National Audit Office's separate report to Parliament on the audit of the final central government accounts for 2010 and the Report on the Final Central Government Accounts

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To Parliament

The National Audit Office has audited the final central government accounts for 2010 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 2010, 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, 25 May 2011

Auditor General Tuomas Pöysti

Assistant Auditor General Marjatta Kimmonen

Main content

On the basis of the financial audit of the final central government accounts, it is the opinion of the National Audit Office that the accounts for 2010 have been prepared in accordance with provisions. On the basis of the audit of the fiscal policy information base and its effectiveness, the information presented in the Report on the Final Central Government Accounts concerning compliance with the spending limits in 2010 can be regarded as providing a true view.

With regards to events after the closing of the accounts, international arrangements aimed at stabilising th e euro area and the euro will increase Finland's financial commitments. The National Audit Office has drawn attention to risks linked to the economic development of the euro area and to the commitments taken on by Finland as part of the financial stabilisation system and the correct evaluation of these commitments. In the workings of the European Financial Stabilisation Facility and the permanent stability mechanism it is important to ensure the implementation of good governance and transparency as well as independent external audit that is adequate for this purpose.

Owing to an interpretation of the Constitution that has been adopted in central government, the Finnish state borrows more money than is needed to maintain liquidity, which causes unnecessary risks and costs. The situation could be corrected by asking the Constitutional Law Committee for an interpretation regarding the impacts of the budget covering requirement on the implementation of the budget, and the National Audit Office recommends that in connection with the consideration of this report, Parliament should ask the Constitutional Law Committee for a statement on the interpretation of the budget covering requirement in managing central government debt.

On the basis of the audit of the fiscal policy information base and its effectiveness, the information presented in the Report on the Final Central Government Accounts concerning compliance with the spending limits in 2010 can be regarded as providing a true view. In evaluating whether information provides a fair view with regard to underspending, it should however be pointed out that the relation between expenditure included in the spending limits and the budget and off-budget funds and certain state-owned companies is not entirely transparent.

On the basis of the audit of information on effectiveness in the Report on the Final Central Government Accounts, positive development has taken place in the presentation of effectiveness information. This has particularly concerned shifting from describing activities to evaluating the achievement of objectives. To further improve reporting, attention should be paid to well formulated effectiveness objectives in the Report on the Final Central Government Accounts.

The National Audit Office also draws attention to positions taken by Parliament requiring a response in the Report on the Final Central Government Accounts.

Contents

1 Financial audit report on the audit of the final central government accounts for 2010

The National Audit Office issues this financial audit report on the audit of the final central government accounts for 2010. The audit was conducted by Financial Audit Principals Aila Aalto-Setälä and Sari Lakka. The audit was supervised by Assistant Auditor General Marjatta Kimmonen.

The audit was conducted in according with the National Audit Office's financial audit manual 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.

The examination of the budget outturn statement revealed procedures contrary to the budget and section 3 a of the State Budget Act in recording revenues in a gross budgeted item. Interest income on funds connected with state aids were recognised in item 24.30.66 (Actual development cooperation work, 3-year transferable appropriation), proceeds from compensation for damages (2 million euros) in item 31.10.78 (Certain transport infrastructure projects, estimated appropriation) and interest on advance payments (about 1.3 million euros in 2010) in item 32.50.64 (EU and national financing for EU structural fund programmes during the programming period 2007–2013, estimated appropriation).

Contrary to the budget and section 5 a of the State Budget Act, revenues that should have been allocated to other fiscal years (126.3 million euros) were recognised in item 29.50.01 (Universities' operating expenses, 2-year transferable appropriation in the 2009 Budget) and were taken into account in determining capital items paid to the universities. Revenues could only have been recognised in this item if its dimensioning and justifications had been changed.

An estimated subappropriation in the budget outturn statement was exceeded in item 29.10.30.16 (Grants for private education providers' operating costs under section 44:2 of the Act on Financing, maximum, overspending 103,924.00 euros). An appropriation approved by Parliament may not be exceeded, even if it is an estimated appropriation.

Contrary to the budget, the appropriation in item 31.10.78 (Certain transport infrastructure projects, 3-year transferable appropriation) was used to cover expenditure that should have been allocated to 2008 and 2009 (about 6.5 million euros). The Budget did not include an appropriation or authorisation for this purpose in 2008, and only 0.7 million euros was left over from the project appropriation in 2009. Had expenditure in 2010 had been properly allocated to subitem 31.10.78.4.4 (Certain transport infrastructure projects, Savonlinna centre 2nd stage, 3-year transferable appropriation), the appropriation for the project would have been exceeded by 2.1 million euros.

The financial audit of accounting units revealed shortcomings in the allocation of expenditure to the fiscal year. In some cases errors in allocating expenditure in budget accounting would have signified the extension of an appropriation's period of use contrary to section 7 of the State Budget Act. Keeping in mind essentiality attention was drawn to such cases in accounting units' financial audit reports. On the whole, however, the procedures followed in preparing and monitoring the budget comply with provisions in section 5 a of the State Budget Decree regarding the allocation of revenues or expenditure.

Financial audits of accounting units also drew attention to procedures involving the application of appropriations that were not in line with section 5 of the State Budget Decree. These concerned the use of an appropriation for consumption and investment purposes and the paying of remuneration to persons in permanent posts from an appropriation that was not intended for this purpose.

In the budget outturn statement an authorisation in item 31.10.79 (Postponed-financing and PPP projects) would have been exceeded by about 20 million euros if the use of the authorisation had been presented according to agreements regarding index adjustments). According to section 10 of the State Budget Act an authorisation may not be exceeded. The budget outturn statement shows about 68.0 million euros having been spent under an authorisation in item 32.50.64 (EU and national financing for EU structural fund programmes during the programming period 2007–2013, estimated appropriation), although the regional councils had not concluded a contract or commitment limited in amount and purpose as prescribed in section 10 of the State Budget Act.

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 as required by budget legislation.

In Note 6 (Loans granted from the state budget economy) a receivable (160 million euros) resulting from a loan granted to Iceland has been recorded in the administrative sector of the Ministry of Finance. Owing to central government accounting practice, in the balance sheet long-term loan receivables denominated in euros include the amount of the budget loan according to the justification in the loan decision while the portion of the loan that has not been disbursed is included in current liabilities. On the whole the information that has been presented on loans can be regarded as providing a true and fair view.

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

According to the note the Finnish state has commitments totalling 17.2 billion euros. Commitments arising from guarantees through the European Financial Stabilisation Facility were expressed in the form of a calculatory maximum (7.9 billion euros), which up to the end of 2010 had only been used for the Irish lending programme (about 740 million euros). Since in the case of new guarantees the use of a guarantee always requires Parliament's approval and since the amount of a legally binding liability for a guarantee depends on individual commitments concerning the use of the financial stabilisation facility, presenting commitments in the form of a maximum amount does not provide a true and fair view of their value.

With regard to agencies' operational commitments the 5 million euro substantiality threshold cited in the regulations issued by the Ministry of Finance should be lowered and the option of presenting commitments orally should be stricken from the form. In all situations agencies should present at least the minimum euro amounts that are likely to materialise as a result of commitments.

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

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

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.

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.

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 again drew attention to the arranging of internal control according to section 24 b of the State Budget Act and agencies' responsibility for internal control particularly when tasks have been shifted to other accounting units or actors operating outside the budget.

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

The final central government accounts for 2010 have been prepared according to existing regulations.

Helsinki, 16 May 2011

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 2010 were submitted for 61 accounting offices and 26 other agencies.

Financial audits for fiscal year 2010 revealed improper procedures in 16 accounting offices and five 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 and 2009 roughly the same number of reports was issued. In 2010 the universities were no longer part of the state budget economy and the number of reports fell. Figures concerning qualified opinions are not comparable for the same reason.

