statistical service. In the context of EU fiscal surveillance, the capacity has been developed to prepare and publish additional fiscal data (ESA-95 based quarterly and annual general government data), introduce fiscal risk and sustainability studies, and adopt numerical fiscal rules. The government also took the initiative to improve the availability and accessibility of information for taxpayers and strengthen the administrative appeals process in tax matters; take additional

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<sup>49</sup> It includes 11 members, including an academic representative of the University of Cyprus.

measures, including the setting up of coordination mechanisms, to combat corruption; implement FIMAS; and expand the role and profile of the auditor general's office.

**55. In part reflecting the recent progress, Cyprus now meets the specific standards of the fiscal transparency code in a number of key areas.** These include (Appendix I):

- Well-defined fiscal responsibilities of the branches of government;
- Legal and operational independence of the central bank;
- A clear legal and administrative framework for fiscal management;
- Availability of detailed information on the level and composition of the debt and the financial assets of the central government;
- A computerized payment authorization, accounting, and reporting system (FIMAS);
- Standardized and well-publicized procurement and public sector employment and pay regulations;
- Robust internal control mechanisms;
- An independent external audit with a broad mandate; and
- Technical independence of the national statistics service;

**56. In some areas, Cyprus is already approaching broadly defined international best practice on fiscal transparency.** Notably:

- The timeliness of the submission of the government budget to the house of representatives and its approval by the house;
- The computerized reporting system tracking budget implementation;
- The annual financial report's detailed quantitative comparison of appropriations and actual expenditure, with comparative information for the preceding year, and detailed data on financial assets; and
- External audit reports that conform to international auditing standards and are the basis for careful examination by the house of representatives and follow-up recommendations.

**57. The main areas where shortcomings have been identified include:**

- Remaining ambiguities in the financial exposure of the government to semigovernment organizations and government-controlled companies;
- The absence of a legal framework for and reporting on PPP projects;
- The absence of an overall legal framework and strategy to improve access to government information;

- Shortcomings in the timeliness and consistency of published fiscal data;
- Budget segmentation, notably during the budget preparation stage
- The absence of an economic and functional budget classification based on international standards;
- The absence of a mid-year budget report and review, which has contributed to the frequent recourse to one-off supplementary budgets; and
- Lack of independent scrutiny of the methodology and track record of the macroeconomic and aggregate fiscal projections underlying the budget.

**58. A number of other issues that raise some significant transparency concerns also deserve attention:**

- The absence of a clear legal basis for transfers between the central and local government levels;
- The financial arrangement between the government and the central bank specifically with regard to the central bank's capacity of financial agent of the government;
- The limited scope of reporting on contingent liabilities;
- The absence of a statement on accounting principles;
- The lack of reporting on accounts reconciliation, quasi-fiscal activities, tax expenditures, the status of pending tax claims and tax arrears, and nonfinancial assets; and
- The lack of differentiation between ongoing and new programs in the budget, and the limited coverage of the special funds and the public loan fund in the budget.

**59. To meet the requirements of the Fiscal Transparency Code in additional areas, the momentum of fiscal management reform efforts aimed at increasing transparency should be maintained, and a continued strong commitment from the authorities to such reforms remains in this regard essential.** In some areas—for instance, as regards semigovernment organizations and government-controlled companies—it will be broadly sufficient to continue ongoing liberalization and restructuring efforts in the context of EU requirements to achieve the desired further improvements in fiscal transparency. In other areas, the large analytical and institutional capacity that has been built-up in recent years is not yet been fully exploited, and major improvements in fiscal transparency can be achieved with relatively minor efforts, taking advantage of the numerous additional functionalities offered by the new methods, systems and reports. Examples of recent capacity-building efforts that can be brought to further fruition include the generation of ESA-95 consistent general government data; the implementation of FIMAS; the preparation of medium-term macroeconomic and fiscal projections in the context of the CP; and the analysis of alternative scenarios, the sensitivity of the budget projections, and sustainability issues, also in the context of the CP. In a number of other areas, finally, steps will need to be taken to develop new methodologies, provide new information, or prepare additional data.

60. **The recommendations below fall into two categories.** The first comprises a number of measures that should be considered with high priority as they could result in major improvements in transparency and greatly enhanced compliance with the Fiscal Transparency Code. The second is other steps that could contribute to enhanced fiscal transparency, including some that would take Cyprus further toward meeting international best practice. Timing-wise, it is indicated as to whether the measures are recommended to be taken in the near term (before end-2005); in the near-to-medium term (before end-2006) or over the medium term.

