

## CONTENTS

### 1. Significance of the budget (Budget Act-Budget Estimates)

#### 1.1 The budget - a political programme and powerful tool

#### 1.2 Functions and structure of the budget

##### Questions

### 2. Preparation and approval of the budgetary proposals by the executive and legislative branches of government

#### 2.1 Background

#### 2.2 Budget preparation by the executive branch

#### 2.3 Budget deliberation and parliamentary budget approval

##### Questions

### 3. SAI involvement in preparation and examination of the budget

#### 3.1 Background

#### 3.2 SAI involvement in preparation of the budget by the executive branch

#### 3.3 SAI involvement in the parliamentary budget examination

#### 3.4 Outlook and potential for change

##### Questions

## **1. Significance of the budget (Budget Act - Budget Estimates)**

### **1.1 The budget – a political programme and powerful tool**

One purpose of the budget is to determine what scope the executive branch (government and public administration) will have for manoeuvring in the future. It is not only an essential element for steering executive branch operations but also a major tool for exercising political power. The Budget Estimates provide the funding needed to carry out proposed policy programmes. Political targets determine the allocation of budget funds to departments, agencies, organisations and purposes.

To restrict the power exercised by the executive branch, in most European countries the power to adopt the budget has been vested in Parliaments (legislative branch). Generally, however, it is the executive branch that has a major influence on the preparation of the Budget Estimates. In many countries it is the duty of the executive branch to submit provisional budget requests for the approval by the legislative branch. Budget requests are based on administrative experience and the specific funding requirements of preceding years.

This is because the budget largely depends on decisions taken in the past. Budgetary receipts largely depend on applicable tax legislation whereas expenditures, for instance, are determined by legislation providing financial benefits to eligible citizens. In addition, expenditure that cannot be reduced in the short run is incurred by the large number of administrative bodies with high staffing levels. As a result, only a minor portion of budget funds is left for flexible use by budgetary legislators.

### **1.2 Functions and structure of the budget**

As a general rule, the number of budgets in a country depends on the structure of the state. In a decentralised state with a federalist structure there may be several hundred or even thousands of budgets to be prepared at each administrative level (such as the central government, regional and local governments and autonomous bodies). Outside the real core of the public sector there are often further bodies that manage public funds and incur public expenditure. Take, for instance, the social security sector that may consist of several branches such as pension insurance, unemployment insurance and health insurance, each of them having their own budget. Frequently, the individual budgets exist separately in their own right without being subordinate to each other in a hierarchical system. Generally, budget preparation, budget deliberation, budget approval, implementation and control is the duty of different authorities. By implication, the authorities (including SAIs) at the supreme level of the state system are in charge of auditing and controlling only a portion of the above budgets, namely those drafted by the central or federal government and those from social security institutions.

A budget may cover one or several financial years. In the latter case, the Budget Estimates are normally divided into portions relating to one financial year each. This structure makes annual accounting and auditing easier.

The budget sets out the expenditures proposed for one financial period and the revenues to be generated within the same period to cover the expenditures incurred. As a rule, budgets may have a variety of different structures. These are the result of differing ideas about efficient and effective budgetary steering. Budgets can be very detailed, including several thousand budget items, or can provide for global budget items covering individual departments and agencies. Budget items can either set out certain types of expenditure such as expenditure on staffing, goods and services or capital expenditure, or they can refer to the purpose for which the appropriations will be used such as specified social purpose funds or research promotion grants. While in the past budgets were mostly input oriented, today there is a tendency towards output-oriented budgets.

Input-oriented budgets are often very detailed and refer to individual types of costs. The political targets and expectations behind such budgets are often not immediately visible. Such budgets define the way towards a target rather than the target itself. If the individual budget items are obligatory and even though, for example, expenditure on office equipment, postage and official travel has been specified, it leaves little leeway for public managers. Public managers normally tend to fully use the budget resources appropriated to them if they are not authorised to carry unexpended balances over to the next financial year. Such structures may give rise to inefficient administrative practices which are nevertheless in accordance with the Budget Estimates.

Generally, output-oriented budgets are less detailed. They provide for global spending authority for each government department or agency. However, performance or output targets are imposed on each of them. Such budget types leave public managers plenty of scope for manoeuvring in budget implementation. Government bodies can decide as they deem fit on the ways to achieve pre-set targets in the most cost-effective manner. The problem is to define sought targets in such a way that actual performance levels can be gauged against set targets.

