



**National Audit Office's separate report to Parliament
on the audit of the final central government accounts
for 2009 and the Report on the Final Central
Government Accounts**

Translation of National Audit Office's separate report to Parliament R 13/2010 vp



**National Audit Office's separate report to Parliament
on the audit of the final central government accounts for 2009
and the Report on the Final Central Government Accounts**

Edita Prima Oy
Helsinki 2010

To Parliament

The National Audit Office has audited the final central government accounts for 2009 and the descriptions of central government finances and the financial management of the state as well as the effectiveness of activities in the Report on the Final Central Government Accounts for 2009, which has

been submitted to Parliament as the Government's report on central government finances and compliance with the Budget according to section 46 of the Constitution, and on the basis of section 6 of the Act on the National Audit Office (676/2000) submits this separate report to Parliament on its audit.

Helsinki, 18 May 2010

Auditor General Tuomas Pöysti

Assistant Auditor General Marjatta Kimmonen

Main content

It is the opinion of the National Audit Office that the final central government accounts for 2009 have been prepared in accordance with provisions.

The information in the Report on the Final Central Government Accounts concerning compliance with central government spending limits in fiscal year 2009 can be considered true. International support arrangements aimed at stabilising the euro zone and the euro made after the final accounts will, however, increase Finland's financial commitments.

The spending limits for 2009 were not exceeded and the entire amount was used. The drop in gross domestic product was larger than projections during the fiscal year and the assumptions in the budget proposal. Nominal central government debt rose to 64 billion euros at the end of 2009, which was nearly 10 billion euros more than at the end of 2008. The drop in the volume of gross domestic product by 7.8 per cent is the largest drop in a single year that has taken place since 1918. The sustainability gap has risen to 5.5 per cent of GDP according to the latest update of the stability programme. The National Audit Office concurs with the view that there is a considerable sustainability gap in Finland's public finances. With regard to the sustainability gap in central government and structural problems in the economy and public finances, preparing a plan to stabilise public finances and close the sustainability gap is thus an extremely important and urgent task.

Commitment to the central government spending limits procedure is a key element in Finland's fiscal-policy provisions, and it

has curbed growth in central government expenditure. The spending limits are limited in their scope, however, since a large part of public spending is not covered by them. In addition to central government, public finances include local government and social security funds. In ensuring the sustainability of public finances and in complying with fiscal-policy provisions it is beneficial to use outside control with sufficient expertise covering public administration as a whole. Public finances as a whole should be brought within the sphere of the external audit and evaluation of the fiscal-policy information base and effectiveness, together with the right to obtain information.

Productivity development in public services has been weaker than in the rest of the economy. The rise in costs is fastest in local government. In evaluating the efficiency of public finances and services, special attention should be paid to cost-effectiveness.

In the Report on the Final Central Government Accounts the Government has reported on the implementation of the measures called for by Parliament in parliamentary communications 11/2009 and 30/2009. The information on social effectiveness that is provided to Parliament in the Report on the Final Central Government Accounts does not provide a true and fair view in all respects on how well social-policy objectives have been achieved. The audit did not find significant misstatements or numerical errors in effectiveness information, however. The reporting procedure clearly needs to be developed so as to serve Parliament's fiscal power. As an audit finding the National Audit Office notes that internal control in the state group as a whole has not

been arranged in a way that ensures the implementation of the requirements in the State Budget Act and good governance. As a result of shortcomings in the division of responsibility between government agencies and the

shared service centre for financial administration and human resources management, internal control as a whole is not sufficiently efficient and comprehensive.

Contents

1	Financial audit report on the audit of the final central government accounts for 2009	9
2	Compliance with the Budget and key provisions regarding it	11
3	Reporting required by Parliament in the Report on the Final Central Government Accounts	13
4	Information on social effectiveness in the Report on the Final Central Government Accounts	15
4.1	The National Audit Office's opinions	15
4.2	Audit findings concerning the presentation of information on effectiveness	17
4.3	Audit method	19
5	The spending limits procedure and fiscal-policy reporting	20
5.1	Conclusions	20
5.2	Audit of the spending limits procedure in 2007-2011	22
5.3	Compliance with spending limits and the transparency of the spending limits procedure in fiscal year 2009	23
5.4	The application of the spending limits in the 2010 budget and the first supplementary budget	25
5.5	Information concerning the central government's financial position and the sustainability of public finances	26
5.6	Developing fiscal rules	28
5.7	Information concerning the sustainability of public finances	31
5.8	Regulation of financial markets	33
5.9	Information concerning central government debt	34
5.10	Information concerning tax subsidies	36

1 Financial audit report on the audit of the final central government accounts for 2009

The National Audit Office issues this financial audit report on the audit of the final central government accounts for 2009. The audit was conducted by Principal Financial Auditors Aila Aalto-Setälä and Sari Lakka. The audit was supervised by Assistant Auditor General Marjatta Kimmonen.

The audit was conducted in accordance with the National Audit Office's audit guidelines and concerned the final central government accounts as referred to in section 17 a of the State Budget Act and the provision of true and fair information with necessary notes as referred to in section 18 of the Act insofar as they concern the state budget economy. The audit included the budget outturn statement, the income and expenses statement, the balance sheet, the funds statement and notes as well as the central bookkeeping on which the information in the final central government accounts is based together with accounting guidelines and control. The audit also focused on procedures aimed at ensuring the unalterability and correctness of information in central bookkeeping and in preparing the final central government accounts.

The final central government accounts

The content and presentation of the financial statements in the final central government accounts and the accounting on which they are based have been examined to the extent required to determine whether the financial statements in the final central government accounts and notes have been prepared correctly in essential respects.

An estimated subappropriation in the budget outturn statement was exceeded in item 29.10.30.11 (Grants for teaching and instruction

in Sami according to section 43 of the Act on Financing maximum, overspending 184,582.00 euros). An appropriation approved by Parliament may not be exceeded, even if it is an estimated appropriation.

The appropriation in item 31.10.78 (Certain transport infrastructure projects, estimated appropriation) was exceeded by 677,738.00 euros without obtaining permission to exceed the estimated appropriation as required by section 7:2 of the State Budget Act. According to the budget outturn statement, a transferred appropriation was exceeded in item 33.01.03 (Operating expenses of the Social Security Appeal Board, 2-year transferable appropriation, overspending 77,320.22 euros). According to section 85:1 of the Constitution and section 7:3 of the State Budget Act, a transferable appropriation may not be exceeded.

An authorisation included in the budget outturn statement in item 24.30.66 (Actual development cooperation work) was exceeded by 15.4 million euros, in item 27.10.01 (Defence Forces' operating expenses) by 1.2 million euros and in item 31.10.78 (Certain transport infrastructure projects) by 1.4 million euros. According to section 10 of the State Budget Act an authorisation may not be exceeded.