61. **The key recommendations to further improve fiscal transparency in Cyprus and help the country achieve the standards of the code in additional areas include:**

- Introduce a proper legal framework for PPP projects, and develop adequate monitoring and reporting mechanisms to reflect the costs and benefits, risks and possible fiscal exposure associated with such projects; the fiscal costs and risks associated with PPP projects should be systematically quantified and transparently disclosed in the budget documents (near-to-medium term);
- Present a composite budget which integrates all expenditure activities (ordinary and development) and revenue inflows comprehensively; in conjunction integrate further the operations of the special funds and the public loans fund in the budget (near-to-medium term);
- Introduce a revised economic and functional budget classification based on ESA-95 and GFS 2001 standards (medium term);
- Integrate further the medium-term forecasts and fiscal policy objectives presented in the CP into the annual budget preparation process, including by using the medium-term fiscal program and the analysis of alternative scenarios, the sensitivity of the budget projections, and sustainability issues presented in the CP as the basis for an expanded fiscal policy statement attached to the budget;
- Develop an effective and comprehensive “open government” strategy, including by adopting freedom of information legislation (medium term);
- Publish fiscal data timely, at regular intervals (at least quarterly) according to a pre-announced schedule, and using a consistent dissemination format. The information should include general government data on either ESA-95 or GFS 2001 basis, detailed public debt data, and links to the fiscal data made available by the EU Commission, the ECB, and Eurostat (near term);
- Develop, using the technical capacities of FIMAS, a mid-term budget review report, to be discussed by the house of representatives (near term); and
- Encourage outside scrutiny of the macroeconomic and fiscal projections, including in the budget documents, by explaining in detail the methods and assumptions underlying these projections (near-to-medium term).

**62. Other steps that could contribute to enhanced fiscal transparency could be considered:**

- Expand the reporting on contingent liabilities in line with EU and OECD guidelines (medium term);
- Clarify the financial relationship between the central bank and the government by remunerating the fiscal agent services provided by the bank and paying interest on government deposits with the bank (medium term);
- Identify and report the cost of QFAs by semigovernment organizations and government-controlled companies; provide information on the status of collectible but pending tax cases and tax arrears and on nonfinancial assets held by the government; prepare a statement on tax expenditures (near term);
- Include a detailed statement on accounting principles in the annual financial report (near term);
- Using FIMAS, develop fiscal reports directly based on a GFS-2001 classification, possibly with the aid of a bridge table (near term); and
- Also using FIMAS, and in tandem with the development of the Project Accounting Module, build up a program structure of expenditures and start generating reports on a program basis; develop the functionality to distinguish running and new programs (medium term).



Table 2. A Summary Assessment of Practices

Code Reference	Summary Assessment	Comment
<b>Clarity of roles and responsibilities</b>		
1.1.1	General government is largely defined in line with GFS principles, and government activities are clearly distinguished from those of financial and nonfinancial corporations in the private sector.	
1.1.2	The fiscal roles of the executive, legislative and judicial branches are clearly defined in the Constitution and laws. The responsibilities of different levels of government are well delineated, but some of the financing arrangements between the central government and the local authorities lack clarity.	
1.1.3	Mechanisms for the coordination and management of budgetary and extrabudgetary activities are well defined	
1.1.4	The relationships between government and public nonfinancial and financial corporations are mostly clear, but financial arrangements between the government and some semigovernment organizations are not always transparent. The central bank is fully independent and does not carry out any fiscal or quasi-fiscal activities,	It would be helpful to clarify the financial relationship between the government and semigovernment organizations, and the arrangements for remunerating the central bank in its capacity of fiscal agent
1.1.5	Government regulation of the nonfinancial sector is mostly transparent, and the government is making efforts to provide more and better information on the regulatory framework	Further steps to develop an effective and comprehensive “open government” strategy are needed
1.2.1	The legal framework for management of public funds, as anchored in the Constitution, is overall clear, but it is not very specific and is mainly focused on the expenditure side	
1.2.2	Taxation has an appropriate legal basis, which is comprehensive and reasonably clear. The tax and customs administrations are set up in a transparent manner, and taxpayers’ legal rights are well defined and well publicized.	
1.2.3	Public servants are subject to a well-defined code of behavior which is enshrined in law, and a comprehensive legal framework against corruption is in place.	Some recent legislative changes have raised the disclosure standards for civil servants
<b>Public availability of information</b>		
2.1.1	The budget documentation does not fully cover the operations of the local government, semigovernment organizations, and extrabudgetary funds. A range of statistical publications and the annual financial report provide information on the government balance, revenue and expenditure, including at the general government level	Steps are needed to (i) fully disclose the operations of the special funds and the public loans fund in the budget; (ii) publish fiscal data timely, at regular intervals according to a pre-announced schedule, and using a consistent