The assumption that legislators can steer public managers by means of budgeting much better in an input-oriented system than in an output-oriented one is not always true. In an input-oriented system, targets are often rather vague so that public bodies can often define their targets themselves.

The budgetary system has a considerable impact on the efficiency and effectiveness of public sector management and on the allocation of powers between the executive branch and the legislative branch. Depending on the type of the budgetary system, differing procedures for budget preparation may be reasonable and appropriate. This also has an impact on the scope of the SAI's advisory activities or other involvement in the budget cycle (cf. Sub-theme II a of XVII INCOSAI 2001 held in Seoul).

<b>Questions:</b>
-------------------

- Is there one aggregate budget covering all and any public expenditure or are there several budgets (for example for the central government, regional, district or local governments, social security institutions)?
- Which of the above budgets are subject to your SAI's audit mandate?
- What period does the budget cover?
- Does the budget's structure reflect the structure of government departments?
- What are the criteria for classifying receipts and expenditures (e.g. on staff, goods and services, capital expenditure projects)? How many budget items does the budget contain?
- Does the budget set out targets or products?
- Are the Budget Estimates of an obligatory or a flexible nature? Are government departments permitted to deviate from their overall budget appropriations or from individual budget items? Can funds be carried over to the next financial year?

## **2. Preparation and approval of the Budgetary Proposals by the executive and legislative branches of government**

### **2.1 Background**

In actual fact, various budget preparation procedures are conceivable. Input-oriented budgets are likely to be prepared by bottom-up procedures where lower bodies in the hierarchy submit budget requests which are aggregated by the government and either adopted, rejected or amended by legislators. Output-oriented budgets are based on a top-down procedure with legislators imposing overall requirements basing on the programme of a political party or coalition agreements specified by the government departments on a step by step basis down to the bottom of the hierarchy. Generally a mixed system is more common.

Usually, the power to decide on the budget is considered an essential power of Parliaments since it may have a far-reaching impact on the executive branch. The general statutory authority for preparing and adopting the Budget Estimates are either incorporated into the respective constitution or into budgetary legislation such as a Budget Code or Budgetary Principles Act.

Normally, the Budget Estimates are adopted as specified legislation. Such legislation may be composed of several elements i.e. the Finance Bill and the Budget Estimates. The Finance Bill may set out basic budget authorisations for the executive branch, such as the authorisation to make borrowings up to a specified limit and overall regulations for budget implementation.

The Budget Estimates determine the revenues and expenditures for the individual federal departments and agencies. Additional budgetary regulations such as taxation levels or saving programmes are incorporated into separate legislation.

### **2.2 Budget preparation by the executive branch**

As mentioned under 1.1, the executive branch has the exclusive right to initiate action for

establishing the Budget Estimates. As a rule the Finance Ministry or Treasury provides leadership for preparing the draft on behalf of the government.

The Finance Ministry may beforehand provide guidance to the requesting departments on how to prepare their budget requests. Guidance may include financial benchmarks, cost caps and guidance (e.g. on drawing up the personnel budget). Where the departments have field offices or subordinate offices they request their provisional budget proposals. The Finance Ministry reviews the received proposals for compatibility with the general funding available. Any controversial issues are argued out by Finance Ministry officials and the requesting departments before the government makes a decision on the draft Budget Estimates. After decision-making, the draft Budget Estimates are usually submitted to Parliament within a given time frame.

In addition to the Budget Estimates, the Finance Ministry or the Treasury is often also in charge of preparing a multi-annual strategic financial plan highlighting the estimated scope for manoeuvring in the future. The financial plan may be very detailed or merely outline the trend of pertinent budgetary data. Frequently the financial plan is approved by the executive branch together with the draft Budget Estimates and is then submitted to Parliament where it serves as valuable information for subsequent budget deliberations.

As to Budget Estimates regarding revenue and expenditure on the part of the SAI and other constitutional bodies, there may be statutory provisions to the effect that budget requests by the aforementioned bodies need to be submitted to Parliament in their original form without any change if the Budget Estimates deviate from the initial budget request. This procedure helps ensure that Parliament is informed of any differences of opinion between the SAI and the government. This procedure serves as a safeguard against any potential undue budgetary influence exerted by the government on the external government audit body.