	FINANCIAL AUDIT REPORTS IN	QUALIFIED OPINIONS ON REGULARITY IN		
	2010	2008	2009	2010
Office of the President of the Republic	1			
Prime Minister's Office	1	1	1	
Administrative sector of the Ministry for Foreign Affairs	1	1	1	1
Administrative sector of the Ministry of Justice	2			
Administrative sector of the Ministry of the Interior	7	1	2	
Administrative sector of the Ministry of Defence	3	2	2	1
Administrative sector of the Ministry of Finance	15	5	3	3
Administrative sector of the Ministry of Education and Culture	8	19	16	5
Administrative sector of the Ministry of Agriculture and Forestry	9		1	2
Administrative sector of the Ministry of Transport and Communications	5	5	4	1
Ministry of Employment and the Economy	27	5	5	7
Administrative sector of the Ministry of Social Affairs and Health	5	2	2	1
Administrative sector of the Ministry of the Environment	3			
	87	41	37	21

The total number of agencies receiving a qualified opinion on regularity fell compared with the year before. In 2010 the number of qualified opinions was 16 less than in 2009. Disregarding universities the number of qualified opinions fell by 6. Cautions concerned different matters and totalled nearly 30.

The most significant reasons for qualified opinions on regularity concerned the use of funds appropriated in the budget, in contrast with past years. Eleven accounting units received such cautions in their financial audit report. Cautions in this category had to do with the exceeding of appropriations, the recording of revenues in a gross budgeted expenditure item, the allocation of expenditure in such a way that it signified the extension of the period of use of an appropriation and the application of an appropriation for a purpose contrary to the budget. Over 20 cautions were issued in this category.

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 two agencies. Shortcomings concerned the purpose for which an authorisation was used and the improper monitoring of an authorisation, which resulted in overspending.

Shortcomings in arranging performance accounting and in presenting the annual result for paid activities and other information on operational efficiency led to the issuing of cautions in eight accounting units' financial audit reports. Three accounting units were cautioned 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 were the reasons for cautions to six accounting units. Arranging performance accounting is the precondition for presenting information concerning operational performance in final accounts. As a whole, the situation improved somewhat compared to the previous year, but the biggest reason was that figures no longer include universities' financial audit reports.

On the basis of financial audits of agencies, attention still needs to be drawn to arranging internal control in accordance with the provisions in section 24 b of the State Budget Act and the principles of good governance. In the opinion of the National Audit Office, special attention should be paid to effective internal control methods and the closing of gaps in internal control. The State Budget Act and the State Budget Decree should be supplemented so that they also support proper procedures in operating models in which responsibility for tasks has been delegated to multiple actors.

Qualified opinions generally concern a particular area of financial management or individual procedures. Consequently the conclusion cannot be drawn that about one-fourth of the state's financial management as a whole does not meet the requirement of regularity. Nor does a qualified opinion on regularity mean that an abuse of state funds is involved. In evaluating the significance of a qualified opinion on regularity one must also keep in mind that agencies vary in size financially. 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 16/2010 Parliament called for the Government to report on the implementation of the following measures in the Report on the Final Central Government Accounts for 2010:

1 Parliament calls for the Government to develop the setting of social effectiveness objectives and the provision of information on outcomes, for example on the basis of the evaluation model used by the Ministry of the Environment. Objectives concerning final accounts that serve Parliament's budgetary power and decision-making have in some respects remained unachieved with regard to information on social effectiveness.

2 Parliament calls for the Government to report on the results of a study of tax subsidies as soon as possible and to include the study's key conclusions in the next Report on the Final Central Government Accounts.

3 Parliament calls for the Government to give proper consideration to measures concerning budget statements that were outlined in a report.

4 Parliament calls for the Government to study and compare the costs and economic benefits of the arrangement of public social and health services by local authorities in-house or in the form

5 of purchased or outsourced services.

6 Parliament calls for the Government to report on the implementation of the measures in points 1–4 in the next Report on the Final Central Government Accounts.

In parliamentary communication 30/2010 Parliament called for the Government to report on the implementation of the following measures in the Report on the Final Central Government Accounts for 2010:

7 (2) Parliament calls for the Government to take measures to ensure stricter compliance with the budget and provisions regarding it.

8 (3) Parliament calls for tax subsidies to be controlled and monitored by the Government in the same way as budget appropriations.

9 (4) Parliament calls for the Government to correct shortcomings that have come to light in implementing benefit-cost calculations for transport infrastructure projects so that Parliament receives more reliable and higher quality information on which to base decision-making.

10 (5) Parliament calls for the Government to prepare labour forecasts according to different scenarios concerning the portion of the labour force employed in the central government and local government sectors in future and the size of required central government personnel in different scenarios.

11 (6) Parliament calls for the Government to allocate more resources to law drafting in order to ensure the quality of leg-

islation. Particular attention should be paid to the number of legal norms, the maintenance of legislation, better regulation, the assessment of impacts and fairness with respect to different target groups.

12 (7) Parliament calls for the Government to report on the implementation of the measures in points 2–6 in the next Report on the Final Central Government Accounts.

In the Report on the Final Central Government Accounts for 2010 the Government has reported on all the matters concerning which Parliament had called for it to report. The National Audit Office has conducted audits in the past concerning all the points listed above. Some of the points are also being examined in current audits or follow-ups. The National Audit Office's annual activity report in autumn 2011 will contain information concerning points 4, 6, 8 and 10.

Point 1

The Government has reported on problems regarding the setting of social effectiveness objectives and the provision of information on outcomes. In developing the quality of reporting it is important to pay more attention to the setting of objectives. Well set objectives allow better reporting. The current reform of final accounts is a good opportunity to take this matter into consideration. The audit of information on effectiveness in the Report on the Final Central Government Accounts led to the same conclusion. Findings regarding this subject are presented in Chapter 4.

Points 2 and 7

With regard to these points, which concern tax subsidies, development has been positive. A study of tax subsidies shows that their significance is greater than was previously calculated. There is thus even more reason to pay greater attention to tax subsidies in the budget and the Report on the Final Central Government Accounts. The National Audit Office examines tax subsidies particularly in the course of fiscal policy audit. This subject is discussed in Chapter 5 of this report.

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

4.1 The National Audit Office's opinions

The National Audit Office audited information on social effectiveness in the Report on the Final Central Government Accounts following a different method than in previous years. In the past the quality of information was evaluated insofar as audits conducted by the National Audit Office have touched on matters covered in the Report on the Final Central Government Accounts. This time the audit looked at the budget process more broadly. The information in the Report on the Final Central Government Accounts was compared with the effectiveness objectives that were set for each administrative sector in the budget. The audit method is described in more detail in section 4.3 of this report.

On the basis of the audit, positive development has taken place in the presentation of effectiveness information in the case of several ministries. This has particularly concerned a shift from describing activities to evaluating the achievement of objectives.

Objective setting also has a bearing on reporting

The National Audit Office found a clear link between the quality of reporting in the Report on the Final Central Government Accounts and the quality of objective setting. If a ministry has set clear objectives steering activities and clear indicators describing the achievement of objectives, reporting in the Report on the Final Central Government Accounts has also been successful..

The financial controller instructed the ministries to prepare a table outlining the achievement of objectives. When ministries presented the achievement of objectives in table form, reporting was comprehensive. Some ministries failed to comply with instructions and this was reflected in other aspects of reporting. When objectives were not analysed, reporting suffered in many respects. Some objectives were not mentioned at all while reporting included things for which objectives had not been set. In such cases reporting easily reverts to a description of activities that are under way or simply outlines the purpose for which appropriations are used.

The audit clearly indicated that the improvement of reporting in the Report on the Final Central Government Accounts is not enough to achieve good results. Attention must be paid to the entire process. In many cases weak reporting can be attributed to gaps in the setting of objectives in the budget. If objectives merely describe activities that are under way or planned, quality reporting cannot be achieved. First of all, well formulated effectiveness objectives naturally lead to better reporting. When objectives are set and indicators are selected, one should have some idea of how the achievement of objectives can be reported. Secondly, if something is considered significant enough to deal with in the reporting stage, this should have been taken into consideration when objectives were set. Objective setting cannot succeed if the significance of a matter is only realised in the reporting stage. Effectiveness objectives should be set for every significant matter and application of funds.