Shortcomings were found in information concerning authorisations that was sent to the State Treasury for the drafting of the final central government accounts. Consequently the information in the budget outturn statement in the final central government accounts concerning authorisations, their use and expenditure resulting from their use cannot be considered reliable in all respects.

Otherwise the financial statements have been prepared in the manner required by budget legislation.

The information in Note 12 (Government guarantees, pledges and other commitments) contains errors and the risk of errors. The note does not provide true and fair information on the amount of all material commitments.

Otherwise the notes to the final central government accounts have been presented in the manner required by the State Budget Decree.

The state's central bookkeeping has been arranged in accordance with the State Budget Decree.

The audit found certain key shortcomings influencing the final central government accounts from the viewpoint of good accounting practice as referred to in section 14 of the State Budget Act and the principle of coherence included in it. These concerned the purpose for which funds were intended, the arranging of the monitoring of authorisations and the allocation of costs to the fiscal year.

Internal control

Internal control of the final central government accounts has been evaluated in a risk analysis and checked in connection with the audit of central bookkeeping, the final central government accounts and agencies' final accounts and in the audit of the steering and monitoring of accounting.

According to the view that was formed during the audit of the final central government accounts, internal control of central bookkeeping has been meant to ensure that the central bookkeeping information that is the basis of the final central government accounts does not contain essential errors. The control of central bookkeeping information is based mostly on

the analysis of data, however, and cannot replace the accounting offices' own activities or the steering of the state's central bookkeeping.

Differences in principles concerning the evaluation of balance sheet items, slack procedures in delimiting information on asset and capital items in the balance sheet and determining their values and shortcomings in monitoring fixed assets weaken the usefulness of the balance sheet to some extent.

When the legal position of an organisation that is part of the state budget economy changes, more attention should be paid to specifying and evaluating transferred assets and the internal control of arrangements involving assets.

On the basis of audits of agencies, attention has been drawn to the arranging of authorisation accounting and errors and risks of errors with regard to the reporting of information to the State Treasury and in Note 12 (Government guarantees, pledges and other commitments) in the final central government accounts.

The audit indicated that the arranging of internal control with regard to shared service centres and their customer agencies as a whole does not meet the requirements of section 24 b of the State Budget Act and good governance. Special attention should be paid to efficient internal control methods and preventing gaps in internal control

The National Audit Office's opinion on the final central government accounts

The final central government accounts for 2009 have been prepared according to existing regulations.

Helsinki, 17 May 2010

Auditor General Tuomas Pöysti

Principal Financial Auditor Aila Aalto-Setälä

2 Compliance with the Budget and key provisions regarding it

Financial audit reports concerning fiscal year 2009 were submitted for 84 accounting offices and 32 agencies that do not operate as accounting offices but were required to prepare a review of operations under section 65 a of the State Budget Decree¹.

Financial audits for fiscal year 2009 revealed improper procedures in 34 accounting offices and three other agencies on the basis of which one or more cautions were issued that constituted procedures contrary

to the Budget or key provisions regarding it and concerning which a qualified opinion on regularity was included in the financial audit report. In 2008 a qualified opinion on regularity was included in the financial audit report for 37 accounting offices and four other agencies.

Comparable information for three years and a breakdown by administrative sector is presented in the table below.

	FINANCIAL AUDIT REPORTS	QUALIFIED OPINIONS ON		
	IN	REGULARITY IN		
	2009	2007	2008	2009
Office of the President of the Republic	1			
Prime Minister's Office	1	1	1	1
Administrative sector of the Ministry for Foreign Affairs	1	1	1	1
Administrative sector of the Ministry of Justice	2	2		
Administrative sector of the Ministry of the Interior	13	6	1	2
Administrative sector of the Ministry of Defence	4	2	2	2
Administrative sector of the Ministry of Finance	13	2	5	3
Administrative sector of the Ministry of Education and Culture	28	21	19	16
Administrative sector of the Ministry of Agriculture and Forestry	9	2		1
Administrative sector of the Ministry of Transport and Communications	9	4	5	4
Ministry of Employment and the Economy	27	11	5	5
Administrative sector of the Ministry of Social Affairs and Health	5	2	2	2
Administrative sector of the Ministry of the Environment	3			
	116	54	41	37

The total number of agencies receiving a qualified opinion on regularity fell compared with 2008. The most significant reasons for qualified opinions on regularity remained shortcomings in arranging performance accounting and in presenting the annual result for paid activities and other information on

operational efficiency. Cautions were issued to 13 agencies concerning the monitoring of the profitability of paid activities or the presentation of the annual result for paid activities. Shortcomings in other information concerning operational efficiency and the arrangement of performance accounting

¹ The State Budget Decree was amended on 29 December 2009 and the provision requiring such agencies to prepare a review of operations was abolished. Section 65 a was still applied with regard to the final central government accounts for 2009, however.

were the reasons for cautions to 24 agencies. Arranging performance accounting is the precondition for presenting information concerning operational performance in final accounts. As a whole, the situation worsened somewhat compared with the previous year.

Another significant category consisted of errors concerning the use of funds appropriated in the Budget. Cautions regarding such errors were included in 11 audit reports. Since cautions concerned different matters, the total number of errors was nearly 20. The most significant errors involved the exceeding of appropriations, which led to four cautions. Other cautions in this category concerned errors in the purpose for which funds were intended.

Errors in the exercising of an authorisation and shortcomings in the monitoring of authorisations led to a qualified opinion on regularity in the financial audit reports for five agencies. Shortcomings concerned confirming the use of an authorisation and the period of use as required in section 10 of the State Budget Act, and in four cases cautions were also issued for exceeding authorisations.

The National Audit Office also drew attention to serious shortcomings in the arranging and management of bookkeeping. Three audit reports noted that an agency's bookkeeping had not complied with generally accepted accounting practice as required in section 14 of the State Budget Act.

On the basis of financial audits of agencies, the arranging of internal control with regard to shared service centres and their

customer agencies as a whole does not meet the requirements of section 24 b of the State Budget Act and good governance. Shortcomings concerned key payment traffic and bookkeeping arrangements, and they led to a qualified opinion on regularity in the audit report for the State Treasury. The National Audit Office considers that special attention should be paid to efficient internal control methods in the presentation of the annual result for paid activities and other information on operational efficiency. Clear provisions create proper conditions for good internal control and a clear division of labour in tasks that have been rearranged. The State Budget Decree should be supplemented on a rapid timetable so that provisions support appropriate procedures in new operating models.

Qualified opinions generally concern some particular area of financial management or individual procedures. Consequently one cannot draw the conclusion that about one-fourth of the state's financial management as a whole does not meet the set regularity requirement. Nor does a qualified opinion on regularity mean that the question involves the abuse of state funds. In evaluating the significance of a qualified opinion on regularity one must also keep in mind that agencies vary in terms of financial size. A qualified opinion on regularity should always be regarded as a serious matter for the agency in question, however, and the purpose of financial audit is to report on procedures that signify a deviation from regular compliance with the Budget.

