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OECD

Volume 2019/1

OECD Journal on Budgeting, Volume 2019 issue 1



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Please cite this publication as:
OECD (2019), *OECD Journal on Budgeting, Volume 2019 issue 1*, OECD Publishing, Paris, *https://doi.org/10.1787/f2d48bce-en*.

ISBN 978-92-64-81593-3 (pdf)

OECD Journal on Budgeting
ISSN 1608-7143 (print)
ISSN 1681-2336 (online)

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Foreword

The OECD Journal on Budgeting is a unique resource for policy makers, officials and researchers in public sector budgeting. Drawing on the best of the recent work of the OECD Working Party of Senior Budget Officials (SBO), as well as special contributions from finance ministries of member countries and from other practitioners, the Journal provides insights on leading-edge institutional arrangements, systems and instruments for the effective and efficient allocation and management of resources in the public sector.

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Budgeting in Uruguay
Towards modern budgeting practices in Uruguay

by

Camila Vammalle, Ana Maria Ruiz Rivadeneira

Uruguay is the only country in the world which has a five-year budget. A budget is prepared by each new government taking office and voted within 6 months of its swearing in, for the whole five-year government term. Each year, an annual revision ("budget update") takes place, where the government reports budget implementation to the Parliament and some adjustments to the coming year's budget can be made.

Uruguay has done significant improvements in budget management in the last decade since 2005, achieving great results in terms of financial stability and funding predictability for spending institutions. The governance of the budget process has shifted, with the leadership for the budget process being now in the National Budget Unit and the Macroeconomic Assessment Unit (both located in the Ministry of Economy and Finance), and the Office of Planning and Budget (located in the Presidency) developing planning functions.

While the new roles and responsibilities seem quite clear today, they are not yet institutionalised. This budget review aims to provide a detailed description of how Uruguay's budget institutions work today and present roles and responsibilities of each actor in the budget process. It also analyses Uruguay's budget practices in the light of OECD countries best practices, and proposes policy recommendations for further modernising Uruguay's budget process, in particular in the areas of aligning the budget with medium-term strategic planning and measuring results.

JEL codes: H50, H61, H80

Keywords: Uruguay, Five-year budget, Budget process, Strategic planning

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The authors would like to acknowledge: Mr Michael Borchardt for co-ordinating the review process in Uruguay; Ms Marta Abilleira for supporting fact finding process, Mr Gabriel Papa for comments on the final draft; the authorities and officials in UPN, AM, UGD, TGN, CGN, OPP, AIN, TCR and Budget Institutions, who provided inputs during the fact finding mission and comments on earlier versions of the draft; Mr Karl Bergstrand, senior advisor at the budget department at the Swedish Ministry of Finance for participating as peer reviewer in the fact finding mission and providing comments and inputs on the draft; Mr Marc Robinson for fruitful discussions; Mr Jon Blondal for his supervision of this report; Ms Delphine Moretti and Mr Ronnie Downs for inputs and comments; Mr Bonifacio Agapin for editing the draft, Ms Hélène Leconte Lucas and Ms Lyora Raab for administrative support.

Acronyms

Acronym	Name in Spanish	Translation in English
	Balance de Ejecución Presupuestal	Budget Execution Account
	Centro de Estudios Fiscales de Uruguay	Uruguay Center for Fiscal Studies
	Dirección de Descentralización e Inversión Pública (OPP)	Decentralisation and public investment department
	Dirección de Planificación (OPP)	Planning department
	Dirección de Presupuestos, Control y Evaluaciones (OPP)	Budgeting control and evaluation department
	Entidades del artículo 220	Autonomous agencies "Art. 220 entities"
	Exposición de motivos	Bill's explanatory statement
	Incisos	Budget institutions
	Rendición(es) de cuentas	Annual budget update(s) / Annual update law
	Tribunal de Cuentas de la República	Court of Accounts (Uruguay's Supreme Audit Institution)
AGESIC	Agencia para el Gobierno Electrónico y la Sociedad de la Información	Agency for Digital Government and Information Society
AGEV	Dirección de Gestión y Evaluación (OPP)	Management and Evaluation Department
AIN	Auditoría Interna de la Nación (MEF)	National Internal Audit
AM	Asesoría Macroeconómica y Financiera (MEF)	Macroeconomic Assessment Unit
ANEP	Administración Nacional de Educación Pública	National Administration of Public Education
ASSE	Administración de los Servicios de Salud del Estado	National Administration of State Health Services
BCU	Banco Central de Uruguay	Central Bank of Uruguay
BPS	Banco de Previsión Social	Social Protection Bank
CGN	Contaduría General de la Nación (MEF)	National General Accounting Department
CUN	Cuenta Única Nacional	Single Treasury Account
DGI	Dirección General Impositiva (MEF)	General Tax Authority
ECH	Encuesta Continua de Hogares	Household Survey
GEMAP	Sistema de Gestión de Modificaciones Presupuestarias	System for the Management of Budget Modifications
INE	Instituto Nacional de Estadistica	National Statistics Office
MEF	Ministerio de Economía y Finanzas	Ministry of Economy and Finance
MIDES	Ministerio de Desarrollo Social	Social Development Ministry
ONSC	Oficina Nacional del Servicio Civil	National Civil Service Department
OPP	Oficina de Planeamiento y Presupuesto	Budgeting and Planning Department
RR.GG.	Rentas Generales	General Government Revenues
SIIF	Sistema Integrado de Información Financiera	Integrated Financial Information ystem
SIPREF	Sistema de Proyección de Créditos Presupuestales y Planificación de Pagos	System of Projections of Budget Allocations
SNIP	Sistema Nacional de Inversión Pública	National Public Investment System
SOEs	Empresas públicas	State Owned Enterprises
SPA	Sistema de Presentación del Articulado	System for Submitting Budget Requests
SRPFFAA	Sistema de Retiro de las Fuerzas Armadas	Armed Forces Pension System
SRPP	Sistema de Retiro Policial	Police Pension System
TGN	Tesorería General de la Nación (MEF)	National General Treasury
TOCAF	Texto Ordenado de Contabilidad y Administración Financiera	Accounting and Financial Administration Annotated Text
UGD	Unidad de Gestión de Deuda (MEF)	Debt Management Unit
UPN	Unidad de Presupuesto Nacional (MEF)	National Budgetary Unit

1. Introduction

After a decade of vibrant growth averaging 5% of annual real GDP between 2009 and 2014, Uruguay's economy is currently facing a slowdown in a difficult regional and international context. With the government implementing a fiscal consolidation and the need for monetary tightening to contain inflationary pressures, growth is unlikely to return to the strong growth rates of the past in the medium-term – even though the economy started showing signs of recovery since mid-2016. This context has several implications for budgetary and fiscal policy in Uruguay, including the importance of understanding the key drivers of baseline expenditure, such as wage pressures, the need to strengthen medium-term budgeting and fiscal constraints, and to improve the quality of public expenditure and value for money.

Uruguay has used this economic growth to improve its results in terms of development, in particular in the reduction of poverty and social inequality (Box 1). As international economic conditions are likely to be tight for some years, leading to moderate growth perspectives, Uruguay is seeking to improve the quality of public expenditures, in order to sustain growth and social progress in a more difficult environment. Uruguay recognises the central role of the budget and budget process and institutions for achieving this goal. Danilo Astori, Uruguay's Minister of Finance stated in his introductory speech for the 10th anniversary of the creation of Uruguay's National Budget Unit (*Unidad de Presupuesto Nacional*, UPN), that the budget is a key instrument to implement a political project and a government plan. Politicians define the objectives to be reached, analyse the different paths and options to reach them and design the most effective policy given the country's constraints and political priorities. The budget is then the central instrument to implement these policies, generate the information needed to assess policy options and policies, evaluate results, and use these results to feedback and improve policies.

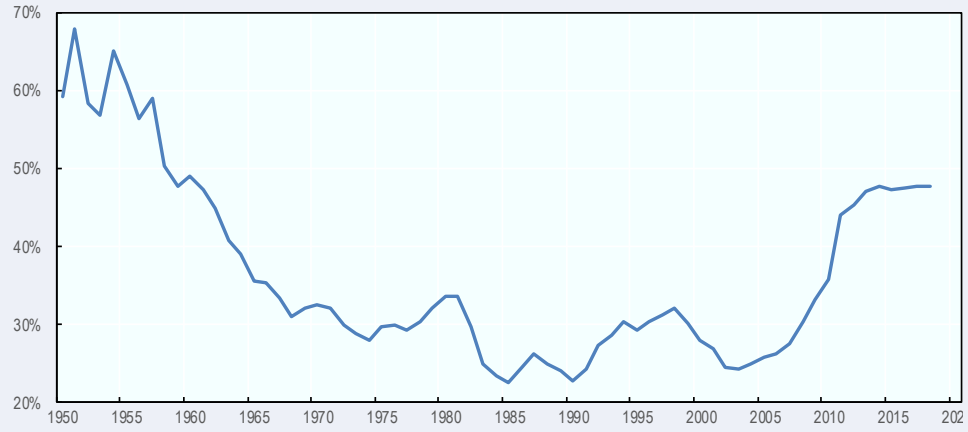
Uruguay has carried out important reforms in its budget process since 2005, and wishes both to institutionalise these (to prevent them from being reverted), and to further modernise its budget process. This Budget Review aims to help Uruguay continue the modernisation of its budgeting practices by 1) assessing present practices in the light of the OECD Recommendation on Budgetary Governance and practices in the most advanced countries; and 2) providing tailored recommendations and suggestions to move forward.

Box 1. Social progress in Uruguay

Uruguay has experienced 15 years of continuous GDP growth. This growth, combined with institutional improvements and reforms, and active policies, has allowed the country to reduce poverty and inequality, and improve a number of social indicators. Unemployment rate is historically low, thus improving labour conditions and wages.

Since the aftermath of the 2002 crisis, Uruguay's GDP per capita has been catching up with the average of G7 countries (Germany, Canada, United States, France, Italy, Japan and United Kingdom), thus reverting a long trend of relative decline since the 1950s (Figure A). In the 1950s, Uruguay GDP per capita represented around two thirds of that of G7 countries. Between 1990 and 2002 however, it had fallen to less than one quarter. It is now growing steadily, and has reached a level of 40%.

Figure A. Uruguay GDP per capita as a share of G7 average GDP per capita (adjusted for purchasing power parity)

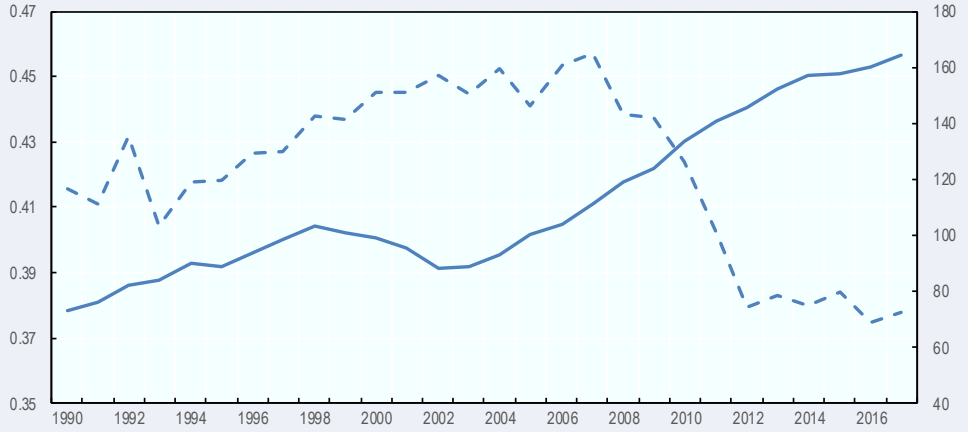


Source: MEF

This recent economic growth was used to achieve greater levels of income distribution, which is visible in the improvement of the GINI coefficient, the reduction of poverty rates and indigence rates since 2005 (Figure B).

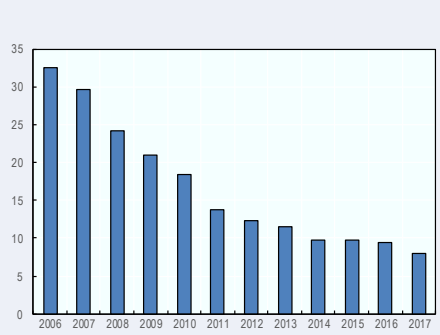
Figure B. Recent evolution of growth, inequality, poverty and indigence in Uruguay

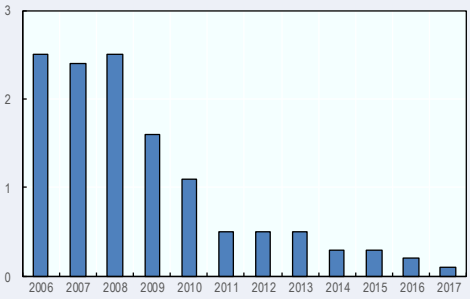
Poverty and inequality (1999-2017)



Poverty (total, share of people)

Indigence (total, share of people)





Source: Data provided by the MEF (based on ECH microdata) and INE

1.2. Objective and structure of this Budget Review

This Budget Review analyses Uruguay's budget institutions and practices, identifies the particular challenges the country faces, describes recent reforms which were carried out. This review also suggests recommendations and policy options to 1) ensure that the improvements achieved in recent years are institutionalised and cannot be reverted; and 2) to further modernise Uruguay's budgetary practices to the standards of the most successful OECD countries, in the light of the OECD's Ten Budgetary Governance Principles (Box 2).

Box 2. The Ten OECD Principles of Budgetary Governance

1. Manage budgets within clear, credible and predictable limits for fiscal policy
2. Closely align budgets with the medium-term strategic priorities of government
3. Design the capital budgeting framework in order to meet national development needs in a cost-effective and coherent manner
4. Ensure that budget documents and data are open, transparent and accessible
5. Provide for an inclusive, participative and realistic debate on budgetary choices
6. Present a comprehensive, accurate and reliable account of the public finances
7. Actively plan, manage and monitor budget execution
8. Ensure that performance, evaluation & value for money are integral to the budget process
9. Identify, assess and manage prudently longer-term sustainability and other fiscal risks
10. Promote the integrity and quality of budgetary forecasts, fiscal plans and budgetary implementation through rigorous quality assurance including independent audit

Source : OECD (2015b)

This report starts with a brief overview of recent economic trends and budget reforms, highlighting key improvements as well as ongoing challenges. After this initial overview, the report covers five topics: 1) legal and institutional characteristics; 2) budget formulation and approval; 3) budget implementation; 4) aligning budget with the strategic priorities of government; and 5) performance budgeting and evaluation practices. This report provides a detailed description of how Uruguay's budget institutions work today, and the present roles and responsibilities of each actor in the budget process. In doing so, the report compares Uruguay's practices with the most developed OECD countries in terms of budgeting. It provides recommendations to Uruguay's authorities on how to modernise its budgeting practices in light of the OECD's best practices, and provides concrete examples of how OECD countries have built their budgeting systems by finding solutions to challenges which are often shared.

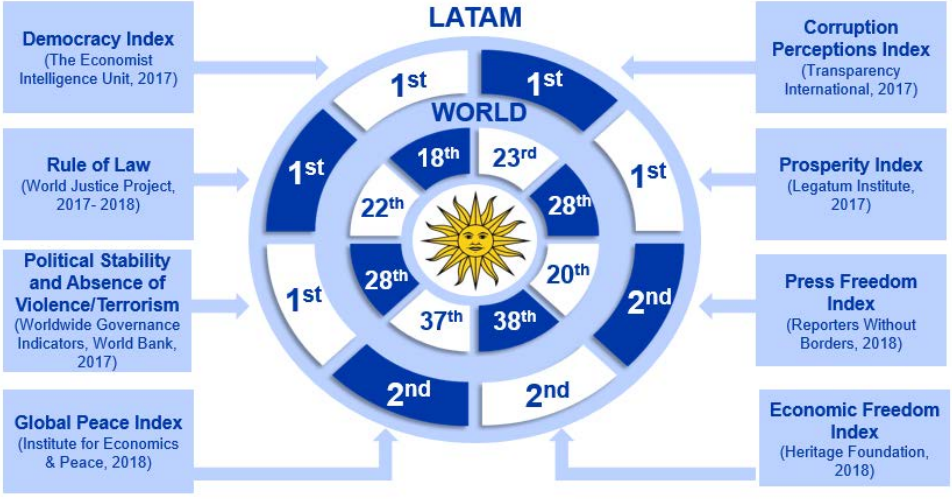
2. Recent economic trends and budget reforms

2.1. International perception of Uruguay

2.1.1. Uruguay benefits from a positive international perception

Uruguay is a very small country (3.4 million inhabitants), which has historically been closely linked to the economic cycles of its two large neighbours - Argentina and Brazil. However, unlike its neighbours, it has been characterised these last decades by strong political stability, and low perception of corruption (Figure 1). In particular, Uruguay has a history of respecting its contracts, paying off its debts, maintaining the rules of the game, open markets and free mobility of capital. This has created trust in international markets, and attracted large amounts of foreign direct investment. Its positive international image is also reflected in the investment grade that Uruguay enjoys from rating agencies.

Figure 1. Ranking of Uruguay in international governance indicators



Note: Ranking position in LATNAM and worldwide, respectively.
Source: Data provided by the Debt Assessment Unit (Unidad de Gestión de Deuda), MEF

This positive perception (both from internal and external stakeholders), coupled with active economic diversification policies have allowed Uruguay to decouple its economy from its neighbours. The combination of these factors have allowed Uruguay to not be too heavily

affected by the present crises in Argentina and Brazil (although Uruguay's growth rate fell from an average of 6% per annum during the 2005-13 period to around 2% per year in 2016-17).

2.1.2. A small open economy

Given the scale of the economy and its important links with Argentina and Brazil, shocks that originate in these neighbouring economies often spill over into the Uruguayan economy. In this sense, Uruguay's long-term GDP growth partly driven by economic growth in Argentina and Brazil (Figure 2) and as most recently experienced in 2014-6. It is worth noting however, that the impact of the economic crises in Argentina and Brazil on the Uruguayan economy has been much more moderate than in the past, which speaks highly of the efforts carried out to diversify economic partners in order to delink Uruguay's economic cycle from that of its neighbours.

In 2002 in particular, vulnerabilities highlighted when a severe crisis hit the Uruguayan economy, triggered by the devaluation of the Brazilian Real in 1999. This was followed in 2001 by a major economic crisis in Argentina, and a strong devaluation of the Uruguay peso in 2002 (Box 3). Agricultural export prices softened and energy import prices rose sharply. As Argentina's economy weakened and the authorities there took measures to discourage imports, Uruguayan domestic demand contracted, and both public sector and current account deficits widened. However, despite these difficulties and unlike other countries in the region, Uruguay did not default on its obligations (it paid its debts in the agreed currency with no forced conversion of debts, etc.). This certainly contributed to building Uruguay's good reputation in international financial markets.

Box 3. The 2002 crisis in Uruguay

In 2002, the economy of Uruguay faced one of its deepest crises in history. Reversion of capital flows to the region, the Argentinian economic crisis, a strong currency devaluation of the real in Brazil, combined with some internal vulnerabilities (e.g. floatation band) were some of the main drivers of the crisis.

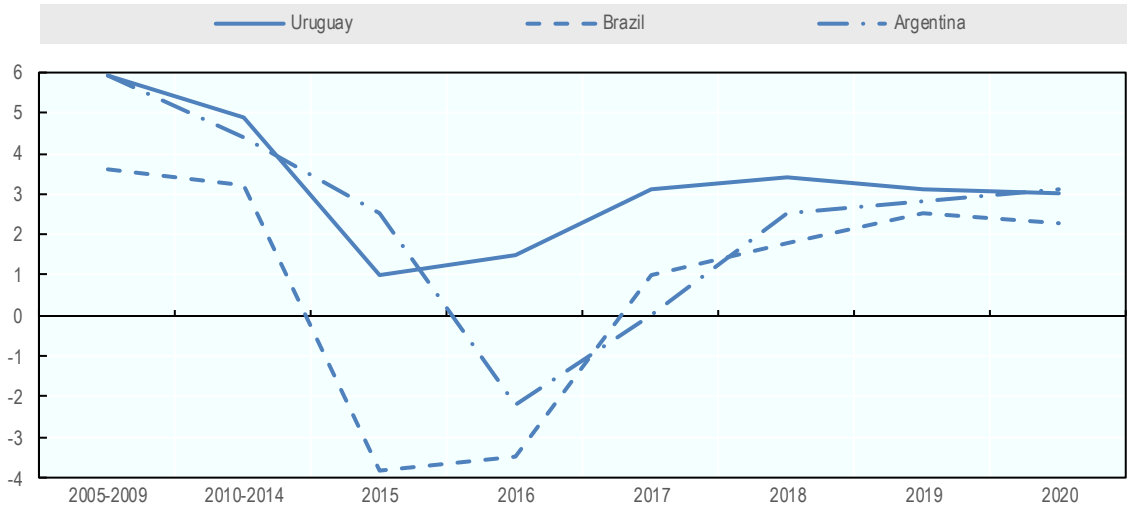
The economic crisis was further amplified by a deep financial crisis. A big outflow of bank deposits (both from residents and non-residents), the failure of some of the main domestic private banks and the drain of international reserves had a major impact in bank solvency, causing a virtual collapse of the economic system of the country.

The 2002 crisis also had a major impact on government financing and increased fiscal deficit. Public debt rose sharply as a consequence of the assistance given to the financial sector and the effect of the increase of nominal exchange rate relative to domestic prices. Gross public debt rose as a proportion to GDP up to almost 100%.

Furthermore, the crisis caused a sharp decrease in real GDP and an increase in unemployment. Real GDP went down four years in a row completing a decrease of almost 18% in this period. The rate of unemployment rose up to almost 20% by the end of 2002.

Source : Dominioni (2004)

Figure 2. Annual real GDP growth



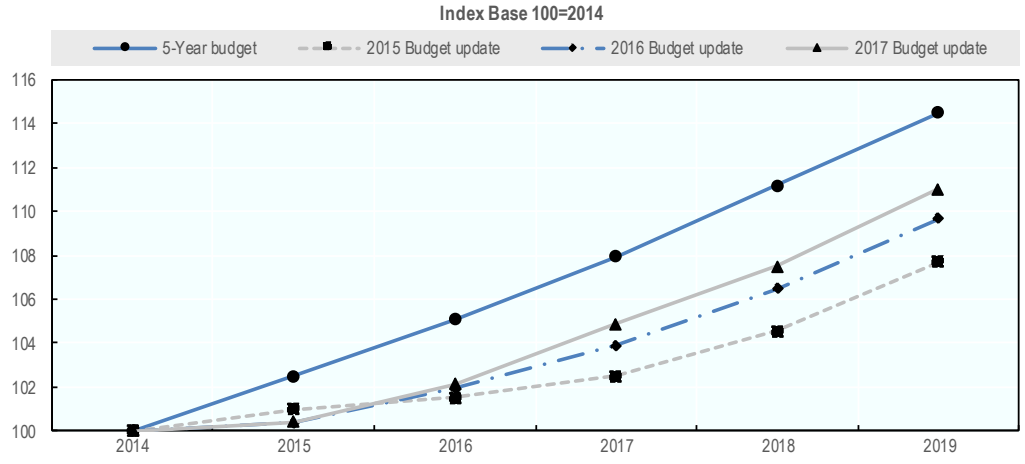
Source: BCU, Article IV consultation, IMF (2018)

2.2. Recent economic trends

2.2.1. More moderate growth: a "new normal"

The Uruguayan economy is undergoing a gradual recovery after having one of the lowest GDP growth rates of the past 15 years in 2015 (0.4%). Due to a more difficult international and regional context than the one initially expected, the Government had to revise downwards its annual GDP growth forecasts and assumptions underlying the 2015-19 Budget. This revision was slightly adjusted upwards in 2016 and 2017given the improvements observed (Figure 3).

Figure 3. Evolution of GDP projections



Source: Data provided by the MEF

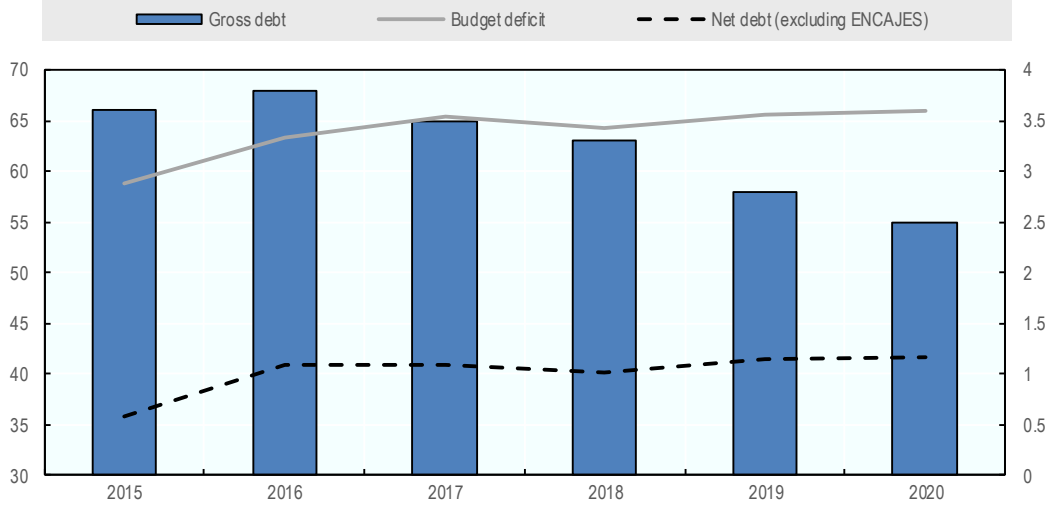
During 2015-16, growth slowed both because of cyclical and external reasons. In part, this slowdown was driven by dampening consumer confidence and consumer spending, and less growth in Uruguay's main export markets and the overall downturn in export commodities. For example, forecasts in 2013 expected GDP growth in Argentina to be 2.4% in 2014. One year later the Argentinian economy was expected to shrink by - 0.4% in 2014. Similarly, average growth forecasts for 2014 in Brazil went from 3.7% in 2013 to 1.8% in 2014. While these forecasts were overly pessimistic, they did drive expectations down at the time. A stronger than expected slowdown in China's growth could also have an impact on the Uruguayan economy via lower export prices and volumes.

2.2.2. Inflationary pressures and fiscal consolidation

Despite the cooling economy, inflation remained above the central bank's 3-7% target range until 2017. The Government has set new wage-setting guidelines that aimed at moderating wage growth and alleviated the indexation of wages to past inflation. This led to a strong reduction in the non-tradable component of inflation. Since March 2017, inflation has fallen rapidly, and reached the target range (3% to 7%) until March 2018, when it breached the target again, mainly due to the exchange rate depreciation (following a devaluation of 8% in May 2018).

The medium-term budget for the new government's 5-year term projects a tightening of the fiscal deficit by 1% of GDP over 5 years from 2014's value to reach a targeted 2.5% of GDP in 2019. The Explanatory Statement of the 2016 Economic Financial Report estimates a fiscal deficit of 3.3% in 2017, 2.9% in 2018 and 2.5% in 2019[1]. However, the 2017 Explanatory Statement increased the deficit estimates to 3.3% in 2018, 2.8% in 2019 and 2.5% in 2020. Despite relatively low levels of net debt to GDP (around 40%), gross debt level estimates are quite stable around 65% of GDP (Figure 4).

Figure 4. Government Budget Deficit, Net and Gross Domestic Debt (as a percentage of GDP)



Source: CGN (2017a) and MEF (2017)

2.2.3. Changes in the budget strategy

Due to the economic and financial crisis which started in 2002, the 2005-10 budget took a very prudent strategy, and set very low budget allocations for the first years, with gradual increases towards the last years. This was crucial to channel expectation and fulfil political commitments during the 5-year period. It was also made possible politically, as citizens understood that it was the only way to get out of the crisis. With the return of economic growth, revenues were higher than anticipated and endogenous expenditure was significantly reduced. This allowed increasing discretionary expenditures at the annual budget updates during the five-year period.

As the economic situation stabilised, the government decided to increase expenditure, in particular in education, health and internal security. The 2010-15 budget therefore integrated annual increases of budget allocations (based on the experience of the previous five-year execution).

Given the sharp economic slowdown, the MEF has taken an particularly prudent position. With the high level of uncertainty and the lack of flexibility to decrease expenditures once they are allocated in the five-year budget, the government decided to increase expenditures only for three years (2015-17) in the five-year budget. However, 2016 and 2017 revisions made some incremental allocations and reallocations, in particular in favour of education.

2.2.4. Recent improvements in budget practices

Uruguay has done some significant improvements in budget management in the last decade. Before 2005, Uruguay was governed by coalition governments, and the budget process was not sufficiently strong and institutionalised as to impose realistic limits on political budget negotiations. At the time, the budget process was a bottom-up process, where the budget authority had little capacity to contain funding requests by line ministries in the budget. This created a mismatch between the voted budget and the cash management, to the point that the voted budget was almost irrelevant, and could not be used as a tool for planning and orienting policies. The executive therefore used to set "administrative execution ceilings" ("*topes de ejecución por vía administrativa*") to control budget deficits and the accumulation of public debt. This reduced predictability of funds and planning capacity of line ministries. Likewise, cash limits were set in a restrictive way in order to achieve fiscal objectives. Budget executions were higher than cash transfers leading to accumulation of a high level of floating debt in Line Ministries.

Since 2005, there was a move towards a top-down budgeting process. The Macro Assessment Unit (*Asesoría Macroeconómica y Financiera*) of the Ministry of Economy and Finance (MEF) carries out projections for the five-year period and proposes fiscal targets, which are discussed and agreed by the Executive in the Council of Ministers (*Consejo de Ministros*). Budget allocations are discussed in the Council of Ministers, and remain within this envelope. The Parliament has ample faculties to modify the budget proposal of the government, but in the last three budget cycles, it has not increased total expenditures. Administrative budget ceilings are no longer used.

The governance of the budget process has also shifted during the last 30 years, with the leadership for the budget process being either in the Office of Planning and Budget (OPP), located in the President's office, or in the MEF. While not yet fully institutionalised, the allocation of roles and responsibilities seems quite clear today. Since 2005, the Ministry of Finance has built capacities to manage the budget and has now the leading role during the budget process. In particular, it created the National Budget Unit and strengthened the

Macroeconomic Assessment Unit. The OPP was initially created as an advisory unit for the President. It is now developing its planning functions, and working to design a long-term vision, and change the culture of line ministries towards a performance focus, improving programme budgeting and performance indicators.

Other important improvements in recent years, which should be praised: creation of the Debt Management Unit in the MEF; improving long-term management of the public debt and public liquidities; reform of the Treasury; creating a clear calendar for disbursement together with line ministries; and making sure payments are carried out on time. This was one of the pre-requisites to build trust with line ministries and agencies, and thus convince them to close their individual bank accounts, and rely on the Single Treasury Account (*Cuenta Unica Nacional*, CUN).

2.2.5. Gradual reform of the budget process and strong improvement of technical capacities

Uruguay carried out the necessary reforms of the budgetary system in a gradual way, allowing time to build the necessary capacities in the Ministry of Finance, the OPP and line Ministries. In contrast with other international experiences, the reform was not carried out in a central and lineal way. Different organisations had reform initiative and the general strategy was adjusted through the implementation.

The first stage was led by the MEF aiming to improve fiscal and financial consolidation (2005-09). The aim was to give credibility to the budget, by ensuring availability of funds and corresponding payments. This required improving financial and budgetary planning. The Macroeconomic Assessment Unit in the MEF was thus reinforced, a Debt Management Unit was created in 2005, and the National Budget Unit was created in 2007. Before these reforms, macroeconomic, fiscal and debt management were carried out by the Macroeconomic Assessment Unit in the MEF, which only had four stable professionals. In addition to the budgetary reforms, Uruguay carried out important reforms in taxes (increasing direct taxes participation, simplifying the system, and creating investment incentives), tax administration (consolidating the role of the General Tax Authority, *Dirección General Impositiva*, DGI), health (creating a national integrated health insurance), and customs.

The second stage (2010-16) concentrated in strengthening internal capacities of the MEF and OPP to carry out their mission. The capacities of the Macroeconomic Assessment Unit, the National Budget Unit and the National Treasury were increased. A programmatic structure of the budget was pushed forward by OPP. IT systems have been developed, improving the availability of data and budgetary information for decision making, controlling expenditures and making the budget formulation and the in-year budget changes more transparent.

Since 2017, Uruguay has engaged in the third stage of its gradual reform process. This stage has a more technical vision with a bottom-up perspective, strengthening spending unit's capacities and giving them better management tools. Some of the main objectives of this reform stage are: 1) improve the quality of public expenditure, by strengthening the capacities of the units in charge of executing policies; 2) support the implementation of management systems in executing units, work towards defining the products and services provided by each executing unit and the corresponding costs; and 3), raise awareness in executing units of the need to improve the quality of public expenditure and monitor and evaluate results in order to develop more efficient policies. The role of the UPN has been

crucial to ensure the strategy's success. The co-ordination role it plays allows for better interaction not only with the transversal institutions but also with other spending units.

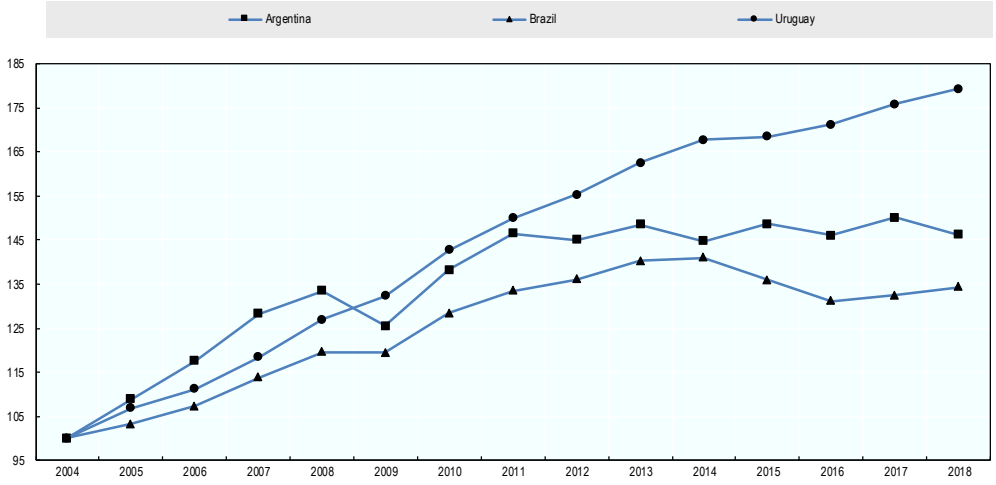
2.3. Medium term economic and fiscal challenges

2.3.1. Economic and export growth

As mentioned previously, Uruguay used to experience frequent large economic contractions due to shocks and instability in neighbouring countries. These contractions were at those times even larger than in the countries where they originated, due to the Uruguay's financial weakness, the low diversification of its exports, the fragility of its fiscal and financial base and the lack of strong policies and instruments to intervene.

The transformations carried out in the economic structure, the improvement of fiscal and financial management and the various reforms in the economic institutions mentioned previously allowed to delink Uruguay from regional fluctuations. However, while Uruguay has grown more resilient, it is by no means immune to the regional difficulties and the medium and long-term economic and social challenges Uruguay faces should not be minimised.

Figure 5. Accumulated GDP growth of Uruguay, Argentina and Brazil (GDP 2004 = 100)



Source: IMF (2018a)

A first challenge – which could be both a risk or an opportunity, depending how well it is addressed – is the quality of the access to markets. Indeed, the continuation and intensification of the productive diversification of the country and the capacity to add value to Uruguay's production depends on access to markets.

As mentioned previously, Uruguay is a small open economy, and thus heavily relies on international markets for its internal growth. The country has made important progress in the diversification of its clients and export products (both goods and services), and to improve the quality of the latter. However, the price of exports – and in particular the agricultural goods – are subject to important fluctuations. Industrial goods are mainly exported within the region, and therefore are affected by the regional political and economic instability.

Uruguay is a member of Mercosur, which is a large economic space, but also limits the possibility of negotiating other trade agreements. Thus, Uruguay has bilateral free trade agreements with Mexico and more recently with Chile, in addition to regional agreements in the context of Mercosur and investment agreements with many countries (including the US).

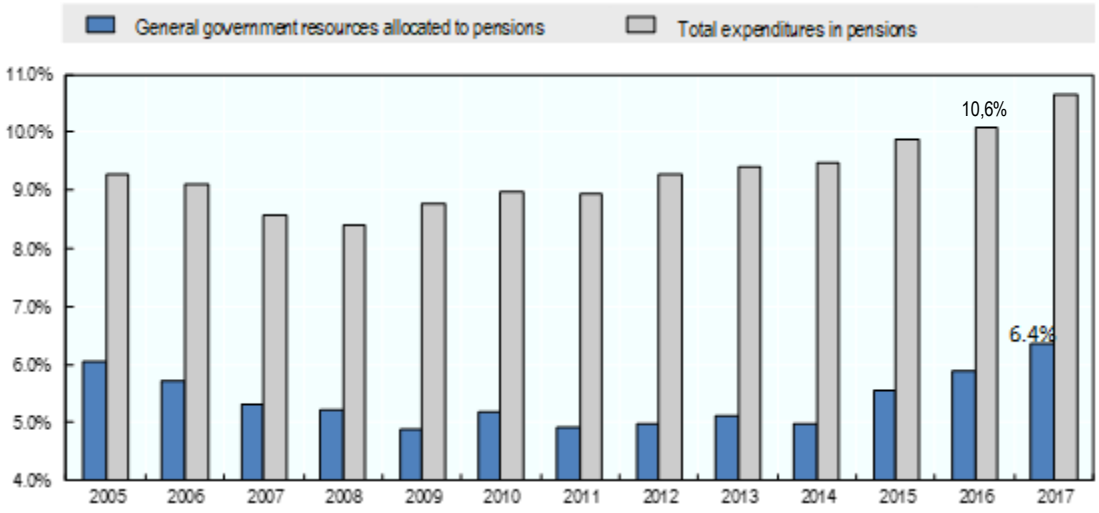
In short, the evolution of the strong exporting agro-industry depends, in part on the capacity of Uruguay and its Mercosur partners to secure trade negotiations with large consumption markets, despite their trade protections. The evolution of the manufacturing activity in turn depends on the consolidation of Mercosur's own internal rules, which are often violated. Finally, the future of the export of services, which is a growing sector thanks to the dynamism of technology, will depend on the regulations and normative frameworks which are being discussed in various multilateral spaces.

2.3.2. Social public spending

The second important challenge is fiscal, and is linked to the evaluation of social public spending, in particular for pensions. Uruguay's population is traditionally deeply attached to universal access of its population to social security, and has a strong preference for equity. This cultural feature, combined with the demographic evolution of the population lead to an increasing share of social security spending in total public expenditure.

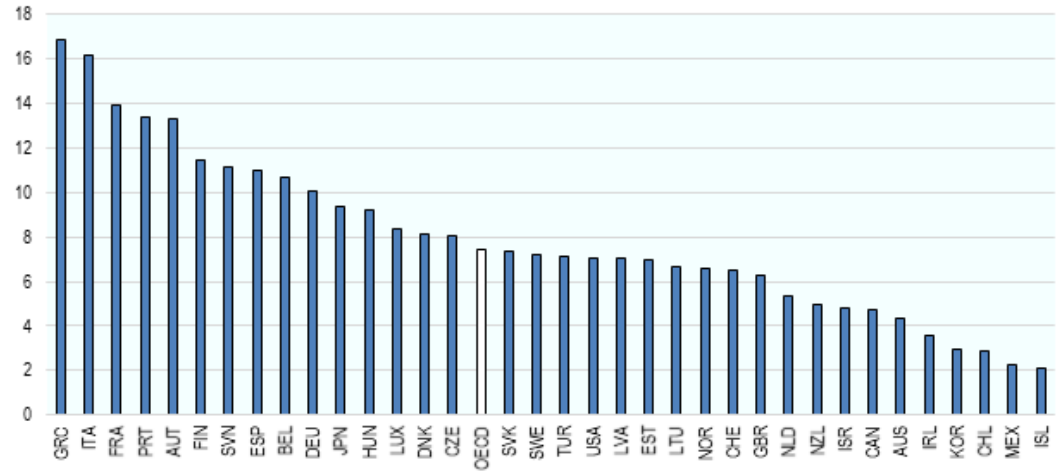
Thus, pensions and retirement benefits represent the largest public expenditure in Uruguay, and is larger than the OECD average of 7.5% of GDP (Figure 7). In 2017, pensions in Uruguay represented 10.6% of GDP[2] and relied heavily on general government resources (the difference between revenues of the different pensions schemes and their obligations amounted to 6.4% of GDP in 2017[3], Figure 6). The Social Protection Bank (*Banco de Previsión Social*, BPS) managed 80% of the pensions. Pensions for the armed forces are managed by the Armed Forces Pension System (*Servicio de Retiro y Pensiones de las Fuerzas Armadas*, SRPFFAA) and represent about 15% of total pension expenditure. Finally, pensions for police officers are managed by the Police Pension System (*Servicio de Retiro y Pensiones Policiales*, SRPP) and represent about 5% of the total.

Figure 6. Total expenditure in pensions and general government revenues allocated to pensions



Notes: BPS includes earmarked taxes, SFPFFAA includes pensions and retirment benefits financed by general government revenues (*Rentas Generales*, RR.GG).
Source: Data provided by the MEF

Figure 7. Public Expenditure on Pensions as a percentage of GDP in OECD countries (2015)



Note: Information on the data for Israel appearing in OECD documents and publications: The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Source: OECD (2019)

In addition, the pension system in Uruguay includes some unique characteristics. For example, a constitutional amendment in 1989 provides that pension increases should follow the Index of average wages (IMSN). In a growing economy, this implies a rapid growth of government pensions liabilities (Box 4).

In synthesis, taking into account the increase in life expectancy and the trend in health expenditure, the social security system in Uruguay requires adjusting parameters and important entitlements. This is a common trend in most countries, and is increasingly acknowledged by all the political and social actors.

Box 4. Evolution of the pension system in Uruguay

The pensions system of Uruguay is laid down in the Constitution. Article 67 states that:

- Pensions and social security shall guarantee that all workers are given by the government decent retirement, and these pensions shall be granted to their families in case of death.
- All citizens who have lived sufficient years in the country and do not have sufficient resources are also entitled to an old age pension.
- Adjustments to the levels of the pensions should be carried out yearly, together with the adjustments of the wages of civil servants, and cannot be smaller than the average increase of wages (*Indice Medio de Salarios*) (amendment of year 1989).
- The pensions shall be financed by contributions from workers and employers, and when necessary, by "financial support" from general government revenues.

The Social Protection Bank (*Banco de Previsión Social*, BPS) is the largest social security body in Uruguay (it manages more than 80% of total social security expenditure).

In 1995, as the Social Protection Bank faced long-term sustainability issues, Law No. 16.713 reformed the pensions system, creating a mixed system, which was compulsory for people who were younger than 40 years old on the 1st April 1996. The first pillar of this system consists of a pay-as-you-go (PAYG) system with defined benefits managed by the Social Protection Bank. The second pillar consists of a mandatory private funded system with defined contributions managed by pension funds (*Administradoras de Fondos de Ahorro Previsions*, AFAP) during the accumulation phase, and by insurance companies (*empresas aseguradoras*) during the payment phase. The creation of this second pillar implied a financial burden for the government during the first decades of operations as part of the contributions would go to the pension funds rather that to the PAYG system. This resulted in increased deficits of the Social Protection Bank as contingent liabilities were turned into present liabilities.

The system had a wide coverage since its creation, and greatly benefited from the labour reforms carried out after 2005, which increased the share of formal workers in a context of sustained economic growth. This increased the contributions to the system, thus reducing the need for financial support from general government revenues.

However, two later reforms increased expenditures in benefits. In 2008, Law No. 18.395 shortened the minimum contribution period from 35 to 30 years and computed one year of contribution per child for women (up to five years). This law also loosened conditions to be eligible for disability pensions. These changes led to increased benefit payments and according to an estimation by the CEPAL, it has an annual cost around 1% of GDP.

More recently, in 2017, Law No. 19.590 allowed people who were 30 years old and above on the 1st of April of 1996 to withdraw from the private pension fund and opt for the PAYG defined benefits system. While this implies higher revenues during the first years (as funds are transferred from private pension funds to the PAYG system), it is expected to cost about

0.4% per year after 2030. Estimations show this could cost about 4% of GDP in present value, distributed over a period of 50 years. Additional revenues collected during the first years are to be deposited in a specific fund to ensure transparency and about these transitory revenues.

Pensions of the armed forces have seen a sharp increase in recent years. Indeed, the armed forces offer a very generous pension system, with a retirement age of 49 on average, and benefit payments which in about half the cases, exceed 100% of the wages received during service. In the absence of reform, increases in benefit expenditure are projected to continue. A project for a gradual reform of this system has been submitted to the Parliament and should be carried out to ensure the fiscal sustainability of the system. A reform of the pension system of the armed forces was approved in October 2018 (Law No. 19.695). It includes a long transition period and has therefore very little impact on the short and medium term trajectory of this system.

The cost of the police forces pension system (SRPP) has also recently increased in spite of recent reforms.

Source : Data provided by the Macroeconomic Assessment Unit, MEF

2.3.3. Infrastructure needs

A third challenge arises from the increase demand for infrastructure works, in an effort to improve the country's economic competitiveness and social well-being. In particular, the increasing agricultural production pushes for new infrastructure, and social demands (education, public security) also require infrastructure.

In 2011, a Public Private Partnership (PPP) Law (No. 18.786) was approved, to facilitate the building of new infrastructure. This law limits the fiscal commitments that the government can take on PPPs: the net present value of total liabilities (actual and contingent) cannot exceed 7% of the GDP of the previous year; and the annual commitments with private stakeholders cannot exceed 0.5% of the GDP of the previous year.

The PPP projects under discussion are to be financed by general government revenues, as in general they do not establish user payments (such as tolls on road projects). In addition, some of the projects (as those in education) focus on the building and maintenance of infrastructure, but operational costs will draw from the budget (for example for paying teachers). Only the two most advanced projects have specific allocations of funds, for a cost equivalent to 0.6% of GDP on their lifespan. The other projects do not yet have a budget allocation. This will affect fiscal space. In addition, this new contracting mode generates new challenges and risks.

The present portfolio of PPP projects includes a jail, roads, educational infrastructure and a railway (Box 5).

Box 5. PPP projects in Uruguay, 2019

In February 2019, the PPP portfolio of Uruguay included 14 projects:

- 1 jail (in operation)
- 7 roads (of which 1 is in construction, 5 are provisionally allocated, and 1 is under evaluation)
- 4 education structures (2 provisionally allocated and 2 under evaluation)
- 1 railway (provisionally allocated)

The railway is the largest project in the portfolio. It is related to the construction of a new cellulose plant by UPM in the centre of the country. This project implies an initial investment of about 1.5% of GDP, and the annual payment is evaluated at about 0.3% of GDP.

Source : Data provided by the PPP Unit, MEF

2.3.4. Deficit of the Central Bank (Banco Central del Uruguay, BCU).

The Central Bank of Uruguay has two main missions in its charter: 1) ensure price stability which contributes to the objectives of economic growth and employment; and 2) the regulation of the operations and the supervision of the payment system and the financial system, ensuring its solidity, solvency, efficiency and development. Therefore, the results of the actions of the Central Bank affect both its balance sheet and the public sector as a whole.

In Uruguay, the Central Bank is included in the fiscal statistics, and therefore influence the result of the consolidated public sector. In recent years, this has represented about 1% of GDP.

3. Legal and institutional characteristics

3.1. Legal framework for budgeting in Uruguay

3.1.1. A five-year budget law with annual updates

The particularity of Uruguay's legal framework is that it has a five-year budget law, with annual budget ceilings, as enshrined in a constitutional provision. The budget is voted every five years. Article 214 of the Constitution states that budget exercises correspond to the civil year (from January to December). Multi-year budgets for the whole of government period are a deeply-rooted historical feature of the budget process in Uruguay. The Budget has been for five-years since 1968, but already in the 1950s, the government term was four years, and the practice was to have a budget for the whole of government period.

However, in practice, the budget tends to work very much as an annual budget. Indeed, budget allocations for years 2 to year 5 are often constant in nominal terms (or sometimes incorporate annual increases, when economic conditions allow), but all actors understand that these represent spending floors, which may be increased during the annual budget "updates" (*rendición de cuentas*).

Article 214 of the Constitution states that the Executive should send an "update" to the Parliament at the latest six months after the end of the fiscal year, which is by 30 June each year. At this instance, the Executive can propose modifications to the multi-annual budget for the following year, including to the total level of expenditure, as well as totals for investments, wages or revenues. The executive can also create, suppress or modify programmes for reasons that should be justified. This "update" provides results of the previous economic exercise, expenditures, resources and investments foreseen and already incurred, and reports on the degree of achievement in terms of objectives and goals programmed, showing performance indicators.

3.1.2. Legal basis of budgetary practices

The legal basis for Uruguay's budgetary practices is highly fragmented. The budget process is governed by provisions in the National Constitution and the Accounting and Financial Administration Annotated Text (*Texto Ordenado Ley de Contabilidad y Administración Financiera*, TOCAF, Box 6). However, there are many supplementary administrative laws that regulate various aspects of the country's financial administration practices. These are mostly decrees issued by the Executive Branch of Government, ordinances issued by the Court of Accounts and instructional manuals issued by the National General Accounting Department, that regulate various aspects of the country's financial administration practices.

Box 6. Accounting and Financial Administration Annotated Text (TOCAF)

TOCAF is a text adopted by decree, compiling legal standards regarding financial administration. It has changed according to the different legal provisions approved over the years, and especially according to the different laws adopted in the five-year budget and annual accountability periods, which has generated a highly flexible and complex financial administration regulatory framework. TOCAF covers all the State organisations, entities and services, regardless of their Constitutional and Legal provisions. TOCAF applies to state enterprises, as long as their organic laws do not include special regimes.

Source : Data provided by the MEF,

The five-year budget law is in line with the five-year mandate of government. The National Constitution specifies in articles 77-79, that elections should occur the last Sunday of the month of October every five years. According to article 214 of the Constitution, once a new government is sworn in, the Executive has six months to submit the five-year budget bill to Parliament, submitting it by 31 August. Article 208 states that while the budget is not approved, the budget of the former government will be in place. In practice, this usually means that in its first year, the incoming government functions with the budget of the former government. Law N° 18.362 (articles 34 and 35) establishes internal deadlines for the Executive to reach the goal to send the budget to Parliament within six months, but in practice, the deadlines set in the Constitution drive the process, and legal deadlines are not always enforced.

3.1.3. Budget line adjustments

The five-year budget allocates funds in nominal terms. Remunerations budget lines have an automatic adjustment each year taking into account annually negotiated wage increases.

There are two non-automatic mechanisms to make adjustments to a specific budget line (MEF authorisation is required):

1. Using the budget line for enhancement/unexpected events (see below); and
2. Allowing current expenditure credits for up to the last year's CPI variation (reform introduced in 2013).

3.1.4. Budget line for enhancement/unexpected events (6%+1% per year on the year's budget)

According to article 41 of Law 17.930, the executive can make annual adjustments for up to 6% of the budget credits of groups 1 (consumption goods), 2 (non-personal services), 5 (transfers to public and private sector) and 7 (other expenditures not specified) of the budget to enhance investment or operating expenditures allocations. According to article 464 of Law 15.903, the executive can also make adjustments for up to 1% of the total budget for unforeseen expenditures (natural disasters, etc.). Discussions about these adjustments are made outside the annual budget formulation process (*rendición de cuentas*) and can be performed at any time during the budget cycle. Since the introduction of the reform to allow particular adjustments for CPI variation (2013), only 30% of the budget line for enhancement/unexpected events has been used.

3.2. Actors involved in the budget process in Uruguay

3.2.1. A centralised budget process

The budget process in Uruguay is relatively centralised with two important state institutions leading the process: 1) The Ministry of Economy and Finance (MEF), in particular its Macroeconomic Assessment Unit and its National Budgetary Unit (UPN); and 2) the Budgeting and Planning Department (OPP), with the latter reporting to the Presidency of the Republic (see Table 1 for an overview of the roles and responsibilities of budget actors).

The MEF focuses on the design of the fiscal framework and budgetary documentation, and during budget execution, the approval of modifications; The OPP, together with the MEF, focuses on overall strategy and policy development and most recently, the OPP has been leading Uruguay's efforts to implement performance-informed budgeting and to carry out prospective analysis.

The current division of roles and responsibilities between the MEF and OPP has been in place since 2005, having evolved over time without necessarily being institutionalised, through for example budgetary regulations, or without being communicated clearly across budget actors. However, the celebration of the tenth anniversary of the National Budget Unit (*Unidad de Presupuesto Nacional*, UPN) in November 2017 was a clear recognition of the central role that this unit and the MEF play in the budget process.