Quality of reporting

Problems in presenting information on effectiveness in the Report on the Final Central Government Accounts have remained the same as in past years. Reporting is often restricted to describing activities, without showing what impact activities in a ministry's administrative sector have had on the achievement of objectives. Reporting says nothing about negative development or poorly implemented objectives. Reporting on the achievement of objectives is incomplete in other respects as well.

For those ministries that presented the achievement of objectives in table form, reporting was generally comprehensive. The criteria used in evaluations were open, however, and some highly positive results are consequently of dubious value. On the other hand presenting information in such a concise form does not leave much room for explanations, and priority is given to comprehensiveness. The Ministry of Justice, the Ministry of the Environment and the Ministry for Foreign Affairs presented objectives in table form according to the financial controller's instructions. The Ministry of Agriculture and Forestry, the Ministry of Transport and Communications, the Ministry of Defence the Ministry of the Interior also presented tables showing the achievement of objectives, but their form of presentation deviated from instructions to some extent.

Problems regarding the quality of reporting were observed particularly in the Ministry of Education and Culture, the Ministry of Finance and the Ministry of Employment and the Economy. The Ministry of Education and Culture and the Ministry of Employment and the Economy had the biggest gaps between the objectives presented in the budget and reporting in the Report on the Final Central Government Accounts. Reporting does not provide information on the achievement of anywhere near all the objectives that have been set, but at the same time it includes matters for which objectives have not been set. The Ministry of Finance, on the other hand, has set only two social effectiveness objectives for itself at the main chapter level in the budget. Social effectiveness objectives have also been set for agencies in justifications, but reporting on these varies considerably.

One persistent problem in the Report on the Final Central Government Accounts is that there is no linkage between the application of funds or the amount of funds and reporting on the achievement of objectives. Such a linkage has been made only when the achievement of an effectiveness objective has been interpreted as the use of an appropriation mainly for the purpose outlined in the budget.

4.2 Audit findings on the presentation of effectiveness information

This section includes examples of findings on which the above opinions are based. Examples are intended to shed light on good and bad aspects of reporting so that information on the setting of social effectiveness objectives and the achievement of objectives can be improved. As a rule examples of poor reporting are not confined to a single case but represent problems that commonly arise.

Reporting by the Prime Minister's Office on state-owned companies' activities serves as an example of the omission of essential information. Reporting on listed companies is good, but information on unlisted companies is lacking. One possible reason is that information on listed companies is easily available. Information on other companies exists, however, and could be reported. No justification has been given for the discrepancy, and reporting in this respect is not adequate.

An example of the good and fairly comprehensive selection of indicators and related reporting is provided by the Ministry of Agriculture and Forestry. In its reporting it has nevertheless failed to describe how and to what extent the ministry's measures have had an impact on the state of affairs described by the indicators in question.

Reporting by the Prime Minister's Office has successfully and systematically presented policy programmes' effectiveness objectives and the achievement of objectives. Reporting has also done a good job analysing why certain objectives have not been achieved.

In addition to evaluating the achievement of effectiveness objectives, the Ministry of the Environment has explained how this was done: in the form of self-evaluation by management. This is understandable in view of the tight timetable, and other ministries have probably acted in a similar manner. Self-evaluation tends to give a rather positive picture. The Ministry for Foreign Affairs, for instance, gave itself a mark of good on the achievement of 20 out of 21 objectives and excellent on the remaining objective.

An example of describing activities rather than the achievement of objectives concerns reporting by the Ministry of Employment and the Economy on innovation policy. One objective regarding innovation that was included in the budget was to maintain Finland's standing in international comparisons. The Report on the Final Central Government Accounts does not provide information on Finland's international standing, however. Instead it describes the target for R&D expenditure in the Government Programme and its achievement together with the Ministry of Employment and the Economy's part in increasing funds available for this purpose.

4.3 Audit method

The audit focused on the information on social effectiveness that was presented 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 examine information that was provided on operational performance or efficiency. Audit findings concerning these are included in the National Audit Office's annual activity report. The next activity report will be submitted in autumn 2011.

The audit of effectiveness information in the Report on the Final Central Government Accounts for 2010 followed a different methodology than in previous years. In the past the quality of information was evaluated insofar as the National Audit Office's audit or expert work had touched on matters covered in the Report on the Final Central Government Accounts.

This time the main focus was on the adequacy of information in the Report on the Final Central Government Accounts as well as the accuracy of reported information. To evaluate the adequacy of information the audit first identified the effectiveness objectives that were set for each administrative sector in the 2010 Budget. Reporting on the final central government accounts was analysed in relation to these objectives. Adequate reporting means providing information on the achievement of all effectiveness objectives or related development.

The main question was:

– Does the Report on the Final Central Government Accounts provide a true and fair view of social effectiveness objectives and their achievement in an administrative sector.

The main question was supplemented with the following subquestions aimed at evaluating the quality of objectives and information in the Report on the Final Central Government Accounts:

– Were social effectiveness objectives presented in the budget?
– Were objectives essential for the administrative sector and functional from the viewpoint of management and monitoring?
– Was information provided in the Report on the Final Central Government Accounts concerning all the objectives that were set in the budget?
– Was information on the achievement of objectives in the Report on the Final Central Government Accounts of high quality?

The audit thus drew attention mainly to objectives and related reporting. In evaluating the quality of objectives and reporting the primary criteria were findings made in the course of the National Audit Office's audit and expert work. Other research and evaluations were used only in special cases where this was warranted, for example if they were completely at odds with the information in the Report on the Final Central Government Accounts. The audit was conducted in a collegial manner according to the National Audit Office's performance audit manual.

5 The central government spending limits procedure and fiscal-policy reporting

5.1 Conclusions

On the basis of the National Audit Office's audit, the estimate of underspending the spending limits that is presented in the Report on the Final Central Government Accounts for 2010 can be regarded as providing a true view in essential respects. According to calculations made by the National Audit Office, the level of expenditure in fiscal year 2011 will remain within the spending limits after a supplementary budget proposal. The National Audit Office considers it good that the Ministry of Finance revised reporting on compliance with the spending limits in the Report on the Final Central Government Accounts for 2010. In evaluating whether information provides a true and fair view with regard to underspending, it should nevertheless be pointed out that the relation between expenditure included in the spending limits and the budget and off-budget funds and certain state-owned companies has not been sufficiently transparent. Central government expenditure has been covered with money from off-budget funds and state-owned companies. VR Corporation, for example, furnished 80 million euros to cover the cost of track renewal in 2009–2010.

On the basis of the National Audit Office's audit, a clearer picture of central government liabilities and the state's net worth position should be provided in connection with the Report on the Final Central Government Accounts. The current balance sheet, which covers only the state budget economy, and the picture it gives of the state's solidity and net worth position can be deemed inadequate for parliamentary decision-making since the state also has significant off-budget liabilities. On the whole the final central government accounts in their present form, which focus on the state budget economy, do not provide a true and fair view of the state's financial position.

From the viewpoint of medium-term sustainability, the rise in central government debt is on an alarming track, and improving the balance of central government finances requires active measures. Active measures are also needed to support economic growth, increase the rate of employment and develop and reform innovation policy.

The sovereign debt crisis in the euro area is causing uncertainty in the economic operating environment. Commitments linked to EU stabilisation mechanisms will increase the Finnish state's liabilities and risks. The National Audit Office draws attention to risks linked to the economic development of the euro area and to the commitments taken on by Finland as part of the financial stabilisation system and the correct evaluation of these commitments.