Code Reference	Summary Assessment	Comment
		dissemination format; and (iii) prepare budget documents and fiscal reports directly based on an ESA-95/GFS 2001 classification
2.1.2	The summary and detailed tables in the budget statement cover only the budget outturn for the previous year, the current year's appropriations, and the proposed appropriations for the following year	Information for the two preceding years and the two years following the budget could be derived from the CP
2.1.3	Statements on contingent liabilities are not included in the budget documents, but a statement of outstanding guarantees is provided in the financial report. The budget documents nor the financial report contain information on tax expenditures and quasi-fiscal activities	Steps are needed to (i) quantify and transparently disclose the fiscal costs and risks associated with PPP projects; (ii) identify and report the cost of QFAs by semigovernment organizations and government-controlled companies; (iii) expand the reporting on contingent liabilities in line with EU and OECD guidelines; and (iv) prepare a statement on tax expenditures
2.1.4	Information on the level and composition of the central government's debt and financial assets is publicly available	Steps should be considered to provide information on pending tax cases and tax arrears and on nonfinancial assets held by the central government
2.1.5	The statistical service publishes data on the deficit/net borrowing of the general government and the consolidated local government (municipalities and communities) as well as on the main expenditure and revenue items of the general government	No data are available on the main expenditure and revenue components of consolidated local government, which is, however, relatively small in size
2.2.1	Legal commitments for regular publication of fiscal data are in place	
2.2.2	Advance data release calendars for fiscal data are not announced, but the statistical service updates a general release calendar every week	The publication of advance data release calendars should be envisaged
<b>Open budget preparation, execution, and reporting</b>		
3.1.1	A statement on medium-term fiscal objectives is included in the minister of finance's budget speech, but is not further discussed in related budget documents	Steps are needed to integrate further the CP's medium-term forecasts and fiscal policy objectives into the annual budget preparation process, including in the policy statement attached to the budget
3.1.2.	The budget reflects the deficit and debt rules of the SGP, combined with quantitative ceilings on the growth of most expenditures	

Code Reference	Summary Assessment	Comment
3.1.3.	Budget forecasts and the underlying macroeconomic and policy assumptions are not clearly presented in the budget documents. Fiscal sustainability issues and fiscal risks are not covered as such in the budget documents.	Macroeconomic and policy assumptions are reported in the CP, which also discusses fiscal sustainability issues and risks. Integration in the budget documents is warranted
3.1.4	Estimates of new initiatives and ongoing costs are not clearly distinguished in the budget documents, although information on new projects is provided in the explanatory memoranda to the development part of the budget	Using FIMAS, the functionality to distinguish running and new programs should be developed
3.1.5	The sensitivity of budget estimates to changes in economic variables is broadly assessed in the minister of finance's budget speech, but a more in-depth analysis and a discussion of fiscal risks is only offered in the CP	There is a need to (i) develop adequate monitoring and reporting mechanisms for the risks and possible fiscal exposure associated with PPPs; (ii) expand the reporting on contingent liabilities; and (iii) incorporate in the budget documents the CP's sensitivity and sustainability analysis
3.2.1	The annual budget process is open, but the presentation to the house of representatives is not consolidated and the classification is not based upon internationally recommended methodology	The government should aim at presenting a composite budget which integrates all expenditure activities and revenue flows comprehensively and at introducing a revised economic and functional classification based on international standards
3.2.2	The objectives and expected results from government policies and activities are discussed only in general terms	A statement specifying the objectives and results of major budget programs should be provided
3.2.3	The deficit/net borrowing of general government is the main indicator of the fiscal position and is monitored regularly. Such indicators as the government primary and structural balance and the balance of the consolidated central government are also tracked.	
3.2.4	Fiscal reporting covers all of the consolidated central government. There is no reporting on the QFAs of semigovernment organizations and government-controlled companies	These QFAs, while non-negligible, are limited in scale and scope
3.3.1	The new FIMAS accurately records and monitors expenditures and receipts of the consolidated central government on a monthly basis, and also has the capacity to check payments against budget allocations and record commitments	
3.3.2	Procurement rules, codified in the new 2003 procurement law, are clear and well publicized. The rules comply with EU norms and are followed in practice	Major progress has been achieved with the adoption of the new legislation
3.3.3	A new internal audit service has been set up, the activities of which are guided by international standards. The internal monitoring and control mechanisms of the tax and	Also an area of recent progress