3.2.2. Ministry of Economy and Finance (MEF)

In practice, Uruguay's budgetary process is mainly co-ordinated by a relatively small institution of 50 staff members, within the MEF. The MEF has also recently been reorganised, with the National Budgetary Unit created in 2007 to advise on the strategic

aspects of the budgetary process, including design, discussion, approval, execution and assessment stages.

Within the Ministry of Finance, three units are responsible for the budgetary process: the Macroeconomic Advisory Board, the National Budgetary Unit and the National General Accounting Department.

1. The Macroeconomic Assessment Unit develops macroeconomic and fiscal revenue forecasts and sets the fiscal goals. It also supervises state-owned enterprises (jointly with the OPP), and oversees some policy areas, such as health, social security, education and infrastructure. It consists of 15 staff members.
2. The National Budgetary Unit on the other hand develops the budgetary expenditure proposal, oversees budget execution and authorises modifications during budgetary execution.
3. The National General Accounting Department (*Contaduría General de la Nación*) is responsible for managing the Integrated Financial Information System (*Sistema Integrado de Información Financiera*, SIIF) and the operational aspects of the Budget management and execution, and it produces the Budget Execution Account (*Balance de Ejecución Presupuestal*) which is presented to Parliament.

The National Budgetary Unit, as well as the remaining MEF units, are small. It presently employs about 20 members of staff and a Director who is in charge of the Budget's design and monitoring. The National Budgetary Unit is divided into two areas:

1. One area for sectorial budget analysis and management which is divided into two units: sectoral management and analysis (nine staff members); and aggregated analysis (three staff members); and
2. An area for budgetary and financial management reinforcement, to support management capacity building in spending units, through the development of information systems, and trainings (ten members of staff).

Finally, the National General Treasury within the MEF produces the calendar of disbursements for ministries and Art. 220 entities, and evaluates the financial and fiscal impact of budgeted operations.

3.2.3. Budgeting and Planning Department (OPP)

The Budgeting and Planning Department or *Oficina de Planeamiento y Presupuesto* (OPP) advises the Executive Branch in budgetary issues as per Article 214 of the Constitution. About 55 people work on budget issues, of which 34 in the Management and Evaluation Department (AGEV) and 8 in the public budgeting department. Since 2005, the OPP is responsible for preparing the first draft strategic guidelines of the government, and support line ministries and other institutions in the formulation of their strategic plans. It also analyses investment projects that institutions want to carry out. Finally, the OPP co-ordinates the relation between the Executive branch and sub-national governments. This includes the discussion of central government transfers to sub-national governments, which is carried out together with the MEF.

3.2.4. Council of Ministers

The Council of Ministers plays an important role in the budget preparation and negotiations. The budget strategy is first discussed between the Minister of Economy and

Finance, the Director of OPP and the President, and then presented to the Council of Ministers. All the aspects of the budget process are discussed there, and most decisions are reached at the Council of Ministers.

3.2.5. Line ministries

Line ministries' role is not clearly specified in the budget process and regulations. Although the law provides a calendar for line ministries and Art. 220 entities, in practice, it is not strictly followed. Therefore, the timing by which line ministries must provide information to the MEF, or the nature of this information is not clear. Line ministries provide budget submissions to the Ministry of Finance for the five-year budget and for the annual update process.

Line ministries in Uruguay follow the "conventional model": central finance function is not very strong. It is largely technical and administrative in nature. However, the National Budget Unit does not interact directly with sectoral programme units in line ministries, as often is the case in the "conventional model". The MEF usually interacts with line ministries' central bodies, such as the Minister, Under-secretary, Director General or Financial Director. The most advanced OECD countries are moving away from this "conventional model", and adopting a "modern finance model", where the finance function in line ministries is strong ("each ministry is its own finance ministry"), and the central budget office interacts exclusively with these finance functions. Such an approach allows ensuring fiscal sustainability, while providing greater flexibility to line ministries in the allocation of their fund, thereby achieving better efficiency of spending.

3.2.6. Art. 220 Entities

Under article 220 of the Constitution, a certain number of agencies are given budgetary initiative: "they prepare their own budgets and present them to the Executive, who will integrate these into the budget proposal. The Executive can propose changes to the initial budgets, and must submit both the initial and the modified budgets to the Parliament". When the Executive and the Art. 220 Entity reach an agreement, a single budget proposal is presented to Parliament. When they do not reach an agreement, two different budget proposals are presented to Parliament: one by the Executive, and the other by the Art. 220 Entity. Usually, the latter is significantly larger than the former.

In addition to budget initiative, the Art. 220 entities have greater autonomy and flexibility in the management of their budget. Each of these entities has its own budget norms, which differ from those of the central administration. In particular, Art. 220 entities can make some reallocation of funds internally from wages to operations or investment, while such reallocations of funds are usually impossible for regular government entities. Art. 220 entities also have the faculty to hire staff, without referring and seeking approval from the Executive branch (as ministries must do). Finally, they have more flexibility in the structure of their budgets, in the definition and approval of the structure of employment and manage wage allocations, in the regulation of their services, etc. Like other government entities, Art. 220 Entities are subject to audits by the Court of Accounts.

This greater flexibility, in particular regarding the budgetary process, explains that many institutions want to become Art. 220 entities. Creating a new Art. 220 Entity requires passing a law. Demands from institutions to become an Art. 220 entity are therefore submitted to Parliament by the Executive through the Council of Ministers. Parliament then sanctions the law. The MEF participates in the discussions, but there is no formal

consultation on the potential cost of such a creation. There were frequent creations of Art. 220 entities in the last decade (Box 7).

The share of public expenditure by Art. 220 entities has increased at a higher pace than the rest of the government expenditures in recent years. Today, Art. 220 Entities represent 27% of central government expenditure in Uruguay, including areas such as education, health or justice. On the other hand, spending by line ministries represents only 21%, the other expenditures being transfers, social security benefits and interest and debt payments.

The status and consequences of these entities for budget sustainability and efficiency are discussed in the next section.

Box 7. Art. 220 entities

1. the Judiciary Branch of Government;
2. the Administrative Court;
3. the Electoral Court;
4. the Court of Accounts,
5. the Public Education National Administration (ANEP);
6. the University of the Republic (UDELAR);
7. the Uruguayan Institute for Children and Adolescents (INAU);
8. the State Health Services Administration (ASSE) (created in 2007);
9. the Uruguayan Technological University (UTEC) (created in 2012);
10. the National General Attorney's Office (*Fiscalía General de la Nación*) (created in 2015);
11. the Uruguayan Institute of Meteorology (INUMET) (created in 2013);
12. the National Institute for Youth Social Inclusion (INISA) (created in 2015); and
13. the Public Transparency and Ethical Board (JUTEP) (created in 2015).

Source : Data provided by the MEF,

3.2.7. Parliament

Uruguay's Parliament is composed of two houses: 1) The Chamber of Senators (upper house), composed of 30 members elected for a five-year term by proportional national representation and the Vice-president of the Republic who presides over the sessions, and 2) the Chamber of Representatives (lower house) which represents the Departments (local governments). It is composed of 99 members, elected for a five-year term by proportional representation, with at least two members per Department.

Parliament intervenes when analysing the Budget law but does not have a role during budget preparation phase. The Constitution states that the Government must present the National Budget for the government period (five years) to the Parliament within its first six months in office. The Parliament votes on the global amounts per budget institution

(*inciso*), programme, grades and numbers of civil servants and resources. Parliament cannot propose changes which would increase total expenditure proposed by the Government (unless it accepts alternative budgets presented by Art. 220 Entities).

Regarding the Art. 220 Entities, the Parliament can choose between the budgets sent by each entity, or the modified budgets proposed by the government. This implies the Parliament could vote for a budget higher than the one proposed by the Executive. Since 2005, while in some cases the Parliament has approved higher resources to Art. 220 Entities than the Executive proposal, this has been compensated by reallocations from other budget lines to stay within the expenditure ceiling set by the Executive.

The Constitution also establishes that any other law than the budget law which implies expenditures for the National Treasury will need to specify the resources with which it will be financed. Parliament cannot propose tax expenditures, and does not have the initiative for creating or suppressing public services and positions. This can only be done through a budget law.

Parliament must approve the report on the budget execution of the previous year based on the reports audited by the Court of Accounts. This constitutes the first article of the budget update.

A permanent joint Budget and Finance Committee participates in each House of Parliament. If this Budget Committee deems it necessary, they may request advisory reports from specific Committees. The Budget/Finance Committee issues majority and minority reports (often one per political party) that are submitted to the House as expert opinion on the budget's content. Parliamentary committees do not hold public hearings, but the stakeholders are regularly received. The minutes of these meetings are public.

There is no parliamentary budget office. However, legislators can appoint up to five people that can act in a budget research capacity in other state organisations and have a limited budget for support personnel for this purpose. Legislators can choose how to allocate these limited resources.

3.2.8. Court of Accounts

The Court of Accounts (*Tribunal de Cuentas*), Uruguay's Supreme Audit Institution (SAI), is independent from the Executive Branch and reports to Parliament, as provided for under Articles 208 to 213 of the Constitution, which also outlines the Court of Accounts' organisation and competencies. All public expenditures are subject to intervention from the Court of Accounts, with some exceptional expenditures considered as confidential. Even though it has the competence to provide an opinion on financial management, the Court of Accounts' intervention is usually limited to reporting on the legality of the expenditure and its financial aspects.

The Court of Accounts does not make an assessment or provide recommendations regarding the quality of performance indicators that are in place. The main audit report is introduced during the Accountability process in Parliament, i.e., a few days after the Balance has been delivered to Parliament. There is no legal obligation on the government to respond to findings and recommendations by the audit institution.

The Budgetary Execution Balance (audited financial reports) is available on the websites of the MEF and of the National General Accounting Department and it is usually publicly broadcasted by the media.

The Court of Account also sends observations on expenditures to the Parliament during the course of the year. However, these are sent as they are being produced, they are very numerous, and are not classified by issue or priority level. For example, there is no distinction made between observations which are only formal issues from those which raise more serious concerns. These observations are therefore rarely analysed and discussed by Parliament.

Table 1. Roles and responsibilities of budget actors

Actor	Roles and responsibilities
MEF	*Macroeconomic and Financial Advisory Unit:* Develops fiscal framework Develops macroeconomic forecasts Develops fiscal revenue forecasts Proposes fiscal targets Publishes aggregate fiscal data Produces budget documentation Produces Statement of Purpose (*Exposición de motivos*) (jointly with UPN) Develops budgetary guidelines (regarding its area of competence) Supervises State-Owned Companies (jointly with the OPP) Oversees policy areas, including health, social security, education and infrastructure *National Budgetary Unit:* Develops the budgetary expenditure proposal Develops the budgetary guidelines (regarding its area of competence) Develops the draft five-year Budget law Develops the annual draft Budget update law Produces budget documentation Produces Statement of Purpose (*Exposición de motivos*) (jointly with Macroeconomic and Financial Advisory Unit)Authorises Budget modifications during Budget execution Monitors budget execution and produces estimations of budget allocations and execution Analyses links between budget execution and cash management and fiscal impact *National General Accountancy Office:* Manages the Integrated Financial Reporting System (SIIF) Develops the Budget execution accounts Manages the operational aspects of budget assignments and its execution Develops budgetary guidelines related to operational aspects of budget assignments and its execution *National General Treasury:* Performs cash management Develops financial planning with the spending units Produces information for the fiscal statistics “above-the-line” Develops and strengthens the Single Treasury Account system
OPP	Develops government’s strategic guidelines Supports Ministries and other entities in managing their strategic plans Analyses investment projects to be executed by the different institutions Supervises State-Owned Companies (jointly with MEF) Co-ordinates relations with sub-national governments (together with MEF) Currently working on developing a government long-term plan Defines budget programmes
National Civil Service Department (ONSC)	Governing body of labour relations in the public sector Participates in the recruiting process and promotion of civil servants of the executive branch
Line Ministries	Submit their spending requests to the National Budgetary Unit in the budget requests Present to the National Budget Unit or the National General Accounting Department (CGN) (as relevant) their requests for Budget modifications during the budget year

	Execute their budgets Participates in the definition of its key performance indicators (with OPP) and provides information about performance results
"220 Entities"	Submit their own budgets to the Executive and the Parliament through the MEF Submit their budget modification requests to the National Budgetary Unit or to the National General Accounting Department (as relevant) Execute their budgets Report on budget execution Define their key performance indicators and report results
Central Bank	Carries out forecasts of macroeconomic variables such as exchange rate, inflation rate and gross domestic product. Produces fiscal statistics "bellow-the-line" and debt statistics for the aggregated public sector
Parliament	Finance and budget committee holds budget closed audiences with stakeholders (Minutes of the meetings are public) Full house votes on five-year budget law Full house votes on annual budget updates
Court of Accounts	Reports on the legality of the expenditure and it financial aspects Audits the budgetary execution balance

3.3. Recommendations on legal and institutional characteristics

R 3.1. Institutionalise today's allocation of roles and responsibilities

As mentioned in this chapter, until 2005, the roles and responsibilities for driving the budget process have alternated between MEF and OPP. However, since 2005, the MEF has gradually created strong technical capacities for handling the budget process and ensuring fiscal sustainability, while the OPP has focused on developing its capacities for strategic planning, in particular for what concerns public investment. Today's allocation of roles and responsibilities is described in Table 1. While these roles are clearly recognised today (this appeared very clearly during the celebration of the tenth anniversary of the National Budget Unit), they should be formalised into a law (for example, an Organic Budget Law, see recommendation below). Box 6 summarizes the main roles and structures of central budget offices in OECD countries.

Box 8. Role and structure of Central Budget Offices in OECD countries

The Central Budget Authority (CBA) is the hub of the central government budget process. Almost all OECD countries have localised the CBA with the Ministry of Finance and/or Economy. The CBA may be located in one directorate (department) of the ministry, normally the Budget Department as is the case in Austria, Estonia, Finland, France, Netherlands, Slovenia, Spain and Sweden, or within a combination of several departments within the Ministry of Finance. Norway has split the CBA between the Budget Department and the Economics Department. In Poland, the CBA is composed of five departments of the Ministry of Finance. Three OECD countries have split the CBA in ministries: Australia has split the CBA between the Department of Treasury and Department of Finance and Deregulation, Canada has split the CBA between the Department of Finance and the Treasury Board Secretariat while Ireland has split the CBA between the Department of Finance and the Department of Public Expenditure and Reform. The CBA in Belgium is located at the Federal Public Service Budget

and Management Control, while the USA has placed the CBA at the President's Office.

In most OECD countries the head of the CBA is a senior civil servant, i.e. a government official who ordinarily remains in this position when there is a change in Government. On the other hand, in Chile, Greece, Hungary, Italy, Korea, Mexico, Poland, Slovak Republic, Spain, the United Kingdom and the United States the head of the CBA is a political appointee, i.e. a person who generally does not remain in this position when there is a change in Government. Denmark does not have a clearly defined CBA within the Ministry of Finance therefore there is no such head of the CBA other than the Minister of Finance and the Permanent Secretary.

The CBA takes care of a variety of tasks concerning the budget process. The most common responsibilities of the CBA in OECD countries are drafting the budget circular, developing the Executive Budget proposal, negotiating with the line ministries, producing supplementary budgets, determining ceilings for line ministries, and producing mid-year and end-of-year reports. Some tasks are generally a shared responsibility with other institutions or agencies (public or private), like methodology for fiscal projections, monitoring performance of line ministries and communication with the public.

Source : OECD Budget Practices and Procedures

R 3.2. Streamline legal texts and consolidate into an Organic Budget Law

Most OECD countries have a clearly defined Organic Budget Law. The legal framework underpinning public financial management in Uruguay could greatly benefit from being simplified and consolidated into fewer landmark legal texts or a Public Financial Management Act or an Organic Budget Law, which could act as a reference to all budget stakeholders. Such a law should clearly describe the budget process and calendar, and state the roles and responsibilities of each stakeholder during the budget process, establish precise moments for dialogue between budget authorities and spending institutions, etc. This Organic Budget Law should also include the Art. 220 Entities, recognising their specificities and formalising their role and responsibilities during the budget process.

An Organic Budget Law stipulates the roles and responsibilities of each actor during the budget process. It is therefore a delicate reform to be carried out. Countries which have recently reformed their Organic Budget Law (such as France and Austria) have found that wide dialogue and consultation with all stakeholders have been key elements to build consensus for the reform, and therefore, to ensure success of the reform (Box 9). The political economy and consensus building in Austria for the implementation of the recent extensive budget reform is a good example (Box 10).

Box 9. The French Budget Framework Law (LOLF)

The first and maybe most important reform of the last two decades in France is the adoption of a new Organic Budget Law for the State (so called "LOLF"), borne out of a bipartisan Parliamentary initiative in 2001 to replace the historical 1959 Organic Ordinance.

Main objectives of the reform

The LOLF constituted a "big bang" in terms of fiscal management for the State. In short, in line with the ideas of the New Public Management, France broke with the old tradition of input control to embrace the more modern concepts of transparency, operational autonomy and performance monitoring.

Rather than allocating funds to Government units and by economic type of spending, with no apparent link to policy objectives, the Government budget started presenting its budget in terms of broad missions. In almost all cases this was done over the policies of a given ministry, even though some ministries were given more than one mission. These broad missions corresponded to main Government policies, broken down into programmes and sub-programmes ("actions"). This approach aimed at making it easier for Parliament to appreciate the resources devoted to different policies and the purposes pursued. In addition, an annual performance plan (PAP) set out the strategy and objectives for each mission and performance indicators, as well as outcome targets for each programme.

The conditions for achieving the LOLF's objectives

The main drivers for achieving the LOLF's objectives, given practical expression in a small number of legal measures, were:

- Mobilisation of the players who might expect to benefit from the "LOLF culture shock", around a new relationship within government: a new relationship between public managers, and between Parliament and public managers, with the Court engaging in close co-operation with both Assemblies, especially their Finance Committees;
- The introduction of management tools derived mainly from business practice, such as general accounting, cost analysis, management dialogue and a results- and performance-based approach.
- A reform carried out in a radically changed context

The Law aimed to trigger a management reform of the public sector as well as rolling out various reform tendencies that had been emerging since 1990. The ministries acted as project managers, the process being overseen by a specially created Budget Reform Directorate within the Budget Ministry. Most of the Budget Reform Directorate's responsibilities were subsequently taken over by the Budget Directorate.

In legal terms, the whole context of public sector governance significantly extended the LOLF's scope. Although a minor amendment was made to the text in 2005, the most important development was the transposition of its principles to the social sphere through the passing of a Constitutional Bylaw on Social Security Financing.

The reform of the Constitution in 2008, provided for public finance programming acts, paved the way for consolidated steering and multiannual management of public finances. Having initially focused on the central government budget, within ten years the scope and content of the 2001 reform had assumed a larger dimension.

In terms of government reform, the General Review of Public Policies (*Révision générale des politiques publiques*, RGPP), implemented at local level through a re-organisation of the territorial administration system, has not called into question the existing budget and accounting framework. However, it has supplanted the initial "shock" created by the LOLF. It has also benefited from the political impetus that the LOLF now lacks to initiate a more general modernisation process.

Source: Cour des comptes, La mise en oeuvre de la loi organique relative aux lois de finances (LOLF) – novembre 2011

Box 10. Building consensus for budget reform in Austria

According to the Constitution and the Organic Budget Law, macro-fiscal policy competence is vested in the Ministry of Finance (BMF), including overall-co-ordination (for federal government but also with lower levels of government), setting the fiscal stance, the federal budget and budget rules, taxes and fees, and economic policy assessments of laws. Given these competencies, the BMF was the natural leader of the budget reform process.

The wide-ranging reforms implemented by Austria in the budget structure and process required adopting amendments to the Constitution, and therefore required cross-party support and a broad political consensus. As these reforms had implications for actors in the budget process, stakeholders needed to be convinced of the reforms' merits and what they stood to gain. The reforms implied significant cultural change within the Austrian civil service and the major actors in the budget process such as the parliament and the Court of Audit.

The BMF worked to build this consensus over several years. In 2004 an informal parliamentary reform committee was established bringing together experts and all parties represented in parliament. This allowed party representatives the opportunity to give their views and inputs from the ideas phase to the detailed legislative proposal phase. In particular, the process ensured that the role and rights of parliament were well considered. Representatives from the Court of Audit were also integrated into the committee and were influential in strengthening political acceptance of the reforms (Steger, 2010). Ultimately, the consensus the committee built led to parliament unanimously adopting amendments to the Constitution and to the budget law in December 2007 – effectively ensuring that the reform process had to move forward – and a New Organic Budget Law in December 2009.

The amendments to the Constitution enshrined four new constitutional principles of budgeting in line with the reforms (see Figure A below).

Figure A. Four new constitutional principles of budgeting



Among other key actors, the Chancellery supported the reform in exchange for a role in monitoring performance aspects of the reform, thus enriching their portfolio. The most difficult negotiations around the reforms took place with the line ministries, despite intended benefits, for example, in terms of increased flexibility in budget preparation and execution and their ability to build reserves – described as every minister being his or her own finance minister (Steger, 2010).

Table A. How did key stakeholders benefit from the reforms?

Stakeholder	Benefits
Line Ministries	- Greater flexibility in budget preparation and execution (new budget structure, reallocation rules, reserve system), and increased budgetary responsibility - Performance information provides opportunity to communicate progress and success stories - Medium-term planning
Chancellery	New role in monitoring/providing quality control of output and outcome indicators and measures
Parliament/ Political Parties	- New more comprehensive reporting requirements of the administration to Parliament - Regular detailed performance information, accrual information - Parliamentary Budget Office (PBO, est. 2012) to support Budget Committee with technical budget expertise
Court of Audit	- New responsibility to evaluate performance Additional reports from line ministries and BMF - Accrual information - Recommendations of Court of Audit now appear in budget documents with goal of creating greater awareness

Source : Downes, R. et al. (2018)

4. Budget formulation and approval

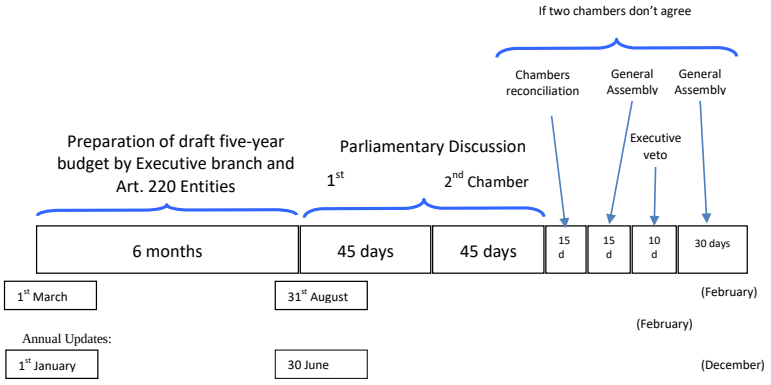
4.1. Budget calendar in Uruguay

The budget calendar in Uruguay is not institutionalised; with the exception of a handful of constitutionally set deadlines throughout the year (see Figure 8). The election calendar acts as a starting point for the budget calendar of the five-year budget. During the last year of the five-year budget, the Government is not allowed to introduce and vote new expenditures.

4.1.1. Constitutionally set dates

Only four dates are constitutionally set and binding in practice in Uruguay's budget calendar, and this does not include the final date by which the Budget should be voted on by Parliament (Figure 8). From the 1st of March to the 31st August, the Government has only six months from the day it takes office to the day that it needs to submit the draft budget law to Parliament.

Figure 8. Constitutional deadlines for five-year budget and annual updates preparation, discussion and approval



Source: Information provided by the MEF.

In such a short time, the tasks that need to be done include: the appointment of Ministers and building of their teams; the development of a five-year national strategy reflecting the newly elected Government's policy priorities; the development of a five-year macro-fiscal framework; the development of budget guidelines; the development of ministerial allocations; the development by line ministries of budget submissions; a budget negotiation process both with Ministries and at Cabinet level; and the full development of budget documentation to be submitted to Parliament.

The budget process for the annual updates is identical to that of the five-year budget, but instead of submitting the budget proposal to the Parliament on 31 August (with six months preparation phase 1 March to 31 August), preparation starts on 1 January. Annual updates must be submitted to the Parliament before 30 June (Figure 8).

During parliamentary discussions, each chamber can introduce modifications to the budget bill. If the second chamber introduces changes, these must be approved by the first chamber. If they are not approved, then the budget bill goes through a General Assembly and reconciliation chambers.

There is no formal date for approving the final five-year budget or annual budget updates. When the second chamber does not introduce changes, or if the first chamber accepts these changes, the five-year budget is approved in December. Otherwise, it can happen that the budget is not approved until February of the following year. In the case of annual updates, if the two chambers do not agree, they may be approved in December of the budget year. However, this has not happened in the last 15 years, and the budget updates are usually approved in October.

4.1.2. Legally set dates

In addition to the constitutional dates mentioned above, Articles 34 and 35 of Law 18.362 aim to organise the budgetary process within the executive branch (Tables 2 and 3). However, in practice these guidelines are only indicative, and the dates stated are not binding.

Table 2. Legal deadlines for the five-year Budget preparation process within the Executive Power (art. 34 Law 18.362)

From	Deadline	Instrument	To
MEF with advisory of OPP	Before 30 June	Proposal of: Prioritisation on appropriations Financial and fiscal programming Management guidelines	Executive Power (must approve it at the Council Cabinet before 30 June)
Central Government Units	Before 31 July	Programmes and expenditures submissions	MEF
Art. 220 units	Before 31 July	Budget	Executive Power (via MEF)
MEF advised OPP and ONSC	Before 15 August	Proposal of National Budget Bill	Executive Power
Executive Power	Before 31 August	Bill approved by all Ministers	Parliament

Source: MEF

Table 3. Legal deadlines to carry out the Annual Update within the Executive Power (art. 35 Law 18.362)

From	Deadline	Instrument	To
Executive branch (cabinet council)	Before 31 December	Definition of the deadline for submitting the annual budget update to the legislative (this deadline cannot exceed the legal deadline of 30 June)	All stakeholders: line ministers, OPP, ONSC, etc.
MEF with the advice of OPP	45 days before the defined deadline	Proposal of: changing expenditure fiscal space, investments, wages, and program creation, elimination or modification.	Executive branch (council cabinet approval)
Central Government Units	45 days before the defined deadline	Allocation proposals made in and articulated, informed and measured way	MEF
Art. 220 units	Before 30 June (legal deadline)	Annual budget	Executive branch (via MEF)
MEF advised by Civil Service (ONSC) and OPP	Prior to 10 days before the due date (ex. 20 June)	Proposal of Annual Budget Bill	Executive branch
Executive Power	Defined deadline (no later than 30 June)	Bill approved by all ministers	Parliament

4.2. Budget preparation process

This section describes the budget process as it is currently carried out. However, this process is not institutionalised, and different administrations could adopt a different process.

4.2.1. Budget Guidelines

The budget process (both for the five-year budget and for the annual budget updates) starts in April, with draft guidelines developed by the Ministry of Economy and Finance with participation of the OPP. The guidelines are then discussed by the Minister of Finance, the Director of OPP and the President, before being presented to and discussed in the Council of Ministers. The guidelines include the macroeconomic situation, fiscal goals, provisioned increase of endogenous expenditure and the performance of the State-Owned Enterprises (SOEs). Based on this analysis, a maximum amount for potential incremental allocations is set or remedial steps are taken (tax measures for government expenditures or profit

measures for SOEs). The Council of Ministers then approves the final guidelines, which can include:

1. Criteria to determine the baseline (*línea base*)[4] (for the five-year budget only);
2. Maximum potential budget increase per year and priority areas which should benefit from these increases; or
3. Cutbacks to the effective Budget: the criteria to be used for these cutbacks and the amount to be cut back, as well as priority areas or expenditure protection criteria.

Specific allocations are not defined at this stage, only general amounts and strategies (for instance, the need to increase taxes, and to reduce or increase expenditures).

4.2.3. Macroeconomic projections

One essential reform carried out after 2005 was to determine that the budget had to be based on fiscal and macroeconomic projections, making sure that the budget allocations voted by Parliament could be executed and paid. This allowed for the budget to reflect the policies of the government, thus ending the use of administrative execution ceilings.

The Macroeconomic Assessment Unit (*Asesoría Macroeconómica*) calculates fiscal space and develops fiscal targets for the five-year budget period, based on projections for the main macroeconomic variables and estimations on budget commitments (*gastos endógenos*). The unit is located in the MEF and works closely with the National Budget Unit. The fiscal targets developed by the MEF are discussed in the Council of Ministers (*Consejo de Ministros*) and approved by the Executive branch.

The forecasts are analysed by Parliament during the budget approval process and they are introduced in the budgetary documentation. However, the development, discussion and presentation of macroeconomic forecasts and the assumptions underpinning general amounts and strategies is not yet done through a formalised and institutionalised step in the budget process, such as through for example a Pre-Budget Statement or Budget orientation document.

This exercise is repeated each year before the budget update (*rendición de cuentas*), and may require adjusting revenues or expenditures. Indeed, if the fiscal space calculated by the Macroeconomic Assessment Unit is negative, consolidation policies are needed.

4.2.4. Setting fiscal targets

Fiscal targets are set for the global public sector and they include the central government, non-financial State-owned companies, the Central Bank, the Social Provision Bank and the regional governments, using a cash measurement basis. Fiscal targets depend on the dynamic of the debt, with an implicit net consolidated public debt target. There is no expenditure growth rule. The fiscal deficit target is calculated to be consistent with the desired debt-to-GDP level. The current objective is to stabilise the debt-to-GDP ratio for example. This has been achieved in the periods 2005-10, and 2010-15. However, net public debt as a share of GDP has been increasing in recent years, moving from 33% in 2014 to 41% in September 2017.

There are some guidelines on how to set and monitor fiscal and debt targets, however these are only indicative. Fiscal targets are approved by the Council of Ministers. Today, the fiscal target is published and explained together in the budget proposal sent out to Parliament. The ceiling for net debt growth could be established in the budget law voted

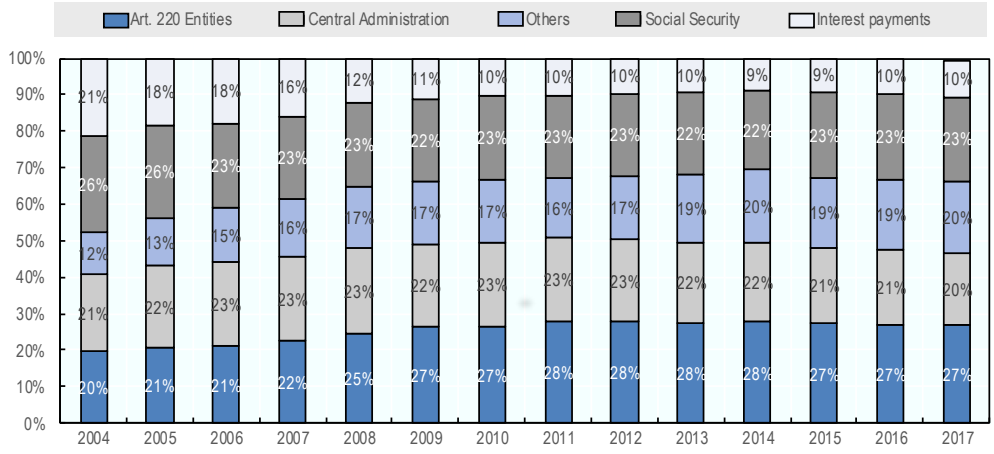
by Parliament or in another specific law, and is monitored in each budget update. If this ceiling is breached, the Executive branch must explain to the Parliament why the ceiling was breached, and the Parliament must authorise a new debt ceiling. However, if the debt level goes beyond parliament ceilings the executive cannot emit government securities, creating an important enforcement tool. In recent years, due to budget deficits higher than anticipated, the debt ceilings have been increased several times, with the necessary approval from Parliament.

4.2.5. Mandatory expenditure: recent trends

Uruguay's expenditure structure has suffered major changes in the past 15 years. Between 2004 and 2009 the share of discretionary expenditure available to finance government priorities (e.g. education, health and security) was reduced. Between 2010 and 2014, discretionary expenditure was stabilised at around 30% of total expenditure. However, starting from 2015, transfers to social security, interests on public debt, and other endogenous expenditure such as transfers to the National Health Fund have increased, reducing space to increase discretionary expenditure (Figure 9).

Currently, mandatory expenditures represent about half of total public expenditure. Public expenditure (including social security) represents about 30% of GDP in Uruguay. About half of public expenditures in Uruguay correspond to mandatory expenditures: transfers to social security (23%), interests on public debt (10%), transfers to sub-national governments (4%), transfers to the National Health Fund (3%) and tax credit certificates[5] (9%). This means that in practice fiscal space is limited and budget discussions only refer to about 50% of total public expenditure, a share which is higher than most OECD countries. However, wages represent about 60% of the expenditures of Ministries and Art. 220 Entities. As civil servants cannot be dismissed and their real wages cannot decline, this creates an important budget rigidity. In addition, pensions and retirement benefits are indexed to the index of wages (Art. 67 of the Constitution), and must be adjusted together with the wages of civil servants. As a result, about 80% of public expenditure has little flexibility. The remaining 20% represents operating expenditures, transfers and investment.

Figure 9. Evolution of expenditure structure (2004-2017)

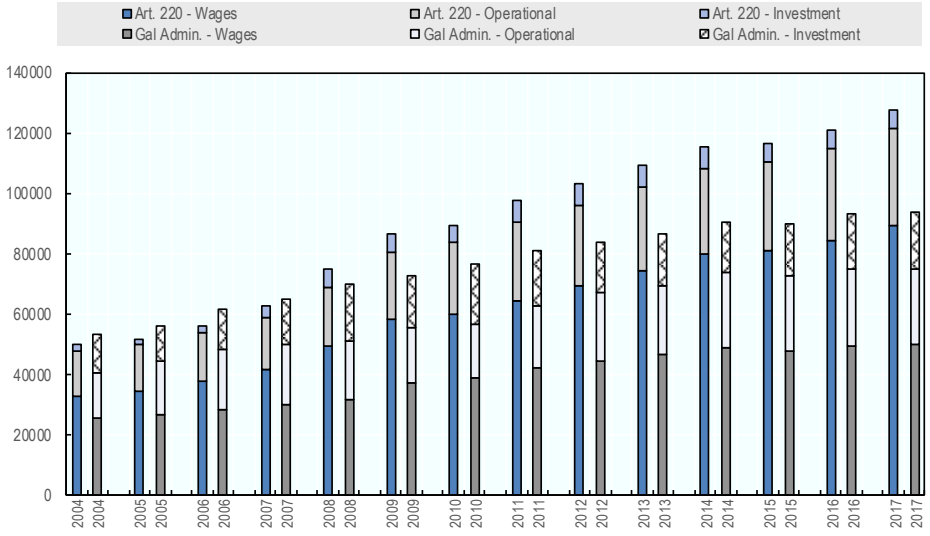


Note: Other=Transfers to the National Health Fund (3%), tax credit certificates (*certificados de créditos tributarios*) (9%), transfers to subnational governments and others.

Source: MEF

Art. 220 Entities represent 27% of public expenditures, which largely lie outside the direct control of the Executive branch. This percentage has increased significantly in the past years due to higher expenditure rates and the creation of new Art. 220 Entities. Budget execution associated to Art. 220 Entities has increased 155% in real terms during the period 2004-17, while the expenditures of the central administration (Ministries and Presidency) has increased by 76% during the same period (Figure 10). As a consequence, the share of expenditure under the direct control of the Executive has been reduced.

Figure 10. Evolution of central administration and Article 220 Entities expenditures by type of expenditure in real terms (2004-20167)



Source: Data provided by the MEF

4.2.6. Budget submissions by line ministries

There is no general pre-established procedure to be followed by line-ministries regarding their internal operations to create their budgetary proposal, or institutionalised dialogue with the MEF or OPP during this preparation phase.

Regarding the annual budget updates, line ministries send the information to the Ministry of Economy and Finance about 30 to 45 days before the executive must send the update to the Parliament[6]. Any new spending proposals should be consistent and costed. Information about the budget execution balance from the previous exercise is prepared by the National General Accounting Department (CGN) based on information in the SIIF.

4.2.7. Budget submissions by Art. 220 Entities

Art. 220 Entities introduce their budgetary proposals to the Executive branch. The Executive branch can modify the original proposals or create a parallel proposal, but must submit both the original and the modified budget proposals to the Parliament. While some "220 Entities" co-ordinate with their Line Ministry, and a unique budget proposal is submitted to Parliament, in other cases, two distinct budgets are submitted to the Parliament. While all OECD countries have such autonomous institutions for the Judiciary, Administrative, Electoral or Audit courts, their scope is significantly larger in Uruguay,

both in terms of share of total public expenditure (27%), as in the core policy areas which fall out of the direct government control (in particular Health and Education). This therefore raises two concerns: a fiscal sustainability concern, and an efficiency concern; and it is not in line with modern budgetary practices.

Regarding fiscal sustainability, the budget submitted by these entities tends to be significantly higher than the one proposed by the Executive. The Parliament is free to decide on the budget allocation, but it is now the practice that the overall expenditure, including the budgets of the Art. 220 Entities, must remain under the budget ceiling decided by the Executive. This has not always been the case, and it would be important to make this practice binding, as reverting to the previous practice could threaten fiscal sustainability.

Efficiency concerns arise because the Executive cannot make well-grounded prioritisation between all government expenditure in its budget proposal. Art. 220 Entities represent 27% of government expenditure (with expenditures by ministries representing only 21%), and the largest Art. 220 Entities are the Public Education National Administration (ANEP) and the State Health Services Administration (ASSE). This represents in practice a decentralisation of basic service provision to these institutions. While ASSE and the Uruguay Institute of Children and Teenagers (*Instituto del Niño y del Adolecenscente del Uruguay*, INAU) usually works closely with the MEF in the preparation of its budget, the ANEP or the University of the Republic (*Universidad de la República*) traditionally presents a separate budget proposal.

4.2.8. Budget negotiations within the Executive

Based on the budget guidelines' clear criteria agreed with the Council of Ministers, discussions between line ministries and the National Budgetary authorities begin, with the purpose of using the criteria and to set the initiatives that will be included in the Budget. The negotiation is driven by the National Budgetary Unit, and representatives from the OPP, the National Civil Service Department (ONSC) and the National General Accounting Department participate in these negotiations.

This institutional budget allocation firstly considers policy priorities and then, within the established guidelines, it considers the proposals received in the first round of meetings and the most critical aspects of budget requests presented by the line ministries and Art. 220 Entities. The negotiations that include exceptions to the criteria established within the Council of Ministers are diverted to political spheres outside the Council, such as Ministers or to the President of the Republic. Once the agreements have been made, the Institutions or Ministries are requested to include the agreed initiatives in the finalised budget submissions.

4.2.9. Election year

During the 12 months prior to elections (October), the Executive cannot make changes to the budget, as it is considered the next government's prerogative to do so, and to avoid increases in spending due to elections. In addition, during these 12 months before elections, the Parliament cannot approve Social Security norms,[7] nor create civil servants' positions. Finally, during the 12 months before the new government steps in (February), civil servants cannot be hired (except in education and defence mainly).

4.2.10. State owned enterprises (SOEs) (Empresas pública)

Uruguay has four types of SOEs: 1) social purpose (drinking water and sewage, mails, housing, settlement (*colonización*),[8] 2) financing and insurance, 3) infrastructure and 4) production of goods and services (electricity, telecom, energy).

In small countries like Uruguay, SOEs have an important impact on the economy: their tariffs influence inflation and purchasing power of households, they have an important effect in the fiscal balance (as their deficits or surpluses count in the consolidated fiscal balance of the public sector). In Uruguay, they represent about 40% of public investment and they are an important tool to implement specific policies. It is therefore important to make sure that they are in line with the general objectives of economic policy. Some of these SOEs usually receive subsidies (mainly the social ones and railways), others on the contrary provide dividends to the state (in particular the goods and services ones). Until the creation of the Energy Stabilisation Fund in 2010 (*Fondo de Estabilización Energética*), the results of the Electricity SOE were very dependent on the levels of rainfall (as a high share of Uruguay's electricity is hydroelectric), which created important fiscal balance fluctuations in the budget. There have been attempts to privatise these enterprises. However, these attempts have failed due to strong rejection from citizens.

State owned enterprises (SOEs) are autonomous institutions and follow public law. There are not many formal rules, which regulate the governance of SOEs. SOEs produce annual budgets which are approved by a decree signed by the Line Ministry, the MEF and the President of the Republic. Budget proposals for the next budget year must be submitted before 31 July (except for the first year of government were they can be summited until 31 December). SOEs' fiscal result is projected and presented in the general budget for information purposes. The law states that SOEs must present a five-year strategic plan with the first budget in the first year of the government. The following years they present and update investment plans.

SOEs receive two types of recommendations from the Executive branch:

- OPP, in agreement with the Macro Assessment Unit, sets guidelines for the budget formulation, including criteria for adjusting human resources and investment expenditure, based on the fiscal space available for the year.
- Since 2015, SOEs and the Executive branch (OPP and MEF) sign inter-institutional management agreements (*compromisos de gestión*). These define strategic aspects such as the level of subsidies/dividends, the level of expenditures, the efficiency, quality of expenditure targets, etc. OPP and the Macro Assessment Unit determine the level of fiscal space and expenditures of SOEs, as these are counted in the results of the public sector. These agreements are monitored throughout the year and must be met on an annual basis. However, besides the potential political impact, there are no sanctions in case of failing to meet the objectives. Usually, the achievement rate is about 85%.

4.3. Top-down budgeting in Uruguay

In an effort to control deficits and constrain expenditure growth, many OECD countries began to adopt top-down budgeting practices in the 1990s. "Top-down budgeting" refers to the budgeting practice whereby the fiscal targets are determined from the outset, with annual and multi-annual budgetary policies subsequently determined in conformity with these overall levels. Typically, in top-down budgeting, the executive first determines aggregate public finance targets (spending and revenue levels) given medium-term fiscal

objectives and prevailing economic conditions. Within this aggregate, sectoral ceilings are set reflecting existing commitments, political priorities in general and key new policy initiatives. The detailed allocation decisions are typically delegated to individual sectoral units. To be implemented effectively, top-down budgeting requires rigorous and prudent economic forecasts and must be combined with complementary fiscal management practices such as medium-term expenditure frameworks.

By contrast, bottom-up budgeting is a reactive, expenditure-driven process that imposes no up-front constraints on sectoral requests; total spending is determined as the residual sum of individual appropriations and remains unknown until the final stages of budget preparation. The detailed appropriations characteristic of bottom-up budgeting foster agency-specific programme ownership and make it difficult to reallocate in accordance with new policy priorities. Such budgetary processes typically lead to unsustainable spending paths.

Top-down budgeting marks a significant reorientation of the budget process as compared to the traditional bottom-up approach (Table 4).

Table 4. Top-down budgeting vs. bottom-up budgeting

	Top-down (integrated) budgeting	Bottom up (fragmented) budgeting
Primary focus	Policy-driven process that aligns spending with key priorities (proactive)	Expenditure-driven process (reactive)
Role of Finance Minister/Secretary	Set aggregate spending level based on fiscal management target and monitor compliance	Negotiate details of individual spending proposals to control detailed allocations
Role of spending ministers/secretaries	Allocate financial resources to individual programmes within assigned spending ceilings	Submit budget requests and negotiate itemised appropriations
Economic forecasting	Aggregate fiscal analysis that takes into account economic forecasts.	Ministry by ministry analysis that largely ignores economic forecasts
Efficiency	Streamlined process reduces inefficient practices excessive requests	Inefficient and time-consuming negotiations process
Timeframe	Multi-year perspective	Annual appropriations process

Source : OECD (2014), Budgeting practices and procedures in OECD countries

4.3.1. Top-down budgeting in Uruguay

While some progress has been made to constrain budget discussions to fiscal targets set by the MEF from the onset, Uruguay does not yet have a top-down budgeting system. Today, the budget process in Uruguay begins with the determination of the fiscal space available and agreement on the total level of expenditure. Budget submissions by line ministries must respect this ceiling. Except for the Art 220 Entities and the transfers to subnational governments, the Parliament can only increase the total level of expenditure decided by the Executive if it approves a corresponding source of revenues to finance it.

Likewise, Parliament can only make re-allocations of funds from one spending area to another, staying under the ceiling. However, the budget is still input based, allocating funds with an important level of detail, and Ministers and managers in line ministries have little flexibility to decide and thus optimise the allocation of funds within their portfolios. Line ministries therefore are subject to binding budget ceilings, but do not have autonomy to allocate financial resources to individual programmes within these assigned ceilings.

By contrast, Art. 220 Entities have this autonomy, as they submit their own budget proposals to parliament, but they are not subject to binding *ex-ante* budget ceilings, as the budget they submit may be (and usually is) larger than the indicative ceiling set by the

Executive branch. The final budget envelope is therefore negotiated during Parliament discussions, which is not in line with top-down budgeting practices.

Since recent years, it is agreed that the spending of the Art. 220 Entities must be calculated under the ceiling provided by the MEF. This however is not stated in the legal or constitutional framework.

4.4. Budget transparency, discussion and approval

4.4.1. Parliamentary discussion and approval

Parliamentary competences are defined in Articles 214 of the Constitution. Parliament has wide competences to amend the budget, within the limits set by several constitutional articles. In particular, Art. 215 of the Constitution specifically prohibits the Parliament from modifying the Bill to increase expenditure. It can reallocate funds, within the ceilings determined by the Executive branch. If it wishes to propose new laws which will increase the level of expenditure (as health insurance reforms), it must identify new revenues to finance these. However, there is no formal mechanism to assess the fiscal impact of new laws. The Parliament can request a costing to the Executive branch, and the Executive can provide a costing even without specific request, but this is not done on a systematic basis. Laws which propose to reduce taxes or modify social security laws must be initiated by the Executive branch. The Parliament may then modify these (and their cost) during the parliamentary discussions.

In practice, Parliament makes use of its competence to amend the budget. In the last three government periods, given that the government party had parliamentary majority, the modifications were agreed upon, and even though there were reallocations, there were no formal increases to budgetary spending.

Budget documentation submitted to Parliament includes the draft five-year Budget Bill, an economic and financial report and the Bill's explanatory statement, a report with the allocation of expenditures by programme, a justification document for all articles, the budgetary initiatives regarding Art. 220 Entities, and a variety of spreadsheets. Regarding accountability, the budgetary execution balance and other reports, such as reports on PPPs or gender issues are also submitted to Parliament. In addition to these documents, the Parliament receives during annual budget updates, a budgetary execution balance, a report on expenditure by programme and of achievement of targets, and a budget analysis report.

The Executive Branch of Government can send amendments to the original Budget within 20 days after the Budget has entered either Chamber (this applies only to the five-year budget). Amendments can be sent to Parliament before 30 June every year and the terms in both Houses are the same as for the Budget (for the annual budget updates).

In general, political contacts are made during the process, firstly within the official government party during the budget negotiation phase, and generally with the opposition parties and other social organisations during parliamentary discussions.

The Chamber of Representatives has 45 days to examine and propose changes to the budget, which is then submitted to the Chamber of Senators, who also has 45 days to examine it and propose changes.[9] If changes are proposed by the Chamber of Senators, they must be submitted to and approved by the Chamber of Representatives. If the Chamber of Representatives does not agree with the proposed changes, the bill is sent to a reconciliation chamber, and voted in a General Assembly. The executive can veto this budget or specific articles. In this case, the bill is sent back to the General Assembly and requires a 3/5

majority to lift the veto (Art. 138 of the Constitution). This is very rare and has not happened in the last 15 years.

4.4.2. Transparency and citizen involvement in the budget process

All documentation provided to the Parliament can be consulted online on the websites of the National General Accounting Department, the Ministry of Finance, or the OPP, and since 2017, a smartphone app allows access to all the official documents submitted to Parliament. All assumptions and forecasts are published on the MEF's website after the Bill is sent to Parliament.

While information regarding the budget is public and of easy access, it is still very technical, and there is no "citizen friendly" version of the budget available (as will be seen later on in this report, producing such a citizen budget would be easier if programmes were better defined). Currently, there are no initiatives in place to promote education and awareness among the public, and/or among parliamentarians, regarding the budget process ("budget literacy" initiatives). There are no pre-existing mechanisms to interact with civil society organisations.

4.5. Recommendations on budget formulation and approval

R 4.1. Develop a detailed budget process guidelines and a binding budget calendar

Uruguay has laws setting formal dates for the main stages of the budget process (in particular Art. 34 and 35 of Law 18.362), but these are not respected. One of the reasons for this may be that there are no rules or guidelines regarding the process leading to each of these stages. For example, there are no rules formalising when and how interactions between line ministries and the National Budget Unit or OPP should occur, or what specific format and requirements line ministries' budget submissions should have. The National Budget Unit could for example produce (with consultation and dialogue with the main stakeholders) some budget process guidelines or a handbook which would specify these interactions, set specific dates for dialogue between the National Budget Unit and line ministries, and describe how the budget requests should be presented. These guidelines could also be described in an Organic Budget Law (see R 3.2).

R 4.2. Create specific moments in this calendar for dialogue between budget authorities and spending institutions

The above mentioned budget calendar should specify a moment for discussing strategic priorities, definition and objectives of programmes, performance indicators and results, etc. between budget authorities (National Budget Office and OPP), and spending institutions (line ministries and Art. 220 Entities). Sweden is a good OECD example of regular dialogue between key stakeholders during the budget process (Box 11).

Box 11. Swedish "whole of year" budgeting model

Sweden's annual and multi-annual budget processes are top-down and anchored within a sound, steady framework for fiscal policy. Accordingly, the annual budget is not a standalone event but is part of a multi-annual chain of decisions that are designed to promote prudence and sustainability. The Swedish "whole

of year" budgeting model is sequenced via a series of events over the course of the year, progressing from the presentation of high-level fiscal aggregates in spring through to the more detailed budgetary proposals in autumn.

Spring Fiscal Policy Bill

The Spring Fiscal Policy Bill, which needs to be submitted by 15 April each year, allows the government to frame the context for the annual budgetary process in broad terms in the early part of the year. The Spring Bill includes comprehensive information on the fiscal policy outlook, perspectives on fiscal risks and long-term sustainability, a follow up of budgetary policy targets, and extensive baseline information on all areas of public spending. It focuses clearly upon medium-term fiscal plans and omitting details on expenditure, which is reserved for the Budget Bill.

The Spring Bill provides for parliamentary debate on fiscal policy, in general terms. As the Bill does not generally deal with detailed budgetary matters, in practice it serves to introduce greater transparency to the budget process to the benefit of the Swedish Parliament and the public in general. A functional benefit of the Spring Bill for parliament is providing a channel for parliamentary engagement in matters of fiscal policy prior to the drafting of the detailed budget.

During the preparation of the Spring Bill (February-April), high-level working groups involving the Ministry of Finance and the Prime Minister's Office meet regularly to help identify political and policy priorities which ought to be reflected in the budget planning. These discussions are informal and help to structure thinking and planning processes; they do not lead to definitive policy conclusions at this early stage. However, when line ministries present their "budget request" in May, it is expected that they will reflect the discussions and orientations from the spring meetings.

Budget Bill

In autumn, the Budget Bill containing the Government's detailed proposals for the coming year is the focal point of the parliament's annual budget dialogue. It aligns with, but provides greater specificity to, the general guidance set out in the Spring Fiscal Policy Bill.

The Budget Bill is the legal vehicle whereby the parliament decides the ceiling for central government expenditure for the third year ahead. The expenditure ceiling for the current budget year is thus decided three years in advance. Within the aggregate expenditure ceiling, the Government proposes in the Budget Bill an allocation of expenditures among about 27 Expenditure Areas in the second and third budget years ahead. These Expenditure Area estimates, or indicative budget frames, are approved by the parliament and function as a guideline for medium-term policy planning.

Source: Downes, R. et al. (2017b)

R 4.3. Start moving towards a "Modern Finance Model" of relation between line ministries and budget office by reinforcing the finance function in line ministries

Today, there is a wide consensus among OECD countries that "top-down budgeting"[10] coupled with a "modern finance model" brings better results than the conventional model on the three core functions of the budget: macroeconomic, allocative and operational (Box 12). However, the development of "top-down budgeting" implies a fundamental shift in the position of the finance function in line ministries. A system of ministerial caps is only feasible if line ministries are capable of implementing them. In order for line ministries to be effective, finance directorates must become stronger, and in particular take on the tasks of budget control, fiscal co-ordination and operational control (Box 12). Line ministries must enhance their capability to ensure compliance with the annual or multi-annual caps that are set for them. If one is to devolve responsibilities from the Ministry of Finance, it is essential to have someone to devolve to. Without strong finance directorates, an expenditure framework based on ministerial caps is not going to work.

Box 12. Conventional model vs. Modern finance model

In all OECD countries, the finance directorate of a line ministry is responsible for the financial administration of the line ministry, even if this task is partly carried out by the sectoral divisions. Financial administration includes the formulation and execution of budgets and the preparation of financial reports.

In countries where the finance function is organised according to the financial control model, the finance directorate is responsible for the financial administration of the ministry similarly as in the conventional model, but in addition carries out the tasks for budget control, fiscal co-ordination and operational control. If these tasks are carried out effectively, it is said that "the finance directorate functions as the line ministry's own ministry of finance".