Government guarantees, pledges and other commitments, which are presented in a note to the final central government accounts, have increased significantly as a result of stabilisation mechanisms. Owing to events after the closing of the accounts, the state's liabilities and the evaluation of financial investments connected to stabilisation mechanisms may change quickly. Furthermore cross-linkages between sovereign debt in the euro area, the European Central Bank and banks' balance sheets easily create non-transparent risks whose significance for the state's financial position and liabilities cannot be evaluated comprehensively in this audit.

The National Audit Office considers that the study of tax subsidies that was conducted in 2010 together with the revision of information on tax subsidies in the Report on the Final Central Government Accounts for 2011 will substantially improve the transparency of tax subsidies.

Owing to an interpretation of the Constitution that has been adopted in central government, the Finnish state borrows more money than is actually needed to maintain liquidity, which causes unnecessary risks and costs. The situation could be corrected by asking the Constitutional Law Committee for a legal interpretation regarding the impacts of the budget covering requirement on the implementation of the budget.

The National Audit Office recommends that in connection with the consideration of this report, Parliament should ask the Constitutional Law Committee for a statement on the interpretation of the budget covering requirement in central government debt management.

5.2 Audit of the spending limits procedure and the fiscal policy information base

To achieve a credible and stable fiscal policy, Finland has adopted fiscal policy rules aimed at curbing the rise in central government expenditure. An incoming Government decides on spending limits for the entire electoral term. The allocation of funds is then revised annually in spending limits decisions. Spending limits thus form a framework of fiscal policy rules that steer the Government's fiscal policy. The Government reports on compliance with the spending limits in the Report on the Final Central Government Accounts. The general justification in the budget proposal and supplementary budget proposals have also provided information on compliance with the spending limits for the electoral term and the relation between the budget proposal or a supplementary budget proposal and the spending limits for the electoral term. The Ministry of Finance monitors compliance with the spending limits by comparing price and structurally adjusted expenditure development with the budget.

The National Audit Office audits the information base used in fiscal policy decision-making and compliance with the spending limits as well as the achievement of fiscal policy objectives. The results of the annual audit of compliance with the spending limits and the fiscal policy information base are included in the National Audit Office's separate report to Parliament on the audit of the final central government accounts and the Report on the Final Central Government Accounts. The audit is conducted by combining financial and performance audit methods according to the National Audit Office's financial and performance audit manuals, which are based on the International Standards of Supreme Audit Institutions (ISSAI), and good practice.[1] The audit examines spending limits decisions, budget proposals and budgets together with preparatory documents, as well as the final accounts. Criteria include the transparency of decision-making and preparation, related risks and the functioning and effectiveness of applied instruments from the viewpoint of fiscal policy objectives.

[1] The application of the financial and performance audit manuals to the audit of the fiscal policy information base and compliance with the central government spending limits has been examined in the National Audit Office's plan for the ongoing audit of fiscal policy as well as the relevant audit theme plan.

5.3 Compliance with the spending limits and the transparency of the spending limits procedure in fiscal year 2010

The Report on the Final Central Government Accounts for 2010 notes that after price and structural adjustments, the overall expenditure ceiling was revised to 36,996 million euros at the 2010 price level in autumn 2009. The total amount of appropriations in the Government's budget proposal was 36,655 million euros in autumn 2009. This left an unallocated reserve of 41 million euros in addition to the 300 million euros reserved for supplementary budget proposals. Parliament added to the budget 41 million euros of expenditure covered by the spending limits. During the year the Government also submitted four supplementary budget proposals to Parliament. According to the Report on the Final Central Government Accounts for 2010, expenditure covered by the spending limits fell 262 million euros short of the expenditure ceiling after the fourth supplementary budget. This means that 100 million euros can be carried forward from 2010 to 2011 according to the fiscal policy rules applying to the 2007–2010 electoral term.

In its separate report to Parliament on the effectiveness of the central government spending limits procedure as a fiscal policy instrument the National Audit Office called for a revision of reporting on compliance with the spending limits in the Report on the Final Central Government Accounts.[2] With regard to fiscal year 2010 reporting on compliance with the spending limits has been revised according to the National Audit Office's recommendations. In the National Audit Office's opinion, in order to increase transparency the Report on the Final Central Government Accounts should clearly indicate what appropriations in the government proposal are covered by spending limits. Furthermore, with regard to supplementary budgets as well as appropriations added by Parliament, appropriations should be broken down according to whether or not they were covered by spending limits. In this way an outsider could easily check whether the appropriations in the final budget comply with the revised spending limits for the year. The Report on the Final Central Government Accounts for 2010 presented in table form the amount of expenditure included in the spending limits in the budget and supplementary budgets as well as the price and structurally adjusted level of expenditure covered by the spending limits. This makes it possible to see how much expenditure included in the spending limits has remained below the ceiling. In the opinion of the National Audit Office, this manner of presentation is clear and should be made a permanent practice in the Report on the Final Central Government Accounts.

The National Audit Office compared the 2010 budget proposal and the budget with the spending limits decision that was issued on 26 March 2009 and the spending limits with price and structural adjustments that was prepared by the Ministry of Finance in connection with the preparation of the budg-

[2] National Audit Office's separate report to Parliament: Effectiveness of the central government spending limits procedure as a fiscal policy instrument, R 21/2010 vp.

et. To perform calculations the National Audit Office used the spending limits decision that was issued on 26 March 2009 with its revision of the spending limits decisions issued on 25 May 2007 and 13 March 2008 adjusted to the 2010 price and cost level as well as the impacts of structural changes in the budget on expenditure covered by the spending limits. The National Audit Office also had access to the Ministry of Finance's preparatory materials, which show indices and price and cost adjustments used in the process. The index and price change percentages used in the 2010 price and cost level adjustment were taken directly from the Ministry of Finance's calculations.

In the calculation the division between expenditure included in the spending limits and expenditure excluded from the spending limits was made following the same principles as in the audit for fiscal year 2009.[3] 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, comparisons between the budget and the final accounts have been carried out in the same way.

On the basis of the National Audit Office's audit, the estimate of underspending with regard to expenditure included in the spending limits that is presented in the Report on the Final Central Government Accounts for 2010 can be regarded as providing a true view. It should be pointed out, however, that the calculations performed by the National Audit Office contain inaccuracies with regard to price and structural adjustments as well as the division between expenditure included in the spending limits and expenditure excluded from the spending limits.

[3] 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, R 13/2010 vp.

5.4 The openness and transparency of the relation between the state budget economy and off-budget funds and state-owned companies in the spending limits procedure and financial management

In financial audit for 2010 as well as a performance audit that is currently under way, with regard to the transparency of the spending limits the National Audit Office has drawn attention to financial arrangements in which VR Group furnished 80 million euros in 2009–2010 for track renewal on the Oulu–Seinäjoki line section, which falls within the scope of the Finnish Transport Agency. From the viewpoint of the transparency of the spending limits procedure, tasks that fall within the scope of the state budget economy should be financed through the budget and financing based on state-owned companies' assets should take place by means of the distribution of profits to the state budget economy. In this particular case a track renewal project that should have been included in the spending limits procedure and the state budget economy was carried out in such a way that the project did not have an impact on the spending limits procedure. Investments that should have been included in the state's balance sheet have been financed directly from state-owned companies. This procedure has weakened the transparency of financial relations between the state and state-owned companies. It also creates problems when it comes to providing a true view of the financial position of the state and state-owned companies according to good practice.

The National Audit Office notes that large transfers were made outside the spending limits procedure particularly from the Housing Fund of Finland and the Fund for Agricultural Development. On the basis of the information in the final central government accounts for 2010, 252 million euros was paid from the Housing Fund of Finland and 103 million euros from the Fund for Agricultural Development. Off-budget funds do not fall within the scope of the central government spending limits. The relation between off-budget funds and appropriations within the state budget economy that are covered by the spending limits is neither consistent nor sufficiently transparent. Broad attention was drawn to this in parliamentary position 50/2010, which Parliament approved in response to Audit Committee report 10/2010, and in the report of a working group that was appointed by the Ministry of Finance to consider the development of the spending limits system.[4]

[4] Ministry of Finance: Developing the spending limits system, Ministry of Finance publications 17/2011, pp. 44–45.