3 Reporting required by Parliament in the Report on the Final Central Government Accounts

In parliamentary communication 11/2009 Parliament called for the Government to report on the implementation of the following measures in the Report on the Final Central Government Accounts for 2009:

- 1 Parliament calls for the Government to submit the Report on the Final Central Government Accounts by the end of April.
- 2 Parliament calls for the Government to take into consideration the measures that are included in Audit Committee report 1/2009.
- 3 Parliament calls for the Government to improve Parliament's access to information on off-budget funds beginning with the Report on the Final Central Government Accounts for 2009.
- 4 Parliament calls for the Government to ensure the introduction of a national public health care information system according to the framework set in legislation by 1 April 2011.
- 5 Parliament calls for the Government to improve reporting on the overall benefits of the Government productivity programme and to investigate the programme's impacts on civil servants' work conditions and occupational health.
- 6 Parliament calls for the Government to report on the implementation of the measures in points 1–5 in the next Report on the Final Central Government Accounts.

In parliamentary communication 30/2009 Parliament called for the Government to report on the implementation of the following measures in the Report on the Final Central Government Accounts for 2009:

- 7 Parliament calls for the Government to prepare legislation according to which the interoperability and compatibility of information systems in the public sector can be achieved as an official task based on legislation.
- 8 Parliament calls for the Government to investigate the measures that have been taken on the basis of the audit of the National Supervisory Authority for Welfare and Health.
- 9 Parliament calls for the Government to report on the implementation of the measures in points 1– 2 in the next Report on the Final Central Government Accounts.

In the Report on the Final Central Government Accounts for 2009 the Government has reported on the matters concerning which Parliament has called for it to report.

The National Audit Office focused attention on the above points in audit activities in 2009. With regard to the Government productivity programme (point 5) the National Audit Office completed a performance audit in May 2010 on the preparation and management of the Government productivity programme (207/2010). The National Audit Office will also report on the Government

productivity programme in its annual activity report in 2010. The productivity perspective is also discussed in Chapter 5 of this report, which concerns the preparation of fiscal policy. In this connection the National Audit Office has evaluated reporting on point 1. An audit concerning ICT projects in the social welfare and health field is under way and is planned for completion in autumn 2010. On the basis of this audit the National Audit Office has evaluated reporting on point 4.

Timetable for the Report on the Final Central Government Accounts (point 1)

The Report on the Final Central Government Accounts was not submitted according to Parliament's timetable. A working group that was appointed by the Prime Minister's Office is preparing for the Report on the Final Central Government Accounts and the Government Annual Report to be combined. The National Audit Office considers that, in addition to timetable issues, attention should be paid to improving the content of the report. On the basis of audits, the quality of information on social effectiveness in the Report on the Final Central Government Accounts in its present form has not been good. A key problem is compiling information in connection with the preparation of the report. In evaluating the implementation of social effectiveness objectives, one year is generally too short a time. Hasty preparation has not allowed the formation of a good picture of the effectiveness of state activities and its development.

Introduction of a national public health care information system (point 4)

In the Report on the Final Central Government Accounts the Ministry of Social Affairs and Health, in response to Parliament's position, reported on measures that the ministry has taken so that a national public health care information system can go into operation on 1 April 2011 according to the timetable set in legislation. The ministry noted that the timetable will be delayed. The National Audit Office is sure that the ePrescription, eArchive and eView services for which the Social Insurance Institution is responsible will not be in operation within the legislative timeframe. The Ministry of Social Affairs and Health reported in a document that ePrescription would be in broad operation within the original timetable set in the Act on Electronic Prescriptions. The National Audit Office is conducting an audit of ICT projects in the social and health care sector. In connection with the audit discussions have been held with different regional actors concerning the introduction of national health care information system services and timetables. The audit has also included participation in briefings arranged by the Ministry of Social Affairs and Health that have reviewed the current state of key patient information systems for public health care. According to the picture that was formed in the audit, ePrescription will not be in broad operation until 2012–2013 and the eArchive service will not be in broad operation until 2012–2015. Furthermore the content of the eArchive service will be limited in the initial stage. Consequently it appears that eArchive will not be in effective operation until the end of the decade. In its reporting the Ministry of Social Affairs and Health has given too positive a picture of the progress of the ePrescription project.

4 Information on social effectiveness in the Report on the Final Central Government Accounts

4.1 The National Audit Office's opinions

On the basis of the audit, the level of information on effectiveness has not improved essentially compared with previous years. The level of information has not been influenced by whether information has been compiled by administrative sector or whether the report examines special themes selected in advance. Problems in presenting information on effectiveness are quite similar to those encountered in previous years. Improvement has taken place in that effectiveness objectives and their achievement have been reported clearly in one administrative sector, that of the Ministry of the Environment. On the basis of the audit, information on effectiveness does not contain significant material or numerical errors.

Problems regarding information on effectiveness that have been reported in previous years have remained unchanged. Cause-and-effect relationships are often simplified. The Report on the Final Central Government Accounts does not evaluate to what extent the achievement of objectives can be attributed to measures and to what extent it can be attributed to other factors. Negative matters are not mentioned, and certain material matters have also been left out of the report. One reason for the latter may be that the report focuses more on the present and describing ongoing activities or measures rather than

achieved impacts and the past. One typical shortcoming that weakens the quality of reporting is also the failure to present the objectives with which achieved impacts should be compared. The following section presents audit findings related to these problems.

The main problem in presenting information on effectiveness concerns the process in which the Report on the Final Central Government Accounts is prepared. In evaluating the implementation of social effectiveness objectives, one year is a short time. The appropriate compiling of information on effectiveness is not possible on the same timetable as the preparation of the final central government accounts after the end of the fiscal year. Consequently the compiling of information on effectiveness according to the timetable for preparing the final central government accounts is clearly visible in the quality of information on effectiveness. The Report on the Final Central Government Accounts cannot properly use information from studies and evaluations to provide more depth. Annual reporting easily leads to the description of measures that have been taken and are under way. Often changes in effectiveness over the long term do not receive attention. The timetable also influences other problems in presenting information on effectiveness. This problem in the preparation process should be

considered in developing the reporting procedure.

On the basis of the Report on the Final Central Government Accounts it is difficult to form an overall picture of the social effectiveness of activities or its development. In a statement concerning the Report on the Final Central Government Accounts, the Government Controller-General has also pointed

out that key matters influencing social policy should be reported more clearly. The National Audit Office considers that the objectives of the 2005 accountability reform and the working group on reporting procedure before that concerning a reporting system that serves Parliament's budget power and decision-making have not been achieved in this respect.

4.2 Audit findings concerning the presentation of information on effectiveness

This section contains examples of different problems related to the presentation of information on effectiveness. To give a representative picture, examples have been selected from different administrative sectors.