- Budget control amounts to the monitoring of the budget preparation and execution and taking timely action, in order to avoid overspending on the budget or on medium term budget caps. In other words, it leads to budgetary discipline.
- Fiscal co-ordination amounts to advising the minister, in consultation with the sectoral divisions of the ministry, about spending priorities. This includes new spending initiatives as well as internal reallocations among sectors.
- Operational control means that the finance directorate maintains a permanent effort to check the effectiveness and efficiency of current policies, including the executive policies of the arm's length and independent agencies under the umbrella of the ministry, and that it advises the minister on its own initiative about possible improvements of effectiveness and efficiency savings.

Table A. Distinctive features of the conventional model and the financial control model of the financial function in line ministries

	Conventional model	Modern finance model
Financial administration	Task of finance directorate	Task of finance directorate. Partial devolution to sectoral divisions an d agencies or to shared service units outside the finance directorate if possible
Commitment and cash control	Task of finance directorate and, subject to certain criteria, the Ministry of Finance	Task of sectoral divisions. No, or limited, commitment and cash control by the finance directorate or the Ministry of Finance if possible
Budget control	Task of line minister advised by sectoral divisions	Task of line minister advised by finance directorate
Fiscal co-ordination	Task of line minister advised by sectoral divisions	Task of line minister advised by finance directorate
Operational control	Task of Minister advised by sectoral divisions	Task of minister advised by finance directorate

Examples of countries where the finance directorate of a line ministry serves in this sense are the Netherlands and the United Kingdom. These countries show that within the financial control model, there is wide variety of practices. This variety is due to significantly diverging divisions of tasks within line ministries between the finance directorate on the one hand, and the sectoral divisions and agencies on the other hand. The size of a finance directorate in the Netherlands varies between 30 employees for small ministries to 100 for larger ones. The size of a finance directorate in the UK varies between less than one hundred for small ministries and several hundred for large ones.

Source : Kraan, D. (2017)

Uruguay has done important progress in its budgetary management since 2005, in particular regarding fiscal sustainability. The country is now seeking to improve the quality and effectiveness of public expenditure. Moving towards full top-down budgeting, with a modern finance model in line ministries seems like the natural next step. However, this implies deep reforms of the budgeting system and procedures, which will be analysed in the different sections of this report. As a first step, Uruguay could start by reinforcing the finance function in line ministries, in order to gradually transfer more responsibilities in the budget preparation and execution process to line ministries.

Some concrete steps could be taken in this direction:

1. Pay special attention to the appointment and training of the heads of finance directorates of line ministries

The role of the head of the finance directorate in a line ministry fundamentally changes with the implementation of the modern finance model. Very special care should therefore be devoted to the appointment of this person. The holder of the position remains an official of the line ministry, but their new responsibilities are in many respects comparable to those of the Ministry of Finance in the conventional model. The head of the finance directorate needs to command the confidence of both the line minister and the Ministry of Finance. In the Netherlands, this requirement is reflected in a provision of the Budget Code that provides for a right of approval of the Minister of Finance for the appointment of the head of a finance directorate of a line ministry. In many countries, a substantial number of them have previously worked in the

Ministry of Finance, showing the close links and the need to possess the necessary budgetary expertise.

1. Clearly recognise all sectoral divisions and agencies as budget holders

This implies that they can incur commitments and order payments, and that they are accountable for the budget from which these payments are made.

2. Develop dialogue between the National Budget Unit and the finance directorate of line ministries, gradually reducing direct dialogue with sectoral units

While such reforms generally do not require deep legal changes, they do imply deep cultural changes. Such a process could be carried out gradually, shifting responsibilities on *ad hoc* manners, in differentiated ways depending on the ministry. Experimentation could be carried out for example with ministries which already have a close and trustful relationship with the National Budget Unit, gradually extending the changes to other ministries, as these see the benefits such a system could bring them, and as the system has been tested and improved over several exercises. Experimentation is a widely used instrument for introducing reforms in OECD countries, as the recent experience of Austria shows (Box 13).

Box 13. Austria's use of pilot projects before full budget reform

Until the mid-1990s, Austria's budget process was traditional, cash-based, highly legalistic and input-oriented. Moreover, with no binding medium-term perspective in budgeting, the Federal Ministry of Finance (BMF) and line ministries experienced difficulties in planning.

A first critical reform in the mid-1990s introduced top-down budgeting. Then in 2000, several pilot projects (so-called 'Flexi-Clause') were undertaken with around 20 administrative offices in different line ministries that experimented with performance information and new forms of budget flexibility (a lump-sum appropriation with appropriations defined several years in advance, flexibility of *virements* within that lump sum, and the possibility to carry forward savings) (Steger, 2010). The positive experiences from these pilot projects helped build momentum for reform. At the same time the BMF began to collect good practice examples internationally, mainly from peer countries within the OECD.

Source : Downes et. al. (2018)

R 4.4. Strengthen the principal of budget unity, by conferring a clear mandate to the MEF to present a unified budget within an overall expenditure ceiling

The OECD Principles on Budgetary Governance highlight the importance of budget unity: "As a contract of trust between citizens and the state, it is expected that the budget document account comprehensively and correctly for all expenditures and revenues of the national government (…)". Furthermore, a full overview of the public finances should be presented during the budget formulation and approval process, as an essential context for a debate on budgetary choices. In a similar way, principle 7 stresses that earmarking of revenues should be kept to a minimum, as this does not allow governments to reorient resources to the priority sectors, and reduces the role of the budget as an instrument to support government policy. Excessive amounts of earmarks can compromise

macroeconomic stability by making it difficult for governments to adjust fiscal aggregates to changing macroeconomic perspectives, leading to further indebtedness in cases of sudden macroeconomic shocks. Fragmentation of public sector has been a major challenge for some LAC countries, such as Costa Rica. Even though the Costa Rican government is aware of the limitations of this approach, progress towards a unified budget is been challenging (Box 14).

Box 14. Challenges of institutionally decentralised sector in Costa Rica

One of the main characteristic of Costa Rica's institutional framework is its fragmentation. On the one hand, about 50% of public expenditure follows a classical budgetary process, where estimated revenues are assigned to the different spending priorities in a budget document prepared by the executive, and discussed and approved by the Legislative Assembly (*Asamblea Legislativa*). The other half of public expenditure is carried out by the institutionally decentralised public sector. These institutions prepare their own budget, which is approved (compliance check) by the Office of the Comptroller General (*Contraloría General de la República*, CGR).

The Office of the Comptroller General does not check whether the goals, objectives and expected results of the institutionally decentralised sector or the deconcentrated agencies are in line with the NDP. The Ministry of National Planning and Economic Policy (*Ministerio de Planificación Nacional y Política Económica*, MIDEPLAN) is in charge of verifying that the entities comply with the NDP's goals and objectives, but does not have instruments to enforce this. It is therefore very difficult to ensure that institutionally decentralised sector's objectives are in line with overall government's objectives. Likewise, large institutionally decentralised sector reduces government's ability to reallocate funds to priority areas and ensure accountability towards central government institutions and citizens.

There have been some recent attempts towards reducing fragmentation in the budget process. In 2017, the government proposed a bill aiming to strengthen budget control of deconcentrated agencies (Bill No. 20.203). The objective of this bill is to include 61 deconcentrated agencies (defined by the Ministry of Finance) in the national central budget. Their inclusion aims to increase budget execution, eliminate administrative duplications in the preparation of the budget, increase co-ordination and internal coherence in the public administration, increase legislative's capacity to prioritise and programme public spending, and strengthen ministries capacity to control sectorial budget formulation and policy implementation. The bill is currently under debate by the Legislative Assembly. However, the budget of all deconcentrated agencies is less than 6% of the non-consolidated total government expenditure. Further developments are needed to ensure that administrative fragmentation does not hamper alignment between government policies, co-ordination between public institutions, as well as effective monitoring and evaluation tools.

Source: OECD (2015)

The principal of budget unity should be maintained, in order to ensure Entities do not present a possible threat to fiscal sustainability, and to ensure that the executive has room of manoeuvre to optimise funds allocation. In consequence, the MEF should be responsible for defining a binding overall celling that covers all public expenditure, including expenditure of Art. 220 Entities. During the budget approval phase, the legislative should exercise its constitutional right to adjust and approve the budget document, but should not jeopardise overall fiscal objectives.

Even tough Uruguay has been implementing this approach in the last years; this is not an institutionalised practise. In order to ensure this practice is not altered, the MEF should have a clear and explicit mandate to propose a unified budget, within clear previously defined fiscal objectives. This mandate could be incorporated under a strategic and sustainable development plan, aiming not only to define the government strategic objective but also enforce fiscal discipline in order to achieve them in a sustainable way.

R 4. 5. Implement a more inclusive and participative process towards defining fiscal objectives and overall expenditure ceilings

Fiscal discipline is better enforced if relevant stakeholders are involved in the definition of fiscal objectives and overall expenditure ceilings. This debate can create awareness of the state of public finances and the trade-offs that are involved in the budget decision-making process. Furthermore, it can build alliances between the different stakeholders for responsible engagement on fiscal objectives. Uruguay, could consider creating such a pre-budget dialogue scenario to involve all relevant stakeholders (including the parliament and Art. 220 Entities), informing on the implications of setting appropriate fiscal objectives and creating an overall culture of fiscal discipline. Some OECD countries have developed such type of roundtables or stakeholders forums with key agencies and citizens to engage them in budgetary decisions. For example, Ireland started conducting National Economic Dialogues in 2015 (Box 15). Even though this exercise has a greater emphasis on civil society participation, it could be an interesting example to inform a similar inclusive process in the Uruguayan context.

Box 15. Ireland National Economic Dialogue

In 2015, the Irish government instituted a new process of National Economic Dialogue (NED), a formalised process of consultation and debate with societal interests to enhance the whole-of-year budget development process. The NED was conducted on 16-17 July 2015. The mid-year timing was chosen so that "the discussions during the Dialogue about where our resources should best be allocated, and how to accommodate the many demands and pressures for increased resources, can then inform the work of the government in deciding on Budget measures, and the work of the *Oireachtas* in considering the Budget later in the year."

By launching the National Economic Dialogue (NED), the government has indicated its willingness to strengthen transparent stakeholder participation in the *ex-ante* budget phase, an objective which is very much in keeping with the international principles of "open government" advocated by the OECD and to which the Irish government has subscribed.

Source: OECD (2017)

R 4.6. Develop instruments to respond to the need for greater budget flexibility to disincentives the creation of new Art 220 entities

There has been a recent increase in the number of Art. 220 Entities. One of the main reasons behind this trend is that Art. 220 Entities benefit from a higher degree of management and budget flexibility. However, this need for greater budget flexibility could be addressed through other instruments, which would not generate the double threat of Art. 220 Entities. Some examples of such type of instruments are: addressing human resource management rigidities (OECD could provide specific study and recommendations on this particular aspect); moving towards full "top-down budgeting" and modern finance function, thereby giving all line ministries greater flexibility in the management of their budgets, provided they comply with agreed targets, rules and ceilings (see R 4.3); creating other types of autonomous agencies under the Swedish or Dutch models, which provide interesting flexibility, while being totally accountable to their line ministry (Box 16).

Box 16. Autonomous agencies in the Netherlands

The Dutch "agency movement" started in the 1990s. The idea was to push all policy execution, including its financial administration, out of core ministries. This would make it possible to manage policy execution more efficiently, making use of management practices of the private sector. In addition, it would lead to a lean and better co-ordinated core government, focusing on policy development and evaluation. The separation between policy development and execution that was envisioned in the agency initiative has been pursued in a systematic way in the Netherlands. With a few exeptions, almost all policy execution in the Netherlands is currently concentrated in agencies. All agencies have their own financial administration units that report to the finance directorate of the ministry.

Source : Kraan, D. (2017)

R 4.7 Strict rules of budgetary discipline should be put in place to guarantee that overspending on ministerial ceilings cannot occur

Regarding the important point of budget discipline, it is often recognised that a programmatic line-item classification may lead – almost by definition – to a certain relaxation of input controls and may thus be seen by the central budget authority as involving additional risks to budgetary control. To minimise such risks, strict rules of budgetary discipline should also be put in place to protect against overspending on ministerial ceilings. These rules (described in Box 17) do not need to be enacted in administrative law. However, they should get full support from the President and Minister of Finance. Usually, committing to this budget discipline is the counterpart for increased managerial flexibility between budget lines under the ceiling, and such flexibility can be made conditional on the respect of the overall ministerial ceiling. In order to be credible, ceilings should be the result of a guided dialogue with line ministers to understand expenditure drivers and priorities. In some countries, IT systems do not allow for overspending on the ceiling.

Box 17. Rules of budgetary discipline

Rules of budgetary discipline are an essential complement of the move towards programme budgeting and the relaxation of input controls. The rules must ensure that ministerial ceilings are maintained and enforced once they have been decided. Rules of budgetary discipline do not need to be enacted in administrative law, but they should be permanently on the desk (or close to the desk) of every line minister and particularly the prime minister or president. At the accession of every new cabinet, they should be handed out by the minister of finance.

The most important rules are:

- Every minister is responsible for the maintenance of their own ministerial ceiling of the fiscal framework.
- Every minister is obliged to compensate every overspending on a budgetary or multi-annual line-item estimate, insofar as it leads to overspending on the ministerial ceiling, by cuts in other line-item estimates, regardless of whether the overspending comes from a policy change or from setbacks under current policies.
- Carryover of appropriations to the next budget year is only possible with the approval of the minister of finance.
- Reallocations between ceilings (for ministries, constitutional bodies and social security funds) can only be decided by the cabinet with the approval of the minister of finance and, except for major disaster of wars, should only be decided in the budget process.
- The prime minister or president is responsible for the maintenance of the ceiling for total expenditures. Source : OECD (2017), Enhancing the finance function in line ministries

S*ource* : Kraan, D. (2017)

5. Budget implementation

5.1. Budget execution flexibility

5.1.1. Adjustments to the five-year budget

The five-year Budget is not a rigid or static tool as it can be modified through various legal procedures, such as:

- Annual update laws (*rendición de cuentas*);
- Salary and public services adjustments;

- Provisions for contingencies or reinforcement of other items (in every case contemplated by the five-year Budget law, which sets a maximum percentage of the total maximum expenditure to be granted under this system);
- Authorisations for inflationary adjustments in certain operational expenses;
- Estimated and adjustable collection allowances (also specified in the five-year budget legislation);
- Allowances to be adjusted by certain indexes, such as Consumer Price Index; and
- Specific legislation bearing budgetary impact.

In addition, Article 644 of the Law 17.296 authorises the executive to set execution ceilings for investment and operation expenditures. This applies only to the central administration and not to Article 220 Entities. Execution ceilings to Article 220 Entities would require a law.

5.1.2. Two types of budget allocations

The budget bill distinguishes between two types of budget allocations: restrictive allocations (*partidas limitativas*), which set a maximum spending authorisation, and estimated allocations (*partidas estimativas*), where the adjustment formula is determined by law (e.g. financing of social health insurance deficit, family allowances, and debt interests). The latter allocations are not discussed during the annual budget debate, but they are a structural element to define the fiscal space available for other initiatives. Over-spending on the initial estimated allocations is allowed. However, these budget allocations are subject to the occurrence of a stated event (e.g. the social health insurance deficit depends on the number of beneficiaries and the contributions they should make according to the law).

5.1.3. Budget reallocations

For the central administration (i.e. excluding Art. 220 Entities), budget reallocations are allowed within programmes or between programmes. They are also possible between different ministries as long as the funds are reassigned for similar objectives. While reallocations within a ministry are quite frequent, reallocations between different ministries are rare. As part of recent reforms, Uruguay has progressively implemented mechanisms to empower line ministers to have the responsibility of reallocations within their budget lines. In particular, there are new mechanisms to reallocate expenditure during the budget execution phase. Some of these changes require approval of the MEF. These changes have been progressive and there is still control over sensitive expenditure; reallocations between types of expenditure (wages, current expenditure and investment) are not allowed.

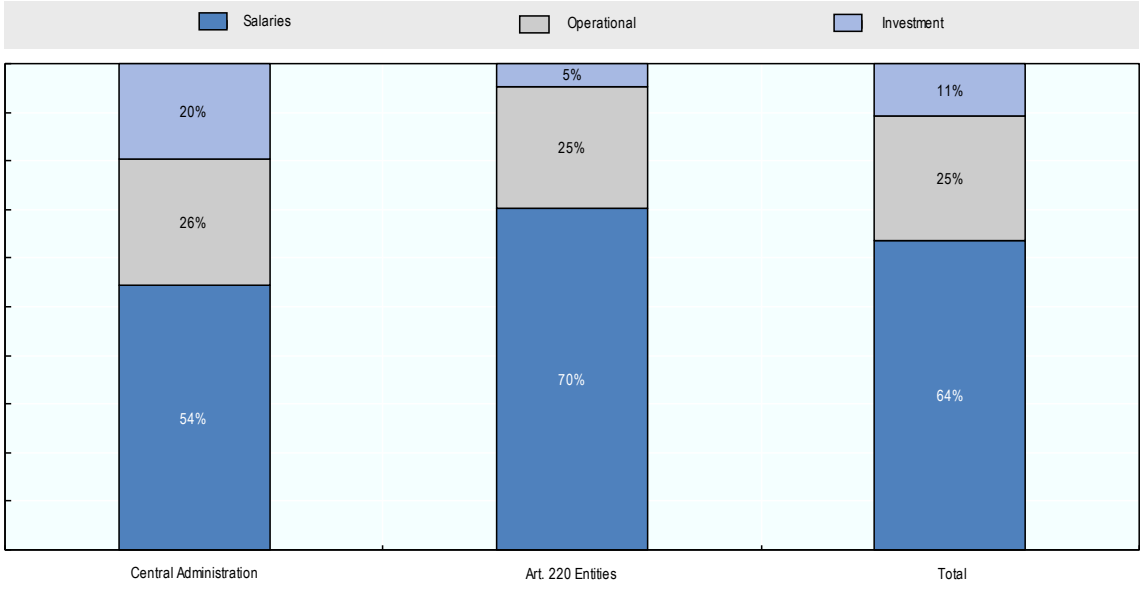
Art. 220 Entities in contrast have some leeway to reallocate funds between different types of expenditure without need for authorisation by the MEF.

5.1.4. Civil service structure described in the budget law

On average, wages represent 64% of central administration expenditure[11] (Figure 11). A specificity of Uruguay is that as a guarantee for the professional carrier of civil servants, the entire structure of functions is defined in the budget law. The fifth volume of the National Budget Law describes each one of the civil servants' positions and basic salaries for each entity of the central administration (excluding Art.220 Entities). In addition, these

civil servants' positions are subject to a regimen of security of tenure. The structure established in the budget Law can only be amended by a restructuring Decree, requiring numerous administrative procedures. An additional factor of rigidity comes from the law which states that the wages of civil servants must be stable in real terms, which implies automatic increases with inflation (Art. 4 of Law 18.719).

Figure 11. Structure of budget expenditures, 2017

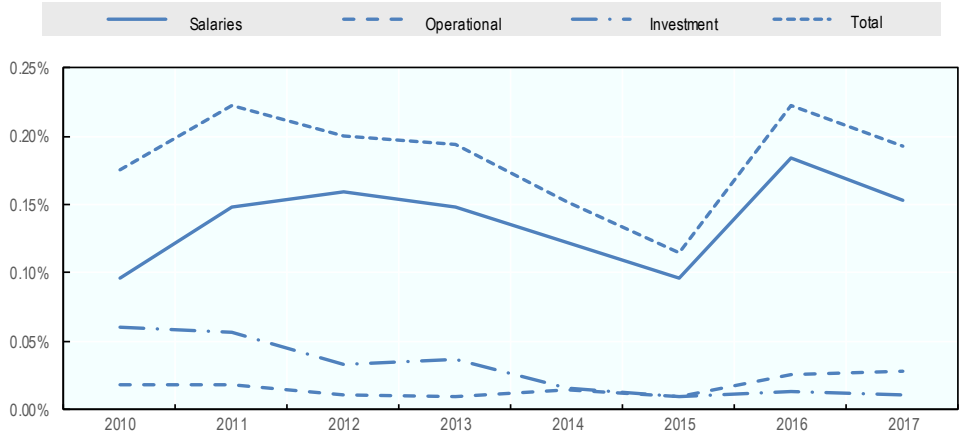


Source: CGN (2017a) and MEF (2017)

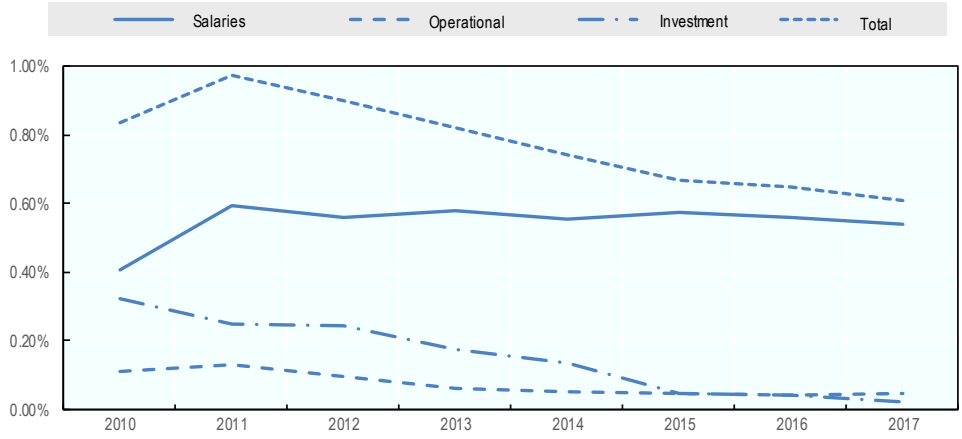
Due to this rigid structure, positions are often not filled because they cannot adapt quickly to the needs of the public entity.[12] This limited flexibility generates on the one hand, an enormous rigidity in human resource management, with no incentives for efficiency gains, and on the other hand, an important budget under-execution on the wage bill, as when positions are vacant, they are still computed in the budget, and funds cannot be used for another purpose other than the narrowly defined position. Under-execution on the wage bill is equivalent to 0.6% of GDP for the central government and is one of the main drivers of underspending in Uruguay. In contrast, some Art. 220 Entities (e.g. ANEP, UDELAR; ASSE) have full flexibility to approve and reform their own structure of functions and salaries. They can also transfer budget allocations from wages to investment under some circumstances. Under-execution on the wage bill is equivalent around 0.2% of GDP for the Art. 220 Entities (Figure 12).

Figure 12. Evolution of budget underspending: Central Administration Vs Art 220 Entities (% of current GDP)

Central Administration % current GDP



Art. 220 Entities % current GDP



Source : Data provided by the MEF

5.2. Debt management

The Debt Management Unit (DMU) was established in the MEF in 2005, tasked with developing a comprehensive strategy for debt management based on cost-risk analysis, taking into account the macroeconomic framework and the objective of supporting the development of domestic financial markets. To carry out its duties, the DMU relies on a solid operational capacity, updated research methods, a proactive approach to investor relations and sound practices on market access.

Over the last decade and a half, the DMU has deployed a prudent and forward-looking debt management strategy, reducing financial vulnerability tied to the structure of Uruguay's public debt. The government has gradually reduced its reliance on foreign-currency financing, lowering the exposure of public finances to an exchange rate depreciation. The share of foreign currency-denominated represented around 49% of Uruguay's total government debt by end-2017, down from 95% in 2002. Furthermore, the average maturity

of public debt has more than doubled over this period to 13 years (among the highest in the EM space), reducing short-term refinancing risks.

In addition, an active pre-funding policy has long been a pillar of Uruguay's debt management strategy to cushion external shocks. The government maintains ample liquidity reserves (more than 4% of GDP) and holds credit lines from multilateral institutions (additional 4% of GDP). Having a sizable liquidity buffer naturally implies a cost of carry, but it gives investors assurance of Uruguay's ability to repay debt, and provides strategic flexibility in deciding future financing strategies, and when and how to tap the market.

Uruguay sees strategic value diversifying sources of funding, as it helps improve financing terms and ensure ready access to international capital markets. The bedrock of this strategy has been a transparent and predictable approach in terms of investor relations and data dissemination. The DMU develops a continuous dialogue with investors and analysts. Its webpage provides timely and detailed information on economic indicators, debt statistics, credit agencies´ reports and the legal framework governing public debt. It also publishes a quarterly Sovereign Debt Report and a quarterly bulletin on recent macroeconomic developments - both available in English.

During the last few years, international financial markets and credit rating agencies have recognised Uruguay's solid institutional stability, macroeconomic development and strong financial buffers, differentiating Uruguay's sovereign credit quality from other countries in the region, in a context of increased volatility. In 2018, for the first time in history, three credit rating agencies placed Uruguay one notch above the investment grade threshold.

The DMU interacts regularly with other divisions at the MEF, as well as other public sector agencies. Within the MEF, it interacts with the Macroeconomic Assessment Unit for defining the fiscal targets. Indeed, the debt policy and trajectory of public debt has important implications for calculating fiscal space, as interest payments for the consolidated public sector represent about 3% of GDP. Reducing the interest bill therefore contributes to consolidation policies carried out by the Executive. It also interacts with the Treasury, to make sure that the amount and currency composition of cash balances are consistent with the Treasury`s needs.

The MEF and the Central Bank have recently taken a number of initiatives to improve the co-ordination of policy and procedural efforts between debt management and monetary policy. One of the most important steps taken was the establishment of the Public Debt Coordination Committee (PDCC) in April 2016, created to set and co-ordinate debt management strategies focusing on monetary policy and government financing objectives. Also under its purview is the development of domestic markets, management of the public sector consolidated balance sheet and potential risk-mitigating strategies for publicly owned companies

5.2.1. Cash management and the Treasury

The National General Treasury (in MEF) is responsible for cash management and payment. Since 2005, great efforts have been carried out to integrate the Treasury with the budget process, improving cash management and increasing planning and foresight. This reflects the transition from fiscal control based on controlling payments, to a fiscal control based on the budget. The Treasury has done important work with the spending units to develop a calendar of their monthly liquidity needs. It can now plan the cash requirements, which are an important input for the debt management unit, to optimise borrowing policy and ensure

liquidity to pay the obligations in the required currency. Treasury also provides the macroeconomic assessment unit the necessary information for the calculation of the cash-based fiscal deficit. There is also a monthly committee established between the relevant institutions. These good working relations have been built in these last years, and are yet to be formalised, to ensure their permanence.

Today, the Treasury receives the monthly cash requirements of spending units for the entire year, checks with the National Budget Unit that these are consistent with the approved budget, and assigns to each spending unit a financial availability quota for each month of the year. Likewise, there is constant monitoring of floating debt to ensure it does not increase beyond desired levels. Spending units then inform the Treasury about the payments to be carried out using an informatics tool that facilitates financial programming. Excluding salary payments, in 90% of cases, the Treasury pays providers directly. However, the Treasury does not count on the necessary IT system and the required standardised information to be able to pay salaries directly to civil servants. Funds for salaries are therefore payed to the spending units, which pay salaries.

The government has two financial agents: the *Banco de la República* to process internal payments to beneficiaries that have an account with this bank, and the Central Bank (*Banco Central*) to process international payments and payments to account in private banks. Due to the need to maintain minimum reserves in the *Banco de la República* accounts, these accounts are not remunerated. This does not create incentives to have an active management of the Treasury's assets.

5.2.2. Towards an effective Single Treasury Account

Uruguay has long had a Single Treasury Account legal framework. However, as spending authorisations were higher than liquidity availability, it was common practice that Treasury would not have the necessary funds to pay spending units' commitments or that cash management was used to control achievements of fiscal targets objective. This led to the opening of bank accounts and the building up of liquidity reserves by line ministries. Since 2005, the introduction of top-down budgeting techniques and the matching of the expenditure budget with revenue forecasts allowed Treasury to build trust with line ministries by paying spending commitments on time. This was a necessary step towards convincing line ministries to close their bank accounts. This has further improved with the single account strengthening process that started in 2012, creating a specific unit inside the Treasury to monitor the total amount of accounts and balances. However, there is still resistance to closing these accounts. About 25% of accounts were closed and payments centralised at the National Treasury, and aggregate balances of the remaining accounts are now stabilised. However, the balance of these accounts still represents about 1% of GDP.

5.3. Ongoing modernisation of IT systems

5.3.1. Modernisation of the Financial Information and Management System

The present Integrated Financial Information System (*Sistema Integrado de Información Financiera*, SIIF) was developed in 1999, and with the exception of few changes, has not been regularly updated. Thus, it now suffers from technical and functional rigidities. In particular, in spite of Uruguay having a five-year budget, the present SIIF does not allow to register and consult budget information for more than one year. This prevents Uruguay from reaping the benefits of having a five-year budget for planning purposes.

The MEF is now leading a process to entirely redesign the SIIF, changing the focus of the tool from a mere registration tool to a modern information system. The new system will include the traditional modules of budgeting, cash management, debt and accounting, but is conceived as a broader system, allowing interactions with the management systems of all spending entities (government resource planning procurement system, National Public Investment System (SNIP), strategic planning system, etc.). Contrary to many countries in the region, which have developed fully centralised systems, Uruguay has chosen to develop specific systems for each module, ensuring their compatibility and inter-operability. This aims to give the systems greater flexibility. The development of these systems has greatly benefited from the technical support of the Agency for Digital Government and Information Society (AGESIC). This system will integrate multiple years, and will allow the registration of operations in different currencies. It will also generate government's accounts as well as balance sheets.

Since 2015, the MEF has been working closely with line ministries and spending units to help them develop government resource planning systems (*sistemas integrados de gestión de gobierno*). Previously, most spending units lacked a proper management system, and relied on *ad hoc* software and excel spreadsheets. These systems will interact with and complement the new SIIF. They will help create, use and share information on flows of goods, financial flows and cost structures. The Agency for Digital Government and Information Society (*Agencia para el Gobierno Electrónico y la Sociedad de la Información*, AGESIC) supports the MEF and spending units in the development of these tools. Participation of spending units in this programme is voluntary. The systems thus developed are tailored to the needs and capacities of each institution. This has allowed the development of a system of integrated modules that encompass different aspects of management. They allow a broad vision of entities' strategies at low costs.

5.3.2. Development of other IT budgeting systems

Since 2010, the process for submitting budget initiatives is supported by the System for Submitting Budget Requests (*Sistema de Presentación del Articulado*, SPA). This allows spending units to develop their spending requests in a decentralised way but with a standardised format, then centralise all requests and automatically generate the draft budget law. It has allowed each spending entity to calculate and submit the cost of its policies, which was previously carried out with Excel by the general accounting directorate (*Condaduría General de la Nación*, CGN). Transversal institutions such as CGN, OPP, National Civil Service Department (ONSC) and UPN can simultaneously analyse the proposals, and UPN carries out the synthesis of the observations and inclusion of these into the draft law, which is produced by the system. This system provides monitoring and transparency of all the proposals submitted by each institution, allows the visualisation of changes, comments, decisions on inclusion or rejections, etc. This therefore deeply changed the budget development process, with each actor able to track the treatment of its proposals, and thus modified the roles and interactions of the different actors, giving greater responsibility to spending units.

Since 2012, budget modifications are carried out through an IT system of Management of Budget Modifications (*Gestión de Modificaciones Presupuestarias*, GEMAP). This allowed the standardisation and management of qualitative and quantitative information which needs to be provided for requesting a budget modification, and automatically feed databases to monitor budget execution.

Finally, to balance the inefficiencies of the existing Integrated Financial Information System (SIIF) the UPN and TGN developed a system to project allocation execution and monitor financial execution of the budget. This is part of the System of Projections of Budget Allocations (*Sistema de información presupuestal y financiera*, SIPREF), which allows the analysis and anticipation of monthly cash requirements for each spending unit. By linking budget allocations and cash requirement planning, it allows the Treasury to keep track of payments due.

5.4. Recommendations on budget implementation

R 5.1. Relax human resource budget rigidities

Today, the structure of human resources is described in the budget law, seriously limiting the flexibility of budget holders to reallocate funds or staff. While control over human resources expenditures can have positive consequences for ensuring fiscal sustainability, this control should not affect organisations' capability to perform their functions in an efficient and timely manner.

Recent efforts to introduce budget flexibility in budget allocations should be reflected in flexibility in the human resources structure. While overall expenditure ceilings for human resources expenditure should be maintained, public entities should have some flexibility to adapt their human resources structure to their current and immediate needs.

R 5.2. Support Treasury's efforts to close line ministries accounts

In most OECD countries, carry overs and unused appropriations are strictly regulated (Box 18) and line ministries cannot build up large reserves. In principle, a "steady state" balance of reserve accumulation and draw-down would have a net neutral effect of the fiscal position, while also yielding the management and performance efficiencies outlined above. However, against a background of severe fiscal consolidation, it has proven difficult over recent years to reconcile the need for rigorous control of fiscal aggregates with the potential for large and unplanned reserve withdrawals.

Treasury's efforts to close line ministries accounts can be supported with clearly defined rules about the build-up of reserves, including qualitative and quantitative safeguards. In many OECD countries, carry-overs may be allowed after a qualitative evaluation and/or with quantitative restrictions (Box 18). For example, as part of an evaluation, the Central Budget Authority would approve or reject requests by ministries or agencies to carry-over funds on predefined expenditures programmes.

Box 18. Carry over of unused appropriations in OECD countries

Most OECD countries permit the carry-over of unused funds, mostly subject to *ex ante* approval from the Central Budget Authority. Only four countries (Belgium, Chile, Greece and Mexico) do not permit carry-overs whatsoever and additional three countries (Ireland, Italy and Luxembourg) do not permit carry-overs for discretionary and operational expenditures, while another two countries (the Slovak Republic and Turkey) do not permit carry-overs for operating expenditures.

Similar to Austria, only two countries (Czech Republic and Denmark) do not require a threshold or approval for carry-over of any of the three types of expenditure. Two

countries (Israel and the Slovak Republic) allow carry-over of discretionary expenditures and investment expenditures respectively without approval from the Executive or Legislature and without a threshold. In addition, three countries (Finland, Korea and the United States) do not require approval as carry over is only allowed when specified in the budget law. In Luxembourg most of the investment spending is managed via funds allowing unused resources to be transferred from one year to another (without approval). In the remaining countries some sort of approval is required from either the executive (Ministry of Finance, joint ministers or Cabinet), the legislature, or both. In addition numerical or other limits may apply (see Table A below for examples of restrictions and approval mechanism for carry-overs in OECD countries). Almost all approvals by the executive are according to *ex ante* procedures while three countries use an *ex post* approval from the legislature in a combination with an *ex ante* approval by the executive (Hungary, Italy and New Zealand). A few countries also require *ex ante* approvals from both the executive and the legislature (Australia, Canada, Ireland, Japan, Poland and for some part, Turkey).

Table A. Restrictions for ministers to carry over unused funds on discretionary, operational and investment spending, within their responsibility (2014)

Country	No, carry over not permitted	Yes without a threshold and without requiring any approval	Yes without a threshold but requiring approval	Yes up to a certain threshold without approval, but above this threshold approval is required	Yes up to a certain threshold and also requiring approval	Other	Approval of Ministry of Finance/ Economy	Approval of legislature	Other type of approval
Australia						D; O; I	●	●	○
Austria		D; O; I							
Belgium	D;O;I								
Canada				O; I	D		●	●	●
Chile	D;O;I								
Czech Republic		D;O; I							
Denmark		D; O; I							
Estonia			I		D; O		●	○	○
Finland						D; O; I	○	○	○
Frnce				D; O; I			●	○	○
Germany						D;O;I	●	○	○
Greece	D; O; I								
Hungary			D; O; I				○	◒	●
Iceland									
Ireland	D; O				I		●	●	○
Israel		D	O;I				●	○	○
Italy	D; O				I		●	◒	○
Japan			D; O; I				●	●	○
Korea						D; O; I	○	○	○
Luxembourg	D; O					I	○	○	○
Mexico	D; O; I								
Netherlands					D; O; I		●	○	○
New Zealand					D; O; I		○	◒	●
Norway					D; O; I		●	○	○
Poland						D; O; I	●	●	●
Portugal			D;OI				●	○	○
Slovak Republic	O	I				D	●	○	●
Slovenia						D; O; I	○	○	●
Spain					D; O; I		●	○	○
Sweden				D; O; I			●	○	○
Switzerland			D; O; I				●	○	○
Turkey	O					D;	●	●	●
United Kingdom					D; O; I		●	○	○
Unted States						D;O;I	○	○	○
Russian Federation					D; O; I		●	○	○
Total (countries)	9	5	6	3	9	10	26	26	26

● = *Ex ante* approval	19	6	7
◒ = *Ex post* approval	0	3	0
○ = No approval needed		17	19

Key: M = Mandatory, D = Discretionary, O = Operational, I = Investment
Source: OECD (2014); § 55 and § 56, Bundeshaushaltsgesetz 2013, (Version of 04.12.2017)

R 5.3. Allow flexibility to reallocate funds within programmes in exchange for commitment on budgetary discipline

In many countries, central budget authority has given line ministries discretion over inputs and the possibility to shift resources between inputs in the programme classification, in exchange for the acceptance of strict budgetary discipline. In the United Kingdom, strict ceilings are set at the organisational level (Box 19). Within these ceilings, line ministries benefit from relatively flexible management of funds; they are able to reallocate funds within their responsibility without approval needed from Finance Ministry or Legislature.

Reallocation rules in many OECD countries usually vary according to the kind of expenditure to which they relate. Line ministries/agencies are typically allowed to reallocate a percentage (2-5%) of current expenditure appropriations within programmes and a smaller percentage between programmes. Usually, the approval of both the Ministry of Finance and Parliament is required for larger reallocations or for reallocations across ministries. Appropriations for salaries can typically be reallocated to other operational spending but not the other way around. Countries have different regimes regarding capital spending. Since entitlement spending is sanctioned in law other than the budget, the amount appropriated is usually a non-binding estimate (Hawkesworth et al., 2013).

It should be widely recognised that a programme classification is a contract between the ministry of finance and the line ministries in which discretion over inputs is exchanged for the acceptance of rules of budgetary discipline. This is not to say that, under a programme classification, reallocation of resources between line items (programmes) should no longer be allowed. Even though the need for reallocation automatically decreases when separate line items cover a larger part of ministerial resources, there will still be a need for reallocation between programmes in order to react to new circumstances, a change of political priorities or unexpected developments in the demand for services. This is true for budget estimates, once they have been enacted in the budget laws, but ever more so for the multi-annual estimates, which cover a more distant and therefore more uncertain future.

However, these reallocations should be subject to a strict regime of budgetary discipline that goes beyond the simple requirement that reallocations should be approved ty the ministry of finance or authorised in supplementary laws. In particular, reallocations need to comply with the compensation rules which erect high barriers against overspending on ministerial budgets (OECD, 2007).

In the United Kingdom, line ministries have two types of expenditure ceilings: Departmental Expenditure Limits (DELs) for discretionary expenditure, and Annually Managed Expenditure (AME) for mandatory expenditure (Box 19).

Box 19. Expenditure ceilings in the United Kingdom

The annual budgetary process in the United Kingdom is determined by an expenditure framework that is established at the occasion of a spending review. The framework can vary in length between two and four years. A new framework covering the budget years 2016/17 to 2019/20 has been put in place in early 2016.

The framework makes a distinction between spending that is subject to a Departmental Expenditure Limit (DEL) and Annually Managed Expenditure (AME). The DEL covers central government as a whole and is split in ministerial sub-ceilings. The DELs are set in terms of net expenditure (gross expenditure minus non-tax revenues). The aggregate DEL expenditure path is fixed in light of medium-term macroeconomic forecasts. Since the spending review of 2010, the macroeconomic forecast is produced by the Office of Budget Responsibility (OBR), which is an independent forecasting institution that reports on the public finances. AME spending covers the entire public sector and is in principle not determined by binding limits. AME spending includes, among other things, social security spending flowing from entitlement laws, interest on public debt and spending of local government from local sources of revenue.

The different treatment of DEL and AME was originally aimed to reflect the fact that AME spending is less controllable (e.g. demand driven and volatile). In addition, many areas of spending that are natural macroeconomic stabilisers are AME. However, in the current fiscal climate the importance of controlling AME is firmly recognised. Nowadays, line ministries have an annual total for AME, just like DEL.

During the spending reviews, DELs and AME targets are determined for the medium term after a negotiation process between Her Majesty's Treasury (HMT) and the line ministry in which all trade-offs are considered.

DEL and AME targets are annually updated at so called fiscal events, generally twice a year at the occasion of the Budget submission to Parliament (in March) and the occasion of the Autumn Statement (in November/December). At both occasions, reallocations between ministries are possible, as long as the aggregate DEL and AME targets are respected. Baseline updates (at the line item level) have to be submitted to the Treasury via an ICT system. The ICT system does not accept baseline updates in excess of an approved DEL.

Source: Kraan, D. (2017)

6. Aligning the budget with medium-term strategic planning

According to the second OECD Principle for Budgetary Governance (Box 20), governments should closely align budgets with the medium-term strategic priorities of government including through "organising and structuring the budget allocations in a way that corresponds readily with national objectives", and "showing the correspondence with expenditure objectives and deliverables from strategic plans". However, aligning budget with strategic priorities of government is a challenge in all countries, as by nature, the budget follows an institutional logic, while planning requires a transversal, multi-disciplinary approach. But, plans which are not reflected in budget lines are mere expressions of wishes, rather than a concrete guide towards development and social inclusion.

Box 20. Budget Principle

2. Closely align budgets with the medium-term strategic priorities of government, through:

a) developing a stronger medium-term dimension in the budgeting process, beyond the traditional annual cycle;

b) organising and structuring the budget allocations in a way that corresponds readily with national objectives;

c) recognising the potential usefulness of a medium-term expenditure framework (MTEF) in setting a basis for the annual budget, in an effective manner which (i) has real force in setting boundaries for the main categories of expenditure for each year of the medium-term horizon; (ii) is fully aligned with the top-down budgetary constraints agreed by government; (iii) is grounded upon realistic forecasts for baseline expenditure (i.e. using existing policies), including a clear outline of key assumptions used; (iv) shows the correspondence with expenditure objectives and deliverables from national strategic plans; and (v) includes sufficient institutional incentives and flexibility to ensure that expenditure boundaries are respected

d) nurturing a close working relationship between the Central Budget Authority (CBA) and the other institutions at the centre of government (e.g. prime minister's office, cabinet office or planning ministry), given the inter-dependencies between the budget process and the achievement of government-wide policies;

e) considering how to devise and implement regular processes for reviewing existing expenditure policies, including tax expenditures (see recommendation 8 below), in a manner that helps budgetary expectations to be set in line with government-wide developments.

Source: OECD (2015b)

The first step towards aligning the budget with the strategic government plan is to actually develop such a strategic government plan. As will be developed below, Uruguay has taken important steps towards planning since 2015 and the creation of the Planning Directorate in the OPP. The OPP has carried out prospective studies to 2030 and 2050, but these studies do not yet translate into actual strategic plans, which can be linked to the budgets. Efforts to develop a medium-term government plan, translating medium-term prospective into strategic plans, and linking these to the budget should be pursued.

There are four essential tools to help align the budget with the strategic priorities of government:

1. Medium-term strategic planning: based on the priorities developed during their election campaign, governments should identify their strategic national objectives and develop a set of measurable medium-term high-level objectives for their implementation;
2. Programme budgeting: budget allocations should be organised and structured in a way that corresponds readily with the strategic national objectives, i.e. budget should be structured according to programmes, rather than institutional organisations and inputs;

3. Top-down budgeting: flexibility should be provided to budget holders to allocate funds within the strict ceiling given to them to reach agreed objectives;
4. Medium-term budgeting: greater assurance about multi-year resource availability should be provided to policy planners; and appropriate medium-term goals, with which the resources should be aligned should be identified.

Hence, programme budgeting, combined with effective top-down medium-term budgeting is a supportive measure towards creating a greater link between budgets, plans and policies.

Finally, linking budget allocations of different programmes across different spending units and several years requires modern and well-designed IT systems. IT systems are an essential tool to generate information, and allow informed decision making.

6.1. Recent developments in long-term prospective and medium-term planning

Uruguay is currently working to create a medium-term development strategy based on a long-term prospective vision of the country. However for the moment, governments do not present five-year strategic government plans defining policy priorities which could guide budget allocations. A first crucial step towards aligning budgets with medium-term priorities of government would therefore be to clearly define these and discuss together with the MEF the different policy options to reach them, while preserving fiscal sustainability.

As mentioned in earlier chapters, prior to 2005, the roles of the MEF and the OPP in the budget process were not clearly assigned, and varied depending on which person was working where. Since 2005, the division of tasks has been stabilised in practice, with the MEF focusing primarily on the institutional relations with spending units and fiscal sustainability, while the OPP focuses on the content of the expenditure through the design of budget programmes and the policy impact of spending. Capacities in each institution have been developed. In particular, in 2015, the OPP created the Planning Directorate (*Dirección de Planificación*), to develop strategic planning as a core instrument for public management. It aims to promote a sustainable development, providing a whole of government strategic vision.

The Planning Directorate created a Strategic Planning Unit (*Unidad de Prospectiva Estratégica*), which is currently working to develop an integrated and shared vision for Uruguay 2050, based on a participatory process. To develop this vision, the OPP is working with different government institutions, academia, the private sector and civil society. The OPP aims to produce this report during the 2015-19 government term. However, this document has a prospective objective and does not aim to link these different scenarios to concrete budget policies and actions. It does not require formal endorsement or approval.

The Strategic Planning Unit is also in charge of identifying strategic decisions to turn the 2050 vision into plans programmes and projects, and to design a 2020-30 National Development Plan, which aims to better channel budget resources.

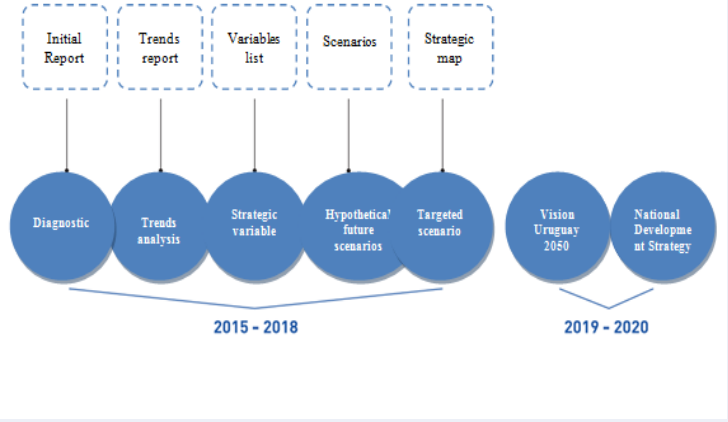
Box 21. National Development Strategy: Uruguay 2050

The Strategic Planning Unit (*Unidad de Prospectiva Estratégica*) of Uruguay is currently working to develop an integrated, participative and shared vision for Uruguay 2050. The main objective of the national development strategy is to have a planning tool that:

1. aligns different views and objectives to create a shared view that guides the planning process of future governments;
2. provides clear guidelines to frame the different public agencies and ministries plans;
3. defines achievable targets with a specific timeframe;
4. provides clear steps towards achieving these targets; and
5. provides inputs for strategic decision making with a medium and long-term perspective.

The plan has two thematic elements as key elements for development: 1) demographic change and transformation of the production model; and 2) three horizontal thematic elements: gender, cultural development and territorial development.

The plan will be prepared according to the following calendar:



Source: OPP (2019)

6.2. Programme budgeting and performance indicators

Programme budgeting promotes closer linkages with the medium-term planning and developmental processes by facilitating a clearer focus on the outputs and impacts of public spending. Indeed, programme budgeting involves the structuring of the budget by reference to functional and/or strategic programmes, as distinct from traditional financial "line items", heads and subheads of expenditure, assigned on an institutional basis. Programme budgeting is one common technique of "performance budgeting" and has been embraced by many countries. The perceived advantages of the approach include enhanced monitoring

of programme effectiveness; improved allocative efficiency; and greater transparency to stakeholders (especially parliamentarians) with respect to the use and impact of public funds.

6.2.1. Reform of the programme structure of the budget in 2010

While formally, Uruguay's budget has always been structured by programmes prior to 2010, these only corresponded to the institutional structure of spending entities. They did not really reflect operational programmes. In recent years, the OPP has done important work on long-term planning and defining budget programmes and performance indicators. This initiative is coherent with the approach of the MEF, who would like to get a better understanding of what lies behind the budget allocations, and how these transform into services and goods for citizens. Since the 2010-14 budget, there has been a deep change in the conception of the budget, grouping budget allocations by programme area, and introducing a programme structure that aims to link the budget with the government plan. However, as this section will show, the definition of programmes could be further improved to make performance budgeting a more effective tool to reach medium-term objectives. Indeed, in spite of the OPP's efforts to create a programme structure, budget discussions are still predominantly based on institutional lines rather than programmes.

In Uruguay, OPP is leading this reform since 2010. It first defined 17 programmatic areas (health, education, culture, gender, etc.), with an 18th area (energy) being added in 2015 (Box 22). These were discussed with the MEF, which strongly supported this move and agreed to apply the new structure to the whole budget.

Each programmatic area is divided into several programmes. Programmatic areas and programmes were designed to be shared among different line ministries. For example, the programmatic area public security is composed of four programmes: 1) prevention; 2) repression of crime; 3) protection around jails and 4) domestic violence. While public security is mainly the responsibility of the Ministry of Interior, the protection around jails is carried out by the Ministry of Defence. The Ministry of Interior, the Ministry of Social Development (MIDES) and the Ministry of Education all carry out actions for the domestic violence programme. On the other hand, the Ministry of Interior contributes to 11 programmes: training and capacity building, social assistance and integration network, social security, registry of firms, information and registry of people and goods, integral health attention, occupational health, prevention and repression of crime, roads security and prevention and fight against fire.

Budget programmes include both operational and capital expenditure. Each budget programme receives a specific code in the Integrated Financial Information System (SIIF).

The OPP has worked and continues working closely with line ministries and Art. 220 Entities to help them define their mission and actions, but are not yet able to cost these. Together, they develop performance indicators (*indicadores de contexto*) and institutional management indicators (*indicadores de gestión a nivel institucional*). This will be developed in more detail in the next chapter.

6.2.2. Introduction of new IT tools

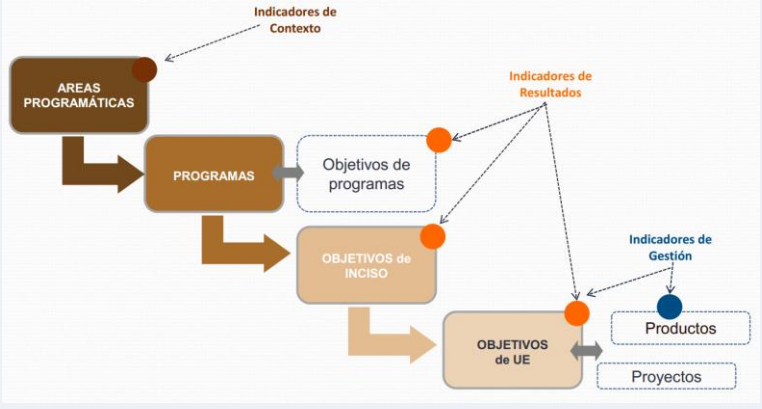
In parallel, the MEF leads a programme to build capacity in line ministries for better management of their budget, the Programme for Strengthening Budget Management (*Programa de Fortalecimiento de la Gestión Presupuestaria*). This programme focuses on products and costs. It benefits from technical support from the Agency for E-Government

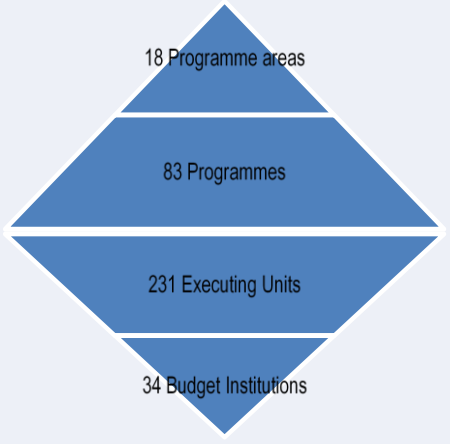
and Information and Knowledge Society (*Agencia de Gobierno Electrónico y Sociedad de la Información y del Conocimiento de Uruguay*, AGESIC). Ministries can apply to this programme by submitting a project to the MEF. The main objective of the programme is to strengthen the capacities of budget holders to plan and execute budgets, in particular by modernising their IT support systems. It finances and co-ordinates the implementation of Government Resource Planning Systems (GRP, *Sistemas Integrados de Gestión*), budget control systems, contract management tools, etc. This programme is mainly dedicated to support functions of ministries, such as HR, budget, accounting, purchases, contract management, inventory management, etc. It supports the development of information tools, the definition and update of standards and processes as well as training to improve management capacities of civil servants.

6.2.3. Programme structure of the budget since 2010

The new budget structure determines 18 programme areas. Programme areas represent the functions that governments carry out, and which by their continuity in time, go beyond government terms (Box 22).