5.5 The application of the spending limits in the 2011 budget and the first supplementary budget

The National Audit Office has also evaluated compliance with spending limits for fiscal year 2011. The 2011 budget proposal and the budget were compared with the spending limits decision issued on 30 March 2010 and the spending limits with price and structural adjustments prepared by the Ministry of Finance in connection with the preparation of the budget. The fact that a supplementary budget proposal had been submitted at the time of the calculation on 15 April 2011 was taken into account.

On the basis of the calculation, after the supplementary budget the level of expenditure in 2011 remains within the spending limits. The same remarks concerning inaccuracies that were noted in connection with calculations for 2010 also apply to this finding, however.

The last spending limits decision of the outgoing Government, which was issued in spring 2011, is a "technical spending limits decision". On 23 March 2011 the Government confirmed "technical spending limits" for 2012–2015. These form a foundation for the Government Programme negotiations and for the actual spending limits that will be decided by the incoming Government in connection with the drafting of the 2012 budget. Parliament will not consider the approved technical spending limits. The level of expenditure in 2012–2015 depends on current legislation and its impacts on expenditure in the coming years. The technical spending limits do not contain political lines. The spending limits decision has been prepared so as to provide a reliable foundation for evaluating expenditure during the coming electoral term in the Government Programme negotiations.

5.6 Information concerning the state's financial position

The balance sheet contains important information concerning the state's financial position since it outlines the state's assets and liabilities. The balance sheet is included in the Report on the Final Central Government Accounts, which is prepared according to general accounting principles. In addition to the state budget economy, the Finnish state has 11 off-budget funds as well as assets in unincorporated state enterprises and state-owned companies. The state group does not keep consolidated accounts or a consolidated balance sheet, which would give a clear picture of the state's financial position as a whole. The national accounts give an overall picture of the financial position of public entities by sector, based on statistics.

In addition to assets, state ownership imposes liabilities on the state. If an unincorporated state enterprise is unable to meet its commitments, responsibility for them falls on the state. Off-budget funds, unincorporated state enterprises and state-owned companies are not included in the balance sheet. Instead their final accounts and balance sheets are presented in notes to the Report on the Final Central Government Accounts. Potential liabilities associated with unincorporated state enterprises, for example, are only placed on the balance sheet if they materialise, so these are referred to as indirect liabilities.

The state balance sheet in its present form also fails to show some direct liabilities, such as the state's pension liability. The Ministry of Finance set up a project on 13 August 2010 to study how the state balance sheet could be developed. A report that was prepared in connection with this project proposed the inclusion of pension liability in the state balance sheet. The working group also noted that, owing to gaps in principles regarding its preparation, in practice the current balance sheet is hardly used in decision-making.[5]

Information regarding commitments is presented in Note 12 in Part III of the Report on the Final Central Government Accounts. Liabilities are stated only in the case of commitments for which liabilities can be specified. According to the Report on the Final Central Government Accounts for 2010, the state's commitments total 101 billion euros. The amount rose by 5.3 billion euros compared to 2009. The biggest commitment is pension liability, which according to the report totalled 90.6 billion euros at the end of 2010.

The state's financial position is influenced by many risks involving such things as guarantee and credit decisions. Information on government guarantees is included in notes to the Report on the Final Central Government Accounts, since it has a bearing on the level of risk in the balance sheet. The guarantees included in the Report on the Final Central Government Accounts for 2010 total 17.2 billion euros. Information on government guarantees is also published in Statistics Finland's guarantee statistics. According to these, government guarantees totalled 19.5 billion euros at the end of 2010. Of this amount 51 per cent consisted of business guarantees. Financial and insurance institutions, foreign countries and public entities accounted for 7 per cent of guarantees.[6]

The total amount of guarantees in the Re-

[5] Ministry of Finance, Specification of the state group's balance sheet management policy, final report of a project group, 11 January 2011.

[6] Statistics Finland, 2011.

port on the Final Central Government Accounts is considerably lower than the figure given by Statistics Finland. This is because the Report on the Final Central Government Accounts only includes guarantees that fall within the scope of the state budget. Statistics Finland's guarantee statistics, on the other hand, include all guarantees for which the state is ultimately liable.

In a performance audit concerning the state's financial liabilities, the National Audit Office evaluated the way liabilities are handled in the most important planning document, the budget, and in the most important monitoring document, the final central government accounts.[7] The audit noted that it is impossible to obtain a proper picture of government guarantees, pledges and other commitments on which to base decision-making, because reporting on different types of liabilities overlaps, reporting does not present information on all liabilities and it does not show which liabilities have materialised. Separate information is presented on authorisations, but this does not shed light on their total amount or development. In sum, proper attention is not given to the state's total liabilities in financial decision-making and monitoring.

The current balance sheet, which covers only the state budget economy, and the picture it gives of the state's solidity and net worth position can be deemed inadequate for parliamentary decision-making since the state also has significant off-budget liabilities. The balance sheet in its current form does not provide a true and fair view of the state's financial position as a whole, as required by international accounting standards; instead the analysis of the final central government accounts and other information that is presented in the Report on the Final Central Government Accounts is vitally important in this respect. In its feedback on the present report the Ministry of Finance concurred on 9 May 2011 that more comprehensive reporting on liabilities is needed.

In addition to direct liabilities, indirect liabilities are an important part of the financial planning and fiscal policy information base. More reporting by itself will not necessarily make it easier to know how to treat indirect liabilities. Some liabilities may never materialise and thus require budget funds or the inclusion of liabilities on the balance sheet.

Problems regarding the treatment of indirect liabilities are highlighted particularly in the current situation, in which the Finnish state's commitments have increased significantly owing to the introduction of stabilisation mechanisms aimed at shoring up the European economy and financial system. These mechanisms along with Finland's liabilities and commitments are discussed in section 5.7 of this report.

Parliament must be given a true and fair view of the current state of central government finances on which to base decision-making. When decisions are made regarding the assumption of new liabilities by the state – whether or not these fall within the scope of the budget economy or come through the EU – it is justified to require information on associated risks regarding the state's financial position.

The management of central government assets and liabilities is fragmented among different units. Furthermore, unincorporated state enterprises, state-owned companies and off-budget funds, which are outside the

[7] National Audit Office's performance audit report 219/2011: Central government's financial liabilities – presentation and consideration in planning and monitoring documents.

budget economy, constitute a deviation from Parliament's budgetary power, although the state is ultimately liable for their commitments. The National Audit Office has noted that reporting on risks arising from off-budget liabilities is inadequate.[8] The usefulness of the information in the final central government accounts could be improved by conducting a more thorough analysis of the balance sheet.

The purpose of a project that was set up by the Ministry of Finance was to make a proposal concerning the organisation of the state group's financing, financial risks and balance sheet management. The working group studied the entire sphere that falls within the Government's decision-making power. In its opinion financial and balance sheet management policy should determine different units' roles, responsibilities, general risk management principles, the optimal relation between centralisation and decentralisation, and the content of reporting to support decision-making. It is also the opinion of the National Audit Office that including off-budget funds and state-owned companies in final accounts for central government as a whole would give a more comprehensive picture of central government finances and asset management than the current balance sheet, which covers only the state budget economy.

[8] National Audit Office's performance audit report 219/2011.