The failure to use studies and evaluations in providing information on effectiveness is visible, for example, in the way the Ministry of Education does not mention the review of the current state of science and research in Finland that was published in 2009 or an international evaluation of the innovation system in information on effectiveness concerning science policy. Similarly the Ministry of Employment and the Economy ignores research results and instead only uses information in its own registers in evaluating the employment impacts of different measures. On the basis of research results the impact of employment measures do not appear to be as good as on the basis of register information.

The simplification of cause-and-effect relationships is visible, for example, in the way the Ministry of Justice considers that the productivity programme weakens the development of the rule of law without presenting any mechanism for this. With regard to the achievement of transport objectives the Ministry of Transport and Communications does not discuss the significance of its own measures for the achievement of objectives. In its information on effectiveness the Ministry of Agriculture and Forestry notes that the salmon stock in the River Torniojoki is presently strong. The ministry does not explain what role its own activities have played in this matter, and it is far from clear how measures in recent years have strengthened the stock of salmon.

There are plenty of examples of how essential matters have been left out of the Report on the Final Central Government Accounts. This is partly because of limited space. In many cases information has not been supplied on the achievement of objectives by state-owned companies. The Ministry of Education has not reported on the Finnish National Lottery or CSC - IT Centre for Science Ltd, the Ministry of the Interior on State Security Networks Ltd or the Ministry for Foreign Affairs on the Finnish Fund for Industrial Development Cooperation Ltd. Reporting by the Ministry of Finance on Hansel Ltd has weakened and no longer includes any mention of profitability. The Ministry of Transport and Communications has not reported on the establishment of unincorporated state enterprises to perform certain functions of the Finnish Maritime Administration. On the other hand the Ministry of Justice has provided more comprehensive information on key effectiveness objectives in its administrative sector and their achievement.

An example of how reporting focuses on the present instead of examining what has actually been achieved is the information on effectiveness supplied by the Ministry of Social Affairs and Health. The ministry describes numerous development projects and programmes that are under way, mainly in terms of the objectives that have been set for projects. Information is not provided on the achievement of objectives in projects that have been concluded or projects and programmes that are under way, however.

One problem regarding the usefulness of information on effectiveness is that objectives that have been set for effectiveness

have not been presented in connection with information on effectiveness. The Ministry of Defence does not present any effectiveness objectives, and the Ministry of Education does not present effectiveness objectives for essential functions. The objectives of ownership steering at the Prime Minister's Office are not reported either. Performance is mentioned as a social effectiveness objective concerning corporate assets, but no explanation is given as to how this is evaluated, i.e.

whether the state's interest in the companies in question is only to maximise the return on capital or whether the state has other reasons for owning the companies in question. The Ministry of Social Affairs and Health does not say what effectiveness objectives have been set for Alko Inc. On the other hand the Ministry of Transport and Communications has done a better job setting out objectives and their hierarchy than in the past.

4.3 Audit method

The audit focused on the information on social effectiveness that was provided in the Report on the Final Central Government Accounts. Social effectiveness refers to the achievement of the objectives that have been set for social policy and the role of policy measures in achieving objectives. The audit did not look at information that was provided on operational performance or efficiency. Audit findings concerning these are included in the National Audit Office's report to Parliament on its activities. The next activity report will be submitted in autumn 2010.

The main question in auditing information on social effectiveness was:

- Does the picture of social effectiveness that is provided in the Report on the Final Central Government Accounts differ from the picture obtained in performance audits and, if so, in what way?

The audit method differed from the previous year, since the presentation of information on effectiveness in the Report on the Final Central Government Accounts has changed. This time information on effectiveness was presented mainly according to administrative sector instead of focusing on special themes

as in the past. The Report on the Final Central Government Accounts describes the situation and development in 2009. Owing to the nature of information on effectiveness, it is not possible to confine reporting to a single year, however. Consequently the information on effectiveness that was presented according to administrative sector was compared with findings in the National Audit Office's audit reports and follow-ups in 2007–2010. Risk analyses that were prepared by the National Audit Office during these years were also used as supplementary materials.

In addition to comparisons the audit looked for clear material or numerical errors and shortcomings in the reporting of essential information on effectiveness in administrative sectors.

The objective of the audit was to analyse whether the Report on the Final Central Government Accounts for 2009 gives a true overall picture in concise form on the social effectiveness of central government, not just different administrative sectors, and its development. In justifying the opinion on the overall picture, examples of different types of problems are presented in reporting on the audit.

5 The spending limits procedure and fiscal-policy reporting

5.1 Conclusions

On the basis of the National Audit Office's audit, the evaluation of compliance with central government spending limits presented in the Report on the Final Central Government Accounts for 2009 can be considered true in essential respects.

The transparency of the spending limits procedure needs to be developed, however. It is still difficult for an outsider to monitor compliance with spending limits, although information related to price and structural corrections in connection with spending limits decisions has been improved. The National Audit Office recommends that special attention should be paid to improving the transparency of the spending limits procedure in documentation related to the preparation of spending limits and the budget.

According to an evaluation based on the audit, the National Audit Office concurs with the view that there is a considerable sustainability gap in Finland's public finances that urgently needs to be corrected. According to the European Commission's analysis of the update of Finland's stability programme on 31 March 2010, Finland is among the countries with a medium level of risk in terms of the sustainability of public finances.

International evaluations concerning Finland have emphasised that a plan with clear objectives for fiscal consolidation in connection with the withdrawal of stimulus measures should be published as soon as possible.

In the opinion of the National Audit Office, this is a very important and urgent task to resolve the sustainability gap and structural problems in central government finances.

The significance of the external control of compliance with fiscal rules and thus ensuring the sustainability of public finances is emphasised in reports issued by the European Commission as well as the OECD and the IMF. The National Audit Office agrees with international evaluations concerning the usefulness of credible and sufficiently expert independent control and evaluation. This is important for fiscal-policy credibility and effectiveness as well as public debate as part of democracy and Parliament's fiscal power.

Last year Finland's credit ratings remained at a high level. In the opinion of the National Audit Office, the condition for maintaining this good situation is that the basic economic matters that underlie state borrowing can be turned in a more balanced direction. Furthermore Finland's debt capacity will no doubt have to be used to support states that face a financial crisis and to stabilise the euro zone.

International aid arrangements and the loans and guarantees that Finland has promised to provide after the closing of the accounts will amount to large sums.

According to the National Audit Office's evaluation, the strongly growing debt of developed countries, including many of the countries in the euro zone, combined with

low economic growth and weak international competitiveness constitute a considerable risk for the international economy. This can lead to a weakening of confidence in countries' ability to pay off debt and to crises in the availability of financing. These crises can harm the euro zone's stability and cause repercussions for Finland's economy and public finances. In addition to stabilisation measures one should rapidly address the basic problem, which is excessive deficits in public finances.