Box 22. Programme structure of the Uruguay Budget





Programme areas:

1. Justice administration
2. Legal issues
3. Science, technology and innovation
4. Monitoring and transparency
5. Culture and sports
6. National defence
7. Productive development
8. Education
9. Infrastructure, transport and communication
10. Environment and natural resources
11. Social security and social protection
12. Books and official information
13. Health
14. Public security
15. General public services
16. Work and employment
17. Housing
18. Energy

Source: Data provided by OPP

Each programme area is composed of several budget programmes. These correspond to the budget allocations in the budget law. Budget programmes must be transversal and be associated with a statement of objective. Programmes refer to the combination of activities carried out to achieve government's objectives, through the production of goods and services.

Executing units, budget institutions (*incisos*) and programmes each have objectives. Programme objectives are qualitative descriptions of the policies to be implemented through the co-ordinated action of the different institutions involved in the programme. Budget institutions objectives state the broader results that the budget institution should achieve in the medium-term. These objectives are determined in accordance with the government framework of strategic priorities. The sum of budget institutions objectives constitutes the strategic plan of the budget institution. Executing units' objectives describe the results that the executive unit aims to achieve in the medium term. The sum of executing units' objectives constitutes the strategic plan of the executing unit. Each of these objectives must be associated to at least one indicator and target, which will allow the measurement of the achievement of the objective.

Products are the goods and services produced by the executing units for external users, combining several inputs. Identifying the goods and services produced by each executing unit has been an important task carried out by the MEF together with budget institutions and the executing units. This work is associated with the Government Resource Planning activities.

Projects are the budget instrument to allocate resources within each programme. These can be either investment projects or operational projects.

Uruguay distinguishes two types of indicators: 1) output indicators (*indicadores de resultados*), which measure the capacity of the institution or programme to solve the problems which are described in its objectives; and 2) management indicators (*indicadores de gestión*), which measure the way in which executing units provide the goods, considering the use of inputs and processes.

Information on programmes, objectives and targets are presented in the volume II of the budget law, called "Planning and Evaluation". This volume is prepared by the budgeting control and evaluation department (AGEV) of the OPP (Box 23).

Box 23. Structure of the 2015-19 budget document

The budget information consists of the budget document (five volumes) and three important documents: the Economic and Financial Report and Bill's explanatory statement; the Budget Analysis report and the Justification of the budget initiatives (*Fundamentación del articulado*).

1. Economic and Financial Report and Bill's explanatory statement

This document is prepared by the Macroeconomic Assessment Unit and UPN. It analyses the macroeconomic and fiscal context and projections and the determinants of fiscal space; explains the priority policies of the governmnet; analyses the execution and budget modifications; and reports the use of resources in previous years and results achieved.

2. Budget Analysis report

This report is prepared by UPN based on information provided by the National General Accounting Department (CGN), the National Civil Service Department (ONSC) and the budget institutions. It provides a simple display (through graphs and summary tables) of the budget allocation and execution of the budget institutions and information regarding their human resources, revenues and some products.

3. Justification of the Articles

This volume explains analyses and substanciates the budget modification proposals. It is prepared by UPN based on information provied by the budget institutions (*incisos*) in the System for Submitting Budget Requests (SPA).

4. The five-year budget document consist of five volumes:

1) Volume 1: Summaries

Chapter 1 (CGN):

Total budget by budget institution (*inciso*), years 2015 to 2019

Information by programme area, allocations provided by programme, by budget institution (*inciso*), by programme and budget institution combined, and by type of expenditure (current: salaries, operational, current transfers; and investment: goods, capital transfers). Years 2016 to 2019.

Chapter 2: revenues

Chapter 3: balance sheet

Chapter 4: comparisons (current vs projected for years 2015-2019)

Volume 2: Planning and evaluation (OPP)

Part 1: Information by programme area

Short description of the programme area

List of programmes: programme number, programme name, objective of the programme, reach of the programme, validity of the programme, budget institutions which participate in the programme.

Part 2: Information by institution

For each of the 34 budget institutions:

mission, vision, programme areas where the budget institution and its executing units participate (programme area, name and number of the programme, objective of the programme, reach, validity, executing units which participate).

For each programme area: description each programme within the programme area, objective of the budget institution for this programme, list of executing units which participate.

For each executing unit: description of the objective of the executing unit for the programme, **indicators for the objective** of the executing unit (name of the indicator, description, formula for calculating indicator, unit, validity, baseline – year and value; objectives – year and value).

Volume 3: Current expenditure and investment (CGN)

Volume 4: Revenues (CGN)

Volume 5: Structure of positions and contracts of civil service (ONSC)

Annexes

Source : MEF (2019) and CGN (2019)

Sectoral strategic plans are developed by the budget institutions themselves, and the Art. 220 Entities which wish to do it, based on methodological guidelines developed by OPP. The identification of programmes within the programme areas, and how each contribute to the overarching result is still a work in progress, carried out by the OPP in collaboration with line ministries. For continuity purposes, the OPP decided to keep as many of the existing programmes as possible, with only the necessary adjustments for the 2015-19 budget.

Participation of the Art. 220 Entities in the new budgetary format varies from one institution to the other. While their status of budgetary autonomy does not oblige these institutions to follow the government's guidelines, many have taken part in the process.

6.3. Medium-term budgeting

Most OECD countries use medium-term expenditure frameworks (MTEFs) as the main tool to integrate a medium-term perspective in their annual budget processes (see Budget Principle no. 2c, Box 20). MTEFs strengthen the ability of the government collectively, and of the Ministry of Finance in particular, to plan and enforce a sustainable fiscal path.

If properly designed, a MTEF should force stakeholders to deal with the medium-term perspective of budgeting and budgetary policies rather than adopt an exclusively year-by-year approach. MTEFs typically cover a period of three to four years and aim to improve the quality and certainty of multi-annual fiscal planning by combining prescriptive yearly ceilings with descriptive forward estimates. 'Estimates' in this context are calculations of how expenditure, revenue and the aggregate fiscal position will turn out under certain assumptions.

While the budget in Uruguay is for five years, in practice, Uruguay does not yet reap the full advantages of having a multi-year budget to improve planning and prioritise expenditure on a multi-annual basis. Indeed, budget discussions de facto take place annually during the budget "updates" (*rendición de cuentas*), The MEF has created an internal information system which allows it estimate budget allocations and executions for the full five-year budget. This system allows the MEF to see budget allocations of coming years, and carry out estimations of execution. However, this system is for internal use only.

Uruguay sees its five-year budget as fundamentally different from a MTEF because it creates allocations which are entitlements to spend, while a MTEF's allocations are only indicative and do not constitute a right to spend. It would therefore be legally difficult for Uruguay to reduce a budget allocation of future years in case of economic downturn,[13] while it would be feasible (even though politically very difficult) for countries to reduce future appropriations within a MTEF. However, considering out-year allocations as budget "floors" rather than budget "ceilings" is not unique to Uruguay. While some countries do consider the MTEF's allocations as ceilings (the United Kingdom, the Netherlands, Sweden), this is not always the case. Austria for example reformed its budget process between 2009 and 2012, introducing top-down budgeting and a MTEF. However, a recent review by the OECD shows that the budget reform has not yet proven effective in increasing the perception of financial discipline within line ministries. Indeed, the multi-year expenditure ceilings are not yet regarded as "fixed" due in part to an established practice of continual adjustment. In fact, several stakeholders in Austria have expressed their concerns that a cultural change has not yet taken place and that expenditure ceilings are seen by line ministries as minimum and, essentially, as the basis for negotiations, rather than as an effective ceiling within which resources will be stewarded. Other countries on the contrary have used MTEFs to phase in spending cuts. During the crisis years 2008-2012, Ireland actively used its MTEF to set downward expectations for line ministries: the ceiling figures for future years were cut, and ministries were expected to put forward reduced annual budget requests to stay within the ceilings.

6.4. Suggestions for ways forward to improve alignment of the budget and strategic planning

6.4.1. Suggestions for improving strategic planning

The main rationale for national planning is to enable governments to envision and achieve a future that differs from what would occur if the future were not planned. Strategic planning considers how changes in the policy environment make existing plans or budgets obsolete or open opportunities for new policies. The changes may be technological, economic or demographic.

Few OECD countries have national planning systems. Most European countries had national planning systems in place, typically with five-year plans, but many were removed in the 1990's. For example, France's last five-year plan was 1989-92. Korea terminated its

planning ministry a few years ago because government perceived that it needs to turn to different policy instruments. In most OECD countries, the political platform of the government has taken over planning functions. Fragile countries on the other hand generally have planning systems, but those are ineffective because their plans promise more than the government can deliver. Developing countries have the most potential for using and benefiting from national planning. Plans can prepare the way for investments and policy initiatives that stimulate development. Most Latin-American and Asian countries make use of national planning systems.

Without effective planning, governments may give inadequate attention to future development opportunities, as the budget short-term view may ignore considerations of social needs. But subordinating the budget to national planning would weaken fiscal discipline. Planning and budgeting should therefore coexist: separate, but linked. A country benefits from the different perspectives of planning and budgeting: it is useful to plan for social needs independent of the budget; but it is necessary to have realistic budgets that are financed with available resources.

R 6.1. Develop a medium-term government plan, in coordination with the MEF to ensure it is fiscally feasible, and reflected in the five-year budget

The OPP is currently working on a Uruguay 2050 prospective vision and aims to design a 2020-30 National Development Plan, but the country still lacks a government medium-term strategic plan which could drive its policy choices and budget. But the test of national planning is not whether the plan makes promises but whether expected social and economic transformations are realised. And for plans to get implemented, it is necessary that they are linked with the budget. Otherwise they are unrealistic and lack resources needed to implement them.

A good starting point would be for each government to develop its five-year strategic plan, using the reports prepared by the OPP as inputs, and in close co-ordination with the MEF to discuss the financial implications of the different strategies, ensuring the fiscal sustainability of the chosen path. Given the multi-year dimension of the budget in Uruguay, it is essential to ensure that the five-year budget is closely linked to the priorities and objectives identified in the government strategic plan. Ideally, the plan should be structured by programmes, which mirror the programme structure of the budget. This would probably require changing the structure of the budget, as will be addressed in the coming recommendations.

OECD best practices suggest that strategic priorities of governments should be turned into concrete, measurable and costed medium-term plans. These plans should be easily accessible on official websites, be composed of a limited number of high-level objectives, and show indicators, which allow for the monitoring of progress. Box 24 presents the medium-term planning framework on the European Union.

Box 24. Europe 2020 10-year plan

The Europe 2020 framework was established in 2010 as a 10-year "jobs and growth strategy" for the EU, succeeding the "Lisbon Agenda" of the previous decade. It aims to be an organising framework for EU policy making, focused upon 3 pillar objectives – smart, sustainable and inclusive growth. The framework includes specific, high level targets for the EU, to be achieved by the year 2020, under five headings.

The Europe 2020 strategy is also underpinned by a number of "flagship initiatives" in the various policy domains, and these in turn are supported by sector-specific frameworks. For example, under the pillar of Smart Growth, one flagship initiative is the "Innovation Union", which is supported by the Horizon 2020 framework programme for the research & development programme, one of the Europe 2020 flagships, directing EUR 80 billion of funding during the period 2014-20.

Europe 2020 – 3 pillars, 7 flagship initiatives, 5 headline targets

Flagship policy initiatives:

PILLAR 1 – SMART GROWTH	DIGITAL AGENDA FOR EUROPE INNOVATION UNION, YOUTH ON THE MOVE
PILLAR 2 – SUSTAINABLE GROWTH	RESOURCE-EFFICIENT EUROPE AN INDUSTRIAL POLICY FOR THE GLOBALISATION ERA
PILLAR 3 – INCLUSIVE GROWTH	AN AGENDA FOR NEW SKILLS AND JOBS EUROPEAN PLATFORM AGAINST POVERTY
HEADLINE TARGETS	TO BE ATTAINED BY 2020:
1: **Employment**	→ 75% of people aged 20-64 years to be employed
2: **Research & Development**	→ 3% of the EU's GDP to be invested in R&D
3: **Climate change and energy sustainability**	→ greenhouse gas emissions 20% (or even 30%, if the conditions are right) lower than 1990 → 20% of energy from renewables → 20% increase in energy efficiency
4: **Education**	→ Reducing the rates of early school leaving to below 10% → at least 40% of 30-34–year-olds completing third level education
5: **Fighting poverty and social exclusion**	→ 20 million fewer people in or at risk of poverty and social exclusion

Source: Downes et al. (2017a)

R 6.2. Set performance targets and milestones in the plan

Without targets, progress is difficult to monitor. Plans should focus on high-level results; detailed results are better suited for the budget. The plan should specify the socio-economic changes expected from proposed policy initiatives. Estonia provides a good example of setting precise targets for policies: it has different government plans, each of which comes

with a small number of detailed targets (Box 23). The OPP is doing an important work in gathering indicators for different sectors (as in the Uruguay 2015 report), however to date, these mainly focus on inputs and activities, rather than products and results. This kind of information should be used as the basis for developing plans and setting targets.

Box 25. Estonia's key national strategies

Strategy	Time horizon	Ministry/unit responsible	Goals and objectives
Government Programme 2014-2015	For the term of the government, (i.e. in this case less than one year)	Strategy Unit, Government Office	14 policy areas covered, with 4 key quantified priorities: – Reducing the poverty of children: Reducing the absolute poverty rate of children to 8.4% – Reducing the tax burden of labour: Reducing the implicit tax rate on labour to 33.2% – Securing Estonia's national security: Ensuring the state's readiness to cope with internal and external threats. Defence expenditure remaining at the level of 2% of GDP – Sustainable public finance: General government's budgetary position in 0.2% structural surplus
Government Programme 2011-2014	For the entire term of the government (i.e. usually for four years)	Strategy Unit, Government Office	Seven quantified priority areas, covering 55 objectives in 18 different fields of policy: – Reduce the share of early leavers from education (18-24 year-olds) – Increase productivity per employed person compared to the EU average –Increase the employment rate in the 20-64 age group – Increase the tertiary educational attainment (30-34 year-olds) – Structural surplus of the government budget – Achieving positive population growth – Level of greenhouse gas emissions does not exceed 2010 level
National Competitiveness Strategy "Estonia 2020"[1]	2020	Strategy Unit, Government Office; State Budget Department, Ministry of Finance	Two primary challenges: – Increasing the employment rate in the 20-64 age group to 76% – Increasing productivity per employed person compared to 80% of the European Union average
State Budget Strategy	4 years, rolling	State Budget Department, Ministry of Finance	Four priorities and 22 strategic objectives with approximately 80 indicators. Divided between 14 policy areas, following the structure of the Government Programme.
National Security Concept of Estonia[2]	No time frame, renewed periodically	Ministry of Defence, co-ordinated with Government Office[3]	The National Security Concept states the foundations of the Estonian security policy (adopted in 2010). It lists the activity trajectories in four areas – foreign policy, defence policy, security policy, societal coherence and endurance. Based on the overarching concept, the National Defence Strategy was adopted and National Defence Development Plan for 2013-2022.
Estonian National Sustainable Strategy: "Sustainable Estonia 21"[4]	Until 2030	Strategy Unit, Government Office	– The viability of the Estonian cultural space – The growth of welfare – A socially coherent society – Ecological balance

Source: OECD (2015a)

R 6.3. Make sure government priorities are reflected in budget decisions

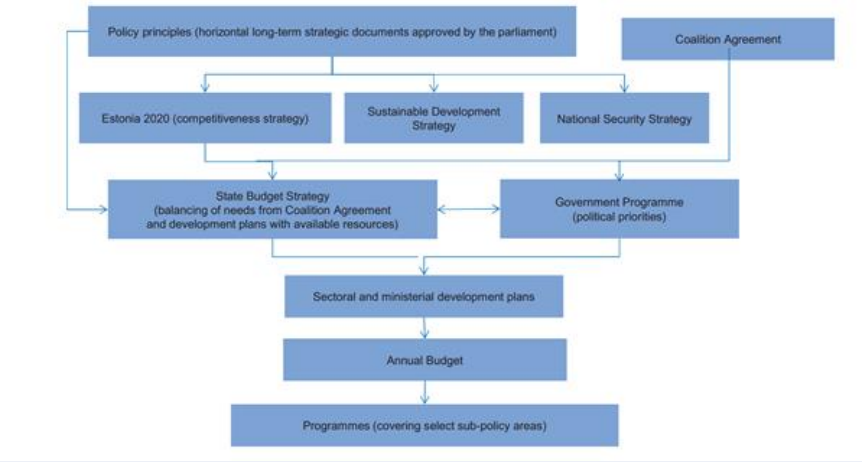
Making sure that government priorities are reflected in the budget will only be feasible if the MEF has been sufficiently involved in the development of the plan. Translating plans into budget allocations is challenge for all countries. Estonia has developed a special unit to ensure that government priorities are effectively reflected in budget allocations (Box 26).

Box 26. Role of the Government Office's Strategy Unit in Strategic Planning in Estonia

The Estonian Strategy Unit is responsible for translating the Coalition Agreement into the Government Programme and actionable commitments for implementation by the government.

- It leads the translation exercise of the coalition's political commitments into the Government Programmes, working with the other centre of government institutions and with line ministries on translating political commitments into action plans
- This includes refining the policy objectives by sector and sub-sector along with the performance information needed to assess whether departments and ministries eventually achieve the results to which the government commits under its programme.
- It sustains close working relations with the network of deputy secretaries-general responsible for policy in line ministries for this purpose and for monitoring performance as these action plans are being implemented.
- It sustains close working relations with the Ministry of Finance to ensure that the government Programme, the National Competitiveness Strategy and the multi-year budget framework are linked.

Strategic planning in Estonia, 2014



Source: OECD (2015a)

R 6.4. Ensure that planning and budgeting information systems are integrated

Planners and budgeters often use incompatible information systems, which greatly reduces the relevance of the plan, and the chances that it influences the budget. As Uruguay is in the process of modernising its IT systems, MEF and OPP should co-ordinate to ensure that they do not develop parallel systems, which would duplicate some information and would not allow the necessary exchanges between budgeting and planning information.

6.4.2. Suggestions for improving programme budgeting

Programme budgeting in Uruguay is still a formal exercise with very little real impact on budget discussions and allocations. It is considered as an instrument to classify expenditures, and not a basis for budget discussions. The only exception to this is the Integrated National Care System (*Sistema Nacional Integrado de Cuidados*), which is a programme with a single head – even if the execution of the programme is divided among several budget institutions (*incisos*). Most programmes do not yet create clear links between budget allocations, products, objectives and performance indicators, and programmes are not used by line ministries to guide their decisions.

While this reflects the usual difficulties inherent to changing the government culture towards a programme and performance-based budget state of mind, it is also due to the programme structure, with programme areas and programmes being shared among ministries, and ministries participating in many different programmes, many of which do not constitute their core function. Such a split structure does not create ownership and accountability for the programmes, or the right incentives to improve efficiency in service delivery. Uruguay could therefore envisage a new reform of the programme structure of its budget, in light of OECD best practices, in order to facilitate discussions regarding objectives and programmes, and alignment between budget allocations and government priorities.

International experience in introducing programme budgeting

Introducing a programme structure in the budget requires a deep cultural change, both for the budget authorities (MEF and OPP), and for line ministries. As in all countries prior to the introduction of programme budgeting, line ministries in Uruguay lack a clearly defined mission, and a vision about the activities they carry out, how much these cost, and how they are linked to the results they aim for. International experience suggests that programme budgeting should be implemented in a progressive manner, shifting from detailed "line-item" budgeting to programmatic and thematic budgeting, in an effort to promote greater engagement with the policy content and "meaning" of budget allocations. In many countries, programmes are selected within the context of a policy "cascade" from high strategic and developmental goals which inform medium-term and specific outcome goals, in turn informing departmental or sectoral objectives and associated output targets and deliverables. Once programmes have been selected, countries can then move to allocate clear assignment of responsibility (organisational and, ideally, managerial) for the achievement of the selected programmes and targets (Box 27).

Box 27. French programme budgeting system

In 2001, France enacted a new organic budget law including a well-defined programme structure, shifting budget classification from nature of expenses to public policy objectives. According to this new approach, the budget must be divided into missions, programmes and actions:

- A mission covers a series of programmes designed to contribute to a specific public policy. A mission can involve a single ministry or several ministries. The Parliament cannot change or adjust the Missions. It has to accept the budget allocations proposed by the executive government and has power only to vary the allocation between programmes.
- A programme covers a coherent set of activities of a single ministry targeted to a specific public policy objective. If more than one ministry participates in a large public policy, each of them should have a separate Programme, covering its own responsibility in that matter, and ensuring co-ordination. Thus a programme corresponds to a centre of responsibility. Accordingly, for every programme, a programme director is appointed. All the resources from the State Budget should be allocated and spent within a Programme. In a similar way, resources allocated by the Parliament to a particular programme cannot be spent by the ministers for another programme.
- An action covers a set of operational means to implement the programme. The budget breaks down resources allocated to the actions of each programme; however, this break down is indicative and not committing. There is indeed a high degree of freedom for expenditure choices for ministers, in order to allow the Programme to reach its forecasted performance. However, there is one exception to this increased freedom: appropriations for personnel are not indicative but binding, in an asymmetrical way: personnel appropriations can be used for other purposes, but appropriations for other purposes cannot be used for personnel costs.

The Organic Budget Law prescribes an extensive performance reporting process to integrate performance information in the budget system through the following two types of mandatory budget documents: annual performance plans (*projets annuels de performances*, PAP) and annual performance reports (*rapports annuels de performances*, RAP). For a given mission, the PAP provides a detailed description of its purpose, goals, policy targets and performance indicators. As part of the annual budget act, the PAP documents are forward looking and are meant to contribute to the public debate about the costs and benefits of public policy. The RAPs are published in the first quarter along with the budget review act; they focus on performance achievements and provide detailed information on programme implementation and results. The RAPs are thus backward looking and tend to contribute to the public debate on the administration's performance.

Source : République Française (2019) and Moretti and Kraan (2018).

R 6.5. Programmes should be ministry-specific

Uruguay has chosen to set programmes and programme areas which run across different institutions. This was the approach followed by countries that have introduced

programmatic classifications in the 1970s and 1980s, and failed (Box 28). Indeed, today's more pragmatic approach consists of trusting that the existing organisational structures are the optimal response from ministers and directors general to the challenges faced by their institution and the policy goals they seek to achieve. Furthermore, frequent restructuring of the ministry's units and divisions reflects the evolution of priorities within the ministry and government.

Box 28. Modern paradigm for introducing programme budgeting

In general, the programme classification closely follows the organisation structure of the line ministry, so that every director general is made responsible for one or more programme line items and there are no overlapping responsibilities. Thus directors general are appointed as budget holders and made responsible for results as well as budgetary discipline for (each of) the programme(s) assigned to them. Overlapping responsibilities, in the sense that several directors general are responsible for the same line items, inevitably lead to problems. Even more problematic are overlapping responsibilities between line ministries. In practice, the reclassification has sometimes led to a reflexion on the organisational structure of ministries and the division of tasks between ministries. However, this tendency should be avoided, because embarking upon a general discussion about the organisation of government would bring any reclassification exercise to a halt. Countries that have introduced programmatic classifications have initially stayed as close as possible to existing organisational structures on the assumption that, once the programme classification is in place, existing problems in organisational structures can be addressed. Implicit in this assumption is that these problems will probably be addressed all the more rapidly once they are reflected in the programme classification, because in that case they will cause additional difficulties by being entangled in the debates over resources.

The pragmatic approach followed by countries that have introduced programmatic classifications in the last decade stands in contrast to the attempts that were made in the 1970s and 1980s to introduce programme budgeting. In those exercises, starting with the "Planning Programming Budgeting System" (PPBS) under the Johnson administration in the United States, and followed by many similar reforms in European countries, the starting point was always to develop a logical programme structure based on policy objectives, regardless of the organisational structure of government. Implicit in this approach was that the existing organisational structure was historically determined and inherently arbitrary, but that this did not matter because the budget could be reclassified according to actual policy objectives anyway.

The early reforms were based on the idea that organisational structure was not relevant for the budget classification, whereas the recent reforms suppose that the organisational structure itself is based on the best available programme structure, so that there need not be any inconsistency between the two. In the latter view, the organisational structure is evolving in a separate process. Line ministers are regularly reorganising their ministries. They are splitting and margin divisions in order to create new units under the new authority for policy objectives that they consider as more important than the objectives that motivated

the previous organisational structure. There is no implication however, that after reorganisation, the need for horizontal co-ordination will disappear. Such a need will never go away. If the responsibility for youth protection in located in a different division (or even ministry) than law enforcement, there will still be a need for horizontal co-ordination between officials who take care of youth delinquency.

The essential point is that the existing organisational structure reflects the actual policy objectives as ween by the line ministers (or the cabinet) in the best possible way. In this view, the budget classification has to follow the organisational structure.

Source: Kraan, D. (2008)

Having shared responsibilities for programmes and objectives weakens accountability for achieving results. It also undermines the role of budget programmes and their objectives as the basis for budget discussions and allocations. Internalising programmes within single ministries also allows for the identification of overlaps between different ministries, thus encouraging the rationalisation of responsibilities and organisational structures.

Uruguay's 2010 budget structure reform was a good step towards changing the culture of the budget, but authorities should consider redefining the budget programmes following international best practices, i.e. ensuring that each programme is embedded in a single ministry.

R 6.6. Reduce the number of programmes per ministry, concentrating on the core functions of these

Today, Uruguay has 34 budget institutions (*incisos*) and 83 programmes divided into 18 programme areas. This leads some programme areas to be shared across institutions (on average, there will be about two institutions per programme area). Potentially, each budget institution could manage two to three programmes, but as the present structure requires programmes to be shared across ministries, each has on average about ten programmes. Many of these programmes are very large and generically defined and have little to do with the core responsibility of the ministry. This decreases the likelihood that the ministry will devote efforts and resources to the programme. For example, the Ministry of Interior is part of the "occupational health" programme.

Programme budgeting in Uruguay would be more effective if the number of programmes under the responsibility of each budget institution was reduced and reflected the core activities and purpose of budget institution. This would also facilitate setting objectives, and monitoring performance of the programmes.

R 6.7. Programmes should be based on clear outputs delivered to citizens, and the administrative budget should be separated from the operational budget

Many budget programmes in Uruguay are not based on outputs delivered to citizens, but on internal services to staff or other internal activities. Good programme budgeting practices do not consider internal services (such as ministries' human resources management, legal support or accounting) as outputs (Box 29). These should therefore not constitute budget programmes.

Uruguay clearly distinguishes in budget allocations the transfers that the institutions make to citizens, from their operating expenditures. For example, in the case of the Social Development Ministry (MIDES), these transfers include the payments of Uruguay Social cards, transfers to NGOs which collaborate with the Ministry. However, internal services and operations are considered as separate budget programmes.

In their discussions with line ministries, budget authorities in Uruguay could start working towards separating their budgets between operational and administrative expenditure. All internal support services should be grouped in a single "administration" programme, which should be discussed separately from the core programmes of ministries. This administration programme will then constitute a core element in the calculation of the expenditure baseline, and its growth should be closely monitored to ensure fiscal space (see recommendations below).

Box 29. Advantages of separating operational and administrative budgets

The central budget authority and parliament are often worried about authorisation of the administrative expenditures of line ministries. The concern is that resources intended as subsidies, cash transfers to citizens, and grants to local governments will instead be used for the recruitment of additional staff, improvement of office buildings or other administrative expenditures. Keeping the administrative budget of the core ministry separate from the operational budget can minimise the risk of using operational budgets to increase administrative expenditure, as in this case, the administrative budget cannot be increased by moving programme spending into the administration budget.

As far as core ministries are concerned, the risk of spending more on administration to the detriment of programmes is aggravated by the problem of splitting administrative budgets of core ministries into programme areas. For this reason, some governments (e.g. the Netherlands, Sweden, the United Kingdom) that have moved to programme budgeting have exempted administrative budgets of core ministries from the programme classification or have maintained separate line items for administrative budgets in general. Administrative budgets consist of staff pay and office development and legislation, support divisions like finance, human resources, communications, internal audit, legal services and ICT, and technical and maintenance and catering services. Administrative budgets of core ministries may represent only a small part of the overall budget (less than 10%). Keeping the administrative budget of the core ministry separate does not mean that ministers cannot reprioritise spending – e.g. spend more on staff at the expense of other administrative budget items – but that they cannot increase the administrative budget by moving programme spending (subsidies, cash transfers, grants, etc.) into administration (Kraan, 2008).

These elements are possible when budgetary control and appropriation are undertaken on a programme basis. In more advanced models, administrative costs are apportioned across programmes using an objective methodology (ideally agreed in advance with line ministries and with key stakeholders including the supreme audit institution) but pay and non-pay administrative costs are reported as separate items alongside the programme details. This approach

allows for monitoring and comparison of staff efficiency ratios in different programme areas.

Source: Kraan, D. (2008)

R 6.8. Ensure clear responsibilities for programmes

Once programmes are precisely defined, and embedded within one budget institution, Uruguay should clearly identify the manager responsible for each of these, to ensure proper incentives for managers and accountability.

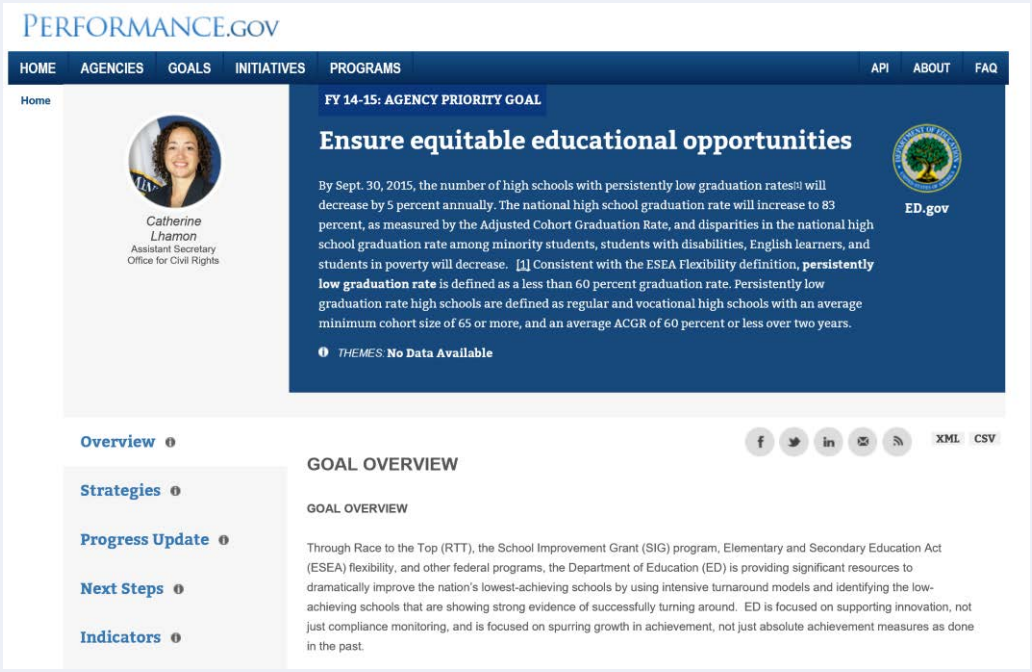
Programme setting should be guided by bottom-up reasoning based on the sectoral laws and policy structures that are currently in place. In the countries that have introduced a programme classification, it is generally done under the common responsibility of the line minister and the central budget authority (usually the minister of finance). Usually, every director general is made responsible for one or more programme headings and there are no overlapping responsibilities. Thus directors general are appointed as budget holders and made responsible for results as well as budgetary discipline for the programme(s) assigned to them. Box 30 shows how programmes are clearly linked to one specific official in the United States. In this context, countries that have introduced programmatic classifications have initially stayed as close as possible to existing organisational structures on the assumption that, once the programme classification is in place, pre-existing challenges in organisational structures can be addressed.

Box 30. United States "Agency Priority Goals"

The US government Performance and Results Modernisation Act 2010 created a more defined performance framework by defining a governance structure and by better connecting plans, programmes and performance information. The law included specific requirements for performance reporting by Federal Agencies. Specifically, it requires the head of each agency to identify a small number of "Agency Priority Goals" from among the agency's performance goals. The responsibility for achieving the goal is clearly assigned to one specific manager. The Director of the Office of Management and Budget (OMB) has the authority to determine the total number of agency priority goals across the federal government, as well as the number of priority goals to be developed by each agency. A limited number of cross-agency Priority Goals are also adopted to improve cross-agency co-ordination and best practice sharing.

For the fiscal year 2012-13, there were 103 Agency Priority Goals in total for 24 agencies, along with 14 Cross-Agency Priority Goals. Agencies outline long-term goals and objectives in their strategic plans, and annual performance goals in annual performance plans. All this information is available on line at www.performance.gov

Example of a webpage of a specific goal:



Source: US Government Office of Management and Budget
www.performance.gov/node/5562/?view=public

R 6.9. Ensure flexibility of budget holders to reallocate funds within their budgets

It should be kept in mind that the essential aspect of programme budgeting is the discretionary authority of line ministers and budget holders over resources, in particular the possibility to shift resources between inputs (Kraan, 2008). Rigidities deriving from public sector labour law reduce the possibility of shifting funds from labour to other categories of spending in the short run (due to the lifetime nature of civil service in Uruguay). However, staff could be moved from one programme to another within a ministry.[14] However, reassigning positions from one executing unit to another would require a decree or a law. In the 2008 General Revision of Public Policies (RGPP) for example, France set the target of replacing only half of retiring civil servants in order to reduce public workforce.

R 6.10. Avoid information overload and ensure active involvement of Parliament

Finally, a critical lesson from OECD countries in advancing with a programme budgeting system has been the need of avoiding information overload and securing the interest and buy-in of parliament and the public for the programme budget as the focal instrument of policy-making (Box 31).

Box 31. Parliamentary engagement and performance information

Budget approval at a programme (more aggregate) level fundamentally alters the way a parliament, and its committees, hold government to account for budgetary decisions. Parliamentary engagement is needed if a performance budgeting system is to "come alive" but in practice parliaments often face challenges in using performance information effectively. Links between performance information and budget allocations tend to be very loose, or only indirect, and there are inherent difficulties in documenting clear links between funding and outcomes. In addition, while outputs can be attributed to a specific programme and fiscal year allowing government bodies to be held accountable for their delivery, with outcomes it is often impossible to clearly attribute responsibility for failure or success. While programmes should be linked to outcomes so that their effectiveness can be assessed against stated objectives, large-scale introduction of outcome information into the annual budget documents will more likely hinder than facilitate parliamentary scrutiny.

Another key challenge for parliaments is information overload. A few good measures can go a long way toward understanding performance. Too much information on all budget levels impedes oversight and makes it difficult to identify political priorities. This challenge highlights the importance of engaging the legislature in thinking strategically about what information is most useful in its budgetary deliberations and on how the presentation of performance information should be designed. In addition, parliaments may wish to take a proactive role in reviewing the quality of indicators.

In Austria, a subcommittee of the Budget Committee plays this role. The Budget Committee is also assisted by a Parliamentary Budget Office (PBO) with a unique mandate in relation to performance budgeting. Parliamentarians have found this particularly useful. Among its performance-related work, the PBO:

- creates maps with overview of performance information (objectives, measures and indicators) to improve transparency
- provides general information on key performance budgeting questions and issues (e.g. understanding outputs versus outcomes)
- analyses the outcome orientation in the performance information (e.g. stronger harmonisation of targets between different line ministries)

Performance reports sent to the legislature should make key messages visible and accessible and help parliamentarians to identify and focus on performance information for programmes with the greatest financial or societal impacts. Parliaments can also assess performance through other budget-related processes such as impact evaluations or value-for-money audits, particularly those that focus on effectiveness of individual programmes. The German Parliament provides an example of good practice. Its audit committee is a sub-committee of the Budget Committee ensuring that members can easily draw on their knowledge of audit information when making budgetary decisions.

R 6.11. Present all information related to the budget in a dedicated web site

Today, there are several institutions, and within these institutions, different directorates and units who carry out work related to the budget: forecasting, budgeting, defining the programmes and targets, evaluation reports, etc. All the information produced is accessible on the web. However, the user needs to know which institution and unit within government has produced the information to find it, as information is published on each unit's own page. This makes it very difficult for citizens to be aware of what information exists, and to find it and use it.

To facilitate users' experience and disseminate budget-related information more broadly, Uruguay should create a dedicated webpage for each five-year budget. This dedicated web-page should gather all the relevant information regarding the five-year budget, and should not be attached to any specific institution: the five-year budget document, macroeconomic projections, debt evolution, information on programmes and targets, reports such as the Uruguay 2015, performance evaluations, development of long-term vision to 2050, etc. Australia has a good example of such a dedicated website for each year's budget. The webpage: www.budget.gov.au provides easy access to all the documents and information that citizens may need regarding the budget.

6.4.3. Proposed steps to advance medium-term expenditure management

Uruguay could make better use of its five-year budget for medium-term budgeting. While it is recognised that there are clear differences between a five-year budget and a MTEF, Uruguay could adapt some features of a well-functioning MTEF to its five-year budget to make it a more useful tool for planning. Some of these features could be particularly useful for phasing in and phasing out policies, and allowing budget holders to plan and prioritise their actions, while ensuring fiscal sustainability.

As will be further developed below, Uruguay should make a clear distinction between expenditure ceilings and baseline estimates. It could start by building baseline estimates, i.e. estimations of the cost of current policies, grounded upon realistic forecasts. In parallel, Uruguay should agree on fiscal targets for the five-year budget period (such as debt or deficit targets) and calculate the expenditure ceilings coherent with these targets (from total expenditure to sectoral ceilings). Comparing the baseline estimates with the ceiling for each year would provide an indication of whether expenditures should be cut (by efficiency gains of by phasing out programmes), or whether there is fiscal room to increase expenditure (in line with the government medium-term strategic plan). Budget estimates should be updated regularly to monitor available fiscal space, and the need to anticipate or delay implementation of programmes to stay within the agreed fiscal targets. Transforming the five-year budget allocations into binding budget ceilings probably can't be achieved immediately. However, Uruguay could envisage setting strict expenditure ceilings for the year t+1 of the budget on a rolling basis.

The different stages of this process are detailed below.

R 6.12. Distinguish between expenditure ceilings and baseline estimates

In all medium-term budget frameworks, expenditure ceilings and baseline estimates of actual expenditures are important components but have different purposes and functions.

Baseline estimates are estimates of actual measured expenditures over the medium term. The role of baseline estimates is to describe a reliable picture of the future budgetary consequences of current laws and/or policies at any given point in time. These estimates

are calculated for every single line item based on the most recent macroeconomic outlook for the economy and other relevant information, such as the most recent outcome.

Medium-term estimates must be given the same importance as budget year figures in updating current year; and following budget year and medium-term years should be updated in the same process. Total expenditures are the sum of baseline line item estimates. Together with revenue baseline estimates calculated on the same premises, these give the best possible indication of the development of public finances in the medium term provided that no new policy is enacted.

Expenditure ceilings, on the other hand, define a binding constraint on some level of aggregation. Normally, an aggregate ceiling corresponds to total expenditures and in some countries the aggregate ceiling is broken down into sectorial ceilings. A ceiling is normative in character, whereas estimates are descriptive. A ceiling marks the maximum level that actual estimated expenditures cannot exceed.

Box 32. Expenditure ceilings vs. baseline estimates in Sweden

Expenditure is classified into 27 Expenditure Areas, which form a basis both for budgeting and reporting on performance. The aggregate expenditure ceiling for the third year is proposed in the budget bill in the autumn. At the same time, expenditure frames (i.e. estimates of existing expenditure under no policy change) are presented for each of the Expenditure Areas for the next fiscal year, and indicative expenditure frames are presented for the outer years of the medium-term framework.

These indicative expenditure frames are not binding. The function of the expenditure frames is to provide clear budget constraints for (a) the government's internal processes of budget re-prioritisation and reallocation and (b) the Parliament's two stage decision process for the budget. The expenditure frames also give policymakers a reasonable perspective on the level of resources likely to be available for their sectoral areas each year.

This principle of compliance with the expenditure ceilings appears to be widely understood within Sweden's public administration, and lends a strong, medium-term continuity to the budgeting and planning processes.

Sweden's fixed expenditure ceilings and indicative frames for Expenditure Areas provide a solid framework for realistic discussion about policy priorities and trade-offs. The top-down system requires that new spending priorities must usually be matched with offsetting savings elsewhere within that expenditure area, unless there is some scope for unfinanced reforms and the reform is of high political importance. In a normal year a large part of the budget requests is rejected by the Ministry of Finance, either because of a lack of corresponding expenditure cuts or because of a risk of reduced efficiency.

Source: Information provided by the Central Budget Authority, Sweden

R 6.13. Produce baseline budget estimates for the five-year budget cycle

In the case of Uruguay, the allocations in the five-year budget are mostly determined by the level of the past allocations with a marginal increase, and not by the projection of the

cost of current policies, i.e. they are not baseline estimates; and they are usually considered as a spending floor, rather than a ceiling.

In order to make better use of its five-year budget both to ensure fiscal sustainability and for planning purposes, Uruguay should complement the five-year budget with a document showing the medium term evolution of budget baselines.

Forecasts for baseline expenditure should be based on information and realistic assumptions about the consequences and costs of current policy, taking into account the development of demand, and of alternative or proposed policies. Multi-annual estimates that do not take future outputs into account and only result from a mechanical extrapolation of the trends in input costs will be intrinsically unreliable.

Inflation represents a special case regarding changes in costs per service. OECD countries that have moved to a programmatic classification use mainly two mechanisms for the compensation of cost inflation (wage costs and procurement costs). The first mechanism entails that budgetary and multi-annual estimates are stated in fixed prices of the previous year and that there is a separate line item for nominal compensation on the basis of multi-annual inflation forecasts. Compensation takes place by reallocation from this line item during the execution year on the basis of observed inflation. The second mechanism entails that inflation forecasts are built into budgetary and multi-annual estimates. In this case, inflation setback and windfalls are not automatically compensated but may, under certain conditions (large deviations, specific line items such as salaries), be compensated from a contingency fund. Whatever the mechanism, budgetary and multi-annual estimates should be updated as soon as new observations and forecasts become available.

R 6.14. Clearly explain budget estimates, preferably in terms of outputs and costs per unit

Explanations in terms of outputs and costs per unit (PxQ) make it possible for the ministry of finance and the parliament to shift attention from inputs to outputs in the exercise of their supervisory tasks. In general, explaining estimates in terms of outputs and costs is easier for programmes concerning the provision of individual goods (education, health care services, social security benefits, tax administration, promulgation of licences, etc.) than for programmes for the provision of collective goods (police services, national defence, road construction, etc.). The reason is that the financing rules for individual goods are usually less complicated than for collective goods. Nevertheless, in both cases, these rules are usually far too complicated to be reproduced in the budget documentation. It is therefore necessary to limit the PxQ explanations to a rough summary of the actual financing rules, which allows the users (ministry of finance, parliament, citizens) to assess the plausibility and acceptability of the estimates.

In cases where outputs are not used in any way to finance the services – for instance, the service is provided by a single national agency (the foreign service, the armed forces) or in the case of unique infrastructure projects (construction of airports, harbours or bridges) – an explanation of the estimates based on inputs (number of staff, office equipment, construction materials, etc.) should still be required.

Today, the OPP is working with line ministries and other budget holders to design their programmes, helping them define their objectives, and aligning the programmes and actions with these objectives. On the other hand, the MEF is also working with line ministries and budget holders, to develop their information systems and capacities for improving their management skills. These two approaches would benefit from increased

co-operation between the OPP, MEF and budget holders working together to define their programmes, actions, cost and build the relevant IT systems for effective management.

R 6.15. Regularly update baseline estimates

Baseline estimates need to be regularly updated for the Government to be able to evaluate actual expenditures against the ceiling. There will be different reasons for amending baseline estimates, and these should be treated differently in the budget process.

First, amendments may arise from changing external circumstances. For example, under existing laws or policies, demand for services may be larger or smaller than foreseen at the time of budget approval. Equally, cost per service unit may be larger or smaller. Updates with regards to external circumstances should be done at the start of budget preparation and regularly during budget execution. The role of these updates is to inform political decision making with respect to the medium-term framework and the ceilings. In other words, updated base line estimates are the basis in the evaluation over the medium term of whether there is room for new spending or a necessity for consolidation.

The frequency of baseline updates varies among countries. For instance, Denmark updates three times a year (a four-monthly cycle), the Netherlands has a monthly cycle (meaning that line ministries have to report monthly to the ministry of finance on their most recent updates), and Sweden updates four times a year (a three-monthly cycle). Box 33 describes budget estimates updates in Sweden.

Box 33. Regular updates of budget estimates in Sweden

Sweden's Ministry of Finance devotes a lot of attention, throughout the course of the year, to keeping abreast of annual and medium-term economic and fiscal developments and feeding these analyses into budget preparations. In fact, a full set of economic projections is prepared five times during the year, two of which are directly for publication, the other three being mainly for internal use.

The January/February forecasts set the scene for the annual fiscal policy preparation process, using the latest outturn data from the previous year. This set of forecasts includes, for the first time, the projections for the incoming fourth year of the multi-annual cycle. Another set of forecasts are prepared in March to inform the preparations for the Spring Fiscal Bill, and so are published. In May/June, the figures are updated once again to set a basis for negotiations with line ministries on their budget requests. In August/September, the new round of forecasts is used to inform the Budget Bill and is published in that context. In December, an internal set of forecasts is produced showing the updated end-year projections.

The economic projections from December to August are based upon existing policies and rules for expenditures and revenues (adding to the baseline the impact of measures in the spring supplementary budget, although these measures normally affect only the current budget year). In light of this, the Ministry of Finance assesses whether the forecasts and baseline projections are compatible with compliance with the fiscal rules in each year. Any remaining fiscal space is referred to as "room for reform". If no fiscal room is available, consolidation measures may need to be brought forward for consideration in the context of the

subsequent negotiations with line ministries. All of these elements – forecasts, baseline analysis, expenditure limits and frames for Expenditure Areas – are presented in the Spring Fiscal Policy Bill in mid-April along with the government's narrative of economic policy and outlook.

Source: Information provided by the Central Budget Authority, Sweden

Baseline estimates must also be amended when new policies or substantive laws are decided or enacted (Box 34). This reason for amending is essentially different from the reasons mentioned above in that it arises from ministerial or cabinet decisions. Whereas updates with regards to external circumstances should be done regularly, decisions on new policies need to consider the evaluation of regularly updated baseline estimates against the ceilings.

Box 34. Updating entitlement expenditure in OECD countries

In most OECD countries, the largest part of the central government budget is determined by expenditures based on large demand-driven entitlement laws in the sphere of education, health, social security, agricultural subsidies and grants to local governments. This implies that the reliability of the multi-annual estimates for these programmes deserves special attention.

In many OECD countries, these estimates are produced by large automatic forecasting models owned by the line ministries. These models can also simulate the budgetary consequences of changes in the entitlement laws. However, given the importance of these forecasts for the macroeconomic steering of the budget, it is important that independent experts also look at these forecasts. In countries where independent public forecasting bureaus exist (the Netherlands, the Nordic countries), these bureaus have a role in the updating or supervision of these estimates.

Source: Kraan, D. (2008)

R 6.16. Set medium-term budget ceilings based on the government's medium-term fiscal objectives

By their very nature, high-level fiscal ceilings are set in a medium-term context. The ceilings may be updated annually or fixed for a period (Box 35). For the medium-term framework to work effectively, estimates and ceilings need to be reconciled within the context of a forward-looking approach to budgetary planning and policy formulation.

Accordingly, Uruguay should clearly state the government's medium-term fiscal objectives in terms of high-level targets such as the level of aggregate revenue, expenditure, deficit/surplus and debt. It should also facilitate stakeholders in identifying the policy choices and trade-offs that will be necessary considering the estimates of what would happen in the following years based on unchanged policies.

Box 35. Main characteristics of Sweden's MTEF

Sweden's multi-year budget framework operates on three cascading levels. The first level constitutes the articulation of the government's fiscal policy objectives in macroeconomic terms, i.e. the level of surplus or deficit as a percentage of GDP. At the second level, these objectives are translated into a maximum level of total expenditure based on certain economic assumptions. At the third level, the limit for total expenditure is further operationalised by giving indicative funding levels for each of 27 Expenditure Areas.

The multi-year budget framework is legally binding. Parliament approves the maximum level of total expenditure for the government (Level 2) and the indicative level of funding for each of the 27 Expenditure Areas (Level 3). The amount of spending authorised in the annual budget is below the spending ceiling amount for that year, thus leaving a "budget margin" to deal with uncertainty. The purpose of the budget margin is to provide a buffer against any forecasting errors so that the maximum level of total expenditure approved by Parliament will not have to be amended. As a result of cautious planning and the existence of the budget margin, the Swedish expenditure ceiling has never been breached since its introduction, even during the recent economic crisis.

Sweden maintains a three-year forward ceiling that is updated on an annual basis by adding a new ceiling for the second out-year (this was legally required in 2009). As a multi-year budget framework is in place, the starting point in the annual budget exercise is to update the information for Year 2 in the framework. The multi-year budget framework therefore provides an "anchor" for the annual budget process and thereby fosters discipline.

The key political commitment to aggregate fiscal discipline is to remain below the three-year nominal ceiling on central government expenditure. The ceiling is not revised once set and an additional year is added to the ceiling each autumn alongside the budget. With regards to policies, nominal medium-term estimates are set for 27 expenditure areas, which are updated twice a year to reflect changes in macroeconomic factors and policy changes.

In addition, each of the 500 appropriations, the budget is defined in the medium-term to remain constant in nominal terms, to be updated with inflation or to be determined by volume. Dependent on its definition, the medium-term estimate for each appropriation is update twice per year together with the budget.

The cabinet's annual budget retreat in the spring is the focal point for all major expenditure decisions, the outcome of which is an agreement on the level of expenditure for each of the 27 expenditure areas.

Sweden's fixed expenditure ceilings and indicative frames for Expenditure Areas provide a solid framework for realistic discussion about policy priorities and trade-offs. The top-down system requires that new spending priorities must usually be matched with offsetting savings elsewhere within that expenditure area, unless there is some scope for unfinanced reforms and the reform is of high political importance. The officials of the Ministry of Finance can exercise the prerogative to de-prioritise proposals that intrude upon the fiscal constraints or

are considered inefficient, whereas significant proposed additions, with policy sensitivity, can be escalated for decision at political level.

While budgeting in Sweden retains an annual legal character, in practice the multi-year framework imposes significant constraints upon what may be decided during the annual process. The law provides that, as is the case in many other OECD countries, the annual fiscal and budgetary documentation includes details for the budget year and a perspective on the following two years. For each of these three years, an overall, aggregate expenditure ceiling is proposed for approval by the *Riksdag*, and each ceiling has de facto binding effect. (In practice, since 2014 Sweden has provided data for an additional year, with an indicative non-binding expenditure ceiling, so that the perspective of medium-term framework spans four years.)

While there is nothing in the law preventing the *Riksdag* from re-opening the fixed expenditure ceiling each year, no government has to date changed the expenditure ceiling which it has introduced. The Ministry of Finance maintains the position that the expenditure ceilings may not be re-visited from year to year, as to do so would undermine the effectiveness of the medium-term framework. The law requires that once an expenditure ceiling has been approved by the *Riksdag*, the government must take all necessary measures to avoid exceeding the ceiling, including proposing legislative measures to the *Riksdag* if necessary.

Source: Downes, R. et al. (2017b)

R 6.17. Uruguay could start by providing fixed ceilings for the first outcoming year

Uruguay could not credibly commit to fixed expenditure ceilings for the five years of its budget cycle, as it would not be possible to have reliable forecasts of the relevant underlying variables (such as growth, interest rates, unemployment rate, etc.). The average length of MTEFs in OECD countries is 3 to 4 years, and several countries only consider one year ahead of the budget year (Box 36). Using this as a reference, Uruguay could start by setting binding expenditure limits for year t+1 within the five-year budget, based on the macroeconomic assumptions prepared by the Macroeconomic Assessment Unit, and the target level of fiscal balance. These ceilings should be set at very aggregate level (expenditure area for example). Each year, a new ceiling for year t+1 would be discussed and fixed, in a rolling fashion.

Box 36. Key features of the budget process in Slovenia

Budget preparation in Slovenia proceeds according to the calendar set out in the Decree on Strategic Development Documents and on the Bases and Procedures for Preparation of a Proposed National Budget. The first budget circular from the Ministry of Finance should arrive within five days after the session of the Government where the ceilings of the MTEF are decided. This session must be held before the end of June.

The circular includes ceilings for expenditures of ministries and select other spending units in the upcoming budget year and one subsequent year. These are decided by the Government on the proposal of the Minister of Finance. The ceilings are based on the spring economic forecast produced by the Institute of Macroeconomic Analysis and Development (IMAD) and targets for deficit reduction.

Slovenia has an annual budget cycle. However, normally the Government proposes and Parliament approves every year the annual budgets for two subsequent years. This implies that the proposal that the Government annually submits to the Parliament is formally a proposal to change the budget for the upcoming year, and to establish the budget of the subsequent year.