Code Reference	Summary Assessment	Comment
	customs administrations have been strengthened	
3.3.4	The tax and customs administrations are administratively under the ministry of finance but operate independently. They prepare an annual report on their activities	
3.4.1	The legislature does not receive in-year reports on budget outturn, and does not undertake a mid-year review	FIMAS capacities should be used to develop a mid-term budget review report for discussion by the House
3.4.2	Audited final accounts are normally available within twelve months of the end of the fiscal year	
3.4.3	The budget documents do not present a detailed evaluation of the outcome of major budget programs	Using FIMAS, it is possible to build up a program structure of expenditures and start generating reports on a program basis
<b>Assurances of integrity</b>		
4.1.1	Budget appropriations tend not to reflect fully accurately recent spending trends, underlying macroeconomic developments and well-defined policy commitments	Further integration of the budget and the CP would be beneficial in this regard.
4.1.2	Statements on accounting policy are not included in the budget and final accounts documents	A detailed statement on accounting principles should be included in the annual financial report
4.1.3	Accounting reports are reconciled internally and with bank accounts. At the aggregate level, fiscal data are not checked against monetary accounts data	A regular reconciliation of aggregate fiscal and monetary accounts data should be carried out
4.2.1	The external audit function and its independence from the executive are enshrined in the Constitution. The audit office's mandate covers all units of general government and involves any type of audit required. The legislature discusses external audit reports and holds the executive accountable for follow-ups	
4.2.2	The macroeconomic models and assumptions underlying the fiscal forecasts are not published, which hampers external scrutiny	Outside scrutiny should be encouraged, including by explaining in the budget documents the methods and assumptions underlying the fiscal projections
4.2.3	The national statistical service is given legislative assurance of technical autonomy	

Table 3. Public Availability of Information—A Summary

	Budget and fiscal report element	Included in budget/report documents	Available to the public	Para. ref.	Code ref.
1.	Central government (CG) budget estimates	Yes	<a href="http://www.mof.go.cy/mof">www.mof.go.cy/mof</a>	37, 38, 39	2.1.1
2.	CG Defense Expenditures	Yes. Defense expenditures are included in the budget, in the same format as the other expenditure heads.	<a href="http://www.mof.go.cy/mof">www.mof.go.cy/mof</a>	37	2.1.1
3.	CG EBFs (including special development funds, social security funds, resource revenue funds)	Semigovernment organizations and EBFs are partially covered in the government budget and the financial report to the extent they receive grants and loan guarantees or make contributions to the Consolidated Fund.	Yes. Information on extra-budgetary funds are consolidated in the annual financial report. Information on semigovernment organizations is published in their annual reports, in some cases available on their own web site (for example, <a href="http://www.cyta.com.cy">www.cyta.com.cy</a> for the telecommunication authority.)	38	2.1.1
4.	CG Budget outturns	Yes. Data for the previous year is included in the budget documents.	Yes. Budget documents and the financial report are published.	33, 34, 39	2.1.2
5.	CG Budget forecasts	No, but forecasts of some main budget aggregates are provided in the CP.	The CP is published on <a href="http://www.mof.go.cy/mof">www.mof.go.cy/mof</a>	39	2.1.2
6.	CG Contingent liabilities	Yes, partially. Information on government-guaranteed debt is published, but not provided in the budget document.	Yes, information on loan guarantees is in the annual financial report.	40	2.1.3
7.	CG Tax Expenditures	No	No	41	2.1.3
8.	CG QFAs	No	No	41	2.1.3
9.	Macroeconomic assumptions	Yes. They are presented in the budget speech and the report on economic developments	Yes.	20	3.1.3
10.	Analysis of fiscal risks/sensitivity analysis	Not included in the budget documents, but some analysis of fiscal risks and sensitivity analysis are carried out in the CP	Yes, on the MoF's website, as part of the CP.	24	3.1.5
11.	CG Debt	Yes, in the budget and the annual financial report.	Yes. Debt data are available in the financial report and on	43	2.1.4

	Budget and fiscal report element	Included in budget/report documents	Available to the public	Para. ref.	Code ref.
			<a href="http://www.mof.gov.cy">www.mof.gov.cy</a> , <a href="http://www.centralbank.gov.cy">www.centralbank.gov.cy</a>		
12.	CG Financial Assets	Yes, in the budget and the annual financial report.	Yes. Data on CG financial assets are available in the financial report.	43	2.1.4
13.	Sustainability Analysis	Not included in the budget documents, but sustainability analysis is carried out in the CP.	Yes, on the MoF's website, as part of the CP.	21	3.1.1
14.	General government budget estimates	No	No	38	2.1.5
15.	CG monthly/quarterly reports on fiscal outturn	Yes, albeit with a lag of few months.	Yes, on the MoF's website.	34, 42, 43	3.4.1
16.	General government monthly/quarterly reports on fiscal outturn	No	Yes, available quarterly, with significant delay as a statistical report on <a href="http://www.mof.gov.cy/mof/cystat">www.mof.gov.cy/mof/cystat</a>	34, 42, 43	3.4.1
17.	CG Final Accounts	Yes, the audited final accounts are published within 12 months of the end of the fiscal year.	Yes, available as a priced document; a summary is provided in the auditor general's report on <a href="http://www.audit.gov.cy">www.audit.gov.cy</a> . A summary of CG final accounts is also available on the MoF's web site.	33-35	3.4.2
18.	Consolidated general government Final Accounts	No	No	33-35	3.4.2