Since the public service sector accounts for nearly a fifth of Finland's economy, its productivity plays an important role for the

entire economy. Growth in costs is fastest in municipalities that also face the greatest cost pressures resulting from the ageing of the population. Growth in social security funds' costs is also rapid. Consequently attention should be paid to the coverage and extension of fiscal-policy objectives based on rules. The focus of productivity work in the public sector should be on improving the productivity of public service activities for which local authorities are responsible. The National Audit Office emphasises that, in evaluating efficiency in public finances and service activities, attention should be paid particularly to cost-effectiveness.

5.2 Audit of the spending limits procedure in 2007–2011

To achieve credible and stable fiscal-policy, Finland has fiscal rules that support the curbing of growth in public spending. At the beginning of the electoral term, the Government decides on a ceiling for budget expenditure for the whole term. For the preparation of the budget, the distribution of appropriations is revised annually within the perimeters of the overall spending limits by making a decision on central government spending limits. Revisions are also made on the basis of price development and changes in the structure of the budget. The ceiling on expenditure that is set for the electoral term together with annual price and structural corrections thus forms the fiscal rule steering the Government's fiscal policy. The spending limits procedure is one stage in the preparation of the budget and budget legislation. In addition to an expenditure ceiling for the electoral term, the spending limits procedure is used to allocate budget resources to each ministry's administrative sector or in other words to set spending limits for the administrative sectors.

The National Audit Office audits the information base for fiscal-policy decision-making and the functioning of the spending limits procedure. The main objective is to evaluate the functioning of the spending limits procedure as an economic steering and fiscal-policy tool. The aim is to determine whether the spending limits procedure has been transparent and objectives have been achieved. The National Audit Office serves as an independent external evaluator of the achievement of fiscal-policy objectives and compliance with fiscal rules.

A separate report is submitted to Parliament annually on compliance with spending limits. The audit is conducted by combining financial and performance audit methods. The audit concerns spending limits decisions for the electoral term 2007-2011, budget proposals and budgets with preparatory materials, and financial statements. Audit criteria are the transparency of decision-making and preparation, risks and the functioning and effectiveness of tools from the viewpoint of achieving fiscal-policy objectives.

5.3 Compliance with spending limits and the transparency of the spending limits procedure in fiscal year 2009

The Government reports on compliance with spending limits annually in the Report on the Final Central Government Accounts. The general commentary to the budget proposal and supplementary budget proposals also contains information on compliance with the spending limits for the electoral term and the relation between the budget proposal or supplementary budget proposal and the spending limits for the electoral period. The Ministry of Finance monitors compliance with spending limits by comparing expenditure together with price and structural corrections to the budget. The Report on the Final Central Government Accounts for 2009 notes that after price and structural corrections, the overall spending limit was revised to 35,944 million euros at the 2009 price level in autumn 2008. The total amount of appropriations in the Government's budget proposal was 35,574 million euros in autumn 2009. Parliament added 69 million euros of expenditure included in the spending limits to the budget. During the year the Government also submitted two supplementary budget proposals to Parliament. A supplementary budget reserve of 300 million euros that was included in the spending limits was used completely in the supplementary budgets. The Report on the Final Central Government Accounts therefore notes that the spending limits for 2009 were not exceeded and that the entire amount of 35,944 million euros was used.

The National Audit Office compared the 2009 budget proposal and budget and the

final central government accounts for 2009 to the spending limits decision that was issued on 13 March 2008 and the spending limits with price and structural corrections prepared by the Ministry of Finance in connection with the preparation of the budget. For this calculation the National Audit Office had access to the spending limits decision issued on 13 March 2008, which presents the revision of the spending limits decision of 25 May 2007 to the 2009 price and cost level. In addition it had access to tables prepared by the Ministry of Finance that present the indices and price and cost level corrections used in preparing the budget compared with the level on 13 March 2008. Some of the changes are statutory or agreement-based. Some corrections take place according to changes in pay, and price corrections vary annually particularly depending on the timing of pay increases. Since all increases are not made automatically according to specific accounting rules, these were not reconstructed by the National Audit Office for 2009, but instead the index and price change percentages used in the 2009 price and cost level correction were taken directly from the Ministry of Finance's calculations.

The division in the calculation between expenditure included in the spending limits and expenditure excluded from the spending limits was partially made by the National Audit Office. The first division into expenditure included in the spending limits and expenditure excluded from the spending limits is obtained annually from the Ministry of Finance

in connection with the spending limits decision. The division for subsequent changes and additions is made by the National Audit Office. These changes concern, for example, items that have not been included in the spending limits or that have been combined or divided after the spending limits decision. With regard to the spending limits, budgets and final accounts comparisons have been carried out in the same way.

On the basis of the National Audit Office's audit, the evaluation of compliance with spending limits presented in the Report on the Final Central Government Accounts for 2009 can be considered true in essential respects. According to calculations made by the Financial Audit unit, it appears that the spending limits for fiscal year 2009 were not exceeded. It should be pointed out, however, that the National Audit Office's calculations contain inaccuracies related to price and structural corrections as well as the division of appropriations between expenditure included in the spending limits and expenditure excluded from the spending limits. This can be considered a problem from the viewpoint of the transparency of the spending limits procedure. It is still difficult for an outsider to monitor compliance with spending limits, although information related to price and structural corrections in connection with spending limits decisions has been improved. In addition to price corrections, particularly situations in which expenditure in budget items fall only partly within spending limits are difficult from the viewpoint of trans-

parency and simplicity. On the basis of the National Audit Office's findings, there is no reason to assume that the calculation made by the Ministry of Finance contains errors or gaps, as was noted in the separate report to Parliament on the audit of the final central government accounts for 2008 and the Report on the Final Central Government Accounts. The National Audit Office recommends that special attention should be paid to improving the transparency of the spending limits procedure in documentation related to the preparation of spending limits and the budget.

The Economics Department at the Ministry of Finance is responsible for evaluating the impact of economic policy measures and drawing attention to the economic perspective for decision-making. In this connection the National Audit Office noted in its separate report to Parliament on the audit of the final central government accounts for 2008 and the Report on the Final Central Government Accounts that the spring economic survey should be linked more clearly to the report on spending limits, since it contains an analysis that provides background for the spending limits decision. The spring 2010 economic survey has been distributed as background material for the spending limits decision². The spending limits decision for 2011–2014 and the Government report on the spending limits refer expressly to the spring 2010 economic survey. Clearly and openly linking the economic survey to the spending limits is in line with the National Audit Office's recommendation.

2 Economic Survey: Economic outlook and fiscal policy for 2010-2014, spring 2010. Ministry of Finance publications 17a/2010.

5.4 The application of the spending limits in the 2010 budget and the first supplementary budget

The budget proposal for 2010 that was submitted in September 2009 was still designed to support total demand and growth. The 2010 budget proposal called for investments to be moved up and other measures aimed at rapidly spurring employment. The first supplementary budget for 2010 also contained stimulus measures.