Source: Kraan, D. (2017)

R 6.18. Expenditure ceilings should be kept at a rather aggregated level, providing only estimations of budget lines below

Keeping expenditure ceilings at an aggregate level (by programme area for example) allows governments to reap the benefits of controlling the expenditure growth path. Indeed, it provides line ministries and spending units with predictability in their revenues to carry out their policies, while at the same time, they retain sufficient flexibility to move funds around and reprioritise policies if the socio-economic context or political priorities evolve. Some countries exclude sectors such as health and social security from the expenditure limits, as these are based on mandatory expenditure, over which the government has no real control (Box 37).

The expenditure ceilings should show the correspondence with expenditure objectives and deliverables from national strategic plans. They must therefore rely on the programme budgeting framework.

Box 37. Legal status of the MTEF in the United Kingdom and in the Netherlands

United Kingdom

Since the 1980s, many important changes in the budget planning process took place in the United Kingdom. These included the development of a full medium-term framework for planning public expenditure; the introduction of a programme structure to the budget and performance assessment frameworks between the Treasury and line departments; and periodic expenditure reviews.

The UK MTEF does not hold legal status as it is solely approved by the Ministry of Finance and does not go through legislative approval. The UK is the only OECD country, along with Chile, in which this is the case. The MTEF is monitored through government reports to parliament.

The MTEF is only adjusted after a government's term, making it very a strict framework (along with that of The Netherlands). When line ministries submit their spending requests, they must do so under the ceilings specified by HM Treasury at organisational level. HM Treasury's influence and authority is also characterised by the fact that it is the Finance Minister, and not Cabinet – which

is often the case in OECD countries - who is responsible for resolving disputes between ministries in the budget formulation process.

Netherlands

Since 1992, the Netherlands has a four-year MTEF, which is the average duration for an MTEF in OECD countries. Both the MTEF and ceilings have a basis in law, but not the lower level estimates. The MTEF requires cabinet approval, but does not require approval from the legislature. Government reports to parliament on progress to date on implementing the MTEF.

The ceilings are fixed for the four-year government period. Objectives, performance targets and resources are all agreed when the MTEF is set. Fixed ceilings in effect mean that expenditure ceilings are completely separate from revenues. These characteristics make the Dutch system one of the least flexible MTEF in OECD countries. While this is an effective system for fiscal discipline and planning, it is less suited to allow flexibility and reallocation of resources in response to changing conditions or policy priorities.

The Netherlands has a binding overall expenditure ceiling, with sub-ceilings for three broad sub-sectors relating to core central government, health care and social security. The first sub-sector is further divided into thirteen sub-ceilings for ministries.

Source: OECD

R 6.19. Expenditure ceilings framework should include sufficient institutional incentives and flexibility to ensure that expenditure boundaries are respected

A possible drawback of setting fixed expenditure ceilings for outgoing years is the lack of flexibility to accommodate to changing economic situations (letting the automatic stabilisers play) or new political priorities. It is therefore important to build in the system mechanisms for flexibility. Using "budget margins", i.e. a buffer amount, which is not allocated in the budget below the expenditure ceiling, can provide the needed flexibility, from year to year, to respond to emerging pressures without re-opening the overall expenditure ceiling for that year. It is important to note that such a budget margin is not included within the budget figures, i.e., it is not an appropriated amount, and therefore if it is drawn upon, it will cause the fiscal balance to deteriorate – while staying under the fiscal target. Sweden is a good example of using budget margins (Box 38).

Box 38. Sweden's budget margin in practice

The budget margin is a tool to balance the medium-term rigour of the Swedish framework with year-to-year flexibility. The margin is calculated according to the guiding principle that actual expenditures should be allowed some leeway to move automatically in response to macroeconomic developments, without jeopardising the overall expenditure ceiling. To achieve this, the Ministry of Finance guidelines specify that the budget margin should amount to 1.5% of ceiling expenditure for the budget year (year y), 2% for the following year (year y+1) and 2% for each of the following two years (year y+1 and y+3). In practical terms, the budget margin is left unaccounted for (and unbudgeted for) within the annual

budget allocations and multi-annual expenditure ceilings. The budget margins are not regarded as "contingency reserves" but rather as operational stabilisation mechanisms.

Calculation of the fixed expenditure ceiling and budget margins 2015-18 *SEK billion, rounded*

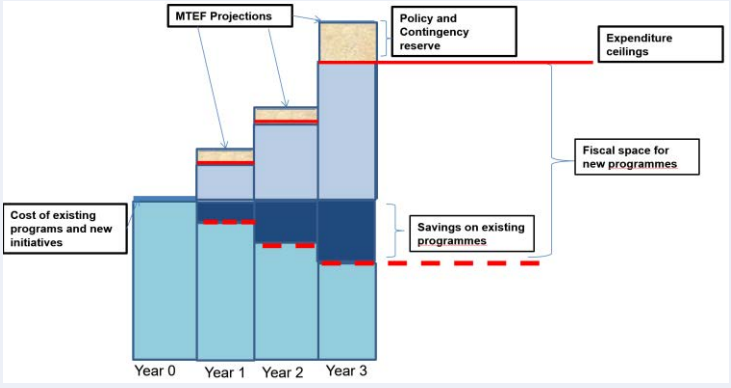
Heading	2015	2016	2017	2018
Expenditure Areas 1 – 27	872	923	959	980
Less debt interest (area 26)	846	912	938	954
Old age pension expenditure	267	286	302	319
Ceiling-restricted expenditure	**1 113**	**1 198**	**1 240**	**1 273**
Budget margin	47	17	33	59
Expenditure ceiling	**1 158**	**1 215**	**1 274**	**1 332**

Source: Adapted from Swedish Ministry of Finance.

In light of the projected pressures arising principally from refugee costs, the fiscal forecasts presented as part of the Spring Fiscal Policy Bill in 2016 do not meet the above minimum guidelines for all years of the forecast period.

Source: Information provided by the Central Budget Authority, Sweden

Box 39. MTEF, contingency reserves and fiscal space for new programmes



Source: Authors.

7. Measuring results

One of the most challenging elements of budgetary governance is ensuring that public funds, once they have been allocated and spent, can be subject to ongoing monitoring and evaluation to ensure that value-for-money is being attained. OECD budget principle 8 calls for: *"evaluating and reviewing expenditure programmes (including associated staffing resources as well as tax expenditures) in a manner that is objective, routine and regular, to inform resource allocation and re-prioritisation both within line ministries and across government as a whole" and for "taking stock, periodically, of overall expenditure (including tax expenditure) and reassessing its alignment with fiscal objectives and*

national priorities, taking account of the results of evaluations; noting that for such a comprehensive review to be effective, it must be responsive to the practical needs of government as a whole".

Programme monitoring and evaluation (M&E) is a tool for the assessment and improvement of policies, and for the reallocation of resources to where they can achieve the greatest impact. The monitoring dimension of M&E involves using data generated during programme execution to ensure compliance with budgetary restrictions and to assess achievement of objectives. Systematic evaluation of programmes uses standardised, professional methodologies to allow a broader re-assessment of the policy rationale for a programme's continued existence, in light of other modalities and competing policy priorities, and to ensure that lessons learned can be integrated in policy revision.

7.1. Measuring results

In recent years, Uruguay has carried out efforts towards creating and improving processes for measuring results.

7.1.1. Yearly reporting in Budget Updates

The annual budget update report has the same structure as the five-year budget. The budgeting control and evaluation department of OPP prepares Volume II, which provides both financial and performance information.

Information is presented by budget institution (*incisos*). Section 1 presents the mission and vision of the institution (as entered in the Strategic Planning System, SPE). Section 2 presents a synthesis of achievements. A first sub-section presents financial information: distribution of allocations per programme and executing unit, execution of funds by programme. The second sub-section summarises the achievements of targets, providing the share of achieved/not achieved goals by programme and executing unit. The third sub-section describes the performance of "institutional planning", i.e. the size of the deviation from the initial target (green if deviation less than 25%, yellow if deviation above 25%, red if deviation cannot be measured). This does not measure whether goals were over or under performed, just whether they were consistent with the plan. Section 3 shows the indicators by executing unit, presenting the previous year's value, the target, and the achieved value. Section 4 provides management reports. These are syntheses prepared by the budget institutions following OPP's guidelines, presenting the mission and vision of the institution, its performance in the past year, a section on gender equality policy, a summary of qualitative and quantitative aspects of the past exercise, and challenges for the coming year.

However, performance indicators measured focus mainly on processes and intermediary goods (ex. Number of institutions audited, number of student who received the communication material, number of agreements with municipalities, etc.), rather than outputs and outcomes (which could be growth of the production level, growth in exports, etc.). As mentioned in previous chapter, such a report would benefit from a better definition of programmes and performance indicators.

7.1.2. Report on outcome and outputs by programme areas, 2015

In 2015, the OPP produced a report called "Outcome and outputs by programme areas (*Contexto y resultados en áreas programáticas, 2015*). This is a useful report, linking planning (statement of objective of programme areas and programmes), budgeting (funds allocated and executed by programme) and results (outcome and output indicators). This

information is presented in a simple, user friendly way. The first section shows a pie chart with the distribution of expenditure by programme area. Then, for each of the 17 programme areas (in 2015), it provides the reach or the programme area, the link with the Sustainable Development Goals, the distribution of executed budget by programme area and by budget institution, and outcome (*indicadores de contexto*) and output (*indicadores de resultados*) indicators. It is a pity however that the statements of objectives of programme areas and programmes do not provide targets for these indicators.

7.1.3. Reporte Uruguay

Since 2009, the OPP and the Ministry of Social Development (Ministerio de Desarrollo Social, MIDES) produce every two years a report on social outcomes in Uruguay. Since the 2015 edition, this report takes the more general name of "Reporte Uruguay", as it incorporates additional areas, not strictly related to social outcomes, but important for sustainable human development. The report is divided into three sections. The first section exists since the 2009 report, it gathers and analyses trends in social indicators, such as: revenues, inequality and poverty, labour market, housing and habitat, education, culture, health and public security. Since 2015, it presents a second section on key areas for sustainable human development: productive development, science, technology and innovation, energy, environment and natural resources. The third section concentrates on special needs groups: early childhood development, youth, the elderly and aging, persons with disabilities, Afro-Uruguayans, and gender.

This report aims to inform citizens about social outcomes, to provide inputs for an evidence-based dialogue on policies and results. However, it does not aim to link these outcomes to policies, rather to analyse trends in outcomes, which go beyond a government term. There is therefore no link to the budget programme areas or programmes, and it does not provide medium-term targets for the indicators presented. Still, the areas covered are very close to the 18 programme areas, and it would be only a small step to fully link these.

7.2. Design, implementation and performance evaluations

Many countries carry out efficiency-focused expenditure reviews to examine the existing allocation of resources from the perspective of value-for-money, without necessarily questioning the policy rationale of the various programmes. Opportunities for efficiency savings can be found in areas of waste or duplication, but can also arise from inefficient policy instrumentation: subsidies on desirable behaviour instead of taxes on undesirable behaviour; the use of subsidies instead of well-designed regulation; in-house production instead of out-sourcing and external service delivery (whether by the private sector or by specific public agencies); earmarked grants to local government instead of block-grants or tax-sharing. More fundamentally, efficiency reviews may also encompass a systematic "establishment update" to examine the staffing levels, management structure and strategic mandate of public institutions.

In Uruguay, the Directorate for Management and Evaluation in OPP carries out this type of reviews, called "design, implementation and performance evaluations" (DID). DID evaluations aim to facilitate organisational learning, improve management of public services, and support budget decision-making process. They analyse the performance of a public action, identifying aspects which can be improved, and give the evaluated institution recommendations for improving its management. Such evaluations are also used to identify programmes in different institutions which have similar objectives, target population and actors, and which could therefore be merged to provide better results in a more effective

way. For example, this type of analysis has shown that different Ministries offered similar programmes of support for entrepreneurship, and citizens could apply and receive subsidies from various Ministries for the same project.

These evaluations are based on the matrix of objectives (*Matriz de Objetivos*, MO) of the intervention. They identify the adaptation between the programmes and the objectives. They are short (5 months on average), and carried out by external evaluators, followed by the AGEV-OPP team. The evaluations provide recommendations. There are no sanctions if these are not implemented.

While the primary objective of these evaluations is to support institutions in improving their management practices, the results of all the evaluations are publicly available on the OPP website.

7.3. Management agreements (Compromisos de gestión)

Management agreements are used as an instrument to achieve committed targets. They have been introduced at a small experimental scale in 2006 and generalised and institutionalised in 2009, with the creation of a commission for management agreements between OPP, MEF and ONSC. These agreements state the targets to be reached and actions to be carried out, in exchange for financial resources. These agreements focus on measures for improving public management. They are used within the public administration, associated with wage incentives. They allow for the recognition of the effort and commitment of civil servants in achieving the targets of their institution. Management agreements are also used with external institutions, such as state-owned enterprises, and agencies that receive public funds. In practice however, there are no management agreements in place with Art. 220 Entities.

Management agreements are contracts between the institution and its parent ministry. They are managed by the Commission for Management Agreements which is headed by the OPP and composed of the MEF and ONSC. It is an instrument for ensuring alignment of the institution's policies and actions with the government's sectoral priorities. The institutions involved must implement or improve their management evaluation mechanisms, which often requires updating or developing new IT systems.

This instrument is helpful to create a discussion about and agree on clear goals for spending institutions, and to create incentives for changing behaviours and processes. However, they are linked to wage incentives and transfers for basic operating expenditures, which sometimes leads to the reduction of the scope of the targets.

7.4. Recommendations for improving measurement of results in Uruguay

Measuring results is still a relatively new exercise in Uruguay, and it requires a cultural change among key players that takes time. Since 2010, under the leadership of OPP, Uruguay has put in place the basis for linking budgets to results, but the road to reap the most benefits from this process is still long.

R 7.1. Redefine programmes as described in Chapter 6

Uruguay is in the process of reforming its budget culture by introducing modern tools such as programme budgeting. However, Section 6 has shown that there is still room for improvement in the definition of programmes, in order to make them more relevant for policymaking. A preliminary step to improve the usefulness of results evaluations is therefore to redefine the programmes in a way that are more relevant for policymaking, as

analysed in Section 6. Indeed, evaluations and indicators can only be useful for policymaking if they are linked to relevant programmes and targets.

R 7.2. Ensure that strategic plans presented by line ministries are consistent with their programme areas, objectives and main programmes

As a result of the present definition of programmes, strategic plans presented by line ministries on their webpage are not consistent with the programme areas' objectives, and main programmes for which they are responsible. This runs the risk of the performance information process becoming a pure check the box exercise, with no real impact on the institutions' policies. The programmes should be defined in a way that is coherent with the strategic goals of line ministries, and both should be discussed together to ensure coherence.

R 7.3. Set a very small number of high-level outcome targets per programme area, which should be clearly defined and discussed

Today, Uruguay is missing clear, high-level targets linked to clearly defined government priorities.

As mentioned in the previous section, the choice made by Uruguay to create programmes which are carried out by different institutions also makes the evaluation of the results achieved by each institution more difficult. To some extent to compensate for this, quantitative targets are set at a very disaggregated level: the executing unit level. In addition, these targets are process targets rather than output or outcome targets. This necessarily implies a great number of targets. While this approach may be appropriate for monitoring the executing unit's activity, the targets are too many and too detailed to drive policy discussions within government or in parliament. Broader goals would generate more discussion and debate regarding the most efficient way to allocate funds to achieve government priorities and national targets. France has integrated performance information and discussions since its 2001 reform (Box 40).

Box 40. Integrating performance information in the budget in France

As to integration of performance information in the budget system, the French *Loi Organique relative aux lois de finance* (LOLF) voted in 2001 and operational since 2007, prescribes an extensive performance reporting process. This process is integrated into the budget cycle through two new types of mandatory budget documents, namely annual performance plans (*projets annuels de performances*, PAP) and annual performance reports (*rapports annuels de performances*, RAP).

For a given mission, the PAP provides a detailed description of its purpose, goals, policy targets and performance indicators. As part of the public annual budget act, PAP documents are forward-looking and are meant to contribute to the public debate about the costs and benefits of public policy.

The RAPs are published in the first quarter along with the budget review act. They focus on performance achievements and provide detailed information on programme implementation and results. The RAPs are thus backward looking and tend to contribute to the public debate on the administration's performance.

The first RAPs were produced in May 2007, covering the budget and performance outturn for the year 2006.

Performance indicators can belong to three categories: social and economic effectiveness (citizen perspective), quality of services (user perspective) and efficiency (taxpayer perspective), and PAP and RAP documents must specify the category of each indicator reported.

An intermenstrual Programmes Audit Committee (CIAP) was created to contribute to the methodological soundness of the performance documents.

Source: Kraan, D. (2008)

R 7.4. Involve line ministries in setting up the design, implementation and performance evaluation (DID) and the MEF in the discussion of their results

Design, implementation and performance evaluations (DID) are a relatively new tool, which has focused on a small number of policies for the moment and had little impact on the budgetary process. There is therefore room to expand this practice. Involving line ministries in the setting up of these evaluations should help to make sure that they are considered as a management tool for prioritising activities and allocating resources, and do not become a mere check the box exercise.

Make sure that the results of the evaluations carried out by OPP are brought forward to the MEF and used when discussing budget allocations. If a DID reveals a duplication of programmes, this information should be used by the MEF during the budget discussions to impose the merger of the programmes, through budget allocation measures. In order not to create incentives to hide potential efficiency gains, these could be left within the line ministry, and allocated to new priority programmes.

R 7.5. Consider attaching a specific saving target to DID evaluations

The search for efficiency savings is not necessarily designed to lead to fundamental re-thinking about the rationale of the programmes under review. However it is appropriate in this context to consider current service levels and ask questions such as: What would happen if this programme were abolished or left to the market? What would happen if this particular policy instrument of the programme were eliminated? How does this programme fit with the policy priorities for the government as a whole? In order to promote such fundamental re-thinking, some countries have found it useful to establish an obligatory "savings/efficiency option" for every spending review, e.g. what measures would be necessary to yield public expenditure savings of 20% on this programme?

R 7.6. Consider using spending reviews to create fiscal space for new priorities in addition to the short, focused DID evaluations

Spending reviews are often used in OECD countries as a tool to give the government enhanced control over the level of aggregate expenditure, find fiscal space for new spending priorities, and improve expenditure prioritisation. Uruguay could consider carrying out more in-depth strategic or policy-focused spending reviews to generate fiscal space for new priority spending, by identifying areas of low value for money, and shifting resources to higher value for money areas. Furthermore, spending reviews could be a powerful tool to strengthen the link between evaluation systems and budget allocation,

especially if it becomes a permanent feature of the budget process. In particular, it could have the following benefits:

1. Improve expenditure prioritisation (allocative efficiency). Spending review processes expressly recognise that substantial room for new priorities – while keeping aggregate public expenditure under control – can only be found through the willingness to prune back waste and cut ineffective, outdated or otherwise low priority services.
2. Improve control over the level of aggregate expenditure. Spending reviews are a tool specially designed to identify options and implement cuts on baseline expenditure, bringing the growth of baseline expenditure under control. A systematic spending review process could help Uruguay in the objective of finding adequate fiscal space for high priority new spending, while keeping control over aggregate expenditure.
3. Even though there is no one-size-fits-all methodology for spending reviews, previous international experiences point out a common set of factors that are crucial when designing and implementing a spending review exercise (Box 41).

Box 41. Key factors for implementing a successful spending review process

1. Spending review should be a regular an ongoing feature of the budget process. Simultaneous consideration makes it possible for governments to adopt other high priority new spending proposals without increasing aggregate expenditure, by selecting additional savings options sufficient to fund the extra new spending. In other words, both allocative efficiency and aggregate expenditure restraint benefit from simultaneous consideration of new spending proposals and savings options. In addition, implementing a spending review as an ongoing feature of the budget process ensures that the scale of the spending review effort is calibrated to the government's budgetary objectives for aggregate expenditure (Robinson, 2014).
2. Clear definition of the scope of the spending review. There is not a unique way to implement spending reviews; they can be focus on efficiency and/or strategic savings; they can be selective (limited to a specific list of review topics) or comprehensive; and they can examine specific programmes, business processes used in the production of government services, or organizations (ministries and agencies). There is not one type of review that is a priori better than the other ones; they serve different purposes and have different strengths and limitations. However, a proper alignment between the objective of the government and the type of review implemented is a key success factor for the spending review exercise.
3. Political oversight and direction of the spending review process. Spending review is not a purely technical function; it should be under the direction of politically-appointed officials who are sensitive to the priorities of the Presidency. The overall management of the spending review process at the bureaucratic level by DIPRES – together, where relevant, other central agencies which play an important role in the budget process – is essential for its success.

4. Clear definition of roles in the spending review process. In particular, Uruguay should clearly define the particular roles of OPP, MEF and line ministers, to ensure that the spending review process builds on current evaluation process while informing the budget process.
5. Ensure line ministries buy in. Increase efforts to promote the evaluation function within spending institutions could be a good strategy to increase engagement and support from line ministers. External evaluations are undoubtedly an essential part of the system; however, a limitation of external evaluation is that the institution being evaluated may not "own" the evaluation. Rather, it may regard the evaluation as an external imposition and, as a consequence, fail to make full use of its recommendations.
6. Develop standard terms of reference. Setting standard terms of reference to be followed by the spending review teams, including a defined set of questions or criteria to be applied in the search for strategic savings and whether there will be pre-set savings targets, are well known strategies to support the spending review implementation process.
7. Have a system of outcome evaluation (using existing relevant performance indicators) and efficiency analysis already in place.
8. Have a well-defined programme budgeting. A successful spending review depends in large extent on the Ministry of Finance knowing exactly which programmes are being delivered by each spending ministry and how much is being spent on each, making the programme classification of the budget particularly relevant to program review, and to the search for strategic savings (Robinson, 2014).
9. Implement the review at the right moment in the political cycle. Because cuts to existing programmes usually create some political resistance, the best time to carry out an in-depth spending review may be at the start of each presidential term of office. The best approach to the conduct of spending review may therefore be to carry out an in-depth spending review in the first year of each presidential term of office, plus more limited spending reviews in other years.

Source: Robinson, M. (2014), OECD (2015c)

R 7.7. Gradually move towards output and outcome targets in Management Agreements

Today, Management Agreements are very input-oriented, stating the targets to be reached and actions to be carried out in terms of processes rather than results. As the whole structure of programme budgeting in Uruguay becomes more coherent with policymaking, Management Agreements should also move from process and input indicators towards output and outcome indicators, leaving more flexibility to managers to allocate resources and design processes to reach these targets.

Notes

1. The fiscal deficit calculation does not take into account the impact of the change in the social welfare law (*ley previsional*). This law, approved at the end of 2017, generates extraordinary revenues of about 1% or GDP per year from 2018 to 2021. This positive transitory effect will end in 2021. From that year, the new law is expected to have a negative impact, increasing the deficit by about 4% from 2018 to 2068 (in net present values).

2. Social Protection Bank (*Banco de Previsión Social, BPS*): 8.8% of GDP; Pensions of armed forces (SRPFFAA): 1.1% of GDP; Pensions of police forces (SRPP): 0.7% of GDP.

3. In 2017, Social Protection Bank (BPS) received transfers of general government revenues amounting to 4.8% of GDP; the Armed Forces pension scheme (SRPFFAA) 1.0% of GDP and Police Forces pensions scheme (SRPP) 0.4% of GDP.

4. The term "budget baseline" (*línea base*) in Uruguay does not have the same definition as in OECD terminology. In particular, for what concerns public investment, the baseline is calculated on the hypothesis of maintaining a similar level of investment in out-years; whereas in OECD definition, the baseline for capital expenditure only includes approved capital projects, and therefore should decrease in out-years as the projects are completed, therefore creating fiscal space to be distributed to new capital projects. For operating expenditures, the "budget baseline" in Uruguay is defined "backward looking", i.e. based on the past budget executions (or a share of these), instead of representing the cost of maintaining current policies.

5. Tax credit certificates (*certificados de créditos tributarios*) are certificates issued by the General Directorate of Taxes arising from refunds of excess contributions, indirect export taxes refunds and refunds from tax incentive regimes.

6. According to Art. 35 of Law 18.362, the Council of Ministers sets a date for the presentation of the Budget Update, and line ministries must provide their information 45 days before that date.

7. It should be noted that the budget laws (five-year budget and annual budget updates) cannot include norms about social security, to ensure that social security issues do not become one element in the budget negotiations.

8. Settlement refers to the buying of land by the National Institute of Colonisation, which is then leased back to families to foster settlement of farmers in rural areas and social inclusion.

9. Usually the Chamber of Representatives reviews the budget first, but it could also be the Chamber of Senators.

10. "Top-down budgeting" means that budget preparation starts with the establishment of a binding constrain on aggregate spending. This implies that the negotiations between the line ministries and the Ministry of Finance henceforth focus on the allocation of available resources among ministerial expenditure envelopes subject to this constraint, and no longer on the size of the ministerial increments.

11. Central administration expenditure excluding transfers to social security, subsidies and transfers, interest on public debt and other obligations (*generales del Estado*).

12. The recruitment process by competition is also slow and in part responsible for positions not being filled.

13. For the central administration (excluding salaries), it could be carried out by decree. For more general reduction of allocations (including for Art. 220 Entities and salaries), this would require a new budget law or budget update.

14. Indeed, the human resource structure and its formal allocation is carried out at the level of budget institutions and executing units. The classification of budget allocations into programmes and the

budget execution of wages is only illustrative and not managerial. It would therefore be easy to transfer those human resources from one program to another.

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Financial reporting in Ireland

by

Delphine Moretti, Scherie Nicol, Emeline Denis, Tim Youngberry

The OECD Review of Financial Reporting in Ireland assesses opportunities and challenges associated with adopting accruals in Ireland for government accounting. Due to issues with the comprehensiveness and legibility of the current financial reports, the Review recommends that going forward, the Irish Government establish accrual financial statements compliant with international standards for its departments and offices and harmonise accounting standards used by entities within the general government sector. The report notes that accrual data would be a "building block" for richer, more reliable fiscal information, which would, in turn, help formulate improved assumptions for fiscal forecasts and be better equipped to identify fiscal risks. Beyond the adoption of accrual accounting, this report proposes that the Irish Government considers modernising its financial reporting framework by preparing integrated reports for departments and offices and consolidated financial statements. Integrated accounts for departments and offices would provide an overview of each department's resources and spending alongside information on their strategy and performance. This would enhance and improve scrutiny and examination of departmental performance by the Committee of Public Accounts and by the Oireachtas Sectoral Committees.

JEL codes: H11, H30, H60

Keywords: Ireland; financial reporting; accruals; transparency; accountability.

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Foreword

The OECD *Review of Financial Reporting in Ireland* builds on the experience and knowledge acquired by the Budgeting and Public Expenditures Division of the OECD Directorate for Public Governance over past decades through the meetings and workings of its Network of Financial Management and Reporting Officials.

The Review also draws upon the close collaboration between the OECD and the Irish Government, including the participation of Ireland in the OECD Working Party of Senior Budget Officials. This collaboration enriches the assessment and results of the Review of Financial Reporting in Ireland.

The aim of the Review is to assist the Irish Government in assessing opportunities and challenges associated with adopting accruals, the accounting basis used by a large majority of OECD countries, and more generally to provide recommendations for the modernisation of its financial reporting system.

This mission was organised in the broader context of the work underway in the European Union for developing a single set of harmonised accrual-based accounting standards.[1] This mission was organised with funding from the Structural Reform Support Programme (SRSP) and co-ordinated by Mr. Guilhem Blondy of the European Commission's Structural Reform Support Service (SRSS).

To write this report, two missions were conducted in Dublin in September 2018 and January 2019. During the first mission, interviews were held with key stakeholders of the Irish fiscal reporting ecosystem: representatives from the Government, Houses of the *Oireachtas*, Comptroller and Auditor General, Irish Fiscal Advisory Council, and the Central Statistics Office as well as think tanks and representatives of the accounting profession. During the second mission, the preliminary findings of the Review were discussed with representatives from the same institutions. The authors would like to thank the Irish stakeholders for their availability and openness to recommendations.

The missions benefited from the presence of two examiners from the United Kingdom (Mr. Ian Bulmer) and Portugal (Mr. Luis Viana). The authors would like to express their gratitude to them as well as to Mr. Guilhem Blondy for their invaluable inputs during discussions with Irish stakeholders and comments on the draft report.

This report was written by Ms Delphine Moretti, Scherie Nicol, Emeline Denis, all at the Budgeting and Public Expenditures division of the OECD Directorate for Public Governance, and Mr Tim Youngberry, OECD consultant. It reflects comments provided by delegates who attended the 19th Annual OECD Senior Financial Management and Reporting Officials Symposium.

Box 1. Accruals, accrual accounting and accrual budgeting

What does "accruals" mean?

The term "accrual" is associated with two related concepts.

Firstly, the recognition of economic events at the time at which they occur, regardless of when the related cash receipts and payments change hands. Economic events can include the delivery of a taxable service by a private company (for which the government accrues tax revenue), performance of a public service by a government employee (for which the

government accrues a salary and perhaps a pension expense), or the loss or theft of a government asset such as a vehicle or equipment (for which a reduction in the asset stock will be recognised). These economic events may generate a corresponding or simultaneous cash flow, but in many cases – such as depreciation, revaluations, or impairment – they do not. This is an important difference between cash and accrual bases.

Secondly, the recognition of all stocks of assets and liabilities in balance sheets. Under accrual accounting, governments recognise all assets and liabilities including financial assets (such as equities), non-financial assets (such as land and buildings), and liabilities other than debt securities and bonds (such as payment arrears and pension obligations). These stocks are usually recorded at their current market value, or some approximation, and regularly revalued to ensure the balance sheet reflects the government's true financial position at a given point in time. Governments that follow pure cash accounting typically account only for their cash holdings on the assets side and, possibly, debt on the liability side of their balance sheets. These are often valued at or the value at which they were initially acquired or issued.

What is accrual accounting?

"Accruals" concepts are used for producing government accounting and statistics - that is the reporting of past activities of government – in a growing number of countries. Accrual accounting and accrual-based statistics are governed by standards, including those set by international standards setters (e.g. International Monetary Fund, or IMF, and Eurostat for statistical standards; International Accounting Standards Board, or IASB, and International Public Sector Accounting Standards Board, or IPSASB, for accounting standards).

What is accrual budgeting?

"Accruals" concepts are also increasingly applied to budgeting - that is firstly the forecasting of the future resources and costs of government activities and secondly the granting of the authorisation for spending of public funds. The principle of accrual budgeting is simple: it consists of forecasting economic events that will be generated by the government policies on an accrual basis and/or controlling the utilisation of those resources against the authorisation granted by Parliament on the same basis.

Accrual budgeting is developing and is not governed by international standards. Governments have therefore adopted different approaches for their accrual budgeting regimes. Some countries forecast assets, liabilities, expenses and revenue on accrual basis in their budget; while others do so only for revenues and expenses forecasted. Some countries using accrual budgeting continue granting authorisations for spending public funds on cash basis.

Source: Moretti and Youngberry (2018)

Executive Summary

The budget process in Ireland has undergone profound reforms during the last quarter of a century, particularly since the 2008 global financial crisis. Together these changes have facilitated fiscal consolidation, introduced medium-term planning, increased transparency, and allowed greater parliamentary and public participation in the budget process. However, by contrast, progress in the area of financial reporting has been limited.

The main purpose of the Irish Government's financial reports is to allow control and scrutiny of the regularity of government cash operations. In keeping with this objective, their format and content is fully aligned with those of the budget documents that they report against, in the sense that they use the same accounting basis (cash), nomenclature (Votes) and accountability boundary (the Exchequer).

Despite having recognised strengths, the Irish financial reporting framework is not fully aligned with the OECD Recommendation on Budgetary Governance, which advises that countries present a comprehensive account of public finances. Compared to other OECD countries, in Ireland, information on government assets and liabilities is very limited; time lags for publishing reports are among the longest in the OECD; and institutional coverage of the accounts is particularly narrow.

Interviews conducted for this review with a variety of stakeholders confirm that improvements to the financial reporting framework are considered necessary. Most stakeholders identify issues regarding the completeness, timeliness and comparability of the accounts prepared by the government that are mostly "technical" in nature. They also express more general concerns regarding the clarity and legibility of the accounts currently prepared at central government level.

Preparing accrual accounting information compliant with international standards; harmonising accounting standards used by entities within the general government sector; and implementing a "faster closing" initiative for Government departments and offices, funds and State bodies are possible solutions to address these concerns, while being cognisant of the need to maintain the core elements of the existing cash basis framework.

The report notes that accrual data would be a "building block" for richer, more reliable fiscal information. Having reliable information on liabilities, provisions and contingent liabilities would help formulate improved assumptions for fiscal forecasts. Implementing accrual accounting enables governments to be more conscious of fiscal risks and better equipped to mitigate them. This in turn can help better planning and risk management for any future fiscal shock.

Further, the quality of fiscal statistics required for reporting under the EU's economic governance framework is linked to the quality of underlying accounting data. To reliably assess how Ireland performs against these fiscal targets defined on an European System of Accounts 2010 (ESA2010) basis, it is crucial to maintain both government accounts and fiscal statistics on an accrual basis.

Beyond the adoption of accrual accounting, this report proposes that the Irish Government considers modernising its financial reporting framework by preparing integrated reports for departments and offices and consolidated financial statements. Integrated accounts for departments and offices would provide an overview of each department's resources and spending alongside information on their strategy and performance. This would enhance and improve scrutiny and examination of departmental performance by the Committee of Public Accounts and by the *Oireachtas* Sectoral Committees.

Consolidated financial statements would provide a complete picture of Ireland's underlying fiscal position, regardless of whether activities are carried out through a Vote, fund or State body. The report also notes that, within consolidated financial statements, certain government activities (e.g. health) could also be presented as "segments", allowing readers of financial statements (or stakeholders) to gain an understanding of spending, and the accumulation of government assets and liabilities by function in totality.

Finally, the report underlines that the ongoing Financial Management Shared Services (FMSS) project and Civil Service Renewal Initiative offer timely opportunities for moving forward the financial reporting framework's modernisation agenda. In particular, the new IT system could readily support the introduction of accrual accounting and delaying decisions on the reform could generate significant opportunity costs. Whilst the FMSS can provide a platform for the introduction of accruals, the management of that project to scope and schedule, including dealing with any project delays, will be critical in the implementation phase of accrual accounting.

To start the financial reporting modernisation, the report advises that the Government agrees on a blueprint for the reform and gets necessary approval from the Houses of the *Oireachtas*. This blueprint should include a roadmap and define milestones. The report proposes a six-year roadmap to be considered by the Government. The roadmap's first phase would aim to bring the information already disclosed in the Appropriation Accounts up to international standards. The second phase would aim at introducing consolidated financial statements and other accrual information required by international standards, across all relevant areas.

Concerning consolidation, the report recommends a sequenced approach – that is the preparation of consolidated financial statements covering all government departments and offices, to be extended to funds and State bodies as soon as the degree of harmonisation and integration of accounting systems across government allows it.

For a successful reform, it will be crucial that the Department of Public Expenditure and Reform fully exercises its oversight and governance mandate on accounting and financial reporting. This should be done by setting up a Government Accounting Directorate within the Department of Public Expenditure and Reform, which would become the permanent unit in the Irish administration responsible for maintaining a uniform set of accounting rules and procedures and overseeing the quality of the finance function.

At all stages of the transition to accruals, the Department of Public Expenditure and Reform should work in close co-operation with all key stakeholders, in particular the Comptroller and Auditor General. To this aim, the new Government Accounting Directorate could be tasked with leading working groups in charge of identifying necessary changes to legislation, setting accounting policies, ensuring these standards and polices meet all user requirements, improving financial controls and delivering training.

Finally, to ensure that accounting standards are developed with the expected level of quality and integrity, this report recommends that the Government Accounting Directorate seeks inputs from all relevant stakeholders (i.e. users, preparers, auditors) for establishing accrual standards that will be applied by general government entities and that an Independent Advisory Body be established to oversee outputs of the working group.

1. Introduction

1.1. An evolving budget framework

Ireland's budget system is based on legislation inherited from the United Kingdom at independence in 1922, itself dating back to the Magna Carta. Indeed, although the Constitution of Ireland ("*Bunreacht na hÉireann*"), adopted in 1937 (replacing the Constitution adopted on independence in 1922), comprised a number of provisions relevant to public financial management and laid out a number of foundational budgetary principles (Box 2), neither it, nor the constitution it replaced, instituted a full set of new budgetary rules and procedures, as is the case in some other OECD countries. Therefore, the Irish system of accountability for public moneys remained, until recently, largely grounded in legislation dating back to the 1860s, in particular the Exchequer and Audit Departments Act, 1866.

Box 2. Ireland: Legal basis for the "System of Accountability for Public Moneys"

There are a number of provisions relevant to the "System of Accountability for Public Moneys" in the Constitution of Ireland, whose essential elements are as follows:

- All State revenues accrue to a single fund (the "Central Fund") subject to such exception provided by law and all allocations from this fund must be governed by law;
- Each year, the government brings forward estimates of expenditures and receipts, and presents these estimates to *Dáil Éireann*, the chamber directly elected by the people) for consideration;
- The government alone has the authority to move forward legislative proposals which affect the public purse, such as budget-related proposals;
- The Houses of the *Oireachtas* (*Dáil Éireann* and *Seanad*) alone may implement these proposals in law; and in budget-related matters, the *Dáil* has pre-eminence over the *Seanad*;
- "Financial Resolutions" (whereby the *Dáil* adopts budgetary measures for the year on an interim, provisional basis in advance of legislation) must in general be effected in legislation within the same year;
- The Comptroller and Auditor General (supreme audit institution) audits public accounts (except for the accounts of local authorities, regional assemblies and 4 other bodies) and reports to the *Dáil*.

The Constitution also includes a reference to "Financial Resolutions", which are not defined or described in the constitution itself but refer to the corpus of rules and procedures laid out, at the time, in pre-existing legislation (mainly the Exchequer and Audit Departments Act, 1866) and, nowadays, in the Public Financial Procedures guide maintained by the Department of Public Expenditure and Reform.

Source: Authors based on Downes and Nicol (2016)

Recent decades, however, have seen many changes to the traditional budget system, with European economic integration, the 2008 global financial crisis, and reforms to parliamentary budget oversight acting as catalysts for change.

Following the onset of the crisis in 2008, regulations were being developed at the EU level for member states to put in place stronger fiscal frameworks, including an effective medium-term planning horizon, numerical fiscal rules and clear and credible budget forecasts. The establishment of an independent fiscal institution to assess economic forecasts was also required. These EU reforms, together with the EU/IMF programme in Ireland, accelerated Ireland's budget framework reforms and the Fiscal Responsibility Act was enacted in 2011. This established a Medium-Term Budgetary Framework (MTBF), national budget rules – consistent with EU rules – and the Irish Fiscal Advisory Council (IFAC). These changes were aimed at strengthening Ireland's fiscal framework and improving budget management.

Further, in 2013, the IMF conducted a fiscal transparency assessment for Ireland. Its objective was to evaluate Ireland's fiscal reporting, forecasting and budgeting, and fiscal risks analysis and management practices against the standards set by the IMF's Fiscal Transparency Code. The IMF Report contained 35 recommendations for change, with a view to full implementation by 2017. To implement the recommendations, the Irish Government set up a Steering Group comprised of the Department of Finance, the Department of Public Expenditure and Reform, the Central Statistics Office, and others. The Irish Comptroller and Auditor General assessed progress in a 2016 report on fiscal transparency. It found that most progress was made in implementing recommendations related to the budgetary process, progress was more mixed in recognising a wider range of assets and liabilities, while least progress was made in implementing recommendations related to financial reporting.

The OECD "Review of Budgetary Oversight by Parliament in Ireland" published in 2016 identified shortcomings in Ireland and proposed enhanced parliamentary engagement through procedural changes, the provision of enhanced budget information and the establishment of an Estimates Committee and Parliamentary Budget Office. In response, a Budget Oversight Committee was set up in 2016 and a Parliamentary Budget Office was established in 2017. These reforms aim to considerably reinforce the role of the Houses of the *Oireachtas* in budget oversight, particularly through the addition of *ex ante* interactions on policy priorities.

In 2015, the Irish Government instituted a new process called the "National Economic Dialogue" (NED), involving consultation and debate with societal interests to enhance the whole-of-year budget development process. By launching the NED, the government has indicated its willingness to strengthen transparent stakeholder participation in the *ex-ante* budget phase, an objective which is very much in keeping with the international principles of "open government" advocated by the OECD. The government publishes a Summer Economic Statement, and this provides the macroeconomic and fiscal context for the discussions at the NED conducted in June/July.

In the area of reporting, notable reforms include improvements to the completeness of budget documentation. For example, there is now regular reporting of the government's financial sector interventions in the form of capital injections, guarantees, and other exposure in fiscal reports, and more recently, information on public private partnerships (PPPs) has been included in the budget documents.

Membership of the European Union requires extensive reporting on government finances as defined under the European System of Accounts (ESA2), which is done on an accruals basis. The European integration process also imposed significant additions to statistical reporting: to assess Ireland's compliance with fiscal rules as set out under the Maastricht Treaty and subsequently the Stability and Growth Pact, the Excessive Deficit Procedure and other EU fiscal monitoring arrangements. All of these economic indicators use ESA2, an accruals-based system, as the basis for assessment.

Overall, most observers consider these reforms have helped modernise the budget system and increased fiscal responsibility and transparency. However, there is consensus that improvements in the area of financial reporting have been limited, or at least slower. In terms of progress made as a result of the IMF Fiscal Transparency Assessment (2013), the Public Accounts Committee (PAC) at the Houses of the *Oireachtas* produced a Periodic Report where it took a view on the timeliness of accounts published by public institutions, with recommendations for shortening it.[3] This has resulted in some improvement.

It should be noted that, in parallel to these budgetary governance reforms, there has been an ongoing programme to increase public sector efficiency in Ireland. An initial vision of a performance-oriented public service was first introduced in the mid-1990s (Strategic Management Initiative) and these efforts have been given new momentum in the wake of the financial crisis, with increased public sector efficiency being an important plank of the fiscal consolidation programme. Further, in 2016, a rolling three-year spending review was announced with the aim of maximising the impact of government spending. This is to be achieved through reprioritising spending from programmes with poorer outcomes to those with better outcomes, thus creating a clear link between the programme evaluations carried out across the public sector and budget decision-making.

The Public Service Reform Plan 2020, which was launched in December 2017, is the new framework for development and innovation in the public service with a significant focus on people and organisations. The framework was developed with input from citizens and the public service, and was informed by lessons identified in the OECD Assessment of the Public Service Reform Plan 2014-16[4]. Key achievements of the reform programme to date as noted by the OECD include the Civil Service Renewal Plan; the establishment of the Office of Government Procurement and the National Shared Services Office; and one-stop-shops such as Intreo for jobseekers and Local Enterprise Offices for businesses.

1.2. Financial reporting in the wider budget cycle

Financial reporting is a component of the wider budget cycle, sequenced by a series of events and documents presented to the Houses of the *Oireachtas* over the course of the year. It comprises three distinct parts, the medium-term planning process, the annual budget process and the annual estimates process. As in other countries with a Westminster tradition, the Irish parliament separately approves the annual fiscal forecasts and appropriations. Annual budget forecasts are included, together with a discussion of fiscal policy and government priorities, in a Budget statement debated in parliament in the form of a vote of confidence towards the government; and annual authority to spend is granted through separate legislation, the Appropriation Bill.

Following recent reforms mentioned above, the Irish budget cycle starts on 1 January with the presentation of economic and fiscal forecasts as well as medium-term plans for high-level fiscal aggregates from April to June. It progresses with the presentation of the detailed policy proposals and resource allocations in the autumn, culminating on *Budget Day*. It

concludes with the preparation of financial reports showing actual spending, and the resulting financial position after the end of the budget year.[5]

All budget documents and financial reports prepared through the budget cycle can therefore be said to fall within one of the three parts of the budget cycle (medium-term planning, the budget process and the estimates process) and one of its three phases (*ex-ante* budget planning; in-year monitoring; and *ex post* reporting), as illustrated in Figure 1. Specifically:

- ***Ex ante* budget planning**: The medium term fiscal policy programme for the government is set out in the **Stability Programme Update** published in the spring. Planning then begins for the first year of that programme as part of the annual budget cycle. This involves the publication of a **Summer Economic Statement** to provide the macroeconomic and fiscal context for budget priority discussions with members of the public at the National Economic Dialogue, held in June/July (see Section 1.1). The Budget Oversight Committee at the Houses of the *Oireachtas* also publishes a **Pre-Budget Report** that sets out budget priorities from a parliamentary perspective, based on a series of parliamentary hearings. The Government's budget proposals are then set out in the **Budget day document**s presented to the Houses of the *Oireachtas* in October, shortly followed by the **Finance Bill** and the **Social Welfare Bill**, which must both be enacted before the start of the fiscal year. More detailed spending proposals are outlined in the **Revised Estimates Volume**, published in December. Once approved by Houses of the Oireachtas, resource allocations in the Revised Estimates Volume are published. The annual Appropriation Act gives statutory effect to the individual Estimates voted by the Oireachtas for the year just ending. It is passed by the Oireachtas when consideration of all the Departmental Estimates (including any Supplementary or Additional Estimates) have been approved by the Dáil. The Irish Fiscal Advisory Council also publishes two **Fiscal Assessment Reports** a year, following the Stability Programme Update and the Budget. These reports assess the Government's macroeconomic and budgetary forecasts, the appropriateness of the fiscal stance, compliance with the budgetary rule, as well as detailing the Council's endorsement function.

- **In-year monitoring**: During the budget year the government publishes a **Monthly Exchequer Statement (Fiscal Monitor)** which measures the cumulative net current and capital Government Departmental expenditure against profile along with the year-on-year variance. The government has also published a **Monthly General Government Account** since 2014, providing information on all general government sectors revenue and expenditure one month after the month end. Information contained in both of these publications is also available in the online **Databank of the Government Department of Finance**.

- ***Ex post* reporting**: After the end of the financial year, the government publishes **Finance Accounts** containing detailed analysis and classification of the payments into and out of the Central Fund as well as details of the National Debt. The Comptroller and Auditor General also publishes a Report on the Accounts of the Public Services. This gives the audit of the Appropriation Accounts for the preceding financial year. It is presented together with the **Appropriation Accounts** for the various Votes. This compares the Supply Estimate voted by parliament for each government department under the Appropriation Act with the actual payments made and receipts brought to account, and explains any substantial differences.

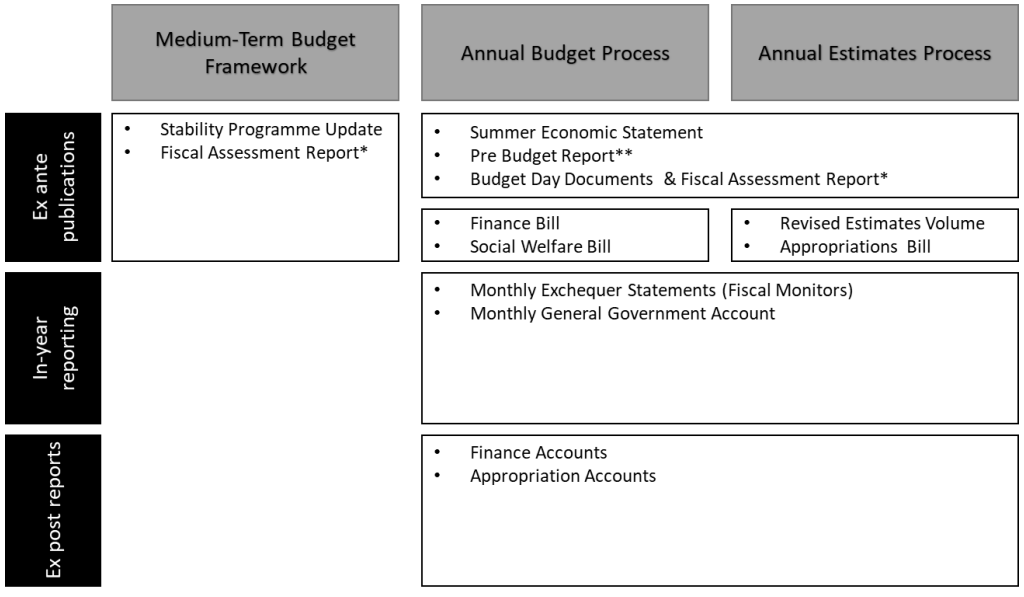
The Revised Estimates Volume presents high-level policy goals and targets and results for outputs that are linked to specific programmes, though not to specific subheads. The targets set out in the Revised Estimates Volume are reported against in the recently introduced **Public Service Performance Report**.

Within government, the key stakeholders in the formulation of the budget are the Department of Finance and Department of Public Expenditure and Reform (DPER):

- The Department of Finance has a central role in implementing Government policy, in particular the Programme for Government, advising and supporting the Minister for Finance and the Government on the economic and financial management of the State and the overall management and development of the public sector;
- The Department of Public Expenditure and Reform (DPER) has a dual function; to control public expenditure and bring budgets back to a sustainable path, and to ensure the necessary reforms in how Government and the public sector works.

Within the frame of these responsibilities, the Department of Finance, under the authority of the Minister for Finance, assumes, among other tasks, principal responsibility for seeking the approval of the Houses of the Oireachtas for the government's economic and fiscal strategy, preparing the Annual Budget including the overall taxation and expenditure levels, setting the annual Government Expenditure ceiling and for preparing Finance Accounts. The Department of Public Expenditure and Reform assumes the principal responsibility for seeking the approval of the Houses of the Oireachtas for the distribution of the overall expenditure among the Votes, and for co-ordinating government departments and offices' preparation of the related Appropriation Accounts, under the authority of the Minister for Public Expenditure and Reform.

Figure 1. Ireland: Fiscal reports through the budget cycle



Source: Authors.

Budget documents and financial reports prepared as part of the Annual Estimates process share a number of characteristics, which can be summarised as follows: they use the cash

accounting basis, they follow the Vote structure and their institutional coverage is mainly limited to central Government. These characteristics are briefly explained below.

As in the majority of OECD countries, Ireland's Appropriation Bill is mainly prepared on a traditional cash basis, which allows strong control over resources spent by ministries and government departments (as opposed to the perceived volatility and discretion in accruals valuations for budgeting).

Annual resource allocation for the Exchequer is done under so-called *Votes*. Each Vote is a coherent area of government expenditure, which is the responsibility of a single government department or office, with one or more Votes covering the functions of each government department or office within central Government. There are 42 individual Votes in total, which make up the *Estimates*.[6]

As shown in Table 1, budget documents and financial reports presented to the Houses of the Oireachtas focus in most cases on central government – that is the 40 government departments, offices and constitutionally independent entities (such as the Houses of the *Oireachtas* and judicial salaries) that have their expenditure managed through the government's treasury single account, the *Central Fund*.[7] Their expenditures are authorised by the Houses of the *Oireachtas* through the annual Estimates/Appropriations process, or funded through standing charges on the Central Fund.

Table 1. Ireland: Institutional coverage of budget documents and financial reports

Financial report	Coverage
Stability Programme Update	Exchequer Account & General Government
Summer Economic Statement	Exchequer Account & General Government
Budget Day Statements	Exchequer Account
Budget Day Economic and Fiscal Outlook	Exchequer Account & General Government
Revised Estimates Volume	Exchequer Account
Monthly Exchequer Statements	Exchequer Account
Monthly General Government Account	General Government
Mid-Year Expenditure Report	Exchequer Account
Fiscal statistics	General Government
Finance Accounts	Exchequer Account
Appropriation Accounts	Exchequer Account

Note: Where information is produced on an "Exchequer Account & General Government" basis, information is usually produced for the Exchequer Account with a reconciliation from the Exchequer Account to the General Government balance also being provided.
Source: Authors.