5.7 The stability of financial markets

From financial crisis to debt crisis

In spring 2010 public debt became a destabilising factor for the European financial system and economy. With the introduction of the euro in 2002, differences in bond yields between the members of the euro area practically disappeared. The absence of a national risk supplement and low interest rates contributed to rising debt in the private sector in many euro countries. In early 2010 the most indebted member states found their access to financial markets restricted and borrowing more costly. Credit risk premiums rose and interest rates on indebted euro countries' bonds shot up. Yields increased particularly on loans to Greece, Ireland, Portugal and Spain. As a result of the debt crisis, in May 2010 the Economic and Financial Affairs Council (Ecofin) decided on the establishment of stabilisation mechanisms.

These mechanisms presently consist of the European Financial Stabilisation Facility (EFSF) and the European Financial Stabilisation Mechanism (EFSM). These temporary mechanisms will remain in effect until June 2013, at which time they will be replaced by a permanent European Stability Mechanism (ESM).[9]

The European Financial Stabilisation Facility is owned by the member states in the euro area. It was established in June 2010 and went into full operation in August 2010. The EFSF grants fixed-term loans to euro countries that are in exceptional financial difficulties. It obtains the necessary funds on international capital markets. The EFSF's nominal lending capacity of 440 billion euros is based on guarantees supplied by the euro countries. Each member state's share is based on its share in the European Central Bank. Finland's share of guarantees is accordingly 1.8 per cent on the facility's nominal lending capacity and works out at 7.9 billion euros. Loans are granted by the facility on certain conditions. A country receiving assistance must reach agreement with the EU and the IMF on an economic and financial adjustment programme. Loan decisions are made by the member states in the euro area and require unanimity. Consequently each loan decision must be approved by Parliament.

The European Financial Stabilisation Mechanism can grant loans to EU member states, and the European Commission is responsible for obtaining funds for this purpose. The EFSM was established in May 2010. The European Commission obtains the necessary funds from capital markets or financial institutions. The total amount of loans depends on the EU's own funds. The Commission estimates the mechanism's total capacity at 60 billion euros. The member states' calculatory shares are based on their respective shares of the budget. Finland's share of the budget is 1.6 per cent and so its maximum liability is about 960 million euros. Loans from the EFSM are also conditional and decisions must be approved by a qualified majority of the European Council, in which all the member states are represented. Although the mechanism itself is new, its function is not. In the past the European Commission has obtained funds from capital markets to finance

[9] EFSF website http://www.efsf.europa.eu/about/index.htm; Term Sheet on the ESM, 21.3.2011; Bank of Finland, Euro&Talous 1/2011; Ministry of Finance, "EU:n vakausjärjestelyt ja Suomi – mitä, miksi ja millä osuudella?", 30 March 2011.

[10] EFSF website http://www.efsf.europa.eu/about/index.htm.

payment assistance and macroeconomic assistance granted by the EU.

The European Stability Mechanism (ESM) will be a permanent crisis management mechanism. In December 2010 the EU member states decided to replace the temporary mechanisms agreed in spring 2010 with a permanent mechanism in June 2013. Details regarding the ESM were still open when this report was prepared in April–May 2011, but its main features are outlined in Annex II to the European Council's conclusions on 25 March 2011 (EUCO 10/11). The ESM will evaluate the debt sustainability of each beneficiary member state before reaching a decision. If its analysis of debt sustainability is negative, the member state must begin negotiations to restructure its debt with creditors in the private sector. Loans can be granted only with the consent of all the member states, and loans are conditional on the objectives set in the beneficiary member state's adjustment programme. The planned total capacity of the ESM is 500 billion euros or the same as the combined capacity of the temporary mechanisms. It should be noted out, however, that the effective lending capacity of the temporary EFSF is less than 440 billion euros, owing to a 20 per cent over-guarantee on loans. Increasing the EFSF's effective lending capacity requires a revision of the framework agreement that was signed on 10 June 2010. Point 17 of the European Council's conclusions on 25 March 2011 (EUCO 10/11) notes that amendments to the EFSF agreement to ensure an effective lending capacity of 440 billion euros will be finalised so as to allow signature of both agreements at the same time before the end of June 2011. The permanent European Stability Mechanism's planned lending capacity of 500 billion euros will be achieved with capital commitments totalling 700 billion euros. This will consist of 80 billion euros paid by the euro countries plus 620 billion euros in further authorisations and guarantees. Finland's share of these, calculated in the same way as in the EFSF, would be 12.6 billion euros. Finland's share of guarantees will thus be 11.2 billion euros and its share of capital payments 1.4 billion euros providing all the participating member states make commitments. Half of the capital will be paid when the ESM is established in June 2013 and the remainder in instalments over the following three years. This structure differs from the temporary mechanism now in place, which is based solely on guarantees provided by the euro countries.

The temporary mechanisms are in operation and new lending programmes can therefore by approved with the consent of all the member states in the euro area up to June 2013. This means that the management and repayment of loans through the temporary mechanisms takes place within their framework. The temporary mechanisms will be abolished when the last loan instalment has been repaid and interest has been credited to the member states.

TABLE 1: FINLAND'S CALCULATORY MAXIMUM LIABILITIES IN CONNECTION WITH EXISTING EUROPEAN FINANCIAL STABILISATION MECHANISMS, MILLION EUROS.

		Lending capacity	Finland's share	Finland's maximum liability
EFSM	EU budget	60 000	1.6 %	960
EFSF	Guarantees	440 000	1.8 %	7 920
Total		500 000		8 880

Sources: EFSF and Ministry of Finance.

Note that the figures in the table describe maximum liabilities supposing that lending capacity is used to the full. In April 2011 less than 10 per cent of the EFSF's total lending capacity of 440 billion euros was in use.

Loans granted through the EFSF are recorded in each member state's lending and national accounts. The EFSF consequently increases Finland's gross debt items in Finland according to Finland's share but does not affect the Finnish state's net position.[11]

Agreed lending programmes and Finland's commitments

In May 2010 Greece became the first euro country to sign a binding economic adjustment programme. The 110 billion euro financial assistance in the Greek adjustment programme includes 80 billion euros from the EU and 30 billion euros from the IMF. The countries in the euro area granted loans to Greece on a bilateral basis, but these loans are managed by the Commission. Finland's loan commitment to Greece is 1.5 billion euros, of which 515 has been disbursed.

In addition to Greece, Finland has granted a 320 million euro bilateral loan to Iceland, of which 160 million has been disbursed. In 2009 Finland agreed to lend Latvia 324 million euros, but none of this has been disbursed so far.

With regard to Finland's bilateral loan receivables, no need has been felt to record depreciation in the final central government accounts. Owing to their nature and development since the accounts were closed, loan receivables are subject to risks that are hard to assess. Therefore the audit could not obtain assurance that subsequent events have not influenced the value of loan receivables in the final accounts.

European financial stabilisation mechanisms went into operation in November 2010 with a package that was granted to Ireland. The package totals 85 billion euros, including 17.5 billion from Ireland (through its pension fund and other sources), 22.5 billion from the IMF, 22.5 billion from the EFSM and 17.7 billion from the EFSF. The remainder (4.8 billion euros) consists of bilateral loans granted by Britain, Denmark and Sweden.[12] Finland's calculatory share through the EFSM is 360 million euros, and the maximum liability associated with financial assistance through the EFSF is roughly 740 million euros.

Although Finland's share of the EFSF's total lending capacity depends on its share in the European Central Bank, for a particular loan its guarantee share may vary. In connection with the financial assistance

TABLE 2: FINLAND'S BILATERAL LOAN COMMITMENTS, MILLION EUROS.

	Year	Finland's loan commitments	Paid 1/2011
Iceland	2008	320	160
Latvia	2009	324	-
Greece	2010	1 480	515
Total		2 124	675

Sources: Ministry of Finance.

[11] EUROSTAT. Treatment of The European Financial Stability Facility (EFSF) in National Accounts. 27.1.2011.