The National Audit Office has also evaluated compliance with spending limits for fiscal year 2010. The 2010 budget proposal and the budget were compared with the spending limits decision issued on 26 March 2009 and the spending limits with price and struc-

tural corrections prepared by the Ministry of Finance in connection with the preparation of the budget. The fact that the budget had been supplemented with one supplementary budget proposal at the time of the calculation on 13 April 2010 was taken into account in the calculation.

On the basis of the calculation, after the first supplementary budget for 2010 the level of expenditure is within the spending limits. The same remarks concerning inaccuracies that were noted in connection with calculations for 2009 also apply to this finding, however.

5.5 Information concerning the central government's financial position and the sustainability of public finances

The crisis that started on international financial markets over a year and a half ago spread and deepened in the international community to become a serious economic recession. The international community took measures to contain the crisis. Economic stimulus was also coordinated in the EU and globally at several levels and cooperation forums.

With regard to the Finnish economy, the crisis was originally due to external problems. The crisis has shown in practice how strongly different countries' economies are dependent on one another and how dependent Finland as a small open economy is on changes in the international economy. In Finland economic policy has been used to alleviate the effects of the crisis, which have mainly been on the financial system's operating conditions and employment. It is still too early to evaluate the effectiveness of economic policy in dealing with the crisis and its consequences. Economic stimulus measures have nevertheless helped maintain domestic demand and curb the weakening of employment. In spite of this unemployment is a key problem for our economy at the moment. The risk of growth in long-term, structural unemployment is also great.

Measures to ensure the availability of financing for companies were in force in 2009, but there was no need to use them during the year. This was due to the fact that the economic crisis was visible in Finland particularly in an exceptionally sharp drop in export demand, which was not due primarily to

companies' difficulties in obtaining financing.

According to preliminary information that was published by Statistics Finland on 1 March 2010, the volume of Finland's gross domestic product fell by 7.8 per cent in 2009, which was the largest drop in a single year since 1918. The drop in gross domestic product was larger than projections during the fiscal year and the assumptions in the budget proposal. In exceptional circumstances such as this crisis, it is difficult to prepare economic forecasts. Most economic forecasters were unable to foresee the depth of the crisis.

The Government reacted to the deep recession with fiscal-policy means and by striving to facilitate access to financing. The impacts of the crisis were mitigated by moving up public investments, lowering taxation and facilitating companies' financing possibilities. The Report on the Final Central Government Accounts notes that in 2009 appropriations were increased in supplementary budgets by an exceptional amount to allow the stimulus required by the economic crisis. In net terms appropriations were increased by 1,753 million euros according to the Report on the Final Central Government Accounts. Most increases in spending were expenditure excluded from the spending limits.

Important criteria that were agreed in the European Economic Recovery Plan that was approved by the European Council in December 2008 were that stimulus should be timely and temporary so that withdrawing stimulus once the recession is over will not be a problem. The Report on the Final Cen-

tral Government Accounts notes that very soon after the start of the recovery plan, attention was also drawn to how and in what timeframe special stimulus measures should be withdrawn. In the background was concern that rising debt and the sustainability of public finances would rapidly become a problem. The Ecofin Council, which is composed of economics and finance ministers, discussed withdrawal strategies in autumn 2009 and concluded that by 2011 at the latest the members states must begin to adjust their public finances. Stimulus measures are not a threat to the sustainability of public finances if they are temporary and if they are withdrawn gradually once recovery is under way.

The tax reductions included in Finland's stimulus measures are permanent in nature. The National Audit Office drew attention to the focusing of stimulus measures on expenditure excluded from the spending limits and factors on the revenue side in its separate report to Parliament on the audit of the final central government accounts for 2008 and the Report on the Final Central Government Accounts.

The European Commission criticised Finland in autumn 2009 for not yet having presented a fiscal consolidation plan³. This is also pointed out in the Commission's analysis of Finland's stability programme dated 31 March 2010. Likewise the OECD's most

recent economic survey for Finland, which was published at the beginning of April 2010, emphasises that a fiscal consolidation plan should be published as quickly as possible⁴. International evaluations have also emphasised that, owing to the permanent nature of Finland's stimulus measures, adjustment will not take place automatically once the economy recovers. In this connection it should be remembered, however, that the share of automatic stabilisers, i.e. expenditure that varies according to economic cycles (particularly unemployment security, housing allowance), is considerable. In Finland's spending limits system automatic stabilisers have been allowed to act and balance cyclic effects.

The spending limits decision for 2011–2014 notes that the Government will prepare a plan to stabilise public finances and close the sustainability gap once it has received the result of tripartite preparation by the Cabinet budget session. In the opinion of the National Audit Office, this is a very important and urgent task to resolve the sustainability gap and structural problems in central government finances. A credible social agreement extending over two electoral periods concerning the basic principles of economic policy and public finances will increase trust and mitigate the negative impacts of the crisis and support a return to economic growth.

³ Sustainability Report 2009, European Economy 9/2009 and European Commission, Economic Forecast, Autumn 2009

⁴ OECD Economic Surveys, Finland, Volume 2010/4, April 2010

5.6 Developing fiscal rules

In Finland fiscal rules and frameworks have been viewed as key means to influence the stability of public finances, the credibility of fiscal policy and long-term sustainability. In international evaluations the spending limits procedure and the setting of fiscal-policy objectives presented as fiscal rules and commitment to objectives have been considered beneficial. According to international evaluations, the fiscal rules that are in use in Finland, which have been observed to be good, should be further developed particularly with an eye to problems related to the long-term sustainability of public finances.

The objectives that have been set for employment and public finances in the Government Programme will not be achieved. One objective in the Government Programme is that a structural surplus corresponding to one per cent of GDP will be achieved by the end of the electoral term in 2011. In spring 2009 the Government announced that this objective can be relaxed for cyclic reasons. In its 2010 economic survey the OECD criticises the rigidity of the Government's numerical fiscal rules and emphasises that a small open economy such as Finland needs flexibility in different cyclic situations.

The key fiscal rule in Finland is the spending limits procedure and the Government is still committed to complying with it. The objective of the spending limits procedure is to control and curb growth in budget appropriations. According to the OECD, however,

the coverage of spending limits is a problem, since a large part of public finances are excluded from the spending limits. This causes problems because growing cost pressures resulting from the ageing of the population will be focused especially on municipal services. This being the case the functioning of the spending limits procedure as the most important tool for ensuring the long-term sustainability of public finances is limited.

Another risk in the spending limits procedure is that the monitoring of the implementation of spending limits has been almost entirely the responsibility of the Ministry of Finance, which prepares spending limits decisions and budget proposals. Planning, preparation, implementation and evaluation are all taken care of by the same body and to a large extent the same people. The risk is that the perspective will narrow and the objectivity of the presentation of information will be endangered. Internationally a risk for spending rules is that they may be circumvented with arrangements that as a whole weaken the transparency of central government finances and financial management.