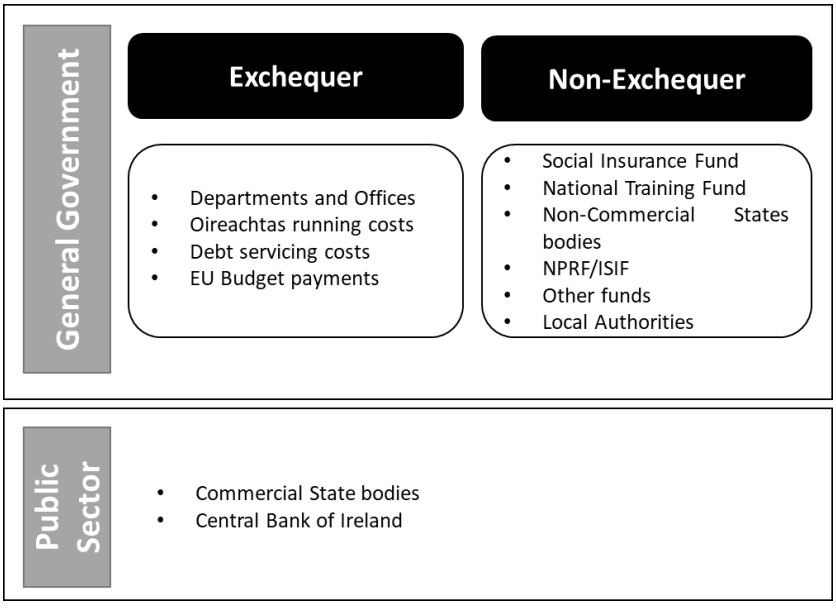
Budget documents directly or indirectly associated with reporting requirements of the EU Stability and Growth Pact have wider institutional coverage. These reports cover the general government, as defined in fiscal statistics. As shown in Figure 2, Irish Government departments and offices, as well as the funds and non-commercial State bodies (called "State bodies" in the remainder of this report) under their purview, together compose the central government sector. The social security funds and other smaller public bodies providing health and social care together are included in the central government. Finally, regional and local governments, and various entities under their purview, form the local government sector.[8]

For most part, the public bodies classified under the general government sector in fiscal statistics share the characteristics of being funded mainly by direct grants from the

Exchequer, although they can also raise their own revenue through taxes, investment income or other sources.[9] They fall under three main legal groupings, as follows:

- Ireland's 40 public funds (also called extra-budgetary funds) serve several purposes, such as, for example, managing social security benefits or providing support to businesses, and may take different forms (e.g. fund-of-funds and co-investment funds). As in many countries, amongst the largest funds are those that partly fund social security benefits, but Ireland also has the Strategic Investment Fund, which took over the EUR 7.1 billion discretionary portfolio of the National Pensions Reserve Fund.
- Hundreds of State bodies operate under government departments and offices. Their activities vary, with around 80 State bodies[10] considered to exercise non-market activities and included in the general government sector in fiscal statistics. Their size differs significantly, with the largest State bodies including, for example, Transport Infrastructure Ireland, Irish Rail or Radio Telefis Eireann (RTE).
- Finally, 31 authorities operate at local level in Ireland, namely 26 county councils, 3 city councils, and 2 county and city councils.[11] Local governments also often have subsidiaries, including local public enterprises. Although local authorities deliver a broad range of services, such as roads, housing and economic and community development, their responsibilities are limited by international comparison.[12] In 2018, approximately 40% of local government funding came from taxes, while 30% came from central governments grants, and 30% from the provision of goods and services.[13]

Figure 2. Ireland: Building Blocks of General Government

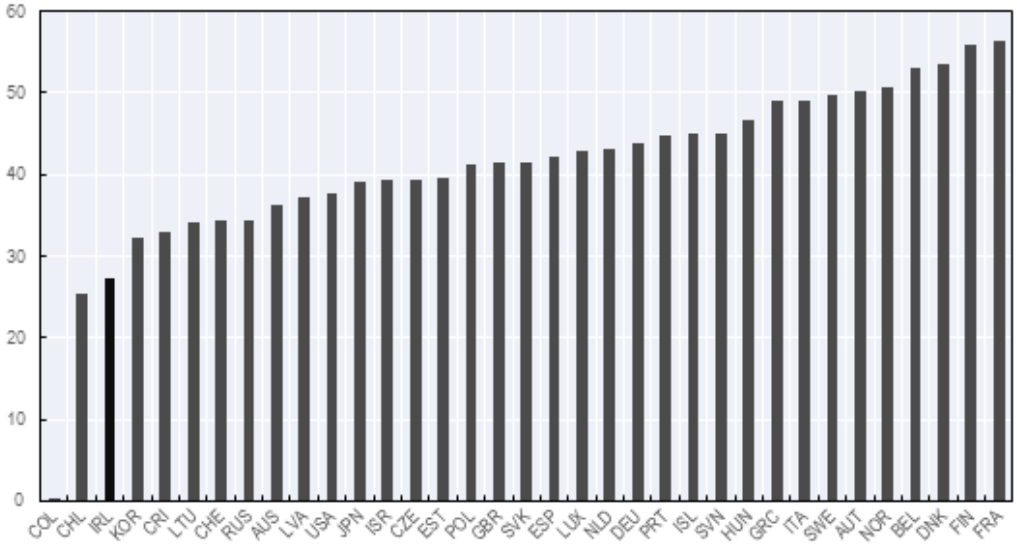


Note: The Central Statistics Office defines and delimits precisely the "General Government sector" biannually as part of the reporting on Excessive Deficit Procedure (*www.cso.ie/en/methods/governmentaccounts/classificationdecisions/registerofpublicsectorbodiesinireland/*). The figure above is an adaptation of the Central Statistics Office definition based on OECD understanding.
Source: Authors, based on IFAC (2016), www.fiscalcouncil.ie/wp-content/uploads/2016/11/Appendix-E-The-General-Government-Sector-2.pdf

Overall, the general government sector in Ireland is relatively small as a percentage of GDP. However, Ireland is a highly globalised economy and the presence of some large multinationals can distort GDP. Modified GNI* removes these distortions and is considered a more appropriate measure of national income for Ireland[14]. General government expenditure as a percentage of modified GNI* is 42.7%, which is closer to the OECD average in Figure 3.

Figure 3. OECD countries: general government expenditure

% of GDP, 2016



Source: OECD (2017a)

2. Understanding the current Financial Reporting Framework

2.1. Legal basis for Exchequer Financial Reports

As noted above, the Irish Government prepares two documents at the end of the budget cycle: the Appropriation Accounts and Finance Accounts. Although their purpose is not specified in primary legislation[15], most stakeholders consider that the Appropriation Accounts and Finance Accounts are primarily for control and scrutiny of the regularity of government financial operations by the *Dáil* but also serve distinct purposes:

- Appropriation Accounts show the amount voted by the Houses of the *Oireachtas* and the corresponding expenditure related to each Vote, serving as an accountability document for spending across different areas; and
- Finance Accounts provide an annual statement of Central Fund transactions, as well as corresponding changes to the National Debt, providing a summary of the executive's overall fiscal position in terms of expenses, revenue, surplus/deficit and debt.

Primary legislation in Ireland – that is the Constitution and Exchequer and Audit Departments Act, 1866 – is also not explicit on the rules applying to the annual accounts, or their purpose. Although the more recent Comptroller and Auditor General (Amendment) Act, 1993 specifies some general principles applying to the accounts, most requirements

for the presentation and content of the accounts are set out in regulations enacted by relevant Ministers.[16] [17]

Specifically, concerning the Appropriation Accounts, Section 22 of the Exchequer and Audit Departments Act, 1866 requires that each Government Department charged with the expenditure of any Vote prepares a corresponding appropriation account for this Vote at the year-end. The Comptroller and Auditor General (Amendment) Act, 1993 further clarifies that Appropriation Accounts shall be prepared in accordance with accounting rules and procedures laid down by the Minister for Public Expenditure and Reform.[18] [19] The Minister's own authority to set the rules and procedures derives from the 1866 Act.

Similarly, requirements to establish the Finance Accounts come from the Constitution and Section 4 of the Comptroller and Auditor General (Amendment) Act, 1993 specifying that Finance Accounts (and the National Debt Statement that is included in the Finance Accounts) are prepared in a form approved by the Minister for Finance.[20]

A focus of the legislation is to assert and detail duties in the overall "System of Accountability for Public Moneys" of the Accounting Officer. [21] Accounting Officers are expected to assure the *Dáil* and the public of high standards of probity in the management of public funds and are required, for this purpose, to sign the accounts that they present to the Comptroller & Auditor General. Accounting Officers may also be called to appear before the Public Accounts Committee of the *Dáil* to give evidence about the account.

Secretaries General of Government Departments and Heads of most Offices that have a Vote are appointed Accounting Officers.[22] [23] The Secretary General of the Department of Finance is the Accounting Officer responsible for preparing the Finance Accounts. The Statements relating to the National Debt are the responsibility of the National Treasury Management Agency.

The Comptroller & Auditor General, as stated in the Constitution, audits the accounts of moneys administered by or under the authority of the *Oireachtas*, namely the Finance Accounts and the accounts of government departments. The institution is constitutionally independent from both government and parliament.

It conducts its audits in accordance with the International Standards on Auditing as promulgated by the International Organisation of Supreme Audit Institutions and fulfils other ethical responsibilities in accordance with the standards. Audit reports of the Comptroller & Auditor General give an opinion covering the accuracy and completeness of the accounts and ensure that the accounts have been prepared in the approved format. The C&AG reports by exception on matters such as the regularity of financial transactions and the adequacy of the accounting records for audit purposes. The annual audit report is then laid before the *Dáil* and considered by the Public Accounts Committee on behalf of the *Dáil*.[24]

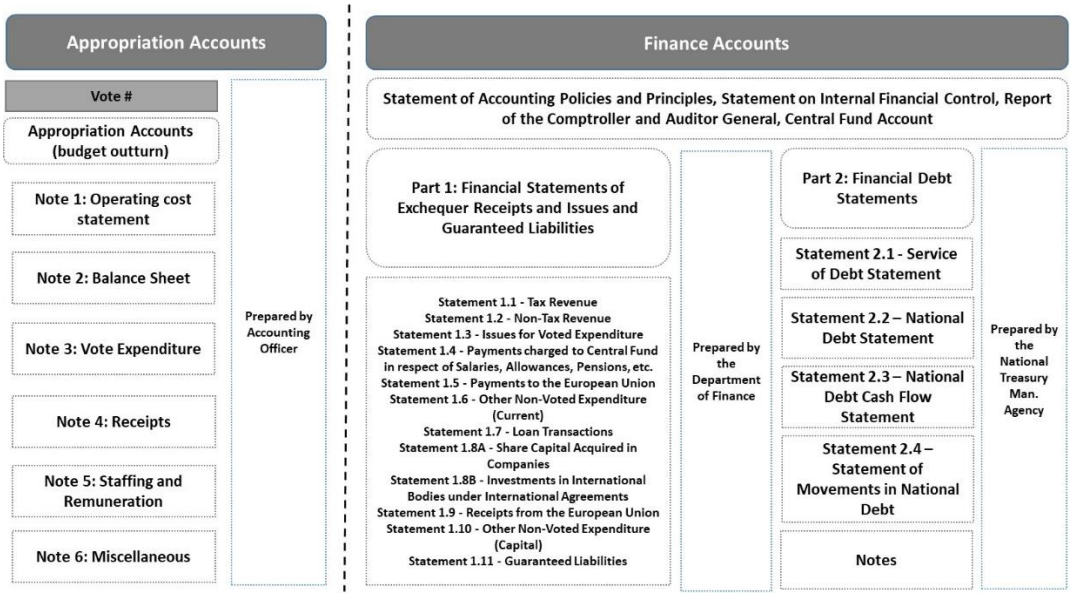
2.2 Characteristics of Exchequer Financial Reports

Against this legislative background, the Appropriation Accounts and Finance Accounts have evolved, with a stable set of core cash-basis information complemented over time with more detailed information on certain significant or sensitive transactions.[25] As shown in Figure 4, in their current format, the two sets of documents disclose a wealth of information on a cash basis, which commands the confidence of many stakeholders interviewed within the frame of this Review.

The Appropriation Accounts show cash basis outturns against appropriations for each Vote. Additional qualitative and quantitative budgetary information has been included over time in the Notes, such as, for example, staff numbers and pay, or the multi-year commitments incurred under each Vote. In addition, since 2011, DPER introduced the requirement for government departments to prepare a balance sheet, with requirements with regards to the elements to disclose and how to measure them specified in the DPER Circular for each corresponding year.

The Finance Accounts comprise the *Central Fund Account*, prepared on cash basis, and two distinct financial statements. Firstly, the *Financial Statements of Exchequer Receipts and Issues and Guaranteed Liabilities* comprises 12 statements that classify receipts and payments into and out of the Central Fund during the year by their nature. Secondly, the *National Debt Statement* details all transactions relating to the national debt, e.g. debt servicing, and outlines related risks. Both statements are prepared on a cash basis, but the National Debt Statement uses some accrual principles, as debt is measured at historical cost and derivatives are disclosed at both their nominal value and present value.

Figure 4. Ireland: Presentation and content of appropriation accounts and finance accounts



Source: Authors.

Although both the Appropriation Accounts and Finance Accounts are prepared on a modified cash basis, slightly different definitions apply to particular elements in the Appropriation and Finance Accounts, which sometimes makes it difficult to compare or navigate them. In particular, differences relating to the dates in which cash flow is recorded results in different amounts being reported for each Vote in the Appropriation Accounts and the Finance Accounts.[26] In addition, figures reported in the Appropriation Accounts and Finance Accounts with regards to contingent liabilities do not fully align.[27] [28]

Although some accrual information is available in both the Appropriation Accounts and Finance Accounts, a preliminary assessment undertaken as part of the OECD Review shows that balance sheets presented in the Notes of the Appropriation Accounts have been populated only partially and significant gaps exist compared to international standards

requirements. These gaps are very briefly summarised below, for assets, financial liabilities and other liabilities.

Regarding assets, although Ireland has been reporting fixed assets in Notes to the Appropriation Accounts since 2011, compliance with detailed requirements of international standards in relation to the classification, measurement, impairment and disclosures is limited. The same applies for equity investments, for which limited disclosures (opening balance, shares acquired, shares disposed and closing balance at nominal amounts) is provided in the Finance Accounts. Intangible assets and inventories are not reported at all.

Regarding financial liabilities, although the completeness and accuracy of debt instruments appears sound with an unqualified audit report issued in the National Debt Agency financial statements, some gaps exist with international standards, mainly in relation to the measurement basis used for reporting the National Debt and the disclosures required in relation to risks attached to financial instruments (particularly quantitative measures of those risks).[29] Debt in relation to leases and PPPs are not reported in any balance sheets, although the government publishes a table with the budget outlining details of all central government PPP projects in operation.[30]

Finally, regarding other liabilities, some information on employee benefits is available in Notes to the Appropriation Accounts (army pensions are disclosed in Vote 35 of the Appropriation Accounts, and pensions for retired civil servants in Vote 12 Superannuation and Retired Allowances). However, requirements of international standards in relation to disclosures are not met and other benefits are not reported. In addition, other types of liabilities (e.g. debtors and provisions in relation to litigations) are not reported in any of the current financial reports.[31]

This assessment is broadly consistent with recent reports of the Comptroller & Auditor General. Although the Comptroller & Auditor General is not required by legislation to formulate an opinion on whether the accrual information in the Notes to the Appropriation Accounts is complete, accurate and free from material error, recent audit reports mention concerns about the overall completeness and quality of data underpinning the accrual notes, as well as issues associated with the overall framework for reporting accrual information.

The Appropriation Accounts and Finance Accounts both have limited coverage (the Voted Expenditure for the former and the Central Fund for the latter).[32] This means that the relatively large share of public spending done outside of the Exchequer (Table 2) is not captured in the accounts laid out before the *Dáil* at year-end.

Table 2. Ireland: Expenditure relating to central government as a % of GDP (2017)

	Expenditure as a % of GDP
Central government expenditure	**25%**
Composed of:	
Exchequer expenditure	*19%*
Extra budgetary funds	*1%*
Social security funds	*3%*
Non-market semi-state agencies	*2%*

Source: Authors, based on information provided by the Department of Finance.

Funds, State bodies and local governments prepare accounts that are separate from those of the central Government due to their administrative autonomy. Requirements about the

accounts of each fund are laid out in their statutes and are not harmonised. State bodies and local governments are required to use accrual accounting standards based on the Financial Reporting Standard (FRS) 102.[33]

Accounting guidance for State bodies is detailed in the *Code of Practice for the Governance of State Bodies (2016)* and *A Guide to the Implications for the Annual Financial Statements and the Annual Report (2017)* issued by DPER. This Code of Practice provides detailed reporting requirements for the annual report, the financial statements, and the Chairperson's Report to the Minister. For local government, an *Accounting Code of Practice* is issued by the Department of Housing, Planning and Local Government, which identifies a number of authorised departures from the requirements of FRS 102.

Finally, legislation provides for clear requirements with regards to the timeline for the preparation, audit and presentation of the Appropriation Accounts and Finance Accounts to the *Dáil*, as shown in Table 3 below. Although these timelines are aligned, in recent years, Finance Accounts have been published earlier than the Appropriation Accounts.

Table 3. Ireland: Timeframes for preparation, audit and presentation of financial reports

	Appropriation Accounts		Finance Accounts	
Preparation	*End of March*	Accounting Officer submits Appropriation Accounts to C&AG	*End of June*	DoF submits Finance Accounts to the C&AG
Publication	*End of September*	C&AG tables Audit Report	*End of September*	SecGen tables Finance Accounts

Note: Finance Accounts have been tabled in July in 2016, 2017 and 2018.
Source: Authors.

Requirements exist also in relation to State bodies and funds. State bodies and funds are required to present their accounts or financial statements to their sponsoring government department within one month of the audit certificate being issued by the Comptroller & Auditor General, together with any report on their financial statements. In turn, government departments and offices are required to lay the audited financial statements of bodies and funds under their aegis before the Houses of the *Oireachtas* within two to three months of such accounts being received, together with any report of the Comptroller & Auditor General on the accounts. Government departments and Vote holders are also required to present a report on the audited financial statements of bodies and funds under their aegis to the Houses of the *Oireachtas* in an annex to their Appropriation Accounts.

2.3 Responsiveness to users' needs

Overall, government financial reports are fully aligned with the budget documents they report against and therefore allow for comparability of fiscal reports prepared throughout the budget cycle. The main users of budget documents and financial reports (Table 4) expressed satisfaction with this consistency and recognise the usefulness of cash-based information published through the budget cycle. In particular, a number of stakeholders underlined that, in the aftermath of the 2008 financial crisis, the cash basis framework proved particularly useful in setting clear spending limits for government departments and offices and monitoring liquidity.

Table 4. Ireland: Main external users of budget documents and financial reports

Institution	Task	Key reports used
Houses of the *Oireachtas*: Public Accounts Committee	Examine financial operations of Government and report on reports of the C&AG.	Appropriation Accounts, Finance Accounts
Houses of the *Oireachtas*: Budget Oversight Committee	Enhance the role of the Houses of the *Oireachtas* in the budgetary formation process.	Stability Programme Update, Fiscal and Economic Outlook
Houses of the *Oireachtas* Parliamentary Budget Office	Provide independent and impartial budget information, analysis and advice to the Houses of the *Oireachtas*.	Stability Programme Update, Summer Economic Statement, IFAC: Fiscal Assessment Reports, Budget Day Documents, Mid-Year Expenditure Report
Irish Fiscal Advisory Council	Independent assessment of official budgetary forecasts and proposed fiscal policy objectives.	Stability Programme Update, Summer Economic Statement, IFAC: Fiscal Assessment Reports, Budget Day Documents, Mid-Year Expenditure Report
Central Statistics Office	Government Finance Statistics reporting, Excessive Deficit Procedure Reporting.	All
Academics, think tanks, such as the Economic and Social Research council, the media and the general public	Analyse budget information in order to hold the government to account.	All, but in particular the Budget Day Documents and Monthly Fiscal Reports

Source: Authors.

Despite these strengths, Ireland's current practices do not fully align with international best practices for financial reporting, including the OECD *Recommendation on Budgetary Governance*, whose budget principle number 6 sets out that governments should *"present a comprehensive, accurate and reliable accounts of public finances" by "accounting comprehensively in the budget document for all expenditures and revenues of the national government"; "presenting a full national view of the public finances; and "accounting in a manner that shows the full financial cost (…) of budget decisions, including the impact upon financial assets and liabilities".*

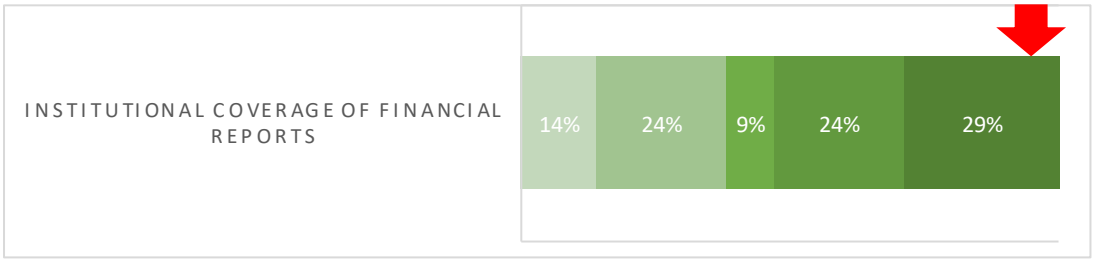
Data collected by the OECD confirms that practices in Ireland lag behind those of other OECD countries in three areas (Figure 5):

- Accrual information is limited, as highlighted by a preliminary accounting gaps assessment done by the OECD. Ireland is therefore part of the small group of countries that use cash or modified cash accounting, while around three quarters of OECD countries have adopted accruals;
- The institutional coverage of the accounts is narrow, which contrasts with the current practices in two-thirds of OECD countries, whose accounts cover at least central government; and
- Time lags for publishing reports are longer than those of other OECD countries, whose average is below six months.

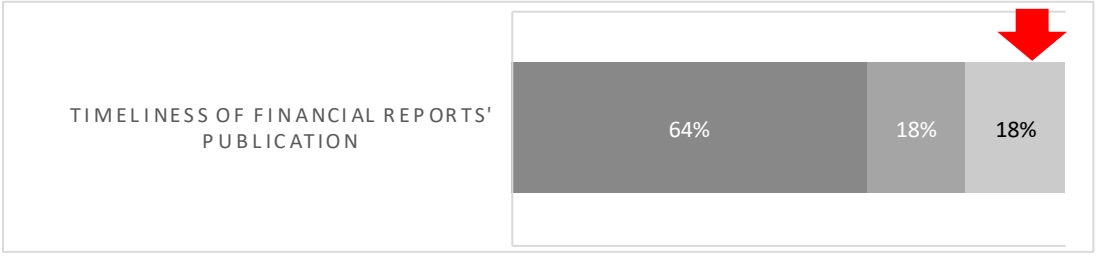
Figure 5. OECD countries: accounting basis, coverage and publication date for year-end accounts



Note: reading from left to right, accrual basis, cash transitioning to accruals and cash. Data above shows practices of all OECD countries. Ireland is positioned with the red arrow.
Source: Moretti (2016).



Note: reading from left to right, public sector; national or federal government; central and local government (general government); central government; and budgetary central government. Data above shows practices of all OECD countries. Ireland is positioned with the red arrow.
Source: Moretti (2016).



Note: reading from left to right, 1-5 months; 5-7 months; and 7-12 months. Data above shows practices of all OECD countries. Ireland is positioned with the red arrow.
Source: OECD Budget Practices and Procedures Survey 2018 (internal document)

Interviews conducted with Irish stakeholders for this Review confirmed that the Irish financial reporting framework is perceived as somehow outdated and that improvements are considered necessary and urgent. Stakeholders identified a number of issues to be addressed that are mostly "technical" in nature, but also expressed more general concerns with regards to the purpose and legibility of the accounts prepared by the government, as summarised below.

The first of the "technical" concerns is in relation to the nomenclature for presenting Appropriation Accounts. Within each Vote, the nomenclature used for presenting expenditure and revenue may differ, which gives rise to variation in the granularity that is available on spending information for each government department. Concerns were expressed during interviews with the level of detail of the budget nomenclature in certain key areas of spending (e.g. health expenditure).

Some observers also underlined that Ireland's cash accounting system has a number of weaknesses. Firstly, the "net cash basis" used in spending authorisations does not capture, in revenue estimates, the so-called *Appropriations in aid* – i.e. revenue that is not paid into the Exchequer Account and is retained by a government department or office to offset its own expenditure.[34] Secondly, as government transactions are recognised only when the associated cash is received or paid, the accounting system creates opportunities for deferring disbursements or bringing forward receipts, a problem that is not unique to Ireland but inherent to the nature of cash accounting.

In the wake of the 2008 financial crisis, there was also increased awareness that cash financial reports, because they did not capture all government assets and liabilities, could not indicate the extent to which public finances would react to economic shocks. The lack of a complete picture of government assets, such as how much land the state owns, and liabilities, such as PPPs, pensions and medical liabilities, is also increasingly considered to limit the depth and breadth of external scrutiny into government fiscal management and the reliability of fiscal forecasts.

The Public Accounts Committee and the Comptroller & Auditor General have both pressed for improved timeliness in the publication of financial statements of funds and State bodies. While the timeliness of monthly income and expenditure on cash terms is recognised by most stakeholders, interviews during the OECD mission highlighted concerns in relation to the nine-month time lag before Appropriation Accounts are laid before the Public Accounts Committee.[35]

The last "technical" challenge is in relation to the fragmentation of the framework. It could be argued that financial information on funds and State bodies is provided in their individual accounts or financial statements. However, policy makers' understanding of the scale and costs of sectoral policy implemented by various public actors is impaired as information is scattered among numerous budgets and financial reports that are difficult to navigate and reconcile.[36]

The fragmentation of the financial reporting framework also generates difficulties for the Central Statistics Office, Ireland's national statistical office, which is tasked with compiling government finance statistics for publication and submission to Eurostat. These statistics are of critical importance, as they form the basis of the assessment of Ireland's compliance with fiscal rules under the EU requirements.

Statistics required by Eurostat are to be prepared on accrual basis (with the exception of tax revenue). Although the Central Statistics Office developed quasi-accrual statistics pre-2014 (and has full data series back to 1995), preparing this data required developing models and estimates of the value of most assets and liabilities held by the government. Indeed, for local authorities and State bodies, which prepare accrual based financial statements, important variations still exist in the interpretation of accounting standards. For central Government, only cash data is available, and broad adjustments are required to move from cash to accrual figures.

Box 3. Ireland: The Central Statistics Office

Mandate and mission

The Central Statistics Office (CSO) was established in 1949 as Ireland's national statistical office. To ensure its independence on statistical matters, it now stands as a separate Office attached to the Department of the *Taoiseach*, the Prime Minister and Head of Government in Ireland. The Statistics Acts, 1926 and 1946 provided the statutory basis for the compilation of statistics up until 1994, after which the Statistics Act 1993 came into force, providing a modernised basis for the compilation and dissemination of official statistics.

The CSO's mandate is built on the Statistics Act 1993 and on EU Regulation 23/2009, and allows for "The collection, compilation, extraction and dissemination for statistical purposes of information relating to economic, social and general activities and conditions in the State" (Section 3, Statistics Act 1993).

As such, the CSO has a formal co-ordination role to play across the public service in relation to official statistics. Under Section 10 of the Statistics Act, the CSO has authority to co-ordinate official statistics compiled by other public authorities and to assess and realise the statistical potential of their administrative records. Under Sections 30 and 31 of the Act, the CSO also has powers of access to the records of public authorities, for statistical purposes, and to obtain the co-operation of public authorities in developing the statistical potential of administrative records.

Work programme at national and international level

The CSO's strategic planning is informed by both national and international developments.

At **national level**, for instance, the Department of Public Expenditure and Reform recognised in November 2011 that good quality data and information was essential to deliver on their actions of improving customer services and public sector efficiency. As part of this plan, the CSO was assigned the task of developing 'a code of practice and standards for the gathering and use of data for statistical purposes in the Public Service'. The CSO developed the Irish Statistical Code of Practice (ISSCoP), which sets out a standard for statistical production and dissemination of Official Statistics by other Public Sector organisations. The ISSCoP was launched in November 2013 and this was a first step in formalisation of the co-ordinating role of the CSO within the ISS.

At **international level**, meeting EU requirements has been the single most important factor shaping the development of the CSO's work since the 1970s. Since accession to the European Community in 1973, the CSO's work programme has been almost completely driven by the mandatory requirements of EU Directives and Regulations.

In 2015, the Regulation (EC) No 223/2009 on European Statistics was revised. This new EU Regulation 2015/759 fundamentally changed the role of the CSO, which became responsible for co-ordinating and overseeing the quality of all European Official Statistics in Ireland. The CSO now ensures that all 15 public sector bodies which produce European statistics are adhering to the quality and methodological standards set out by the EU and detailed in the European Statistics Code of Practice.

Structure and outputs

The CSO comprises six Directorates The Economic Directorate is responsible for the development and compilation of national accounts; financial accounts; government accounts; balance of payments, international investment position, foreign direct investment and international trade in services statistics; and international trade in goods statistics.

The CSO prepares a consolidated Annual Statistical Work Programme covering statistical surveys and other statistical activities. It also prepares three-year Statements of Strategy setting out the key objectives, outputs and related strategies (including the use of resources) for the CSO over the three-year period. Progress in implementing these statements of strategy is outlined by the CSO in Annual Reports prepared for the National Statistics Board.

In the area of government accounts, the CSO's outputs are Government Finance Statistics (GFS) annual and quarterly publications, the Excessive Deficit Procedure (EDP) biannual transmissions and the ESA transmission programme. These reports are used as the baseline for the fiscal analysis of the government in the context of the European Stability and Growth Pact. Since the CSO are downstream beneficiaries of the outputs produced by DPER, the quality of financial reporting is critical in the production of these statistics.

Source: Authors, based on public information.

Beyond these technical issues, stakeholders raised a number of concerns with the overall framework for financial reporting, expressing the desire that the reports be clearer and more informative. This concern is not unique to Ireland, as highlighted by a recent OECD study (Box 4).

Firstly, the Vote structure of the Appropriation Accounts, despite being well known and understood by users, creates challenges. It does not fully align with the responsibilities of government departments and offices. This means that, when a government department is responsible for one, two or three votes, there is no aggregated vision of their total resources and spending. This hinders users from finding what they might think is relatively simple information on spending allocated to certain government programmes.[37]

More generally, users of Appropriation Accounts find Votes of limited relevance for assessing and improving efficiency within each government department, as they do not align with performance data. In some OECD countries, financial and performance information is integrated. That is the case, for example, in France and Austria.

An additional issue raised during OECD interviews in relation to the Appropriation Accounts was their length (for example, the 2017 Accounts are 958 pages long). The large size of the document can make it time consuming and difficult for users to find the information they are looking for. A related concern is that key figures and analysis do not have due prominence, as these are lost among financial information and detailed disclosures that are not relevant to decision-making.

Finally, in terms of the overall reporting framework, a range of stakeholders and observers also advised that any modern approach to financial reporting in Ireland should aim to clarify the purpose for each report prepared at year-end and avoid duplication of information. It is the perception of a number of stakeholders that there is an overlap in the coverage of the Finance Accounts and the Appropriation Accounts, as both focus on accountability for the use of resources and regularity of transactions, with neither focusing on the financial performance or the financial position of the government.

Box 4. OECD: Rationalising Fiscal reporting

The OECD study "Rationalising Fiscal Reporting" notes that government financial reporting has profoundly changed in recent decades to better address the needs of users in terms of both fiscal transparency and accountability, with an increasing use of the accrual basis for government reporting and more sophisticated budget nomenclatures (e.g. programme classification). However, even in the most advanced OECD countries, a number of issues with government fiscal reports, which are mostly "technical" in nature, are still identified by users. New layers of fiscal reporting requirements have sometimes resulted in "reporting strands" that may not be fully connected to each other. In particular, fiscal reports are difficult to navigate when they use different classifications or accounting bases. Delays in the provision of fiscal documents severely affect their relevance. Fiscal reports fail to represent key figures and analysis with due prominence as, all too often, current budgeting or accounting frameworks may require "overloaded" financial information and detailed disclosures that are not relevant to decision-making. In addition, information provided in fiscal reports is sometimes overly technical, hence difficult to understand and make use of for non-technical readers.

Against this background, the OECD identified eleven areas that governments need to pay attention to for making their fiscal reporting transparent, understandable and legible for users, as follows:

- The need for fiscal forecasts, budgets, and accounts to be aligned or include bridging tables to allow for comparability and accountability;
- The need to present fiscal data in a multi-faceted and connected way (consolidated/aggregated format and entity-level format; classification by type, administration or programme);
- The need for budget documents not only to be timely but appropriately sequenced;
- The need to ensure an appropriate mix of timely in-year provisional reports and comprehensive audited year-end reports;
- The need to use IT to allow parliamentarians and citizens to delve into the detail of fiscal reports and structure their own queries rather than have to only read data the way governments want them to;
- The need to bring financial and non-financial performance information into a simple and unified report;
- The need to provide simple and accessible summaries of fiscal reports for citizens and parliamentarians;
- The need to provide analysis and interpretation of complex and technical government financial information;
- The need for forecasts and budgets and performance information to be subject to the same degree of independent scrutiny as accounts to ensure their integrity;
- The need for regular and formal dialogue between governments and parliaments about their reporting requirements;
- The need for more regular and reliable measurements of costs associated with reporting requirement to inform reviews of fiscal reporting frameworks.

Source: Moretti (2018).

3. Modernising the Financial Reporting Framework

3.1 Addressing weaknesses of the current framework

Any reform of government financial reporting in Ireland would have to be cognisant of the need to maintain the core elements of the existing framework, in particular the accountability information on a cash basis for each Vote, while addressing the three main "technical" weaknesses identified by users – i.e. improving the completeness of the financial operations reported in the Appropriation Accounts; shortening timeframes for the preparation, audit and publication/tabling of all public bodies' financial reports; and allowing users to have a more comprehensive view of the financial position of the Irish Government.[38]

Regarding the timeliness of financial reports, the ease with which year-end financial statements can be prepared depends on the degree of automation and integration of government accounting systems. For the Government departments and offices, the development of a new IT system, discussed in the following section of this chapter, could provide an opportunity for streamlining accounting processes and automating the production of the tables in the year-end accounts.

The government should more generally consider a "faster closing" initiative for Government departments and offices, funds and State bodies and aligning requirements for the preparation and publication of their year-end accounts. However, this would have significant operational implications, in particular in terms of potential increase of resources, and the feasibility would need to be assessed with all stakeholders, including auditors.

To allow users to have a clearer view of the financial position of the Irish Government as a whole, at a minimum, the government should seek to harmonise accounting standards used across entities. While this was already done for State bodies and Local Government, accrual information provided for each Vote is incomplete and funds follow different accounting requirements, as set in their individual statutes. Moving fully to the accrual basis of accounting and further aligning accounting practices across government would allow for more clarity and comparability and, consequently, allow users to better navigate year-end accounts. It would also significantly facilitate the preparation of fiscal statistics and increase their reliability.

To improve the completeness of the financial operations reported in the Appropriation Accounts, a first reform to implement would be to enclose comprehensive accrual financial statements in the Notes of the Appropriation Accounts – that is financial statements compliant with international accounting standards.[39] It is to be noted that, in addition to providing a comprehensive view of the government's financial position and the full costs of its operations, accrual financial statements would include cash flows statements that disclose receipts and payments on a gross basis, as opposed to the net basis used in the Vote tables.

Beyond immediate improvements of the completeness and clarity of the government's financial data, adopting accrual accounting in addition to traditional cash accounting would offer a number of benefits from the point of view of accountability and fiscal management in Ireland, which are described in more detail below. It is to be noted that such transitions to accrual accounting have been done in the past for certain public sector entities and are generally considered to have had positive outcomes (Box 5).

Box 5. Ireland: Accrual accounting in higher education

The public higher education system in Ireland derives a very significant share of its funding from the Exchequer, through the Department of Education and Skills, and an intermediary body, the Higher Education Authority. Although that public funding is provided on the basis of the Exchequer appropriation system described elsewhere in this report, within the institutions, accounts are prepared on an accruals basis, using the FRS standards.

The system switched from cash-based reporting to an FRS approach and is well enshrined today. Some of the advantages identified by stakeholders are as follows:

- As institutions with diverse sources of income, many of which can be transient in nature (e.g. funding won through competitive research allocations), it is essential that the institutions are able to use accruals to identify underlying flows of income and costs, which on a cash basis might significantly distort single year financial reports.
- Some higher education institutions have in recent years sought to use borrowing as a means to invest in capital infrastructure developments; the lending institutions – both the European Investment Bank (EIB) and private banks required significant financial detail, on a very robust basis to support such lending, which would not have been possible without the more robust financial reporting through use of FRS.
- The accruals basis of financial reporting has required institutions to look more rigorously at their asset base, to take into account depreciation, and make provision for such depreciation as part of wider financial planning. It has engendered a more rigorous approach to costing investments on a life cycle basis – which in turn provides a more robust basis to cost/benefit analysis to inform investment decisions.
- The use of a robust accruals system has facilitated many institutions to delegate budgets to the level of academic units (such as Faculties of schools). Those units take responsibility of both their costs and income generation. This enshrines greater cost disciplines across the wider institution, but also incentivises the development of revenue generation ideas locally, that can allow further investment in the institutional mission. Such delegation would be impossible under a cash allocation model.

Source: Authors, based on information provided by DPER/Higher Education Instituations.

3.1.1. Management of assets and liabilities

By capturing non-cash transactions in financial statements, accrual-based fiscal reports allow public sector managers to better monitor the acquisition and disposal of the assets they are responsible for, to identify liabilities generated during the course of the year, leading ultimately to better and more cost-effective management.

Importantly, it also allows policymakers to exercise greater monitoring and scrutiny of certain sensitive government assets (e.g. lands and buildings), liabilities (e.g. PPPs), provisions (e.g. medical negligence) and contingent liabilities (e.g. guarantees).

In Ireland, it has been the case in the past that liabilities, provisions and contingent liabilities have accumulated without formal monitoring, giving rise to spending risks. A move to accrual accounting would therefore be useful in improving monitoring mechanisms in targeted areas, as was done for example in the United Kingdom through the analysis and monitoring of the Whole of Government Accounts (Box 6).

More generally, better managing assets can ensure that they are delivering value and lead to significant increases in fiscal revenues.[40] To achieve this, data availability needs to be improved and transparency in the management of public assets needs to be enhanced, as underlined by the European Commission.[41] Overall, as accrual accounting leads to greater transparency on assets, it can therefore also lead to improvements in government resources management.[42]

Box 6. United Kingdom: Assets and liabilities monitoring and management

Building on the information published in the Whole of Government Accounts, assets and liabilities monitoring and management has been strenghtened in several areas in recent years in the United Kingdom.

- **Intangible assets** – The UK has published a report on improving measurement and management of intellectual property and other intangible assets in the public sector in order to increase financial, economic and social returns and unlock cashable benefits. An academic study of EU countries estimated the UK's stock of intangible assets at GBP 150 billion.
- **Private Finance Initiative** – The balance sheet analysis has given a more detailed understanding of the costs and benefits of PFI contracts. The UK has concluded that the PFI model of public/private partnership is inflexible, overly complex and a source of significant fiscal risk to the government. UK announced in Autumn 2018 that it will no longer use the PFI model for new projects and implement a new Centre of Best Practice to manage existing PFI contracts.
- **Reducing inflation exposure** – The UK government is taking action to reduce its inflation exposure by looking to reduce the proportion of index-linked gilt issuance in a measured fashion over the medium term. This was prompted by a detailed review of the risk exposure on balance sheet liabilities.
- **Debt owed to the government** – The UK government is using balance sheet disclosures to better understand and improve its recovery of over GBP 20 billion of overdue debt through new performance management measures. This has already collected an extra GBP 472 million over the last 3 years.
- **Contingent liabilities** – A more detailed understanding of contingent liabilities (both individual and aggregate risk) led the UK government to introduce stricter controls over the issuance of guarantees and other contingent liabilities. The new regime has already been applied to over 60 new contingent liabilities since its introduction in 2017, with a total value of GBP 158 billion, with over GBP 1 billion of new liabilities rejected outright while others were only approved after significant modification to reduce exposure. The UK continues to explore options to improve incentives and secure appropriate compensation for the taxpayer when providing insurance to the private sector. The balance sheet and financial reporting requirements have driven these reforms.

- **Asset sales and loans** – The UK is planning to introduce stricter disclosure requirements for asset sales and revised budgeting treatment for financial transactions (e.g. loans) to improve transparency, incentives and help drive better value for money when considering asset sales.

Source: Authors, based on public information.

3.1.2. Understanding risks to public finances

In adopting accrual accounting, and increasing the coverage of financial reports, government could get a more comprehensive understanding of past spending, which would in turn allow more accurate planning and effective risk management.

In the case of Ireland, there has recently been a persistent pattern of large overruns in health spending.[43] One of the challenges in forecasting health expenditure has been a lack of comprehensive financial information from hospitals, particularly voluntary hospitals (Section 38 institutions). Harmoning accounting practices across all entities would be a prerequisite for addressing some of the existing challenges.[44] Reporting all assets and liabilities would also allow identifying any liabilities that may exist in relation to the health sector (for example medical negligence claims), which would provide an insight into future spending risks in the sector and hence improve the quality of expenditure estimates.

One question regularly raised during interviews with stakeholders is whether accrual accounting would allow better decision making in the event of a future financial crisis.

In many OECD countries, the 2008 financial crisis demonstrated the existence of shortcomings in fiscal disclosure, such as previously unreported fiscal deficits and debts and the provision of substantial government guarantees to the financial sector. These can be argued to have resulted from gaps and inconstencies in fiscal transparency standards, delays and discrepancies in countries' adherence to existing standards, and a lack of effective multilateral monitoring of compliance with those standards.

Other Governments that have implemented accrual accounting consider that they are now more conscious of risks and better equipped to mitigate them. For example, in an increasing number of countries, non-cash financial operations (e.g. issuance of guarantees, PPPs, leases) are now subjected to the same degree of scrutiny and control as ordinary spending.

A recent OECD study (2018) also underlined the importance of the statement of financial position in providing an assessment of the resilience of public finances. For large economic downturns, citizens expect their governments to act as a shock absorber, and the statement of financial position provides a more enhanced view than a single debt measure of the government's ability to perform this function. In preparing its response to shocks, the government can assess the whole structure of the balance sheet, including the reserves and other financial instruments that the government owns, and better identify options it has to react and adapt.

3.1.3. Improving the preparation of statistics

As noted above, the quality of fiscal statistics for reporting under the EU economic governance framework[45] depends on the completeness and reliability of the underlying accounting data. Maintaining government accounts and fiscal statistics on an accrual basis is crucial to assessing how the government performs against these fiscal targets which are defined on an ESA2010 basis. These statistics are aimed at identifying fiscal risks

comprehensively and precisely, assessing the resilience of public finances, and providing vital indicators of the health of the government's finances and the national economy.

A move to accrual accounting would provide a more solid base for the compilation of these statsitics in Ireland, as currently the Central Statistics Office must develop its own estimates on the value of some government assets and liabilities for inclusion in the finance statistics.

3.1.4. Modernising and rationalising the financial reporting framework

Within the frame of these necessary "technical" improvements, more ambitious reform options could be considered by the Irish Government to better suit the wide needs of stakeholders.

Firstly, the government should seek to provide stakeholders with an aggregated vision of budget outturns for the whole of central Government, which is not provided in the Appropriation Accounts (spending and revenues are disclosed by Vote, but not aggregated) and in the Finance Accounts (spending and revenues outside of the Central Fund are not reported).

Secondly, the government should prepare accounts that allow users to have an overview of each department's resources and spending, ideally alongside information on their strategy and performance, which is currently scattered across various documents (three-year strategic plans, annual business plans, the Revised Estimates Volume and Public Service Performance Report). This would facilitate improved sectoral committee scrutiny at the Houses of the *Oireachtas*, an objective that has been pursued recently by a number of advanced OECD countries.

For example, under the Australian Government's new performance framework, reporting entities have been required to include summary performance information in documents presented to parliament to inform the budget discussion, publish an annual corporate plan and include a performance statement in their annual report. Austria also stands out as a good example for performance budgeting, which was introduced as part of major budget law reforms in 2009 and 2013. In Austria, for each of the 32 budget chapters, each ministry now has to define a maximum of five policy outcomes with related performance indicators, which require the approval of parliament. In turn, the Austrian Parliamentary Budget Office makes recommendations to the government on how performance information can be improved, and pushes for better and earlier access to information.

In the United Kingdom, a new format for Government Departmental Annual Reports and Accounts was adopted in 2016, which combines performance, accountability and financial information (see Box 7).

Box 7. The United Kingdom: Departments' Annual Reports and Accounts

In the UK, the 2013 Simplifying and Streamlining Accounts reforms restructured the presentation of statutory annual reports and accounts produced by Government Departments to better meet the needs of users, structure them more logically and remove unnecessary or irrelevant material. The project has led to a restructuring of the traditional presentation of Annual reports and accounts into three sections combining all reporting requirements: performance; accountability; and financial statements.

The first section, "Performance", gives users a short summary that provides them with sufficient information to understand the organisation, its purpose, the key risks to the

achievement of its objectives and how it has performed over the year. This section includes performance reporting against Government Departmental objectives (priorities and responsibilities including qualitative information and contextual information); corporate governance; statement of purpose and risks to meeting objectives; staff composition, sickness absence and staff policies; reporting on better regulation; reporting on sustainable development, climate change adaptation, rural proofing; complaints to the Parliamentary Ombudsman; effectiveness of whistleblowing arrangements; any other information in the public interest; performance in responding to correspondence from the public; recruitment practice; and health and safety reporting.

The second section, "Accountability", aims at meeting key accountability requirements to Parliament. It is the section where Government Departments demonstrate compliance with norms and specific codes of good corporate governance. It includes the Statement of Parliamentary Supply, which is the primary parliamentary accountability statement. It reports the outturn for the Government Departmental group against the final annual spending entitlements authorised by Parliament. Core Tables provide a summary of Government Departmental spending - looking both backwards and forwards - using the same headings as voted within the Estimate.

The final section, "Financial Statements", presents the entity's financial position according to International Financial Reporting Standards as adapted or interpreted for the public sector. The Annual Report and Accounts includes a Certificate and Report of the Comptroller and Auditor General to the House of Commons. The Comptroller and Auditor General certifies that the financial statements including the Statement of Parliamentary Supply have been audited and gives the Comptroller and Auditor General's opinion on the accounts. Where the Comptroller and Auditor General has specific concerns, he/she may qualify the accounts.

Source: Authors, based on HM Treasury (2014).

Thirdly, the government should establish consolidated financial statements that would provide a complete picture of Ireland's underlying fiscal position and allow a more comprehensive understanding of the level and composition of government spending and revenue and the related accumulation of government assets and liabilities, regardless of whether activities are carried out through a Vote, a fund or a State body.

A consolidated balance sheet would provide the most meaningful picture of the government financial position, by bringing together assets and liabilities that the government generates through government departments (such as infrastructure assets reported on the balance sheet of the Office of Public Works) or agencies (such as the National Debt reported on the balance sheet of the National Debt Management Agency or the provisions recorded in the financial statements of the State Claims Agencies).

Another benefit of preparing consolidated accounts is that they could allow disclosing certain government activities or group of activities as "segments", meaning that assets, liabilities, revenue and expenses carried out by different entities (government departments, funds or agencies) can be aggregated if they relate to a similar activity. In the case of Ireland, this would allow a comprehensive vision of the resources allocated to certain public services, such as health, despite the fact that they may be carried out by several entities across government.[46]

It is also in line with recommendations from the Committee of the Public Accounts at the Houses of the *Oireachtas* in its 3rd Periodic Report. The Committee recommended that the Government prioritise the production of a consolidated central government financial statement, stating: *"There is no report that gives a complete picture of the public sector's net worth. This lack of clarity makes it difficult to follow the flow of public funds, and impedes accountability"*.[47]

Finally, the government should clarify its financial framework by avoiding as much as possible the duplication of information, preparing reports that have a clear and distinct purpose, highlighting key figures and providing management commentaries on the financial reports tabled before the *Dáil*. For example, information on the National Debt is diclosed in the Finance Accounts as well as in the audited financial statements of the National Debt Management Agency.[48]

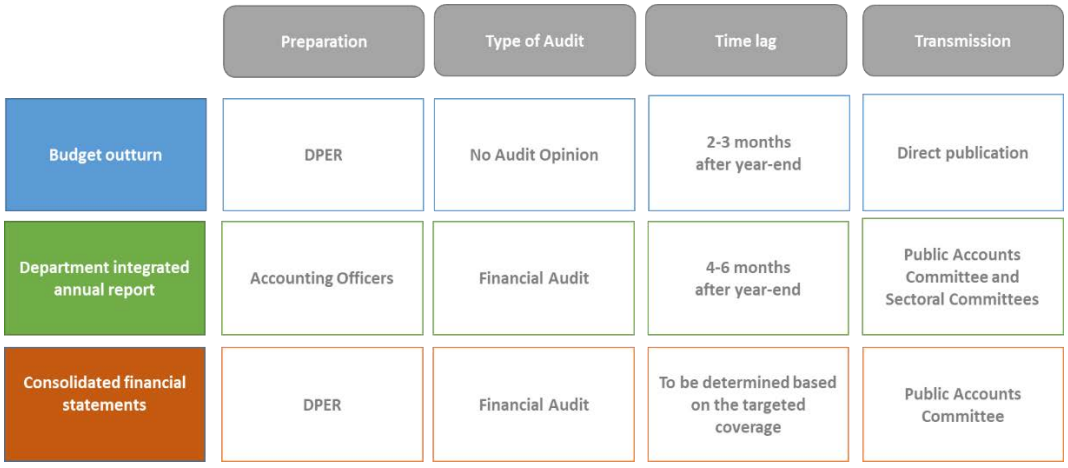
3.2 Rationalising the Financial Reporting Framework

Against this background, it is suggested that the government considers preparing three sets of financial reports at year-end, as follows:

1. A budget outturn could be published just after the end of the fiscal year. The budget outturn would show the aggregate outturn for all Votes, therefore addressing one weakness of the current Appropriation Accounts, which is that there is no overview of the total outturn against the total amount voted. This budget outturn would allow developments in key fiscal aggregates to be tracked in a timely manner, enabling improved monitoring;
2. Departments could be required to prepare "integrated annual reports", which would comprise i) outturns for the Vote(s) that fall within the responsibility of the department, ii) accrual basis financial statements and iii) information on the strategy and performance of the department. These reports, which would be used to hold government departments and offices to account for their spending and performance over the course of the year, could be laid either before the Public Accounts Committee or directly before relevant sectoral committees and;
3. Consolidated financial statements aggregating the individual accrual accounts of each government department and office (and, as soon as possible, those of the funds and State bodies) could be prepared later in the year, but yet still early enough to remain useful for users. These financial statements would be laid out in front of the Public Accounts Committee to enable it to fulfill its oversight responsibility in relation to overall government expenditure.

Publishing the budget outturn, integrated annual reports for government departments and offices and consolidated financial statements separately would provide an opportunity to better sequence the publication of the financial reports after the end of the fiscal year. The budget outturn would be published first to inform the discussion on the Stability Programme Update which needs to be submitted to the EU by end April; integrated annual reports for each department would be submitted on a more timely basis, and directly to sectoral committees; and consolidated financial statements would be published last to accommodate the pace of the slowest entities and to enable the Public Accounts Committee to fulfill its oversight responsibility in relation to overall government expenditure. This would also allow separate and appropriate audit procedures to be defined for each set of accounts, depending on the Comptroller & Auditor General's resources constraints.[49]

Figure 6. Ireland: Summary of proposed changes to financial reporting framework



Source: Authors.

It is important to underline that the proposed framework would not bring about any loss of information compared to the current one, but is focused on rationalisation and modernisation, in line with trends in countries, which, similar to Ireland, follow the Westminster budget tradition (Box 8). As shown in Figure 7, information currently disclosed in the Appropriation Accounts would indeed be presented in government departments and offices' integrated annual reports. Information on National Debt would be provided in the National Treasury Management Agency's financial statements. Information on cash payments and receipts relating to the Central Fund would be reported in the cash flow statement of the consolidated financial statements, albeit in a different format. In deciding the new framework for reporting, the Government should consider whether it would be desirable to continue publishing the Finance Accounts.

Box 8. Selected OECD countries: financial reporting frameworks

In Australia and the United Kingdom, three sets of accounts are prepared at year-end, with some variations in terms of the way the accounts are presented, the time lags for their publications as well as audit requirements:

Firstly, year-end budget outturns show aggregated final outturns against initial and revised spending authorisations and are published within three to six months after the end of the fiscal year. This is the core accountability document about the approved budget and/or spending authorisations.

Secondly, government departments and their dependent bodies publish individual financial reports. They are usually published after the year-end budget outturns, due to longer closing and audit procedures. They are aimed at stakeholders who are interested in monitoring sectoral spend.