## **2.3 Budget deliberation and parliamentary budget approval**

Throughout the various European countries, procedures, scope and duration of parliamentary deliberation on draft Budget Estimates are governed by a multitude of different rules and regulations.

Frequently Parliament confers the responsibility for deliberating on Budget Estimates received by requesting bodies to a specific Appropriation Committee or Budget Committee. This Committee is appointed with submitting proposals for decision-making to the Parliament. Unlike other committees of a more technical nature, the purpose of this committee is to represent cross-cutting interests of the aggregate budget (such as restricting any increase in public expenditure or new borrowing) rather than supporting the interests of individual departments.

A number of questions on individual budget items normally arise in the course of budget deliberations. Answering these questions calls for expert skills that Parliament attempts to generate in various ways. Some Parliaments organise meetings where experts, including SAIs, can testify about matters of importance in size or principle. One key feature is the reporter system. Each parliamentary party represented on the Appropriations Committee designates for the life of the current Parliament one of its MPs as reporter for each departmental budget. These reporters become specialists for their respective departments and prepare all decisions by the Appropriations Committee for

that department. They discuss the individual items of the departmental estimates submitted by the Government with the appropriate officials from the requesting departments of the Finance Ministry and the SAI and prepare all decision-making on departmental budgets by the Appropriations Committee. Once the Appropriations Committee has concluded its discussion of the individual Budget Estimates, it submits its proposals to Parliament for resolution. Parliament adopts the Budget. Usually budget deliberation and approval deadlines leave enough room for concluding the whole procedure in such good time that the Budget Act comes into force well in advance of the new financial year to which the budget relates.

In fact, Parliament's potential right to modify draft Budget Estimates is often restricted because the large majority of Budget Estimates are predetermined by legal obligations arising from contracts or treaties and laws. If Parliament does not amend the applicable legislation, it may only check if the budget figures are in keeping with the respective legislation. The level of expenditure on social benefits for example can only be reduced if pertinent legislation is amended. The same applies to revenues based on tax receipts provided for by tax legislation. This is the reason why in some European countries Parliaments discuss the annual Budget Estimates along with tax laws.

#### **Questions:**

- Is a Finance Act adopted together with the Budget Act? In the affirmative, what are its basic provisions on budget implementation (borrowing authorisation)?
- What other legislation such as tax laws are discussed along with the Budget Estimates?
- **Please describe your country's procedure for preparing and adopting the budget:**
- How are the Budget Estimates drawn up (procedural steps)?
- Are there any specified regulations governing your SAI's budget?
- Is additional budgetary information, e.g. on strategic financial planning for subsequent years, submitted to the legislative branch along with the Budget Estimates?
- How is the draft budget deliberated by the Legislature (procedure)?
- What opportunities for changing the budget does the Legislature have? Please estimate the portion of revenues and expenditures that is predetermined as a result of decisions made in the past.
- Is there a special parliamentary committee that deliberates on the Budget Estimates?
- Are there Members of Parliament who have acquired special expertise concerning the budget or parts thereof?

### **3. SAI involvement in preparation and examination of the budget**

### **3.1 Background**

Their audit work provides SAIs with a thorough insight into government operations and transactions. For this reason, they inevitably discover cases of waste, mismanagement, inefficiency and, as a consequence, inadequate revenue collection or unnecessary expenditure. Hence they have a potential for advising the executive and legislative branches on preparing the Budget Estimates.

Formerly, government auditing focused on financial and compliance audits of the accounts from an ex post perspective. Some SAIs are also involved in budget implementation. Some SAIs have jurisdictional powers with regard to public financial management. These more traditional functions are reflected in the names of many SAIs e.g. Federal Court of Audit of Germany, Cour des Comptes of France or Tribunal de Cuentas of Spain. Today, SAIs are expected and encouraged to cast their nets wider by making suggestions for improvement and by providing advice to the executive and the legislative branches. Such proactive advice is particularly effective if it is given during the process of drafting the budget.

In many countries, the statutory authority of SAIs covers a general advisory role or the provision of advice during budget preparation.

The involvement of SAIs in budgetary procedure can take on various forms.

### **3.2 SAI involvement in drawing up the budget by the executive branch**

Some SAIs have far-reaching powers of involvement in drawing up the budget by the executive branch while others do not have any particular mandate in this respect.