The significance of the external control of compliance with fiscal rules and thus ensuring the sustainability of public finances is emphasised in reports issued by the European Commission as well as the OECD and the IMF. The Ministry of Finance has also drawn attention to the significance of external control⁵. ⁶The European Commission notes in

⁵ Finland's Public Finances at a Crossroads. Approach to fiscal policy in the 2010s. Ministry of Finance publications 8/2010.

⁶ Public Finances in EMU 2009, European Economy 5, June 2009; European Commission, Recommendation for a Council Opinion on the updated stability programme of Finland, 2009–2013; IMF World Economic Outlook, April 2010; OECD Economic Surveys, Finland, Volume 2010/4, April 2010; Restoring Fiscal Sustainability: Lessons for the Public Sector, OECD Public Governance Committee, Working Party of Senior Budget Officials, OECD 2010.

its report Public Finances in EMU 2009 that, although the use of fiscal rules has increased in many member states, the monitoring of compliance with rules is still quite limited. The OECD's economic survey for Finland recommends the establishment of a Fiscal Policy Council on the Swedish model. The task of the Fiscal Policy Council would be to evaluate the Government's economic policies and their effectiveness and to present recommendations before the preparation of the next budget proposal. Otherwise the OECD recommends the strengthening of the independent external evaluation and monitoring of fiscal rules.

The National Audit Office concurs with international evaluations concerning the need for credible and expert independent control and evaluation for the credibility and effectiveness of fiscal policy as well as public discussion, which is part of democracy, and Parliament's fiscal power. The task of the National Audit Office as the supreme audit authority prescribed in the Constitution is also to evaluate the effectiveness of fiscal policy and the reliability and adequacy of the information base for fiscal-policy decision-making and particularly the exercise of Parliament's fiscal power. The external audit of whether information concerning the central government's financial position and its development presents a true and fair view is also the responsibility of the National Audit Office. The National Audit Office can thus function in many respects in the role of a fiscal-policy institution and supplement such an institution.

The credible external evaluation and audit of the effectiveness of fiscal policy must cover public finances and general government as a whole, according to accounting principles. This is also required by the proper implementation of the objectives and obligations

concerning economic and monetary union in the Treaty on the Functioning of the European Union as well as the Union's Stability and Growth Pact. Public finances as a whole and all actors classified as public entities should therefore be within the mandate of such a Fiscal Policy Council and its right to receive information and conduct checks. In addition to central government, public finances include local government and social security funds. These should therefore all be within the scope of the external audit of the fiscal-policy information base and effectiveness and also within the scope of the evaluation and right to information of a Fiscal Policy Council if one is established. With regard to the National Audit Office, certain provisions in the Act on the National Audit Office (676/2000) will need to be amended.

The activities of a Fiscal Policy Council as recommended by the OECD would have close connections and interfaces with the National Audit Office's tasks and activities, and such a council can significantly support the activities of the National Audit Office. This is also the case in Sweden, where a Fiscal Policy Council operates and the National Audit Office carries out its own fiscal-policy audit programme. A division of labour has been worked out between the Fiscal Policy Council and the National Audit Office.

The point of departure is generally that the arranging of the systematic evaluation of Government preparation and the effectiveness of policies is the responsibility of the Government and the task of the National Audit Office is to perform the external audit and evaluation of the evaluation system and the quality and functioning of the evaluations it produces.

Arranging the external evaluation of fiscal policy is one of the issues concerning the future development of fiscal rules and the

management of fiscal policy as well as the spending limits procedure. In autumn 2010 the National Audit Office will submit a separate report to Parliament on the functioning of the current spending limits procedure and

will examine more broadly the use of fiscal rules in Finland. In this connection the National Audit Office will also evaluate issues regarding the external evaluation and monitoring of fiscal policy.

5.7 Information concerning the sustainability of public finances

The effects of the recession on the sustainability of public finances are considerable. The estimate of the sustainability gap in public finances that was presented by the Ministry of Finance in connection with the update of Finland's stability programme in autumn 2008 was three per cent of GDP over the medium term. As a result of the weakening of the starting situation of public finances caused by the economic crisis, the estimate of the sustainability gap has increased to 5.5 per cent of GDP according to the latest update of the stability programme. The sustainability gap shows how much the balance of public finances should be improved by raising taxes and/or cutting spending so that public debt is controllable over the long term. Generally speaking one can consider as sustainable public finances that can cover the costs of current social policies and public services and interest on public debt. The sustainability gap measures the difference between the current situation and financially sustainable policies. The update of the stability programme is prepared according to the European Union's common methodology approved by the European Commission. In calculating the sustainability gap the public debt target is considered to be the objective set in the European economic and monetary union's Stability and Growth Pact that public debt should not exceed 60 per cent of GDP.

The rise in costs due to the ageing of the population in relation to GDP will be faster in Finland in the 2010s than in any other EU

country. In spite of this Finland is still among low-risk countries from the viewpoint of the long-term sustainability of public finances, according to the European Commission's autumn 2009 sustainability report. The recession has considerably deepened the sustainability gap and the risk it presents to Finland's public finances and economy. According to the European Commission's analysis of the update of Finland's stability programme on 31 March 2010, Finland is among the countries with a medium level of risk in terms of the sustainability of public finances⁷.

The sustainability gap in public finances is undeniable, but it should be pointed out that sustainability scenarios involve many uncertainty factors. Sustainability scenarios always depend on background assumptions. These include assumptions concerning long-term growth, employment, interest rates and the development of public spending (particularly age-related expenditure).

The development of productivity is of key importance in closing the sustainability gap. The public service sector accounts for nearly a fifth of Finland's economy. Consequently its productivity plays an important role for the entire economy. Measuring productivity for public services is challenging, however. Statistics Finland's economic statistics strive to produce information on productivity development according to national accounting principles. Productivity development in public services has been weaker than in the rest of the economy, and development

⁷ European Commission, Finland: Macro Fiscal Assessment - An Analysis of the February 2010 Update of the Stability Programme, Brussels, 31 March 2010.

is weakest in local government. Productivity statistics for public activities can observe essential main features of the public sector, to which productivity objectives can be compared. Productivity statistics do not tell anything about the reasons for observed development, consequences or the success of services, however. In productivity statistics the development of service production costs receives great weight. A rising cost level is an indisputable fact. In evaluating the efficiency of public finances and services, special attention should be paid to cost-effectiveness.

In audits of the Government productivity programme the National Audit Office has pointed out that, although objectives concerning the productivity programme have

spoken of overall productivity, in practice the objective has been to increase labour productivity, not overall productivity. (See the National Audit Office's report to Parliament on its activities for fiscal year 2008, R 15/2009 vp). In audits of the Government productivity programme the National Audit Office has also pointed out that the information base used in preparing productivity measures has been inadequate. To achieve a genuine improvement in productivity, the productivity programme's timetables should be more flexible in some respects⁸. Planned productivity measures and the investments they require should also be evaluated in the productivity programme by examining overall costs and benefits in a more uniform manner.