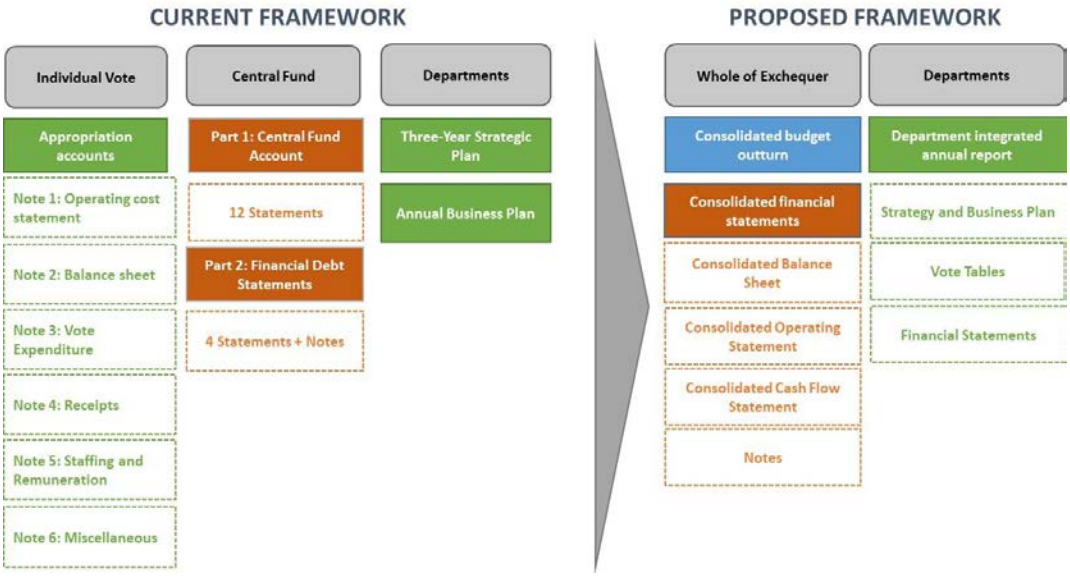
Finally, consolidated financial statements with a wider institutional coverage, are published later in the year. In Australia, consolidated financial statements including government-controlled public corporations are published within 5 months after the end of the financial year. The United Kingdom is the only country that produces consolidated financial statements for the whole of the public sector. They are published within 12 to 14 months

after the end of the fiscal year. These documents are aimed at stakeholders that want to understand the whole of government finances. In addition, the UK also produces a Consolidated Fund report which shows receipts and payments on the Consolidated Fund as well as some accrual information to assist with the whole of government consolidation.

	Financial Reports	Time-lag
Australia	1/ Budget outturn (Final Budget Outcome)	3 months
	2/ Government Department accounts (Annual Reports)	4 months
	3/ Consolidated accounts (Australian Government Consolidated Financial Statements)	5 months
The United Kingdom	1/ Budget Outturn (Public Expenditure Statistical Analysis)	3 months
	2/ Government Departmental accounts (Annual Reports and Accounts)	7 months
	3/ Consolidated accounts (Whole of Government Accounts)	12 months
	Consolidated Fund Account	4 months

Source: Moretti (2018)

Figure 7. Ireland: Rationalisation of the financial reporting framework



Note: Consolidated financial statements would cover the Government departments and offices initially but would be extended to the whole of general government at a later stage.
Source: Authors.

Such changes to financial reporting could also provide an opportunity to assess the usefulness of some of the information currently provided, in co-operation with the main stakeholders, including *Dáil* committees. Consultations could be held on whether all Notes to the Appropriation Accounts are considered useful and should be transferred into the departments integrated annual reports. Consideration could be given as to whether the twelve statements currently presented in the Financial Statements of Exchequer Receipts and Issues and Guaranteed Liabilities provide information that should be transferred into the consolidated financial statements. This would be consistent with the trend observed across OECD countries towards the simplification of fiscal reporting to decrease production costs and increase the clarity of government reports (Box 9).

Box 9. Selected OECD countries: Simplifying fiscal reports

In the Netherlands, the 2012 "Performance Budgeting" reform involved a major overhaul of the performance budgeting structure in order to enable more detailed parliamentary oversight as well as to enhance internal control by the Ministry of Finance and line ministries.

The financial reports of Australian Government entities have been recently simplified and decluttered to 1) assist readers and users by providing simpler, more meaningful information and 2) reduce unproductive workload, which does not add value to the readability of the statements. In addition, budget documents have been reviewed to ensure consistent information and appropriate level of disclosure.

In Canada, the format of the estimates has been revised to simplify their presentation.

In France, the length of budget documents has decreased by around 20% during the last decade following several review exercises.

In the United Kingdom, departments' year-end financial reports were simplified in 2015. The Treasury is also looking at possible reforms to the presentation of the Whole of Government Accounts, including reviewing the content of the accounts to determine whether the disclosures are proportionate and focussed on the material items in the accounts.

Importantly, these government-led simplification exercises have been conducted with great attention paid to not impairing transparency and followed a formal process that involved inputs from key stakeholders prior or post reform implementation.

Source: Moretti (2018).

3.3 Seizing opportunities for change

The Financial Management Shared Services (FMSS) project and Civil Service Renewal Initiative offer timely opportunities for moving forward the financial reporting framework modernisation agenda.

Central government in Ireland is in the midst of a FMSS Project to migrate entities to the National Shared Services Office (NSSO). Entities are being migrated in waves, the plan for the migration of entities to the new service is nearing finalisation, with options for deployment and timelines to be considered and approved imminently. The NSSO scope of activities covers HR Shared Services, Payroll and Finance. When fully implemented, it is expected to support around 52 organisations, process around 625 000 invoices per annum and process payroll for about 124 500 employees.

Importantly, the technology platform that is being rolled out by the Irish Government is a modern accrual-based IT system that could readily support the introduction of accrual accounting. However, this does not mean that the system will be at any point able to do so if decisions on the transition to accrual accounting are delayed. Indeed, as with many technology-enabled projects, clear objectives need to be set out to ensure full and orderly development of the necessary functionalities within the system. It will also be important to ensure that the FMSS is closely managed to ensure that the integration of the schedule for FMSS and the implementation of accrual accounting are not adversely impacted by potential delays in either project.

In the case of Ireland, the NSSO have provided assurance that the new FMSS will be capable of delivery of an accrual accounting system.

If customisations are made to the system, this may limit accrual functionality or otherwise impact on accrual based financial reporting. It is therefore advisable that accrual accounting objectives be set out as soon as possible and communicated to the team in charge of developing and rolling out the new IT system.

However it should also be noted the FMSS does not have complete coverage of central government and may in fact only encompass 20% of total government expenditure. The main omissions from its scope are the Health Service Executive, which accounts for a significant proportion of government expenditure. It is understood that the Department of Health and the HSE are undertaking a project to develop a new financial management reporting system. Ways could therefore be sought to ensure that this system meets the accounting requirements as outlined in this report and should be compatible with the NSSO's FMSS.

It should also be noted that there is a close relationship between the requirements of accrual accounting and statistics. The FMSS project provides an opportunity to develop a chart of accounts that would support the production of both financial reports and fiscal statistics. This would facilitate greater consistency between the two sets of accounts, increasing the reliability of the underlying data for fiscal statistics and considerably streamline their preparation.

This has been achieved, for example, in recent years in Portugal where a single chart of accounts has been developed that is used to record all financial operations and report them according to three different nomenclatures: the cash-basis national budget outturn, the IPSAS based financial statements and the ESA2010 based fiscal statistics.

Ideally the Chart of Accounts underlying the FMSS would be multi-dimensional to provide for a broad range of analyses of the governments accounts both on a statistical basis and on a programme basis to allow for better understanding and interrogation of the accounts.

Box 10. Portugal: Chart of accounts

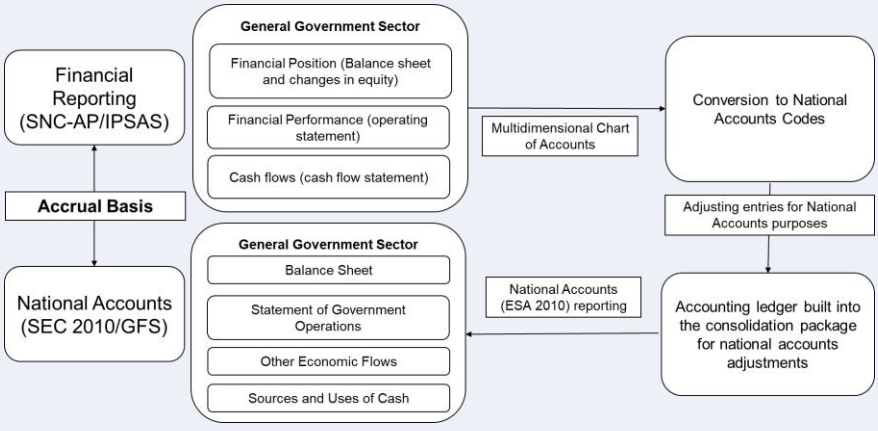
In Portugal, a new Chart of accounts was developed in the context of the transition to accrual accounting for the whole of the public administration, a project running from 2013 to 2019. The Chart of accounts applies to all levels of government (central, regional and local). Local entities can adapt their local Chart of accounts but it should be mapped to the harmonised Chart of accounts.

The Chart of accounts provides a coding structure for the classification and recording of relevant financial information (both flows and stocks) necessary for financial statements on an accrual basis. It is also a multi-dimensional Chart of accounts in the sense that it also includes codes that allow presentation of the data according to other classifications, i.e. budgetary cash accounting and statistics (ESA2010).

The table below shows for example how this functionality works for some high level aggregates between the IPSAS-based Chart of accounts codes and ESA2010 codes.

IPSASs	ESA2010
434 - Machinery and equipment	AN 113 – Machinery and equipment
251 – Loans	AF 4 – Loans
604 – Capital transfers granted	D.9p – Capital transfers, payable
701 – Direct taxes	D 51 – Taxes on income

Ultimately, it is intended that all general government financial operations will be recorded using a single Chart of accounts. Data will be automatically converted into national accounts codes and it will enable the preparation of fiscal statistics fully bridged with the financial statements prepared by the Government.



Source: Authors, based on public information.

The Civil Service Renewal Initiative, launched in 2014 by the *Taoiseach* and the Minister for Public Expenditure and Reform, has a vision and a three-year action plan to renew the Irish Civil Service. Within this plan, Action 14 focuses on strengthening professional expertise within the corporate functions of HR, ICT and Financial Management. In addition, work has commenced on Action 24, including the establishment of a framework for a National Data Infrastructure to improve how data is collected, managed and shared.

Regarding financial management, the plan notes that the creation of the NSSO and implementation of FMSS will, in effect, profoundly change the role and functions of financial management professionals as financial controls and accounting functions will be shared with the Finance Shared Services. Therefore, finance professionals are expected to refocus some of their time on value added and strategic activities.

The implementation of Actions 14 and 24 of the Civil Service Renewal Plan would consequently offer a particularly opportune moment for defining a new set of skills for finance professionals, including accrual accounting capabilities, as was done in a number of OECD countries such as the United Kingdom (Box 11). Accrual accounting capabilities would not be an end in itself, but rather a means for transparent reporting and development of financial analysis within each government department or office. This in turn should foster a more efficient use of resources, and deliver better value for the investments being made.

Box 11. United Kingdom: Managing the Finance Function

The UK Government Finance Function is made up of around 10 000 people working in Government Departments covering a wide range of roles, from strategic business partners to technical accountants. These staff are responsible for managing over GBP 750 billion expenditure a year, over GBP 1 450 billion assets and GBP 3 500 billion of liabilities.

The UK's Financial Management Reform (FMR) programme was launched in 2014 following consultation with accountancy institutes. It was designed as a cross-departmental programme aiming to enhance the skills and capabilities of the whole of the finance workforce, as a means to strengthen financial leadership across government, and overall, support better decision making.

In this context, an agenda for "putting finance at the heart of decision making" was defined comprising six strategic priorities to be implemented in coming years:

1. Getting the basics right: ensuring good forecasting and reporting, robust data and efficient transaction processing.
2. People & capability: building a high performing and diverse function, with people in the right roles with the right skills.
3. Operating model: developing a modern, collaborative finance function that delivers quality services more effectively and efficiently.
4. Finance insight: improving the understanding of, and driving forward, value for money.
5. Trusted advisor: acting as the 'go-to' advisor for colleagues to provide expert advice and informed decision-making.
6. Planning and performance: driving a strong culture of planning and performance with integrated financial and business planning aligned with robust risk and assurance.

Source: Authors, based on public information.

1.2. 4. Implementing accrual accounting[50]

4.1 Phasing the Financial Reporting Reform

As discussed in the previous chapter, any reform should ideally involve three main changes: improving the completeness of the financial information by adopting accrual accounting; shortening timeframes for the publication of financial reports; and harmonising accounting practices across the Irish Government.

OECD studies show that such changes are seldom, if ever, made in a single step. In particular, in most countries, accruals reforms at central government level were rolled out in three to five years, following detailed transition plans that were often aligned with the constraints around the development of IT systems able to support new accounting processes and produce new financial reports. In considering a roadmap for a transition to accrual accounting in Ireland, the OECD suggests that government departments and offices start populating their balance sheets after they have transitioned to the FMSS. However, should

delays on the project's implementation occur, alternative approaches would have to be considered.

Using IPSAS as the reference framework, the roadmap suggests that accrual accounting standards be adopted in two phases by each entity. The first phase will aim to bring information already disclosed in the Appropriation Accounts – that is amend the format of the financial statement and record fixed assets and some core liabilities according to requirements of international standards. The second phase would aim to bring other accrual information required by international standards (e.g. inventories, intangible assets) into financial statements.

An important decision to be made at the beginning of the project is whether the government will prepare consolidated statements. As noted in the previous chapter, the OECD strongly advises that such consolidated financial statements be prepared – that is, i) a consolidated statement for each department (i.e. for each Department with multiple Votes) and ii) a consolidated statement of all Votes.

International standards also require that governments prepare financial statements that consolidate all entities under their control and define a number of principles to be applied for establishing consolidated accounts. Should the government exclude this option, these standards dealing with consolidation principles would no longer be relevant for Ireland but would hinder the compilation of fiscal statistics which report on government on a consolidated basis.

In any case, the feasibility of preparing consolidated financial statements will depend largely on the degree of harmonisation and integration of accounting systems across government.

For all government departments and offices using similar accounting standards, accounting policies, a chart of accounts and processing their financial transactions through FMSS, it should be relatively straightforward to enable a set of consolidated financial statements to be produced directly from the IT system at year-end.

However, entities outside of central Government use different accounting standards (FRS 102 or other) and operate separate IT systems.[51] Therefore, the consolidation of their individual accounts at year-end may have to be done on a semi-manual basis and will involve more technical and operational challenges. To limit these challenges and facilitate consolidation, a number of elements of the financial reporting frameworks will need to be aligned across government, including the adoption of accrual accounting by all entities, a harmonised - if not similar - charts of accounts, as well as the alignment of financial years (1 January to 31 December) and deadlines for closing the accounts.

Before considering any consolidation beyond the Government departments and offices, the OECD advises that the Irish Government progressively aligns financial reporting practices across government. For example, should local government accounts be consolidated with those of the central government in the future, it would require that all existing departures from the requirements of FRS 102 be examined and addressed. During this alignment process, funds and State bodies would have to be reported in at the equity value in the accounts of the government departments and offices, as required by international standards. Consolidated financial statements would start being prepared as part of the last phase of the proposed roadmap.

Against this background, a roadmap comprising five phases could be considered by the Irish Government, as described below. For each phase, a number of tasks are identified, some of which are further detailed in the following sections of this chapter.

It is assumed that most of these tasks will be led by DPER. However, when considering this roadmap, it is important to acknowledge that in the case of Ireland, the implementation of each phase, and related timelines, will depend on coordination with the Department of Finance and other key stakeholders such as the Comptroller and Auditor General and the Central Statistics Office on one hand, and the FMSS project and its capacity to support the requirements of accrual accounting on the other hand. It is also important to recognise that much of the work will need to be undertaken in departments in terms of implementing specific actions to record financial transactions and balances on an accrual basis.

Finally, in implementing this roadmap, it is advised that as each standard or group of standards are developed, the requirements should be piloted in a small number of affected departments and offices to identify potential issues with the interpretation or application of the standard. These pilot exercises can also assist in identifying workload issues with the implementation of specific standards.

Phase 1: Project inception and setup (2019)

1. Document reform objectives, outcomes and estimated costs (the "new framework") in a concept document (or blueprint) as well as legislative changes required (if any) and seek government/parliament approval.
2. Define governance arrangements for the project.
3. Refine the gaps assessment (if needed) and finalise the project organisation and roadmap.

Phase 2: Defining the New Framework (From 2019)

1. Establish institutional arrangements for setting accrual accounting standards, accounting policies and the multi-dimensional chart of accounts, in co-operation with NSSO and stakeholders. Possible approaches are discussed in detail in Section 4.2.
2. Identify necessary changes to financial internal controls and develop instructions.
3. Determine with Comptroller & Auditor General transitional and mature audit arrangements under the new framework.
4. Pilot in 2020/2021 at the latest the first stage of the implementation of the New Framework in one or two departments (early adopters of FMSS). As part of the pilot process, subjecting the resulting items to a review or audit process can also help highlight any issues in the preparation of accrual based information for those items.
5. Deliver training on accounting standards and policies and financial controls to finance professionals and staff of the Comptroller and Auditor General in two phases: the first in 2021 as the first implementation wave commences; the second in 2024 as the second implementation wave commences.
6. Identify possible changes to legislation, as needed. Amendments to legislation should happen only when the vision and overarching principles of the new

framework have been established, and are therefore not yet positioned in the roadmap.

Phase 3: Implementing the New Framework (From 2021)

1. For each government department or office migrating to the FMSS, prepare an opening balance sheet bringing information already disclosed in the Appropriation Accounts at the level of requirements of international standards. This would mean implementing the following international standards, adapted as needed to the European and Irish context:
    - **in relation to the format of the financial statements**: presentation of financial statements (IPSAS 1), cash flow statement (IPSAS 2), accounting policies (IPSAS 3) and separate financial statements (IPSAS 34);
    - **in relation to assets**: property, plant and equipment (IPSAS 17), impairment of non-cash generating assets (IPSAS 21);
    - **in relation to liabilities**: provisions, contingent liabilities and contingent assets (IPSAS 19), employee benefits (IPSAS 39);
    - **in relation to specific financial operations:** leases (IPSAS 13), service concession arrangements (IPSAS 32).

Operational implications are discussed in detail in Section 4.2.

Phase 4: Project Assessment and Next Steps (From 2023)

1. Realise a formal post implementation review.
2. Adjust roadmap for extending the scope of particular items recorded in the accounts and widening the institutional coverage of the standards to central government entities outside central Government.

Phase 5: Finalising Implementation of the New Framework (From 2024)

1. For all central government entities using the New Framework, prepare an opening balance sheet in compliance with all relevant international standards. This would mean implementing the following international standards, adapted as needed to the European and Irish context:
    - in relation to assets: inventories (IPSAS 12), investment property (IPSAS 16), agriculture (IPSAS 27), intangible assets (IPSAS 31), impairment of cash-generating assets (IPSAS 26);
    - in relation to revenue: revenue from exchange transactions (IPSAS 9), revenue from non-exchange transactions (taxes and transfers) (IPSAS 23), construction contracts (IPSAS 11);
    - in relation to specific financial operations: the effects of changes in foreign exchanges rates (IPSAS 4), borrowing costs (IPSAS 5);
    - in relation to disclosures: events after the reporting date (IPSAS 14), presentation of budget information (IPSAS 24);
    - in relation to financial instruments: financial instruments (IPSAS 28, 29, 30 and 41).

- in relation to consolidation: consolidated financial statements (IPSAS 35); public sector combinations (IPSAS 40), segment reporting (IPSAS 18), related party disclosures (IPSAS 20), investments in associates and joint ventures (IPSAS 36, 37, 38).

2. Establish whole of central government consolidated financial statements, coverage to be assessed depending on progress with the alignment of financial reporting practices across government.

Figure 8. Ireland: Proposed reform roadmap

Activities	2019	2020	2021	2022	2023	2024	2025
1. Project Implementation and Set-Up							
Prepare blueprint and obtain approval							
Establish Government Accounting Directorate and define project's governance arrangements							
Realise a survey and finalise project organisation							
2. Defining the New Framework							
Establish accounting standards, policies and the chart of accounts	1st phase			2nd phase			
Define internal financial controls	1st phase			2nd phase			
Establish intermediary and mature audit arrangements							
Pilot exercises							
Deliver trainings on new accounting standards and policies and financial controls							
3. Implementing the New Framework							
Prepare accounts using new format for financial statements (IPSAS 1, 2, 3)							
Prepare opening balance sheet for property plant and equipement (IPSAS 17 and 21)							
Prepare opening balance sheet for employee benefits (IPSAS 19 and 39)							
Prepare opening balance sheet for leases and PPPs (IPSAS 13 and 32)							
Prepare opening balance sheet for shareholdings (IPSAS 34)							
4. Projects Assessment and Next Steps							
Post implementation review and report published							
Adjust roadmap							
5. Finalisation of Implementation of New Framework							
Prepare opening balance sheet for financial instruments (IPSAS 28, 29, 30 and 41)							
Develop disclosures (IPSAS 14 and 24)							
Prepare opening balance sheet for inventories and intangible and other assets (IPSAS 31, 12, 16, 27 and 26)							
Record revenue on accrual basis (IPSAS 9, 23 and 11)							
Prepare opening balance sheet for other relevant standards (IPSAS 4 and 5).							
Prepare consolidated financial statements (IPSAS 18, 20, 35, 40, 36, 37 and 38)							

Note: the roadmap is based on on (i) the necessary progress being made in the delivery of the FMSS system, and (ii) the assumption that the period needed for implementing tasks to comply with the requirements of each standard will be of two years at maximum, with the opening balance sheet available at the end of that two-year period.
Source: Authors.

4.2 Project implementation and set up

4.2.1. Political support and leadership

International experience shows that it is critical for any budgetary reform to be well understood and supported at the highest level. Political support and leadership will be amongst the most important prerequisites for any successful reform of financial reporting in Ireland. Therefore, the objectives and expected outcomes of the transition to accrual accounting, proposed new formats for the accounts (for example, in the form of a template) should be detailed in a blueprint. In the first instance, the blueprint will need to be approved at government level. Parliamentary approval at a later stage is likely to be necessary, and would ensure cross-party support for the reforms.

Estimating the cost of the reform will be crucial for policy makers to determine whether the prospective benefits outweigh the costs, and to ensure that there are sufficient budgetary resources to implement the reform. OECD studies show that financial and non-financial costs of reforms can vary significantly depending on several factors, including the nature of the IT systems developed, resources and capacities already available in accounting departments and degree of ambition of the reform (e.g. production or not of consolidated financial statements).

In estimating the cost of the reform in Ireland, a very favourable aspect is that some of the activities required to implement accrual accounting are already being undertaken - meaning that in these areas there should be limited additional cost. In particular, IT system redevelopment, which is one of the main sources of costs for a transition to accrual accounting, is already under way. As shown in Box 12, in Denmark, which like Ireland, had already rolled out an IT system able to support accrual accounting, reform costs were relatively limited.

In addition, some of the skills required for implementing international standards are already available in the public service. For example, an actuarial review of the superannuation liability of public servants is already completed on a three-yearly basis. Moreover, in terms of staff costs, it is expected that most activities to be rolled out as part of the transition would be carried out by staff that are already otherwise involved in financial management, although some additional resources are likely to be necessary.

Therefore, reform cost estimates should focus on new activities, which will include setting up a Government Accounting Directorate; recruiting additional project staff or experts in government departments and offices; and developing and delivering a comprehensive training and communication programme.

In each of these areas, reliable costs estimates would have to be done based on assumptions done by DPER but also information collected in each government department and office. Specifically, the following tasks should be undertaken to inform the cost estimates:

- DPER to identify main activities to be implemented at its level and in each department, with an indicative timeframe;
- DPER to ask each government department and office to identify, for each activity, potential service, IT and staff needs;
- DPER to request each department to undertake a financial maturity assessment, potentially using the model published by the Comptroller and Auditor General's office to help inform the degree of education and training that may be required;

- DPER to establish and document assumptions for costs for each activity and evaluate the overall envelope for implementing the reform;
- For training activities, DPER to estimate the number of training days and number of participants and associated costs based on most recent training costs in public service (e.g. training done as part of the FMSS project).

Box 12. Estimating the costs of central government accruals reforms in Austria, Denmark and Switzerland

Cost data for accrual reforms in central government (in EUR million)

	Austria	Denmark	Switzerland
Policies, processes & people			
External cost	2.89	N/A	18.00
Internal cost	10.48	N/A	20.73
Non-IT cost	**13.37**	**21.85**	**38.73**
Systems			
External cost	26.08	N/A	15.00
Internal cost	7.07	N/A	17.27
IT cost	**33.15**	**0.87**	**32.27**
Total Cost	**46.52**	**22.72**	**71.00**

Note: An accrual accounting reform project can be structured along different streams: Policies, Processes, People and Systems. The categories Policies, Processes and People have been aggregated into one single non-IT category, in order to ensure cross-country comparability.
Source: PwC (2014).

The blueprint should also include the preliminary identification of any legislative changes that would be required. These will vary depending on the depth of the reform envisioned by the government. A very preliminary analysis shows that although the Constitution establishes broad principles for the System of Accountability for Public Moneys, it does not address the question of the preparation, format and content of financial reports.

Regarding secondary legislation, if the current format of the Appropriation Accounts were maintained, with the only change being the inclusion of accrual financial statements compliant with international standards in the Notes, no major amendments would be needed.[52] However, should a more ambitious reform be favoured (i.e. government departmental integrated annual report and consolidated accounts), a number of changes would be necessary.[53]

4.2.2. Governance

Implementation of accrual accounting will be a major exercise due to a multiplicity of factors, including implementation at multiple entities; reliance on the gathering, analysis and verification of large volumes of data from a variety of sources (e.g. fixed assets, debtors, investments and liabilities); dependence on the successful transition to the NSSO of entities in scope to implement accrual accounting; capability development to ensure staff and other stakeholders are equipped with the knowledge they need to operate under an accrual accounting framework; co-ordination and co-operation from a wide range of stakeholders (including finance staff, internal and external auditors, etc.).

Maintaining good project discipline and establishing appropriate governance arrangements will be critical to actively managing the implementation, dealing with technical issues as they arise and not unduly disrupting the delivery of government services or activities of officials, whilst progress will depend on timely resolution of issues.

To achieve this objective, as advised in previous assessments of the government fiscal reporting (IMF, 2013), the preliminary and key requirement would be to establish a Government Accounting Directorate.

As an accounting policy co-ordination body, the new Government Accounting Directorate should not only be adequately equipped in terms of human capital and financial resources, but it should also be able to count on political support and a clear and strong mandate for defining accounting policy across Government.

After the transition to accrual accounting, the Government Accounting Directorate would be the permanent unit in the Irish administration responsible for maintaining a uniform set of accounting rules and procedures applying to all relevant entities, overseeing the quality of finance function, and preparing the consolidated financial statements of the Government, if any.

During the transition to accrual accounting, the Government Accounting Directorate would have to set up small teams in charge of five key areas: 1) changes to the legislation; 2) setting of accounting standards and policies, as well as development of the chart of accounts; 3) identification of improvements needed to accounting processes and internal control; 4) co-ordination with the Comptroller and Auditor General regarding requirements to enable controls and audits; 5) definition of the strategy and delivery plans for training and communication.

These teams would be in charge of leading working groups involving all core stakeholders depending on the area considered. Their main functions would include decision-making on technical issues and production of relevant outputs, as well as identification of risks that need escalation to the Steering Committee in charge of the oversight of the transition to accrual accounting.

Responsibilities for the Steering Committee could encompass: providing strategic direction for the project; approving project artefacts (such as project planning and management documents); monitoring progress against project milestones and deliverables; resolving significant issues and making decisions to ensure successful and timely implementation; providing periodic progress reports to government; and considering any impacts or links with other projects and/or activities.

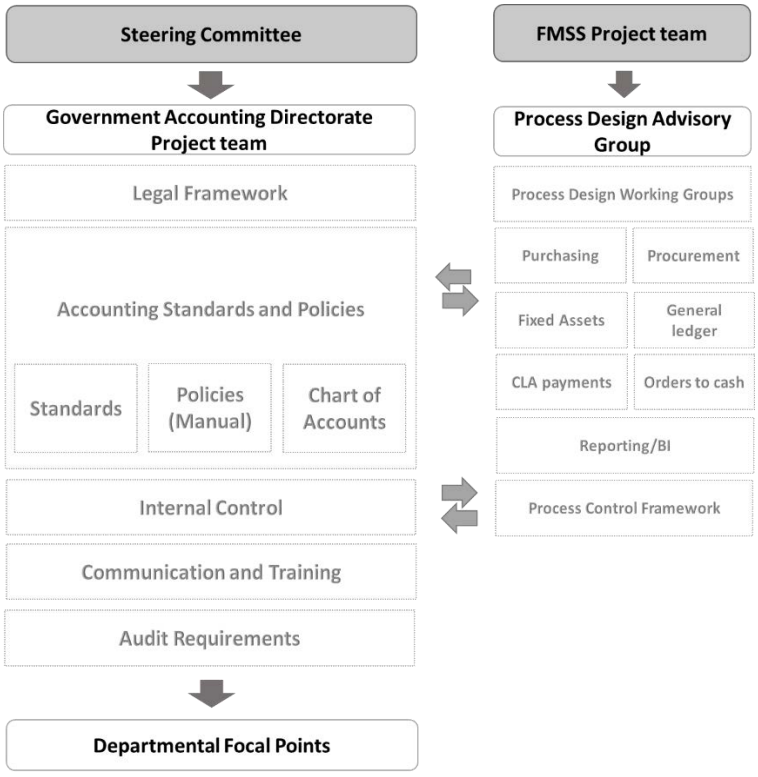
The Steering Committee should be chaired by DPER. It will also be necessary to include representation from the Department of Finance and other affected entities, i.e. government departments and offices, the National Shared Services, the Comptroller & Auditor General and the Central Statistics Office. Including the Department of Finance and other entities, the Steering Committee will assist in maintaining focus on the overall objectives of the reform as well as providing insights on the interaction between the accrual accounting reforms, the budgeting framework and workload impacts on individual departments. The level of representation will be an important factor in dealing with issues and having the authority to be able to address matters in a timely manner.

Finally, focal points should be set within each government department and offices for liaising with the Government Accounting Directorate throughout the implementation phase. Ideally, focal points should be qualified accountants with a good understanding of

accrual accounting, who should be able to promote best practices, ensure legitimacy during the initial phases of the transition and monitor implementation at the technical level.

An important element of the governance framework will be the co-ordination with the NSSO project. The IT system should be developed to serve the needs of financial accountability and reporting. Functional specifications and the Chart of accounts governance process would therefore ideally have to be led by the Government Accounting Directorate, which will have legal responsibility for accounting policies, with NSSO acting as the agent to implement any changes to the Chart of accounts. The new IT system and Chart of accounts will have to support the implementation of the new standards and accounting policies and it will be critical that any issue with system capabilities be identified timely and be resolved between the Government Accounting Directorate and FMSS.

Figure 9. Ireland: Proposed governance for financial reporting reform



Source: Authors

4.2.3. Entities survey and project organisation

In the absence of a Government Accounting Directorate, so far strategic focus for financial reporting across Government has been lacking, resulting in a fragmented framework. Many Irish stakeholders have limited understanding and knowledge of financial reporting practices at each level of Government in specific entities.

In designing the transition to accrual accounting, this report therefore advises that the newly created Government Accounting Directorate realises a comprehensive survey of government departments and offices, funds and State bodies to take stock of accounting practices and capabilities within government and, in particular, clarify:[54]

- existing accounting practices;
- financial reports' publication dates;
- existing findings or qualifications on the accounts; and
- the number and qualifications/experience of finance staff.

Such information will be crucial for the Government Accounting Directorate to refine its reform roadmap; exert in an informed fashion its project co-ordination role; and to identify where risks may exist because resources and capacities are lacking.

4.3 Defining the new framework

The following sections discuss main tasks for the working groups operating under the lead of the Government Accounting Directorate.

4.3.1. Legal framework

As noted above, legislative implication of reforms should be identified very early in the project and discussed in the government blueprint. Once parliament approval is obtained, a working group led by the Government Accounting Directorate should start working on identifying detailed provisions to be changed or removed in the current legislation, with all issues discussed with both the Houses of the *Oireachtas* and the Comptroller & Auditor General.

In particular, as noted earlier in this report, an important element of any financial reporting reform in Ireland would be to harmonise the accounting standards-setting process within general government irrespective of whether consolidated statements will be prepared or not by the government.

It is recommended therefore that legislation strengthens DPER responsibilities' for developing policy for accounting, financial reporting, financial management, risk management and internal audit for the general government area. Specifically, DPER should be clearly tasked with setting accounting standards and policies for entities defined as being part of general government including funds, State bodies (incl. health sector agencies, whose accounting practices are currently regulated by the Minister for Health) and local government, while specifying that this does not change their status and relationship with the government department or office under the aegis of which they operate.

This would not necessarily mean that rules applying to State bodies and local governments, which already use accrual accounting standards, would be changed in coming years, but would pave the way for greater co-ordination and alignment of accounting practices going forward.

Finally, any change to the legislation would give an opportunity to reconsider other elements of the framework that have created challenges in past years. For example, it would be useful to shorten and align requirements concerning time lags for the transmission of year-end financial reports to the Comptroller & Auditor General and to the *Dáil*.[55]

4.3.2. Accounting standards

The governance and leadership for defining rules and principles applying to financial reporting across government will be among the most important challenges to advance the accrual accounting transition agenda.

When considering potential institutional models for standards setting, Ireland will have several options available, including the option of establishing an independent standard setter. However, in the context of the transition to accrual accounting, being able to deliver quickly a consistent and comprehensive set of standards will be crucial for the success of the project. The OECD mission therefore advises that the Government Accounting Directorate be tasked with leading a working group in charge of developing standards with inputs from all relevant stakeholders (i.e. users, preparers, auditors). This working group should be established as soon as possible.

To ensure that standards are developed with the expected level of integrity, it is recommended that the government consult an independent advisory body. In setting such bodies, OECD countries such as France, Portugal and the United Kingdom (Box 13) have adopted different models – i.e. accounting standards and policies are established by the government and reviewed by the advisory body (United Kingdom) or the advisory body establishes standards and submits them to government for endorsement (France and Portugal) - that could be considered in Ireland.

Irrespective of the model chosen, a number of elements would need to be considered for safeguarding the advisory body's independence, which include: a clear legal mandate; appropriate composition of members (e.g. cross section of people comprising academics and representatives of the accounting profession and potentially the user community, such as Parliament and the Central Statistics Office); and transparency on activities (e.g., clear due process, open meetings, publication of advices, activity report).

Box 13. Selected OECD Countries: Advisory body role and responsibilities

France

Accrual accounting standards are enacted by the Ministry of Finance, after receiving advice from an independent advisory council ("*Conseil de Normalisation des Comptes Publics*", or CnoCP).

The CNoCP is tasked with proposing standards to the Ministry of Finance for three separate sectors: the State and its agencies, the Social security and the Local Governments.

The CNoCP has a Standing Committee ("*College*") comprising a Chair and 18 members, including 9 ex officio members and 9 technical experts, who are appointed by the Minister of Finance for a three-year fixed term period, with the possibility of renewal.

For each sector, a Sectoral Committee, working under the leadership of a Chair, composed of qualified professionals is in charge of establishing sectoral standards. Each sectoral committee comprises members with sectoral knowledge, with some members taking part in all committees.

Portugal

In Portugal, the accounting standard-setter role was redesigned following a major reform of the organisational structure of the Ministry of Finance in 2012.

The accounting standard-setting commission (*Comissão de Normalização Contabilística* – CNC) was created by Law-decree 134/2012. It is an independent body under the Ministry of Finance comprising stakeholders from both the private and the public sector. CNC

comprises two committees: one for business accounting, and another for public sector accounting (*Comité de Normalização Contabilística Pública* – CNCP).

According to article 18, the main task of CNCP is to issue public sector accounting standards and interpretations taking IPSASs as reference, as well as to contribute to its development, implementation and improvement.

CNCP comprises 9 members, including representatives of the accountants and auditors institutes, the Budget General Department, Local Government General Department, Finance Inspection Directorate, National Institute of Statistics; Universities teaching accounting, and an independent member acknowledged as expert (article 16).

The United Kingdom

The accounts of central government departments and agencies are prepared in accordance with the Government Resources and Accounts Act 2000 (GRAA) and the Government Financial Reporting Manual (FReM) which applies International Financial Reporting Standards (IFRS) as adapted or interpreted for the public sector by HM Treasury, and sets out the framework by which Government Departments should prepare their resource accounts. To prepare the FReM, HMT is advised by an independent advisory board (Financial Reporting Advisory Board - FRAB).

The FRAB is composed of representatives from the accountancy profession in the private and public sectors, academia and government bodies.

Source: Authors, based on public information.

It will also be important that any legal mandate for standard setting-activity refers to relevant international standards. In doing so, Ireland will have to choose between the two main sources of reference - that is International Financial Reporting Standards (IFRS), produced by the International Accounting Standards Board (IASB) and developed specifically for use by private sector organisations; or International Public Sector Accounting Standards (IPSAS), produced by the International Public Sector Accounting Standards Board (IPSASB) for use in the public sector.

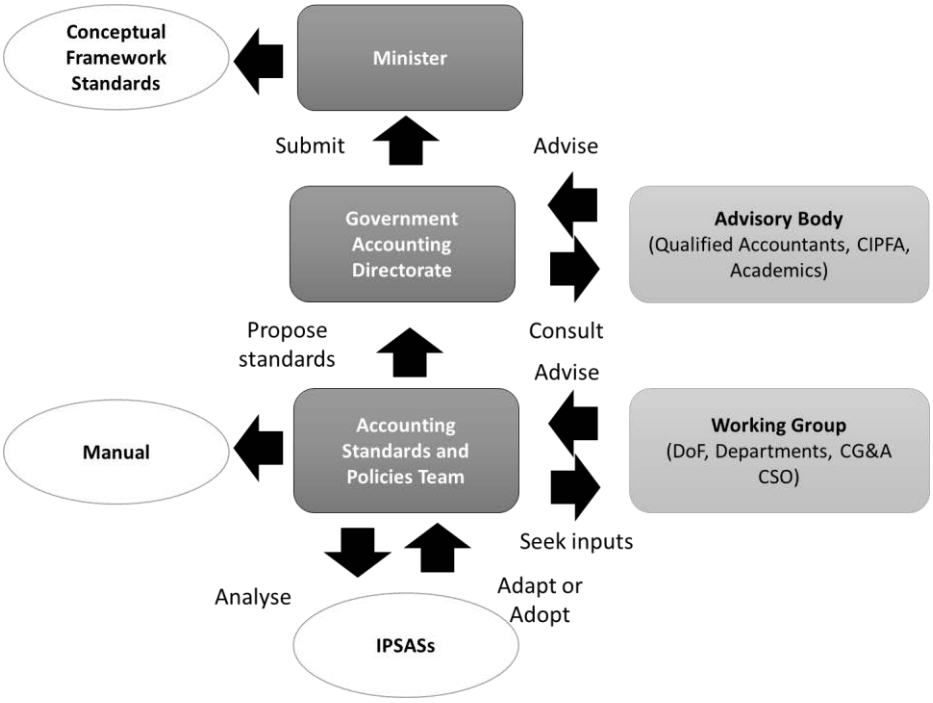
When considering which international standards to use as reference, Ireland will need to give consideration to results of most recent OECD survey (OECD/IFAC, 2017), which shows that only two OECD countries (Australia and the UK) use IFRS as a basis for the development of their public sector accounting standards[56], while an increasing number of countries are using IPSAS. Ireland should also consider the European Union's project to develop its own set of accounting standards for the public sector, the EPSAS, which will use IPSAS as a "reference source".[57]

It will be important for the Government Accounting Directorate to closely monitor the development of the EPSAS project and any potential modifications that may be proposed to IPSAS standards. The European Commission's report on the Suitability of IPSAS (European Commission, 2013) identified that some IPSAS standards would not be adopted without modification. The main areas of concern were outlined in that report and principally covered Financial Instruments standards and Consolidation standards. Specifically, Eurostat (2013) noted that IPSASs 7, 8, 13, 15, 17, 18, 20, 21, 22, 23, 24, 25, 26, and 31 will need adaptation before implementation, and that IPSASs 28, 29, 30 will need to be amended prior to implementation.

Last, in setting a legal or informal requirement to use IPSAS or other international standards as a reference, governments often give themselves a number of options. The first one is to "adopt" an international standard when it covers financial operations that are relevant to the country. The second one is to "adapt" the standard when specific national circumstances or constraints need to be accommodated.[58] [59] The last one is to "develop" a new standard for financial transactions that are not yet covered by existing IPSAS standards.

In the case of Ireland, options to "adopt", "adapt" or "develop" standards would usefully be authorised. However, where such options are used, it is recommended that they are identified and justified, and potentially revised at later stages – for example, areas in which it could be useful to develop standards are social benefits or tax expenditures, but international standards are likely to be issued in coming years in these areas.[60] In addition, in deciding whether to "adapt" a standard, the Government Accounting Directorate will have to consider the range of concessions to facilitate the introduction of IPSAS standards authorised by IPSAS 33.[61] Where concessions are available that may help address temporary operational difficulties, a permanent adaptation of a standard may indeed not be necessary.

Figure 10. Ireland: Proposed governance for accounting standards setting



Source: Authors.

4.3.3. Accounting policies

Accounting standards however only reflect part of the rule set for financial reporting. It is common for accounting standards to allow options for the treatment of particular items, and there are practical issues that will need to be dealt with in terms of guidance available to entities. This will require a process for developing and issuing guidance on the application of specific standards to make clear the accounting policy choice and to promote consistency in methodologies for reporting or measuring for similar items between entities.

In many ways, the accounting manual will therefore be more important than standards in ensuring that information provided at year-end is reliable and consistent across government departments and offices.

In parallel to establishing standards, the Government Accounting Directorate will therefore have to prepare an accounting manual providing guidance on the application of the standards, as adapted and interpreted for the Irish government context – that is which policies to apply when the international standard gives options, templates for financial statements and information to be provided in notes, methodologies for measuring assets and liabilities, etc. (Table 5) The development of accounting policies should be undertaken in a collaborative manner with those that will be applying them. Consultations on proposed accounting policies is a useful quality and feasibility check and assists with communication and implementation of those policies in individual entities/departments.

The accounting manual should seek to primarily address gaps already identified by the Comptroller and Auditor General, including that the operating cost statement does not show accrued retirement benefits of current staff; the balance sheet does not report asset impairment or frequency of revaluations; not all current assets are recognised in that only bank accounts related to the vote or Exchequer are included on the balance sheet – accounts controlled by a Department are only disclosed in notes; debtors such as overpayments are not reported and obligations arising from pensions earned by employers are not recognised.

Table 5. Ireland: Key areas for accounting policies

IPSAS	Areas to be covered in Accounting Policies
Format	Policy on reporting entities' boundaries.
	Template for accrual-based financial statements, including note disclosures (e.g. accounting policies).
	Template for Cash Flow Statement and policy on determining when cash flows are managed in an agent capacity and conversion of foreign currency cash flows and balances.
	Criteria for a material item to be included in the financial statements.
Assets	Policy on definition and classification of property, plant and equipment assets.
	Policy for each asset class on asset recognition thresholds, initial measurement (cost or fair value), identification of components of complex assets, useful life and depreciation methods.
	Policy on the treatment of subsequent expenditure, i.e. to expense in the period or capitalise to the value of the asset.
	Where valuation of assets is required, develop a standard form "instruction for valuers" for entities to use to ensure consistent approach to valuation and frequency of revaluations.
	Policy for the identification and measurement of heritage assets.[62]
Liabilities	Policy on debtors (incl. overpayments to third parties).
	Policy on the nature and type of provisions that may be recorded (e.g. obligations for medical negligence cases; decontamination or remediation costs; restructuring costs; onerous contracts, etc.)
	Policy on recognition and measurement for each type of employee benefit provided, based on background to the entitlement, authority, whether it is vesting or non-vesting and payment/settlement arrangements.

IPSAS	Areas to be covered in Accounting Policies
	Policy for measuring each type of provision (e.g. for long-term liabilities, a methodology for determining the present value of the obligation will be required). Criteria for disclosing contingent liabilities and contingent assets. Methodology for measuring long-term employee benefits to enable calculation of the present value of the liability at the reporting date.
Leases	Methodology for enabling classification of leases as finance or operating. Methodology to calculate lease interest expense and reduction in liability for finance leases.
PPPs	Criteria/methodology for classifying existing concessions and PPPs according to models defined in the international standards. Methodology for recognition and measurement of SCA assets and liabilities and revenue under Grant of Rights model and to allocate payments between financing charge and reduction of liability and service charge for the financial liability model. Template for qualitative disclosures for PPPs, including identifying any contingent liabilities or assets related to the arrangement.
Financial instruments	Policy for each class of financial assets and liabilities, including recognition point, measurement basis and derecognition. Methodology to identify any hedging and derivative arrangements; to measure risk exposures related to financial instruments; assess fair value for each class of financial instrument; and to measure concessionary loans and the unwinding of the discount at each reporting date. Template for disclosures.

Source: Authors.

4.3.4. Chart of accounts (CoA)

The chart of accounts currently developed under the FMSS project will provide a common framework for use by entities moving to the NSSO. As each wave of entities is migrated to the FMSS, the common chart of accounts is expanded to incorporate accounts that may be specific to that entity. This is achieved through a detailed mapping exercise between the entity's existing own chart of accounts and the FMSS common chart of accounts.

Although the detailed content of the Nominal and Sub-nominal segments was not complete at the time of the OECD mission, the general structure used for the FMSS common chart of accounts appears to be capable of supporting the move to accrual accounting.[63] Accounts have been established to separately capture the "stock" value of balance sheet items (such as property, plant and equipment), as well as "flow" transactions (such as asset acquisitions).

NSSO have also confirmed that the design of the chart of accounts has taken into account the future requirements of IPSAS international standards. In particular, disclosure requirements in international accounting standards can be substantial and one way to reduce the amount of work needed in preparing accrual-based financial statements is to ensure that the chart of accounts has specific accounts to address the particular disclosure needs.[64]

It is therefore fundamental that the Government Accounting Directorate, through a dedicated working group, starts identifying specifications for the chart of accounts required under the new set of accounting standards and policies. It is to be noted that the Central Statistics Office has already been consulted on specifications for the development of a

multi-dimensional chart of accounts, and should continue being consulted as appropriate. This will allow providing clear directions to the NSSO project team about which accounts need to be included in the common chart of accounts.

4.3.5. Internal Control

Concerning the internal control framework, guidance currently issued by DPER includes a requirement that the Accounting Officers for each Vote make a Statement on Internal Financial Control and include that statement in the Appropriation Accounts.[65] While the Statement of Internal Financial Control is a very positive element of the control framework, under an accrual accounting framework, it would also have to include an explicit and unreserved statement that the accounts comply with the applicable standards, resulting in a true and fair view of the entity's financial performance and position.

This implies that existing financial internal control be reviewed and strengthened in the context of the transition to accrual accounting and capacity be built in this area for all finance and non-finance professionals. Indeed, under accrual accounting, the range of information to be collected and controlled for producing the year-end accounts will be expanded beyond what was done under cash accounting, with quantity of information to be obtained from outside the accounting services – that is from operational teams.

For example, DPER will have to specify responsibilities, within each government department, for keeping accurate and complete records of debtors and preparing an annual review of bad debts and other indicators of impairment; performing inventories of each class of assets and identify potential write-offs to be done; establishing and updating annually a list of PPPs arrangements, and valuing the assets, liabilities and contingent liabilities that are owned or controlled by the government; and controlling the application of accounting policies (for example, by reviewing whether the costs associated with the construction of assets have been appropriately capitalised or expensed).

Therefore, ideally, as part of the transition to accrual accounting, an Internal Financial Control Manual should be established in co-operation with the FMSS. The Manual should define accounting procedures insuring that all financial operations are reported in the IT system and properly documented outside of the IT system, to allow for verifications by the external auditor. The Internal Financial Control Manual will be an important input to the training plan and implementation phase. It should therefore be a priority area of work and be made available (hard copy and online) for all users as early as possible.

It will also be important to fully utilise the functionality inherent in an accrual based financial system such as the FMSS. For example, the integration of asset purchases from the Procurement module, through the Asset Module and ultimately recording against the relevant asset control account in the General Ledger will provide a higher degree of efficiency and confidence in the reliability of the data. In addition, the calculation and recording of depreciation in accordance with standard system parameters can reduce the amount of effort required in recording those types of transactions. The Government Accounting Directorate should therefore try defining accounting policies that will allow the automation of the majority of the accounting processes.

Whilst the transition to accrual accounting will necessitate changes to the internal control framework, the concurrent implementation of the FMSS will also see an evolution in the roles undertaken by departmental finance officers and accounting officers compared to officers in the FMSS. The dual context of these changes means that changes to the internal control framework should address changes resulting from accrual accounting and FMSS to

ensure that accountabilities for departmental officers in the respective organisations are clear and understood.

4.3.6. Training and communication

The introduction of accrual accounting usually requires significant training in Government, where the cash accounting culture is very strong. As part of assessing the training need, it would be useful to undertake a maturity assessment of financial management in affected departments. The Comptroller and Auditor General has published a model that could be used by departments in assessing their financial management maturity. Having affected departments self assess their maturity and then aggregating the results would provide a view of the overall training need and help inform the development of the training strategy.

In defining a training strategy, the Government Accounting Directorate should analyse the results of its survey of government departments and offices and consult other stakeholders on their capability building needs. This would allow defining a set of modules, with all or only some of them delivered to trainees depending on their specific needs. Training modules could be segmented as follows: presentation of the new financial reporting framework, overview of accrual accounting concepts, detailed presentation of new accounting standards and accounting policies, functioning of the new chart of accounts, and detailed presentation of the new internal financial controls.

Training on accounting standards and policies and financial controls would likely be delivered to finance professionals and staff of the Comptroller and Auditor General; training on new accounting concepts and information requirements for non-finance staff, and general awareness training for senior managers and key stakeholders outside of Government (Houses of the *Oireachtas*, IFAC and the PBO).

In the case of Ireland, it will be important to ensure that the recently established Irish Fiscal Advisory Council and Parliamentary Budget Office will also be offered guidance regarding the changes, as the outcomes of the reform will largely rely on these stakeholders using accrual information to exercise their mandates.

Modalities for delivering training should be adjusted to accommodate operational constraints and give maximum flexibility to trainees in choosing the way they want to receive their training. For example, in addition to "traditional" trainings, online tutorials could be developed, as has been done recently in France and Portugal.

Finally, in the specific context of Ireland, it will be important to try co-ordinating training on accrual accounting with any training that is being delivered by the NSSO as part of the migration of entities to the FMSS. This should allow for both reducing costs and providing more holistic understanding of upcoming changes to staff.

Beyond technical aspects of adopting accrual accounting, any substantial reform of the financial reporting framework in Ireland requires fostering a cultural shift in the mindset of people at all levels of the Government, and resistance to change is likely to be encountered at various stages of the project.

Therefore, a communication plan addressing the broad range of stakeholders, should be developed to provide information on the technical changes being made, progress of the project, as well as the benefits of the accrual accounting project. Specifically, in Ireland, key objectives for the communications plan could include:

- Ensuring a consistent message on the changes, implementation timeframes and reform implications. In the case of Ireland, it will be important to demonstrate to stakeholders that in adopting accrual accounting, the Government will continue delivering traditional high-quality cash information, but will also be more transparent on the nature of its financial operations and improve the quality and completeness of the data that informs fiscal forecasts and fiscal policy decisions;
- Creating an understanding of the practicalities of implementing the changes in each entity;
- Raising awareness on the existence of a training plan, on-line modules, etc. so that staff do not feel left "behind" as part of the reform;
- Providing regular updates on progress with implementation of the project.

4.3.7. Audit requirements

As underlined in recent OECD studies, the achievement of independent audits in accordance with international standards should be incorporated explicitly as a target in the planning of accrual reforms: "where a phased implementation approach is adopted, the audit aspect could also be phased in. For example, audits with specific scope limitations could be allowed in the earlier phases, while a full-scope audit could be included in a later or the final phase." (OECD/IFAC (2017)

In Ireland, consideration should therefore be given as early as possible by all stakeholders in the project to options for meeting audit requirements during and after the transition period. These options will depend on the depth of the changes to the current financial reporting framework, but also on the Comptroller and Auditor General available resources.

Schematically, two options can be envisioned:

1. If Accounting Officers continue to prepare Appropriation Accounts for each Vote, with the only new requirements being that, after their migration to the FMSS, they include in the Notes financial statements and disclosures that are consistent with all new accounting standards and policies, then no change would be required to current audit procedures on Appropriation Accounts. However the Comptroller and Auditor General may consider certifying compliance with the stated basis of accounting for the Notes to the Appropriation Accounts;
2. If Accounting Officers are required to prepare integrated annual reports, comprising i) the Government Department business plan; ii) Appropriation Accounts and other budgetary information (pay, commitments, etc.); iii) accrual basis financial statements, then the Comptroller and Auditor General may consider providing to Parliament both a report on the Appropriation Accounts and an audit opinion of the financial statements, based on relevant auditing standards.

In both cases, it will be necessary for the Comptroller & Auditor General to consider any changes to the audit methodology and approach to ensure that the broader range of financial information is able to be audited to a satisfactory standard within the available timeframe. Possible changes could include undertaking audit work earlier in the financial reporting cycle, working closely with departments on interim close procedures to provide financial information earlier or undertaking a controls-based audit to improve the efficiency and timeliness of the audit process.

Financial statements could also be subject to a period of trial audits to identify and address issues before full-scope audits are instituted. Australia adopted such an approach with the audit of the government's consolidated financial statements. In the case of Ireland, it would be advisable at least that one to two government departments that will transition early to the FMSS be asked to prepare financial statements based on new accounting standards and policies as a trial run in 2020 at the latest, to identify any issue with quality and traceability of information provided to the Comptroller & Auditor General.