If they have a specific legal mandate, SAIs can provide advice to the executive branch on the basis of their audit experience. Some SAIs also have a right of initiative in this procedure. Other SAIs may only become active at the request of the executive branch. In some countries, government bodies are statutorily obliged to submit their budget requests not only to the Finance Ministry but also to the SAI so that it can comment on them in good time.

Once the budgetary procedure is under way, SAI's expertise is usually made available while Budget Estimates are being prepared by the requesting departments and their field offices and while Budget Estimates are being discussed with the Finance Ministry. The SAI's job is to examine the departmental estimates particularly in respect of such criteria as the consistency and plausibility of the underlying assumptions and compare them with its own findings and conclusions. The SAI can advise at any time, e.g. by indicating that certain projects where budget funds are being requested appear to be uneconomic or questionable from a legal point of view. The SAI may also point out potential savings or options for staff reductions. In doing so, the SAI relies on earlier audit findings and conclusions. The SAI is often more knowledgeable than the Finance Ministry about certain issues, and the Finance Ministry officials readily make use of that knowledge in order to oppose funding requests from the other government departments.

### **3.3 SAI involvement in the parliamentary budget examination**

SAIs have differing mandates regarding their involvement in parliamentary budget deliberations. Mandates may range from regular participation in Appropriation Committee meetings (including preparatory discussions held by reporters cf. 2.3) to the legal right to provide audit testimony to Parliament. The mandate of some SAIs, however, does not provide for any involvement in this procedure.

In some countries where SAIs have little influence on budget preparation, their involvement in budget implementation is a more significant feature. These SAIs can block or demand reimbursement of budget funds if they discover irregularities in public sector management.

Those SAIs actively involved in parliamentary budgeting may provide oral or written advice on the basis of earlier audit findings and conclusions. The procedure may be of a rather formal or informal nature. SAIs may be a valuable source of information for Members of Parliament since, apart from their expertise, they are unbiased and impartial where party politics are concerned if they provide information and advice evenly to all parliamentary parties.

Nevertheless, sometimes the SAIs' suggestions do not find support in cases where the policymakers' evaluation of an issue differs from the SAI's assessment based on budgetary law and performance criteria. All SAIs have to respect that. On the whole, the success of the SAIs' proposals, recommendations and initiatives depends on the quality of evidence generated by them on the basis of the submitted facts and figures and on the persuasive skills and auditor's judgement displayed by the respective SIA officials during the budget preparation procedure.

### **3.4 Outlook and potential for change**

While external government auditing is developing from retrospective regularity and compliance auditing to proactive performance auditing (cf. resolution adopted by the XIIth INCOSAI 1986, subtheme I A), SAIs will increasingly be expected to provide quality support to Parliament and government in drawing up budgets and doing strategic financial planning work. What is more, the subject matter and contents of the deliberations are likely to change in the future. In several countries, evidence is emerging that suggests that the budget will gradually change from a very detailed and input-oriented compilation of figures to a set of objectives and performance targets against which results can be measured.

This will also have an impact on the subject matters presented by both the legislative and the executive branches that they seek advice on from the SAIs. As an example, SAIs may provide their input when missions and targets are realigned to enable public managers to measure the target achievement degree or performance levels. SAIs may also step in as impartial and unbiased experts if the pre-set targets are not achieved by the executive branch.

They may comment on the causes of unsatisfactory target achievement or performance levels and make recommendations to departments and agencies on how to address the stated problems. SAIs may also make recommendations to Parliament on redefining or modifying the set targets. There is, however, a risk to these activities that the SAIs could



eventually become too involved in executive or legislative decisionmaking. In order to safeguard SAI independence, it is crucial that they respect policy decisions as the exclusive domain of the legislative branch and the implementation of policy decisions as the domain of the executive branch. When walking the tight-rope between these two powers, SAIs need to ensure that they lose nothing of their impartiality and neutrality.

**Questions:**

- In which stages of budget preparation may your SAI provide advice or get involved? Please give a concise description of your legal authority, the nature and method of your participation.
- Does your SAI have ways in which it can directly bring about changes in individual estimates?
- In which stages of parliamentary budget deliberation may your SAI provide advice or get involved?
- Is your SAI involved in the budget preparation procedure of other public sector bodies such as regional or district governments, social security institutions)?
- Which are the areas in which your SAI should have more opportunities to get involved?