[12] EFSF website http://www.efsf.europa.eu/about/index.htm.

package for Ireland, Finland's share of the 17.7 billion euros granted through the EFSF is more than 1.8 per cent because all loans through the EFSF include a 20 per cent over-guarantee in order to improve credit worthiness and also because Ireland and Greece do not participate in paying for financial assistance through the EFSF because they are themselves beneficiaries. Consequently the more loans are granted through the EFSF, the bigger Finland's share will be in new mechanisms. Finland also has its own quota of the financial assistance provided to Ireland through the IMF.

The Report on the Final Central Government Accounts for 2010 discusses Finland's total liabilities resulting from measures taken to ensure economic and financial stability. The part of the final central government accounts that deals with central government liabilities contains a description of arrangements in which Finland is a participant and reviews resulting liabilities. Finland's current financial commitments to EU member states' lending programmes, direct loan commitments to countries in the EU or the European Economic Area and shares of direct financial assistance and guarantees aimed at stabilising financial markets have been discussed in the Report on the Final Central Government Accounts. Information has likewise been presented on the current state of planned or implemented measures designed to restore European economic and financial stability as well as Finland's participation and principles regarding participation. Figures have also been supplied regarding receivables and guarantee and other commitments connected to crisis management.

In the opinion of the National Audit Office, the Report on the Final Central Government Accounts for 2010 gives a comprehensive description of Finland's participation in measures aimed at stabilising European economic and financial markets. Note 12 in Part III of the report presents information on government guarantees, pledges and other commitments. It expresses Finland's liability for guarantees through the EFSF in the form of a calculatory maximum of 7.9 billion euros. By the end of 2010 about 740 million euros of this total had been used for the Irish lending programme. In Finland the use of a new guarantee always requires Parliament's approval, however. Furthermore it should be pointed out that the amount of guarantee liability that is legally binding depends on individual agreements regarding the use of a financial stabilisation instrument. Consequently, presenting EFSF commitments in the form of a maximum amount does not provide a true and fair view of their value, in the opinion of the National Audit Office.

A key open question is particularly how financial risk linked to these very different liabilities should be quantified. All the instalments in a lending programme may not have to be disbursed, and it may not be necessary to use the full lending capacity of the stabilisation instruments. How should the financial

TABLE 3: THE FINANCIAL PACKAGE FOR IRELAND AND FINLAND'S COMMITMENTS, MILLION EUROS.

	Assistance granted	Finland's liability
EFSM	22 500	360
EFSF	17 700	741*
Total	40 200	1 101

Sources: EFSF and *Ministry of Finance estimate.

risk in a guarantee associated with unused lending capacity be quantified in relation to the risk contained in a loan that has actually been granted and the repayment risk associated with a disbursed loan? The Report on the Final Central Government Accounts for 2010 notes that the total amount of liabilities that have been assumed through approved programmes, slightly under four billion euros, is calculatory and includes quite different types of liabilities. The amount of direct loan financing with impacts on the state budget is fairly small. One problem is how to deal with maximum liabilities linked to stabilisation instruments and related risks.

The debt crisis in the euro area is not over yet. To maintain financial markets' confidence, it is important to achieve a comprehensive and credible solution to European countries' debt problems. If the crisis were to deepen and as a result the entire 500 billion euro lending capacity had to be used and if all the beneficiary countries defaulted on their loans, this would lead to an extreme situation in which the Finnish state would have to take on more debt equal to its maximum liabilities, probably on weaker terms than at present. It is worth noting, however, that in the case of the Irish financial assistance package, less than 10 per cent of the EFSF's lending capacity is in use. Portugal requested financial assistance from the euro countries in April 2011, and the matter will be discussed at the Ecofin meeting on 17 May 2011.

A bigger risk for the Finnish economy would be the uncontrolled expansion of the debt crisis and a return to recession in Europe. This would make it even more difficult to balance Finland's public finances and meet the challenges of an ageing population.

At present risk premiums on sovereign loans are highly dependent on the current state of public finances. Concern over a deepening debt crisis will not go away as long as uncertainty regarding the balancing of European countries' public finances persists. Consequently the link between risk premiums on sovereign debt and fiscal discipline may intensify the incipient split in the euro area. The situation is challenging, since many euro countries have intertwining public finances and if one were to fall, this would immediately create problems elsewhere. Consequently the functioning of crisis management arrangements is vitally important to avoid a pan-European crisis and slump. More attention should also be paid to hidden liabilities in order to ensure awareness of the real burden on states' solidity and prevent additional surprises. In its separate report to Parliament spring 2010 the National Audit Office drew attention to the euro countries' sharply rising debt and the resulting threat to solidity on international financial markets and the Finnish economy and indirectly on central government finances. Problems have been deeper and broader than was anticipated. The financial crisis has also affected the countries in the euro area in different ways. Some countries need assistance and others must help. Steps have been taken to rectify the national and international problems behind the financial crisis. Placing the European economy on a sustainable foundation will take a long time, however, and will require concerted efforts on a sizable scale.

The International Monetary Fund has drawn attention to the linkages between euro countries' and private financial institutions' balance sheets and risks.[13] Private financiers have large amounts of crisis countries' and

[13] IMF. Global Financial Stability Report Durable Financial Stability Getting There from Here. April 2011.

other countries' debt on their balance sheets.

Mr Vitor Caldeira, the President of the European Court of Auditors (ECA), drew attention at the end of last year to Supreme Audit Institutions' role in ensuring the transparency of systems designed to restore and maintain financial market stability and the provision of true and fair information in a letter addressed to Herman van Rompuy, the permanent President of the European Council. The letter noted that it is important to ensure the implementation of the principles of good governance and openness as well as effective, independent external audit in the activities of the European Financial Stabilisation Facility and the European Stability Mechanism. External auditors' mandate should include financial audit according to international standards and recommendations as well as performance audit regarding the functioning of stabilisation mechanisms.

When the present report was drafted In April–May 2011, decisions had not yet been made concerning the legal details of the European Stability Mechanism. Its main features are outlined in Annex II to the European Council's conclusions on 25 March 2011 (EUCO 10/11). This states that the ESM will be established as an intergovernmental organisation under public international law. Thus it will not fall within the scope of the European Union or its organs. The ESM will be integrated into the multilateral surveillance and economic policy coordination procedures of economic and monetary union. The euro area finance ministers will form the ESM's highest decision-making organ, the Board of Governors. Major decisions will require the unanimous support of the Board of Governors. The term sheet on the ESM in Annex II to the European Council's conclusions on 25 March 2011 (EUCO 10/11) does not go into detail concerning surveillance and external audit or the implementation of accountability in the ESM. In view of the large financial volumes involved as well as the nature of activities, clear and effective arrangements are needed to ensure good governance, transparency, external audit and control, accountability and responsibility. INTOSAI has issued a recommendation concerning the audit of international organisations, which notes that all international institutions financed with or supported by public money should be subject to audit by supreme audit institutions to promote better governance, transparency and accountability.[14]

The fiscal policy audit network of the European Organisation of Supreme Audit Institutions (EUROSAI) has drawn attention to auditors' mandate regarding the European Financial Stabilisation Facility and the European Stability Mechanism. The network is chaired by the National Audit Office of Finland.

[14] The International Organisation of Supreme Audit Institutions (INTOSAI). Principles for best audit arrangements for international institutions.

5.8 Information concerning central government debt

Although European financial and capital markets were overshadowed by public debt problems during the year, the international economy recovered briskly in 2010. Developed economies served as engines of growth. The Finnish economy also grew sharply in 2010, with the pace speeding up in the latter part of the year. As a result of the recession, Finland's previously strong central government finances went into deficit in 2009. A large deficit was also recorded in 2010. Central government debt rose to about 75 billion euros in 2010. Debt did not increase as rapidly as the year before, however, nor did it increase as much as had been forecast when the 2010 budget was submitted to Parliament. Nevertheless, from the viewpoint of medium-term sustainability, the rise in central government debt is on an alarming track, and improving the balance of central government finances requires active measures

Interest costs on central government debt exceeded 1.8 billion euros in 2010. Thanks to low interest rates and successful debt management measures, interest costs have not increased in spite of the rising debt burden. If interest rates rise and borrowing continues to increase, there is a risk that interest costs will place greater strains on public finances. They will also place pressure on other operational expenditure and reduce resources available to finance other activities arranged by society and central government.