⁸ See The preparation and management of the Government productivity programme, National Audit Office's performance audit report 207/2010.

5.8 Regulation of financial markets

According to the Report on the Final Central Government Accounts, Finland started and implemented several reforms in its financial market legislation. Finland was also active and strove to influence numerous EU financial market legislation projects after the financial crisis.

Managing the financial crisis also continued last year within the sphere of SAIs and their international cooperation organisations. A key cooperation forum in this matter was the INTOSAI Task Force on the Global Financial Crisis, whose different subgroups prepared possible needs for change in SAIs' audit mandates in relation to financial markets and legislation regulating their stability as well as financial market regulatory offices. SAIs also evaluated whether the regulation of financial markets in general needs to be developed.

The perspective in the work done by the SAIs is always the supreme external audit of finances. SAIs evaluate the timeliness and adequacy of their own audit rights and participate in the international network of control authorities. The division of labour among authorities is clear at the national level. Financial market actors are supervised by national and international regulatory authorities. SAIs do not intend to get involved in this activity.

In developing the regulation of financial markets it is good to remember that financial intermediation currently works quite efficiently globally. The development of regulation should focus on market parties around the world in a balanced manner and should not cause excessive market distortions between different regions, parties or institutions.

5.9 Information concerning central government debt

As a result of the recession the central government's financial position weakened sharply. According to the Report on the Final Central Government Accounts, the deficit in central government finances was 5.1 per cent of gross domestic product in national accounting terms in 2009 and central government finances are expected to be in deficit for the remainder of the electoral term. At the end of 2009 the nominal value of central government debt amounted to 64 billion euros, which was nearly 10 billion euros more than at the end of 2008. Growth in central government debt was the fastest since the slump of the early 1990s.

Debt management followed the same strategy as in past years. In this relation there were no problems. Thus the debt procurement and debt management strategy proved its viability in conditions of rapidly increasing debt. Personnel and systems also operated efficiently while net debt increased sharply. This has been very important because the need to issue bonds in developed economies was great as a result of larger deficits in public finances following the financial crisis. Finland's access to debt financing and the price of debt financing remained on a very good level. The interest costs of central government debt did not rise last year in spite of the increase in debt. This was mainly due to low interest rates. Finland paid only slightly more for the bonds it issued than Germany, which is generally used for reference. On the other hand a clear division was visible on international capital markets according to how each country's economic situation and economic policies were evaluated.

Investors who invested in government

bonds last year did not consider that the credit risk associated with Finland's debt had changed. Finland's credit ratings also remained on the highest level. In the opinion of the National Audit Office, the precondition for maintaining this good situation is that the basic economic matters that are in the background of state borrowing can be made more balanced.

According to the National Audit Office's evaluation, the strongly growing debt of developed countries, including many of the countries in the euro zone, combined with low economic growth and weak international competitiveness constitute a considerable risk for the international economy. This can lead to a weakening of confidence in countries' ability to pay off debt and to crises in the availability of financing. These crises can harm the euro zone's stability and cause repercussions for Finland's economy and public finances. In addition to stabilisation measures one should rapidly address the basic problem, which is excessive deficits in public finances. Furthermore Finland's debt capacity will no doubt have to be used to support states that face a financial crisis. International aid arrangements and the loans and guarantees that Finland has promised to provide can amount to large sums.

On the basis of an audit of the state's cash management (168/2008) and an audit of central government debt management (179/2008), the National Audit Office issued a statement on a report of the Parliamentary Audit Committee. In its statement the National Audit Office focused on discussing the report with regard to the budget covering principle in section 84:2 of the Constitution.

On the basis of the interpretation adopted by the National Audit Office, section 84:2 of the Constitution cannot be considered to require that the budget covering principle should extend to the implementation stage of the budget so that the budget covering principle would require the implementation of a calculation in its present form describing the cash needs of the budget economy by the end of the fiscal year, if necessary with short-term borrowing. The budget covering principle in the Constitution does not directly require that borrowing included in the budget should be understood as an obligation or objective binding borrowing or other financial management in a detailed way.

In addition to the "technical" balancing of the budget, net borrowing naturally has broad economic impacts. The decision to cover the budget with a loan and the amount of a loan is always a significant decision affecting financial management and particularly the future, which includes assumptions and views regarding future economic development. Texts regarding revenues in the operative parts of the budget and the explanatory part of budget justifications have not gener-

ally justified borrowing on other ground besides the balancing of the budget, however. Thus the significance of net borrowing as a decision concerning financial management has not been emphasised in the handling of the budget. In practice borrowing has been considered a payment of the balance and Parliament's genuine decision-making with regard to the size of borrowing has been quite devoid of content from the viewpoint of future obligations and their financing.

To summarise the National Audit Office's statement and position, the current interpretation of the Constitution is not appropriate for financial management since it causes significant unnecessary risks and extra costs. The National Audit Office considers this matter so important and significant that the matter should rapidly be resolved, if necessary in connection with the reform of the Constitution. The Ministry of Justice and the Ministry of Finance have appointed a joint working group to consider constitutional provisions regarding budget covering and their reform. The working group will complete its evaluation and proposals by Midsummer 2010.

5.10 Information concerning tax subsidies

In the Report on the Final Central Government Accounts for 2007 the Government announced that it would start a project to conduct a new study of tax subsidies. The Ministry of Finance has a working group on the development of taxation, whose term ends on 31 December 2010. A new basic study of tax subsidies and an international comparison of tax subsidies are being prepared at the same time, as called for by Parliament. The final results of this work have not been reported yet.

In Finland the aim has been a simple and clear tax system, a broad tax base and through this lower tax rates. However, the number of tax subsidies has been increasing in recent years. The pressure to increase tax subsidies is also growing constantly. Tax subsidies have been used as part of stimulus measures to cope with the economic crisis, for example. Tax subsidies are also being planned as part of future energy solutions, particularly to support the use of renewable domestic fuels.

From the viewpoint of the budget process, the use of tax subsidies is problematic. No change took place last year in the relation between the spending limits procedure and tax subsidies. Tax subsidies are not included in the central government spending limits, although nearly always tax subsidies are meant to have impacts on people's behaviour paralleling normal appropriations.

As a result of the recession and growing central government debt, our tax system and its effectiveness will have to be reevaluated. The size of the tax base must also be reexamined against the background of weaker public finances. In the opinion of the National Audit Office, attention should also be paid to the quality of information concerning tax subsidies and the effectiveness of taxation.

The National Audit Office will report its findings on individual tax subsidies to Parliament in its autumn activity report.



NATIONAL AUDIT OFFICE OF FINLAND
Antinkatu 1, P.O.BOX 1119, FI-00101 Helsinki
Tel. +358 9 4321, Fax +358 9 432 5820, www.vtv.fi