The strategic objective of central government debt management is to ensure that financing needs can be met on capital market terms in all economic situations at an acceptable risk level. The Ministry of Finance and the State Treasury followed a steady and long-term debt management strategy. This concerns the issuing of bonds, cash management and general risk management. The economic crisis increased governments' need for external financing to the point that the bond market was sometimes quite challenging. In spite of rising demand, Finland successfully obtained funds on this market and met its objectives. The bond programme was implemented as planned in terms of amounts, prices and other factors. As a result of the challenging market situation, an thorough analysis of the market and the timetable for issuing bonds as well as bond characteristics was necessary. It is extremely important for the basics of central government finances to be in order so that Finland can maintain its AAA credit rating and retain its creditworthiness among sovereign borrowers. Finland's reputation for strict economic discipline strengthens our position as borrowers on international capital markets. Finland's credit prospects remain steady compared with other borrowers on the euro market.

According to the National Audit Office's findings, a long-term and systematic debt management strategy has promoted Finland's good reputation as a borrower on international capital markets. Buyers of Finnish government bonds appreciate the predictability and transparency embodied in the strategy and the activities of the State Treasury's Finance Division. In the opinion of the National Audit Office, information concerning central government debt management provides a true and fair view of central government debt and related risks.

The Report on the Final Central Government Accounts for 2010 mentions the risk that central government debt and debt management costs will rise unless measures are taken to balance public finances. One of the key policies of Mari Kiviniemi's Government was a promise to take steps towards balancing public finances in 2010. Background work has been done to prepare a plan to balance public finances, but a programme has not yet been drafted. The challenge will be to strengthen the sustainability of public finances in such a way that the required tightening of fiscal policy will not endanger economic growth.

The upturn is extremely vulnerable because of the current debt crisis in the euro area. If the economy falls back into recession and demand for Finland's exports weakens, the effects will have repercussions on the balance of central government finances and make it more difficult to prepare for rising cost pressures resulting from an ageing population.

Debt management and the budget covering requirement

The state budget is always formally in balance or surplus (budget covering requirement). This means that, unless cuts are made in appropriations when revenues fall short of the budgeted amount, the gap must be closed by borrowing funds or drawing on an accumulated surplus. Having to borrow more money than is needed to maintain liquidity has led to increased financial costs and counterproductive transactions. Section 84 of the Constitution has in practice been interpreted and applied so that any gap in the budget has been closed by borrowing even if liquid funds have been available from appropriations to cover payments that are due. The objective of a government proposal to amend section 84 of the Constitution (Government proposal 158/2010) was to increase the transparency of budget covering and create proper conditions to improve debt management. The Audit Committee submitted a statement on the government proposal (Audit Committee statement 7/2010) in which it considered the government proposal justified and necessary and estimated the possible savings of the reform at 20 million euros a year. The Finance Committee for its part recommended the adoption of the government proposal in its original form (Finance Committee statement 6/2010).

Consideration of the government proposal in the Constitutional Law Committee lapsed at the end of the electoral term. Experts appearing at committee hearings suggested that borrowing in excess of liquidity needs could be avoided by changing the established interpretation of the Constitution. This view was also presented in the National Audit Office's performance audit report on the state's cash management (168/2008). According to experts who appeared before the Constitutional Law Committee, changing the established interpretation would require a clear and unambiguous stance on the matter.

Considering the financial costs and counterproductive transactions resulting from over-borrowing as well as counterparty risks, the National Audit Office is of the opinion that the Constitutional Law Committee should be asked for an interpretation regarding the impacts of the budget covering requirement on the implementation of the budget, which would make it possible to change current procedure.

5.9 Information concerning tax subsidies

Many countries have paid increasing attention to tax subsidies in the past decade. A parallel audit that was conducted under the auspices of the European Organisation of Supreme Audit Institutions (EUROSAI) was intended to support this development. On the basis of the audit attention was drawn to improving awareness of tax subsidies as a fiscal policy instrument and to more transparent reporting on tax subsidies in connection with European governments' financial processes. Tax subsidies are seldom subject to the same kind of scrutiny as budget appropriations. Furthermore, the spending limits procedure can be viewed as increasing pressure to use tax subsidies. The latest studies indicate that new tax subsidies have not been introduced on account of this, however. In its report the Audit Committee noted that Parliament has asked the Government to investigate whether tax subsidies should be included in the spending limits procedure.[15]

Parliament called for the Government to conduct a study of tax subsidies examining the justifications for the Government's tax policy and particularly tax neutrality and the handling of tax subsidies as part of the spending limits and budget procedure and to provide information on related measures in the Report on the Final Central Government Accounts. In its Report on the Final Central Government Accounts for 2007 the Government said that it would start a project to prepare a report on tax subsidies. The results of this study were available at the end of 2010. The report surveys tax subsidies that were included in tax legislation in 2009. The amount of money involved was calculated on the basis of available data. The degree of accuracy varies according to the type of tax subsidy, and the study was unable to take behavioural impacts into account.

The report surveys the entire body of tax legislation. In addition to income tax, corporate tax, agriculture and forestry tax and value added tax, which have previously been covered by calculations regarding tax subsidies, the study included asset transfer tax, real estate tax, inheritance and gift tax and social insurance contributions. Excise tax was also included for the first time in practice, since norms in this area have been completely revised. The study looked at norm systems applying to tax categories on which information has previously been reported and found several tax subsidies that had not been identified before.

The methods used in calculating tax subsidies were updated in the study for the sake of clarity. The basic principle that tax subsidies should be calculated in terms of lost revenues was not changed, however: a tax subsidy lowers revenues based on tax regulations, assuming that other regulations have not been revised. Calculations of tax subsidies do not take into account behavioural impacts or possible overlap, and caution should therefore be shown in evaluating the total amount of subsidies. Nor would eliminating tax subsidies necessarily increase tax revenues by a corresponding amount.

According to the Government Institute for Economic Research, 201 tax subsidies were

[15] Audit Committee report 10/2010 vp – R 21/2010 vp.

identified in legislation in 2009. The number of tax subsidies is considerably larger than was previously thought. Some 40 per cent of tax subsidies were contained in the new tax forms that were examined. Broken down by category, social security topped the list, accounting for 23 per cent of lost revenues due to tax subsidies. Housing and the environment accounted for 21 per cent, industry 20 percent and transport roughly 11 per cent. The remainder, about one-fourth, included various functions in different sectors. Tax subsidies totalled 17.6 billion euros in 2009. This corresponds to roughly 23 per cent of tax revenues and is clearly more than previous calculations have suggested. About half of all tax subsidies were prescribed in the Income Tax Act. Tax subsidies applying to asset transfers, value added tax and excise tax each accounted for about one-tenth of the total.

In the opinion of the National Audit Office, mapping the scope and coverage of tax subsidies and updating calculation methods have made it possible to provide a true and fair view of tax subsidies and their impacts. Keeping the monitoring of tax subsidies up to date and developing and maintaining calculation methods requires constant work, however. According to the Report on the Final Central Government Accounts, beginning in 2011 tax subsidies will be presented in the commentary to section 11 of the budget proposal and in the commentary to tax revenue items where this is appropriate. The intention is to pay special attention to changes in the amount of tax subsidies, new tax subsidies and revisions of the criteria used in granting tax subsidies. In future tax subsidies will also be discussed in the Report on the Final Central Government Accounts. The report will examine the focusing and impacts of tax subsidies insofar as this is possible.

The National Audit Office considers that the proposed reporting procedure will significantly increase the transparency of tax subsidies. The National Audit Office also believes that the new form of reporting will link tax subsidies more clearly and closely to other financial processes.

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