Experience of OECD countries shows that initial qualifications on the financial statements should be expected.[66] However, the number of qualifications usually decreases after the first years of implementation and more than one-third of OECD countries had achieved an unqualified opinion of their financial statements in 2016.

4.4 Implementing the new framework

The objective of the third phase of the roadmap will be that each government department or office migrating to the FMSS prepares an opening balance sheet bringing information already disclosed in the Notes to the Appropriation Accounts at the level of requirements of new accounting standards.

To achieve this, a successful migration of historical data in the FMSS will be an important first step. The remediation of any data quality issues before migration into the new system and completion of reconciliations after migration will be necessary to insure that data in the new system is reliable. Although the FMSS project team will lead this process, the involvement of the Government Accounting Directorate in designing quality controls would be advisable.

After the migration of historical data, the preparation of the opening balance sheets compliant with new accounting standards and policies will require populating the chart of accounts with information that was not previously reported by government departments and Offices in their IT systems and prepare financial statements in an entirely new format. This section discusses some of the key tasks to be carried out as part of the preparation of the opening balance sheets.

Regarding changes to the format of the financial statements (including classifying cash flows as operating investing or financing), government departments and offices will have to use new templates and the capability of FMSS will need to be assessed to determine which tables and contents will be automatically generated and which will not. One particular area of attention should be whether the direct or indirect method of preparing the cash flow statement should be used, depending on the IT system capability.

Regarding assets, although Ireland has been reporting non-financial assets in a Note to the Appropriation Accounts for some time, complying with all requirements of new accounting standards is likely to be resource intensive as data problems have been regularly identified by the Comptroller & Auditor General in relation to the classification, completeness and accuracy of asset data.

In terms of preparing the opening balance sheet for property, plant and equipment, verifying the completeness of the asset register for each class of asset will therefore be an essential task. It will require not only formal initial stocktaking of existing assets, but also developing rolling of year-end inventory processes to identify any loss or damage, in order to ensure that the amount reported for assets in the balance sheet is materially correct.

One significant measurement issue in relation to assets that will need to be addressed is the valuation of land and buildings held by the Department of Defence. Although these properties are included in a Note to the Appropriation Accounts, there is no value recorded for any of them. This is a significant gap in the measurement of non-financial assets and one that will need to be addressed as part of the transition.[67] In addition, strict policies need to be established regarding frequency of revaluations of those assets that will not be measured at amortised cost. For example, the Office of Public Works follows accepted industry standard in Ireland for valuation of infrastructure, but these valuations are subject to a number of significant audit qualifications and cannot be regarded as a current estimate of realisable value.

Regarding equity investments, policies that are more consistent need to be defined and applied. Based on information already available, a list of equity investments needs to be established by each government department or office.[68] These investments also need to be evaluated using the equity method, subject to authorised exceptions.

Regarding financial instruments, one of the main tasks to be realised during the preparation of any opening balance sheet would therefore be in relation to the measurement basis used for reporting the National Debt and the completeness of disclosures.

Regarding employee benefits, stocks of annual or long service leave are likely to be recorded in human resource systems, but the corresponding liability is not reported as a liability in the financial statements. As part of the preparation of the opening balance sheet, an assessment of the data held in the human resource systems will be required to determine whether sufficient data on employee benefits is held. The data requirements will then need to be considered in how the liability is measured and reported in the financial statements.

The gap in relation to the recognition and measurement of other liabilities is significant now with only very limited information reported in financial reports. Detailed analysis therefore needs to be undertaken to identify the different types of obligations that may exist, developing accounting policies for them, including the measurement of the liability.

Concerning contingent liabilities, only guarantees issued under specific legislation are disclosed in the Finance Accounts, although a requirement is included in the Appropriation Accounts to report contingent liabilities with a level of disclosure that is below that required under new accounting standards. Government departments and offices will therefore have to identify in a more systematic basis any contingent liabilities and contingent assets that may exist and quantify them using a consistent methodology.

Regarding PPPs and concessions, an authoritative list is disclosed in the Annual Report of the National Development Finance Agency, which is a positive aspect in implementing new accounting standards. However, classification of PPPs against criteria set in new accounting standards is not done. During the preparation of the opening balance sheet, each of these arrangements will therefore have to be reviewed to determine their nature and whether assets and liabilities should be reported in the balance sheets of government departments and offices or of the National Development Finance Agency.

An inventory of leases should also be organised as part of the preparation of the opening balance sheet, to identify assets and liabilities to be reported in the balance sheet in accordance with new accounting standards.

Finally, producing consolidated financial reports will be a significant exercise. Defining the reporting entity for each level of consolidation is essential and ensuring that accounting policies are aligned for the entities to be consolidated will be an essential component before

a consolidation should be attempted. Taking intermediate steps to implement consolidated financial reports will enable experience to be gained and enable the identification of issues that arise and how they should be addressed as part of the consolidation process. In the first instance, preparing consolidated financial statements for the Exchequer would provide an overall view of the financial performance and position of the Exchequer. This could then be expanded to cover all entities in central government before considering the consolidation for the whole of general government.

Notes

1. Article 16 Paragraph 3 of Council Directive 2011/85/EU on 8 November 2011 on requirements for budgetary frameworks of the Member States tasked the European Commission to assess the suitability of IPSAS for the Member States of the European Union by 31 December 2012. One of the main recommendations of the European Commission's Report was the implementation of a single set of harmonised accrual-based accounting standards, consistent with the ESA, at all levels of government throughout the EU. However, the European Commission did not support the direct implementation of IPSAS by Member States. Nevertheless, the Report considered IPSAS to be an "indisputable reference for potential EU harmonised accounts". While no decisions have been taken at EU level regarding harmonised accounting standards, to maintain alignment in anticipation of an EU-wide accounting framework being implemented, the establishment of a mechanism to set standards in Ireland is essential. The EU has provided an indicative timeframe as follows: Phase 1: Increasing fiscal transparency in the Member States in the short to medium term by promoting accrual accounting, e.g. IPSAS, in the period from 2016 to 2020, and in parallel developing the EPSAS framework (i.e. EPSAS governance, accounting principles and standards); and Phase 2: Addressing comparability within and between the Member States in the medium to longer term, by implementing EPSAS by 2025.
2. Current ESA 2010 is the standard under which Government Finance Statistics are reported: https://ec.europa.eu/eurostat/web/esa-2010.
3. PAC Periodic Report No. 4, May-July 2018 –

   https://data.oireachtas.ie/ie/oireachtas/committee/dail/32/committee_of_public_accounts/reports/2018/2018-12-05_periodic-report-no-4-may-july-2018_en.pdf
4. https://reformplan.per.gov.ie/2014/downloads/files/Ireland%20PSR%20Plan.pdf
5. Budget day is the most prominent event over the course of the budget cycle in Ireland. It is the day that the Government lays down its economic and fiscal plan in Parliament to obtain a vote of confidence. Typical budget day documents include a Financial Statement from the Minister for Finance; an Expenditure Statement from the Minister for Public Expenditure and Reform; an Expenditure Report containing detailed spending plans; a Summary of Budget Measures; and the Economic and Fiscal Outlook. The Finance Bill is published within seven to ten working days of Budget day. The Social Welfare Bill is usually published later than this. These Bills have to be passed before the end of December.
6. It is to be noted that, although most budgetary information is presented according to the Vote structure, government departments establish three-year strategic plans and annual business plans. However, these documents are not prepared as part of the budget cycle and are not linked to spending information.
7. The maintenance of the Central Fund derives from the Constitutional requirement that "All revenues of the State from whatever source arising shall, subject to such exception as may be

provided by law, form one fund, and shall be appropriated for the purposes and in the manner and subject to the charges and liabilities determined and imposed by law" (Article 11).

8. It is to be noted that the Irish Government provides significant funding annually to almost 3 000 agencies for the delivery of a range of services, which includes institutions such as universities, churches and so-called Section 38 and 39 agencies to which the bulk of this funding goes (around EUR 3.8 billion). Section 38 and 39 primarily operates in the acute hospital and disability sector. Questions have regularly been raised about whether these entities shall be included in the General Government sector.

9. In the case of the social security funds, their income is mainly made up of the Pay Related Social Insurance (PRSI) contributions of employees and employers.

10. IMF (2013) and questionnaire.

11. Apart from the local authorities in the boroughs of Dun Laoghaire, Fingal and South Dublin and the cities of Dublin, Cork and Galway, all counties, cities and boroughs have been further divided into 95 municipal districts. In addition, three regional assemblies are responsible for co-ordinating, promoting and supporting strategic planning and sustainable development and promoting effectiveness in local government and public services.

12. Local authorities in other OECD countries often have responsibility for a broader range of social services, such as education, health, social services, public transport, and policing.

13. www.housing.gov.ie/sites/default/files/publications/files/local_authority_budget_2018.pdf

14. www.cso.ie/en/releasesandpublications/ep/p-nie/nie2017/mgni/

15. Section 4(5) of the Comptroller and Auditor General Act specifies what is to be reported in the Finance Accounts while sections 4(2) and 4(3) provide for the audit of the Accounts and their laying before the Dáil (Lower house).

16. For the Appropriation Accounts, accounting rules and procedures are laid down by the Minister for Public Expenditure and Reform. Indeed, accounting policies for central government are largely determined through circulars issued by DPER. In particular, Circular 24/2018 set out the requirements for the Appropriation Accounts for 2018, including accounting practices to be adopted, the format of the Appropriation Accounts, Note disclosures and requirements for authorising the Appropriation Accounts.

17. For the Finance Accounts, Section 4.1 of the C&AG Act 1993 stipulates that the Minister for Finance specifies the form of the Finance Accounts and is responsible for ensuring that they are kept in the specified form, and are transmitted to the C&AG for audit on specific dates. However, Section 4.4 states that the Minister for Finance may by order vary one or more of those dates.

18. Section 22 requires that "accounts of the appropriation of the several supply grants comprised in the Appropriation Act of each year shall be prepared by the several Government Departments" and that "the Treasury shall direct that the Government Department charged with the expenditure of any vote under the authority of the Treasury shall prepare the appropriation account thereof: Provided also, that the term "Government Department," when used in this Act in connexion with the duty of preparing the said appropriation accounts, shall be construed as including any public officer or officers to whom that duty may be assigned by the Treasury."

19. For example, accounting requirements for the 2018 Appropriation Accounts were set out in DPER Circular 24/2018 Requirements for Appropriation Accounts 2018 and consolidated into the Guidance Manual for the Appropriation Accounts.

20. For example, the form of the financial statements for the National Debt has been approved by the Minister for Finance under Section 12 of the National Treasury Management Agency Act 1990.

21. Details on Statutory duties of Accounting Officers are set out in Section 19 of the Comptroller and Auditor General (Amendment) Act, 1993.

22. Section 22 of the Exchequer and Audit Departments Act, 1866 empowers the Minister for Public Expenditure and Reform to appoint an Accounting Officer in respect of any body for which a Vote is included in the Annual Appropriation Act.

23. Heads of Offices that have a Vote are appointed to the position of Accounting Officer based on primary legislation, i.e. the legislation which established the Office specifies to whom the role of Accounting Officer is assigned, for the Vote of that Office.

24. The Comptroller & Auditor General's independence as well as its institutional relationship with the executive and legislative branches has been protected by the Constitution, which states inter alia that "there shall be a Comptroller and Auditor General to control on behalf of the State all disbursements and to audit all accounts of moneys administered by or under the authority of the *Oireachtas*" and that the C&AG "shall report to *Dáil Éireann* at stated periods as determined by law."

25. For Appropriation Accounts, the Public Financial Procedures Manual and relevant Government Accounting Circulars issued by the Department of Public Expenditure and Reform (DPER) set out the form of the accounts.

26. For example, the Appropriation Accounts provide a cash receipts and payments view of a Vote, measured at the time the payment is received or made into the relevant bank account, however, Statement 1.3 Issues for Voted Expenditure in the Finance Accounts shows each Vote but with the amount being measured at the time of issuance from the Central Fund to the relevant bank account of the entity.

27. The contingent liabilities shown in the notes to each Appropriation account refers to amounts that may become payable from that particular Vote. The figures that are shown in the Finance Accounts are amounts payable not from the Votes but would ordinarily arise on the Exchequer should they actually materialise.

28. For example, the Department of Finance has EUR 967 259 000 of outstanding guarantees issued under specific legislation; the Appropriation Accounts for Government Department of Finance only list two categories of contingent liabilities (with no amounts reported) – those items are Litigation in respect of Irish Bank Resolution Corporation and third party protections in connection with the sale of Irish Life Ltd.

29. Currently, the National Debt is measured at redeemable par value whereas the financial instruments standards use amortised cost or fair value.

30. Key information on PPPs is now publically available through: (a) value of unitary payments paid thus far, (b) an estimate of future liabilities, (c) project classification, (d) date the project becomes operational, (e) year the final unitary payment will be made.

31. In addition, although a requirement is included in the Appropriation Accounts to report contingent liabilities, the level of disclosure provided is below that required under international standards and only guarantees issued under specific legislation are disclosed in the Finance Accounts.

32. The Finance Accounts cover transactions on the Central Fund which encompass both Voted and Non Voted expenditure. The Appropriation Accounts cover Voted Expenditure – as provided by the Appropriation Act – but now also include a note on Central Fund expenditures arising within the relevant Department's activities.

33. This standard is issued by the UK Financial Reporting Council, which is the standard setter for both the UK and Ireland, with the main financial reporting frameworks in use being International Financial Reporting Standards (IFRS).

34. Examples include: tobacco excise, social insurance contributions, rates, the broadcasting licence fee as well as other taxes and fees. Some non-tax revenues are also not included. This includes charges, fees, and fines levied by government departments that do no flow through the Exchequer account.

35. The situation is exacerbated for sectoral committees at the Houses of the *Oireachtas* who also have to wait until the Public Accounts Committee has gone through the Appropriation Accounts before they can formally look at them, which can be 18 months after the end of the fiscal year.

36. In its Periodic Report No. 3 published in July 2018 the Public Accounts Committee recommended greater harmonisation of accounting across government.

37. For example, in the recent Public Accounts Committee Examination of Financial Statements in the Third-Level Education Sector, members reported that they struggled to obtain a total figure for government spending in this area.

38. This report does not discuss potential improvements to the budget nomenclature, which should be analysed as part of a wider analysis of the budget processes.

39. The operational implications of such a reform are detailed and discussed in detail in Section 4 of this report.

40. IMF (2018)

41. European Commission (2018)

42. Moretti and Youngberry (2018)

43. Budget forecasts have underestimated spending needs with year on year spending overruns in this sector averaging €0.5 billion over 2014–2017.

44. A recent report by the Irish Fiscal Advisory Council recommended that "the Government should seek to develop and publish more data on health expenditure than is currently provided. This would be helped by a move to a timelier, audited, and consolidated general government accounting system for all departments. IFAC (2018) www.fiscalcouncil.ie/wp-content/uploads/2018/11/Fiscal-Assessment-Report-November-2018-Final.pdf

45. https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/european-semester/framework/eus-economic-governance-explained_en

46. IPSAS 18 establishes principles for reporting financial information by segments in consolidated financial statement. Public sector entities will identify as separate segments each distinguishable activity/group of activities that they carry out. In most cases, segments will reflect major classifications of activities identified in budget documentation.

47. https://data.oireachtas.ie/ie/oireachtas/committee/dail/32/committee_of_public_accounts/reports/2018/2018-07-11_periodic-report-no-3-january-may-2018_en.pdf

48. Of note, as it currently stands, General Government Gross and Net Debt as published by the CSO is distinct from National Debt as per the National Treasury Management Agency. It is advised that the objective of a "whole of government" balance sheet be close to the concept of General Government as per ESA2010 – if not identical to it – which would thus allow for the National Debt to be part of the balance sheet. Indeed, although National Debt is a net measure, it is critical to have gross reporting of assets and liabilities.

49. For example, in Canada, the supreme audit institution does not provide an audit opinion on individual financial statements of government departments.

50. This chapter aims at providing the Irish government with operational guidance in case it would decide a move towards accrual accounting and improve its closing procedures.

51. As per Circular 21/2015 issued by DPER, FRS 102 is used for local authorities and non-commercial State bodies.

52. Although the existing basis for presentation of the Appropriation Accounts is embedded within section 22 of the Exchequer and Audit Departments Act, 1866 (as amended by the Comptroller

and Auditor General (Amendment) Act, 1993), detailed accounting rules and procedures are laid down by the Minister for Public Expenditure and Reform and therefore relatively easy to amend.

53. Indeed, under the proposed format for a government departmental integrated annual report, Appropriation Accounts would continue to be prepared, meaning that would comply with requirements laid out in the Exchequer and Audit Departments Act, 1866 (as amended by the Comptroller and Auditor General (Amendment) Act, 1993). However, under the proposed new framework, information previously provided in the Finance Accounts would be integrated into the consolidated financial statements for central government. This would require at least a change to Section 4 of the Comptroller and Auditor General (Amendment) Act 1993, which provides for the transmission of the Finance Accounts to the Comptroller and Auditor General by the Minister of Finance.

54. Of note, the Central Statistics Office maintains a comprehensive list of public sector bodies for statistical purposes in the compilation of Government Finance Statistics. Although this list should not be used as the final register for administrative purposes, it could be used by DPER as the base for determining the scope of the survey.

55. For Finance Accounts and the Appropriation Accounts, the legally binding time constraints for preparing, auditing, and laying accounts before Parliament are respectively set in Section 4 of the Comptroller and Auditor General (Amendment) Act, 1993 and Section 22 of the Exchequer and Audit Departments Act, 1866 (as amended by the C&AG Amendment Act, 1993).

56. In both those countries, a domestic standard setter reviews the relevant IFRS and amends as appropriate, after its own due diligence process to accommodate jurisdictional requirements for the standard.

57. While no decisions have been taken at EU level regarding harmonised accounting standards, an EU-wide accounting framework could be implemented according to the following indicative timeframe: Phase 1: Increasing fiscal transparency in the Member States in the short to medium term by promoting accruals accounting, e.g. IPSAS, in the period from 2016 to 2020, and in parallel developing the EPSAS framework (i.e. EPSAS governance, accounting principles and standards); Phase 2: Addressing comparability within and between the Member States in the medium to longer term, by implementing EPSAS by 2025.

58. In practice, such adaptations of international standards seem to have focused on a limited number of areas, such as limiting the quantity of disclosures (for example, Sweden), defining boundaries for the financial statements that are aligned with the ones used in the budget and the fiscal statistics (United Kingdom, Australia, or New Zealand), or reflecting the specificities of the national legal frameworks and public policies (France, for example, with regard to the accounting treatment for the public service pension system).

59. Of note, the IPSASB has recently issued IPSAS 41 Financial Instruments, which simplifies the classification and measurement of financial instruments. That new standard has an effective date of 1 January 2022 but may be adopted early. When reviewing the existing standards on financial instruments, it may be worthwhile considering early adoption of IPSAS41 rather than implementing the existing IPSAS standards on financial instruments. The gap analysis has assessed the extant IPSAS standards on financial instruments and also included a summary of the main requirements arising from IPSAS41. Key gaps relate to the measurement basis used and the disclosures required in relation to risks attaching to financial instruments (particularly quantitative measures of those risks).

60. These two topics are also included in the IPSAS work programme.

61. Under IPSAS 33, the date of first adoption needs to be specified. This is the date that the accrual basis IPSAS first applies. An opening statement of financial position needs to be prepared at the date of adoption. This is the starting point for the use of accrual basis IPSAS. The accounting policies used for the opening statement of finance position need to be the same as the policies that will be applied under accrual basis IPSAS.

62. The Asset Register of the Office of Public Works includes all buildings but does not include all National Historic Properties, National Monuments or infrastructure assets such as roads. For the remainder of the portfolio, estimates are based on current building cost norms and notional site values (545 buildings, EUR 0.546 billion).

63. In particular, the following segments will play a pivotal role in producing accrual financial statements: the Entity component will enable the production of entity level financial statements, as this segment enables transactions and events to be recorded specific to an entity; the Nominal and Sub-nominal and Subhead segments will enable the accrual classification of the revenue, expenses, assets, liabilities and Net assets/Equity of the entity; and the Affiliate segment will enable identifying related party transactions and providing information on transactions between entities to enable consolidated financial statements to be prepared.

64. For example, IPSAS 2 requires that the CoA categorises cash flows according to type – operating, investing or financing; IPSAS 21 requires that the CoA includes accounts to record impairments and reversals; IPSAS 17 require certain accounts to be created in the CoA to facilitate the production of disclosures; IPSAS 13 requires that the CoA record separately lease asset/liabilities, operating lease payments, commitments for leases in different maturity categories; etc.

65. The Statement on Internal Financial Control covers the following elements: i) the description of the overall risks and control framework; ii) if the government department uses the NSSO, a statement that they have fulfilled their responsibilities under the service level agreement and that they have relied on assurances from the Accounting Officer of the Shared Services Centre; and iii) the assurance that the government department has complied with relevant procurement guidelines.

66. OECD (2017), Accrual Practices and Reform Experiences in OECD Countries.

67. IPSAS 33 First time adoption of accrual basis IPSAS however provides some relief in determining the initial value for such assets.

68. Information on funds is provided in the Notes to the Appropriation Accounts and schedules are provided in the Finance Accounts showing details of shareholdings in State bodies and other companies.

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The Role of Evidence Informed Policy Making in Delivering on Performance: Social Investment in New Zealand

by

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This case study represents the first in a planned series of studies on the 'The Role of Evidence Informed Policy Making in Delivering in Performance'. The case study is based on both interviews with key stakeholders and desk research. It focuses on the social investment approach in New Zealand, which is an evolving approach to thinking long-term and making informed choices on how best to improve people's wellbeing. Social investment brings together different tools and approaches to good governance, building on the respective strengths of performance management and evidence informed policy making. At its core, social investment involves using data and evidence to understand customer needs from a person centric and long-term perspective, proposing innovative solutions that meet citizens' needs and deliver financial savings, evaluating programmes to identify what works and what doesn't, and publishing these results openly and feeding findings into the next set of decisions. The case study concludes with a number of recommendations for improving the social investment approach in New Zealand. These recommendations are also relevant to other jurisdictions trying to strengthen the capacity for evidence informed policy making.

JEL codes: H41, H50, H60

Keywords: Evidence Informed Policy Making; Performance Management; Policy Evaluation; Social Investment.

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The authors would like to thank all stakeholders in New Zealand who gave their time to provide valuable information and feedback during the course of the interviews. Brendan Boyle and Peter Alsop (Ministry of Social Development) provided critical early support to the project. Nick Carroll (New Zealand Delegation to the OECD) was critical in liaising with colleagues in New Zealand and helped to set up the project and keep it on track. The authors are especially indebted to Laura Crespo (Ministry of Social Development) for coordinating this case study, for providing detailed information on the social investment approach and for very helpful comments on an earlier version of this manuscript. The authors are also very grateful to Donald P. Moynihan (University of Wisconsin–Madison) for providing detailed and extremely helpful comments on an earlier version of this manuscript. Editorial work and quality control were provided by Danielle Mulima and Bonifacio Agapin who prepared the manuscript for publication.

Executive Summary

Social investment is an evolving approach to thinking long-term and making informed choices on how best to improve people's wellbeing. Social investment brings together different tools and approaches to good governance, building on the respective strengths of performance management and evidence informed policy making. At its core, social investment involves using data and evidence to understand customer needs from a person centric and long-term perspective, proposing innovative solutions that meet citizens' needs and deliver financial savings, evaluating programmes to identify what works and what doesn't, and publishing these results openly and feeding findings into the next set of decisions.

The social investment approach was initially developed to manage financial pressures, whilst supporting improved outcomes for New Zealand's citizens. More recently, the key focus of the approach has been to make use of disciplines that enhance social outcomes over what would otherwise be achieved. For some portfolios in the social sector, this has led to emphasis on early intervention, reducing avoidable future expenditure and tackling issues early before they become entrenched. Since the election of the current government, focus has emphasised the use of social investment to first and foremost improve New Zealanders wellbeing.

Social investment is increasingly being underpinned by a whole of government approach, with central agencies overseeing and co-ordinating the approach as well as acting as an analytical base, source of expertise and best practice. This case study focuses on the social investment approach within the Ministry of Social Development (MSD), New Zealand's largest government department and where the social investment approach was first implemented in New Zealand. A qualitative case study methodology was used for this work, which involved interviews and desk research. Further details can be found in the Appendix.

Each major spending appropriation within MSD is underpinned by an investment strategy. The focus of this case study is the Employment and Social Outcomes Investment Strategy, which sets out the areas of focus underpinning MSD's funding for employment outcomes. The Strategy set out which groups of clients the employment and work readiness spending will be targeted towards based on various data sources, including the annual actuarial modelling. Also fundamental to New Zealand is integrated administrative data**,** including the Integrated Data Infrastructure (IDI), which is a large research database that holds anonymised microdata about people and households that can be used to enable both the modelling work and impact evaluation. Robust impact evaluation methodologies are used to determine the effectiveness and efficiency of the programmes and policies, with this evidence then feeding back into subsequent strategies and evaluations.

These key facets of social investment also support other aspects of government performance management. New Zealand is one of the major propagators of performance-budgeting and a number of initiatives have integrated social investment within the budget process, including a two-track process for new initiatives, with a special fast track for social investment bids in the 2017 Budget. Between 2012 and 2017, social investment also helped support some of New Zealand's Better Public Service Targets, by helping to deliver better public services within tight financial constraints. With a change in Government, consideration is being given to integrating the social investment approach into broader measures of improvement in wellbeing.

Social investment has already had a positive impact in New Zealand and generated insights into the factors that facilitate the approach and the barriers to delivery. The strong analytical community within MSD facilitated the social investment approach. Given the strong analytical demands made by social investment, continuing to build capacity to generate, analyse and understand evidence across government is warranted. The impact evaluation generated through social investment is a critical source of evidence to inform the budget process; however, at present effective interventions mainly receive marginal additional funding. Interviewees recognised that using evidence on programme effectiveness and efficiency to make significant changes to the composition of baseline expenditure is challenging and needed a longer timescale to implement effectively. Interviewees recognised that as social investment broadens to encompass a whole of government approach, defining 'effective outcomes', such as in areas like adult mental health would be challenging. Building cross government consensus on defining and measuring outcomes will be critical to implement social investment effectively.

The case study concludes with a number of recommendations for improving the social investment approach in New Zealand. These recommendations are also relevant to other jurisdictions trying to strengthen the capacity for evidence informed policy making.

1. Introduction

The social investment approach to public service provision is receiving increasing attention worldwide. It is an evolving approach to thinking long-term and making informed choices on how best to improve people's wellbeing. Social investment brings together different tools and approaches to good governance, building on the respective strengths of performance management and evidence informed policy making. This introduction begins by briefly describing some of the key concepts and challenges in performance management and evidence informed policy making before describing the key features of the social investment approach in greater detail.

1.1. The role of performance management in government

Performance management aims to monitor the progress of government programmes, assess their short-term results and ensure that performance information is used to inform decision making (Blalock, 1999[1]; OECD, 2008[2]; Newcomer and Brass, 2016[3]). Performance management normally entails brief and timely measurement of simple quantitative indictors, often using routinized processes (Nielsen and Ejler, 2008[4]). The processes of performance management are usually carried out by managers with government. One application of performance management is performance budgeting, the systematic use of information about the outputs, outcomes and impacts of policies in order to inform, influence and/or determine the level of public funds allocated towards those polices (Downes, Moretti and Nicol, 2017[5]).

The successful implementation of performance management can bring a number of benefits to governments. Performance management can improve public sector performance by increasing accountability and developing communication within and across branches of government (Downes, Moretti and Nicol, 2017[5]). Performance management can also support strategic planning by shifting government focus from the inputs to the outcomes of intervention (Downes, Moretti and Nicol, 2017[5]). Finally, performance data has the advantage of being timely, low cost and easy to understand which makes it an important tool for informing citizen choice and improving transparency (Nielsen and Ejler, 2008[4]).

1.2. The role of evidence informed policy making in improving performance

While performance management systems provide routine management information at low costs and in a timely manner, they cannot explain variation in performance (Kroll and Moynihan, 2017[6]). Policy evaluations, however, are designed to offer such causal knowledge and can therefore help to make sense of performance outcomes. Many governments have invested in increasing both the quantity and quality of policy evaluation. Across all sectors and across the world, there is an upward trend in the number of policy evaluations being published since the early 2000s – especially randomised control trials (RCTs) and other impact evaluation designs.

Policy evaluation, along with other forms of evidence[1], has a critical role to play in in improving the quality, responsiveness and accessibility of public services. It can play a role throughout the key stages of the policy cycle and is recognised as a critical part of good governance. Policy design benefits from 'policy memory', an understanding of what challenges have been experienced in the past and what previous good practices could be incorporated into the current reform effort. Evidence also has a critical contribution to make in policy implementation, by illuminating how to adapt policies to meet local needs, whilst guarding against changes that may affect outcomes. This can make the difference between a successful implementation of an intervention and one that is ineffective or potentially even harmful (Moore, Bumbarger and Cooper, 2013[7]). Policy evaluation is also critical to understand why some policies work and why others do not, thus enabling governments to allocate resources to areas of greatest need and likely impact.

Despite the potential for policies to be based on evidence, in reality an effective connection with many types of research evidence in policy making remains elusive. Although many policy makers see the value of using evidence, many are not using it systematically in crafting policy analysis and advice (Newman, Cherney and Head, 2017[8]; Campbell et al., 2009[9]). Multiple dimensions of capacity affect the use of evidence in policy making. Oliver et al. in a systematic review (with 145 studies carried out it over 59 countries), found that timely access to high quality and relevant research, collaborations with policy makers, and relationship and skill building with policy makers were reported to be the most important factors in influencing the use of evidence. To overcome these challenges and build more effective approaches to evidence informed policy making governments across the OECD are investing in a range of strategies. The focus of this case study is the social investment approach in New Zealand.

1.3. What is social investment in New Zealand?

Social investment is about thinking long-term and making informed choices on how best to build people's potential and wellbeing. Doing so effectively can improve the lives of people who need support and build more inclusive, equitable and prosperous communities. This vision requires a partnership approach – across government and the wider community – focused on building people's strengths and resilience, and ensuring nobody falls through the cracks.

At its core, social investment involves five key features (Deloitte New Zealand, 2016[10]):

1. Using data to understand customer needs from a person centric and long-term perspective.
2. Proposing innovative solutions that meet citizens' needs and deliver financial savings.

3. Delivering, managing and monitoring services using a mix of government and commercial providers.
4. Using performance data to adjust, add or drop programmes.
5. Evaluating programmes to identifying what works and what does not, and publishing these results openly.

In the New Zealand context, the social investment approach has evolved since it was first seriously considered in 2010. The first dominant approach centred on the welfare system, in particular on working-age beneficiaries, and emerged from the recommendations of a Welfare Working Group in early 2011. This early approach in New Zealand focused on reducing the future lifetime cost of the benefit system, with the assumption that a reduction in this life-time cost would be a proxy for overall improvement in social outcomes (Boston, Gill 2017). Important features of this approach included the use of client segmentation to assess the effectiveness of targeted investment, innovations in interventions through trials and pilots, and an integrated governance approach across government (Destremau and Wilson, 2017[11]).

This New Zealand approach is distinct from the social investment approach in many European countries, where interventions have been centred on the accumulation of human capital to achieve improved social outcomes (Destremau and Wilson, 2017[11]). Following the Australian Federal Government's adoptions of recommendations of the McClure Report in 2015, Australia has begun a similar path to New Zealand's early social investment approach, including the use of actuarial modelling, but has also sought to innovate on the New Zealand approach through initiatives such as the 'Try, Test and Learn' Fund.

By 2016, the population groups targeted by the social investment approach in New Zealand was broadened to include other vulnerable or at-risk populations, such as children, people in the justice system, and people with poor health outcomes. The use of future lifetime cost was extended to incorporate the measuring of broader social outcomes and the analytic tools used expanded to include greater use of big data and more consistent use of cost-benefit analysis (Boston and Gill, 2017[12]). The second period of evolution of the social investment approach in New Zealand culminated in the establishment of the Social Investment Agency in July 2017. The Agency was the expansion of a pre-existing Social Investment Unit (housed in the Ministry of Social Development) and launched with the intent of helping "social sector agencies shift away from focusing on their specific areas into taking a 'whole of system' approach to helping vulnerable New Zealanders" (Adams, 2017[13]).

With the change in government at the end of 2017, the approach to social investment is set to evolve again by focusing the purpose of investment on improving New Zealander's social wellbeing. The use of data analytics and modelling and taking a 'whole of system' view by maintaining the Social Investment Agency will likely continue as foundational. However, the emphasis on using future lifetime cost as a proxy for social outcomes has been removed and the limitations of using 'big data' have been emphasised. Instead there is an increasing acknowledgement of the "the need to appreciate the complexities in people's lives as well as their ability to build resilience and fulfil their potential in different ways"; the broadened approach is also complemented by a stronger focus on the privacy of people's information and the development of the Data Protection and Use Policy (Office of the Minister for Social Development, 2018[14]).

2. Context

2.1. What was the policy context leading to reforms?

In the recently published compendium Social Investment: A New Zealand Policy Experiment, editors Boston and Gill (Boston and Gill, 2017[12]) identify five underlying trends. The trends date back to when the government first gave serious consideration to a social investment approach in 2010. The trends are as follow:

1. The implications of the Global Financial Crisis exacerbated by the economic impacts of the Canterbury Earthquakes during 2010-11.
2. The drive for improvements to the public management system, especially with respect to social services, cumulating in a significant inquiry by the Productivity Commission and its final report Better Social Services in 2015.
3. The concern of the previous government of long-term welfare dependency and growing evidence of intergenerational welfare dependency. This led to the establishment of a Welfare Working Group, which specifically recommended in its final report in early 2011 that the performance of the welfare system be managed through the assessment of its future lifetime cost, and that greater emphasis be placed on investing to prevent welfare dependency.
4. The related concern over children and the high incidence of child abuse and neglect, which led to the establishment of the Expert Advisory Panel in 2015 to review related services, and subsequently, significant changes to legislation and the establishment of a new Oranga Tamariki, the Ministry for Children.
5. The embracing of 'big data' within government agencies, including the development and refinement of large and often complex administrative data sets, together with improved capacity and capability to share, match and analyse the data, most notably through the development of the Integrated Data Infrastructure (the IDI) by Statistics New Zealand. This large database brings together anonymised microdata from a wide range of sources about people and households.

In addition to these underlying trends, interviewees recognised a strong political leadership as being a key driver to achieving sustained long-term political change and the success of the social investment approach (Gill, 2017[15]). Right Honourable Sir Bill English the former Prime Minister (and before that Deputy Prime Minister and Minister of Finance) provided the leadership in requiring ministries to have clear evidence to support investment decisions and interviewees felt this requirement instilled a discipline that was not previously present in a consistent fashion.

2.2. How is the social investment approach being implemented in New Zealand

2.2.1. Whole of Government Governance Arrangements

The social investment approach in New Zealand is increasingly being underpinned by a whole of government approach. *A Social Investment Board* (SIB) was initiated in July 2017 (replacing its predecessor the Social Sector Board). The SIB comprises of the Chief Executives of the Ministries of Education, Health, Justice and Social Development, and is led by an independent chair reporting to the Minister Responsible for Social Investment. The first priority for the SIB was to establish the analytical base for the social investment

approach. The objective was to use this work to examine the investment opportunities that come from critical questions such as:

- Are at-risk children and their families receiving full coverage and access to core/universal services?
- Do agencies have a shared or common view of at-risk and high need to ensure best value for targeted services?

With the recent change of government, this board has expanded its membership and scope and now report to the Minister for Social Development. It is now also referred to as the Social Wellbeing Board.

A further piece of the whole of government machinery is the Social Investment Agency (SIA). SIA was also launched in July 2017 and is responsible for advancing and embedding social investment in the social sector, including supporting agencies in implementing a social investment approach. It works with government agencies and Non-Governmental Organisations (NGOs), to help them take a life-course approach to citizens. The SIA's mandate includes building the architecture to support agencies in applying social investment, developing whole-of system advice and trialling and testing new approaches.

These whole of government initiatives also complement the work of other central agencies. New Zealand Treasury has been active in developing common measurement frameworks, such as Social Cost Benefit Analysis, to help agencies to compare different social investment options in New Zealand. This work led to the development of a tool called CBAx, which is a spreadsheet model that helps agencies monetise impacts, provides a common measurement basis, and makes it easier to do return on investment analysis.

Another agency that plays an important role in social investment landscape was Statistics New Zealand. Statistics New Zealand (*Tatauranga Aotearoa),* is a government department but operates with a measure of statutory independence. It collects information from people and organisations through censuses and surveys and uses this information to provide data and insights about New Zealand. In the context of social investment, it is important to note that Statistics New Zealand houses the Integrated Data Infrastructure (IDI).

2.2.2. Organisational and governance structure in MSD

This case study focuses on the social investment approach within the Ministry of Social Development (MSD) in New Zealand. MSD is New Zealand's largest government department employing people in 260 locations around the country to administer welfare, employment, social housing, student loans, superannuation, and community development programmes. As of July 2018, the Ministry consists of five groups: Insights & Investment, Policy Group, Housing Group, Service Delivery and Corporate Solutions. The Ministry's Policy branch comprises four groups: Community and Families Policy, Employment and Income Support, Seniors and International Policy, and Housing Policy. The Ministry's Service Delivery branch comprises five groups: Work and Income, StudyLink, Senior Services, Integrity Services, and Youth Service. Work and Income provides employment services and income support throughout New Zealand by offering a single point of contact for New Zealanders needing work-search support, income support and in-work support. This work is divided into a network of 11 regions, each headed by a Regional Commissioner.

Alongside these organisational arrangements, MSD had also recently introduced new governance arrangements, which include three governance committees:

- Investment Strategy Governance Committee (ISGC): Where should we invest our resources?
- Organisational Performance Governance Committee (OPGC): How well are we doing?
- Organisational Integrity and Capability Governance Committee (OICGC): Are we set up to operate effectively?

Each of the social investment strategies are governed trough the ISGC, with final sign off sitting with the relevant Deputy Chief Executive responsible for the delivery of the strategy.

3. The role of EIPM and performance management tools in delivering the social investment approach

3.1. The Investment Strategy

The focus of this case study is the (see Box 1. The Strategy sets out the areas of focus underpinning MSD's funding for employment outcomes. Specifically, the Strategy sets outs which groups of clients employment and work readiness spending will be targeted towards, as an investment priority based on various data sources, such as annual actuarial modelling, effectiveness evaluation of interventions, the External Monitor Reports and consultation with various stakeholders. A further purpose of the Strategy is to attract interest from external organisations to work collaboratively with MSD, increasing understanding of the complexities faced by some citizens and thus helping to develop new services aimed at improving client outcomes. A core component of using a social investment approach at MSD is designing and implementing trials to test new and innovative approaches and interventions, to work with clients to improve employment outcomes.

Box 1. The Employment Outcomes Investment Strategy

- The purpose of the Employment Outcomes Investment Strategy is to set out the focus areas which underpin spending allocations for MSD's Multi-Category Appropriation (MCA) funding for employment outcomes. It does this by highlighting which groups of clients employment and work readiness spending will be targeted towards. These investment priorities are informed by a number of data sources including the annual actuarial evaluation, the Benefits System Performance Report, the Quarterly Drivers of Performance Reports, the External Monitor Reports and stakeholder consultations.
- A vital component of the investment approach is client segmentation, which uses statistical modelling to group clients into cohorts with similar characteristics, patterns of service use and needs. This allows for an assessment of the future levels of benefit receipt and the long-term cost of different segments in the population.
- Including this segmentation into the evaluations led to important insights about the clients with complex needs and barriers to employment. Although services were achieving positive outcomes for many of MSD's clients, these same services were not having the same impact for clients that have more complex barriers to employment. This highlighted that there were clients who were far removed from

the labour market for whom the portfolio of services were not adequately preparing them for the labour market. As such the Strategy focused on three groups of client:

- Health and Disability clients
- Maori
- Intergenerational benefit recipients

- Working more intensively with clients that have high barriers to employment also required designing and implementing bespoke interventions to help them achieve better outcomes. Designing and implementing new interventions also requires robust evaluation (see Section 0).

Source: (Ministry of Social Development, 2017[16])

3.2. The Integrated Data Infrastructure

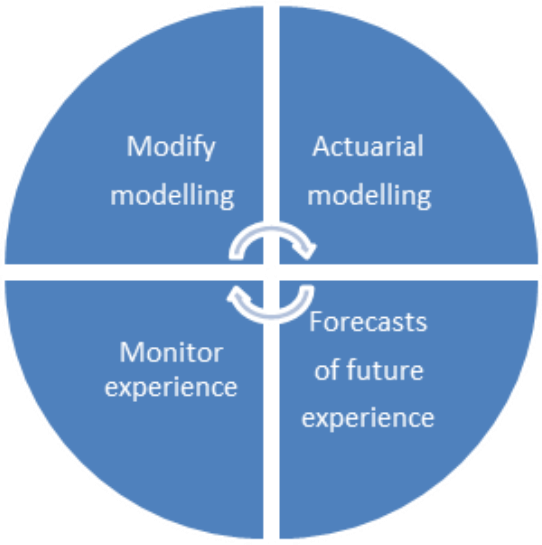
The Integrated Data Infrastructure (IDI) is a large research database. It holds anonymised administrative data about people, businesses and households, and is accessible by accredited researchers. The data is about life events like education, income, benefits, migration, justice, and health. It comes from government agencies, Stats NZ surveys and Non-Government Organisations (NGOs). Many OECD countries have administrative data, but New Zealand's approach is innovative in that this data is linked together, or integrated, to form the IDI. Interviewees were clear that the IDI was a strong asset which enabled high quality evaluation to be carried out both within MSD and also increasingly by external parties such as academics carrying out evaluations using the IDI.

3.3. Actuarial modelling

Another critical component of the social investment approach within MSD has been the use of actuarial modelling. This approach has drawn from financial management principles and has to date involved projecting future cash flows and relating them to the assets held to finance them. This has been used to value the expected future benefit expenditure for various categories of welfare beneficiaries (Destremau and Wilson, 2017[11]). The figure below shows the actuarial control cycle that was recommended by MSD for the overall financial control of the welfare system, which requires four key steps:

- Periodic actuarial modelling of expected future benefit expenditure;
- Forecasts of future experience based on the models and results of the actuarial modelling;
- Monitoring of the experience against the forecasts throughout the period between updates; and
- Updated actuarial modelling incorporating modifications due to the comparison of actual and forecast experience, and other expected changes.

Figure 1. A framework for the modelling of the liability for social welfare benefits using an actuarial approach.



Source: Adapted from Ministry and Social Development and Treasury (Ministry of Social Development and The Treasury, 2011[17]).

With the election of a new government in November 2017, actuarial modelling is extending to encompass a wider range of social outcomes. In particular future modelling will seek to capture the outcomes of the wider population, rather than just the outcomes of those who have received support through the welfare system. It will also seek to capture a broader set of outcomes than simply time away from the welfare system.

3.4. The use of robust impact evaluation methods

Extracting policy relevant information out of the data requires analytical techniques and the capability to turn data into evidence (Kelly and Collins, 2017[18]). A critical component of the social investment approach is determining the efficacy and effectiveness of policies and programmes. MSD has built up its capacity to determine the effectiveness of interventions over a number of years and now use a range of methods including robust methods such as RCTs and quasi-experimental designs such as propensity score matching and natural experiments.

Many evidence hierarchies emphasise the need for rigorous efficacy testing, using randomised control trials where possible, because such studies privilege internal validity, permitting stronger conclusions about whether the observed correlation between the intervention and outcomes reflect underlying causal relationship (Gottfredson et al., 2015[19]; Shadish et al., 2002[20]).

Nevertheless, it is recognised that RCTs are not always practical due to legal, political or ethical considerations or constraints due to time and/or budget (Wakeman and Garret, 2017[21]). Instead, analysts can use a quasi-experimental methods, such as regression discontinuity, propensity score matching and interrupted time series designs to generate comparable samples (Cook, Shadish and Wong, 2008[22]; Gottfredson et al., 2015[19];

Wakeman and Garret, 2017[21]). This was especially important in New Zealand where some benefits and interventions are rights based and so random allocation is not possible.

New Zealand has built up the techniques to carry out propensity score matching (PSM) to a relatively high degree of sophistication. Some of the common caveats and limitations of matching techniques, such as the need for a large sample from which to construct an appropriate control group and the bias introduced where matching is only possible on a restricted set of observable characteristics are reduced or overcome with the IDI which is comparatively rich in terms of both sample size and measured characteristics. This approach has enabled the comparison of different interventions trying to achieve the same outcome, through the development of code that can be applied to estimate the impact of different interventions using the existing data in the IDI (de Boer and Ku, 2017[23]). Interventions are then categorised according to their effectiveness using the rating system in Table 1.

Table 1. Definitions for the Employment A intervention effectiveness ratings

		Definition
Rating	Symbol	
Effective	★★	The intervention has a statistically significant positive effect for the majority of primary outcomes (e.g. income, employment and independence from welfare) and no evidence of a negative impact on any primary outcome.
Promising	★	Trends in impacts indicate the intervention is likely to be effective over the long-term. In addition, we rate interventions as promising if we cannot evaluate the intervention directly, but where a very similar intervention is rated as effective.
Mixed	†	The intervention has both positive and negative impacts on primary outcomes. The most common case is where an intervention increases employment but has a negative impact on independence from welfare.
Makes no difference	O	The assistance makes no statistically significant difference for any of the primary outcomes.
Likely negative	✖	Trends indicate the intervention will have a negative impact on one or more primary outcomes and there is no evidence of a positive impact on any other primary outcome.
Negative	✖✖	The intervention has a statistically significant negative effect for the majority of primary outcomes and no evidence of a positive impact on any primary outcome.
Too early to assess	◵	There has not been enough time to observe the impact of the intervention. Typically, we do not rate an intervention until we have two years of outcome data available.
Unknown		We have not rated the effectiveness of the intervention.
Cannot be evaluated	⦸	It is not technically feasible to estimate the impact of the intervention.

Note: Impact here means change in outcomes for people receiving the intervention relative to a similar group of people who do not participate
Source: de Boer and Ku (2017[23]).

3.5. Budgeting for performance

New Zealand is regarded as one of the major propagators of performance-budgeting, having first adopted measures to initiate performance-budgeting in 1989 (Clark, Menifield and Stewart, 2018[24]). A number of initiatives over successive years have attempted to integrate social investment within the budget process (Gill, 2017[15]):

- 2015 Budget: included a Request for Information on how the government could improve results for vulnerable children and their families.

- 2016 Budget: this included an investment panel to provide an independent assessment of new proposals.
- 2017 Budget: included a two-track process for new initiatives with a special fast track for social investment bids (that are outside the new initiative allocations).

The New Zealand government has proposed three levels for the evaluation of budgeting performance (Gill, 2017[15]):

- micro – resources targeted within existing programmes (e.g., matching clients to programmes based on the expected effectiveness);
- meso – portfolio-related resources allocated across a set of programmes within an agency; multi-dimensional investment strategies encouraged (especially for assisting citizens with complex and multiple needs); and
- macro – whole-of-government; tax/spending debt rebalanced.

The evidence produced by the social investment approach, promises to make significant contributions to each of these levels, resulting in more effective and efficient expenditure.

3.6. Better Public Service Targets

At the same time as the introduction of a social investment approach in New Zealand, the former government also established Better Public Service Targets. The first set of Better Public Service Targets were announced in 2012 and included a target for reducing the number of people continuously receiving unemployment benefits. Targets covered the full range of public service delivery, from educational achievement to crime reduction. Investment strategies, including those that are the focus of interviews in this case study at the Ministry of Social Development, were originally focused on meeting such targets.

The new Government announced in January 2018 that the Better Public Services programme would not continue in this form.

4. What is the impact of the social investment approach and what are the barriers and facilitators to delivery?

4.1. Tensions between a top down hierarchical performance management model and a more devolved approach

Interviewees recognised that the social investment approach created tensions with the traditional hierarchical performance management model. Table 2 highlights how the shift in the focus from ‘programme-centred’ approach to a ‘people-centred’ one requires a shift in the mode of governance from a top-down hierarchical model to a more devolved and polycentric approach (Gill, 2017[15]).

Table 2. Conventional and social investment ideal types compared.

	Conventional approach emphasises	Social investment focuses more on
Dimension		
Focus of decision-making	Programmes supplied by public agencies or private providers	People-centred problem-solving
Locus of decision-making	Ministers or public agency	Devolved decision-making
Target group	Broad populations	People with complex needs, poor outcomes and associated high costs
Focus of analysis	Define problem(s) and select intervention(s)	Use data to identify target group
Commissioning	Outputs	Dynamically evolving outputs informed by outcomes
Interventions	Standardised solutions	Tailored heterogeneous solutions
Monitoring	Output delivery and standards conformance	Iterative framework including outputs and impacts
Learning	'Set and forget'	Iterative/recursive
Conformance	Contract escalation strategy	Joint problem-solving
Accountability	Vertical and hierarchical	Horizontal and mutual
Control	Approval through rules, policies and contracts coupled with internal and external audit	Approval of broad approaches to tailored heterogeneous solutions, ongoing professional checks

Source: Adapted from Gill (2017[15])

There is a tension between the dominant operating modes of civil servants working within their ministries to delivery core government services and the need for cross-agency co-operation to solve 'wicked' policy challenges such as socio-economic inequalities and mental health issues. The risk is that cross-agency working will get suppressed by the traditional operating mode through vertical hierarchies (Gill, 2017[15]). What will be important going forward is for central agencies to support and mainstream ways of working that will allow ministries to adopt a wider range of practices that will enable them to tackle these 'wicked' policy challenges. The example of Scotland, which abolished government departments in order to try and increase cross policy area working, could prove instructive in this regard.

4.2. Social investment requires capacity to generate, analyse and understand evidence

A consistent message in the interviews was the analytical challenges involved in operating the social investment approach effectively. Although MSD was starting from a comparatively strong place in terms of the availability of analytical skills, a number of initiatives sought to further strengthen this. A first area was appointing analysts with the skills to carry out actuarial modelling. A second area was increasing the experimental design and wider research skills needed to carry out the impact evaluation work. One way that this has been achieved has been to link with external experts. This included appointing a Chief Economist whose time would be split between working with the New Zealand Government and being an academic. Working alongside external experts was also an effective strategy when carrying out work that presents very specific challenges, for example a specialist in ethics and human rights had been advising on a trial at MSD that involved citizens with mental health difficulties. A third way of building expertise, specifically in relation to investment thinking was to make strategic appointments of staff with experience of applying investment thinking.

Although having analytical staff with the skills to generate and analyse evidence was critical, of equal importance was having a policy profession that was able to understand and use evidence for effective policy making. New Zealand has benefitted from substantial work in recent years looking at policy making skills. The 'Policy Project' was initiated in 2014 by the New Zealand Department of Prime Minister and Cabinet, with the aim of 'lifting the policy game across the system' (Washington and Mintrom, 2018[25]). The resulting Policy Skills Framework makes transparent that skills concerning evidence, analysis and evaluation are an important part of the policy profession's skillset. However, it was noted in the interviews that this challenges the traditional model of a policy advisor with a public policy background, who is typically strong on drafting papers, but less strong on analytical skills. It was felt that for the social investment approach to be effective, policy professionals also needed to have both quantitative and qualitative research skills.

4.3. Impact evaluation as a source of evidence to inform the budget process

The evidence of effectiveness produced by MSD was felt to have led to rich conversations with Treasury throughout the budget process. Interviewees recognised that Treasury has an important role to play in terms of pushing ministries on whether they were making the best use of the base funding. What has changed under the social investment approach is the richness of that challenge function. For example, given the comparative richness of the evidence underpinning the Employment Outcomes Investment Strategy, Treasury was able to push MSD to identify the spending going to the least effective interventions and encourage them to move some of this funding to interventions with stronger evidence of effectiveness. Given the analytical premise of these conversations, it was now common for analytical staff to be present at budget meetings at MSD.

Nevertheless, interviewees recognised the reality of changing the nature of the baseline funding as challenging and needing a longer timescale to implement. Increased funding for interventions found to be effective was still mostly done through marginal additional funding rather than significant changes to the base spend. One reason for this was because MSD needs to operationally determine on an annual basis which organisations they are signing contracts with, restricting their ability to change the composition to the baseline expenditure. In addition to this challenge, interviewees also recognised that in ministries and/or policy areas without such an established evidence base, shifting the expenditure in this way will be more challenging and will necessitate an upfront investment in evaluation. Furthermore, interviewees noted that conversations between Treasury and MSD were still characterised by an information asymmetry and so ensuring that central ministries have sufficient resource and skills to offer an effective challenge function remains important. International literature acknowledges the challenge of improving public sector productivity (Dunleavy, 2017[26]) with many jurisdictions grappling with the twin challenges of controlling public expenditure and meeting growing demand for high quality public services by exploring different mechanisms for public sector productivity (Barber, 2017[27]).

4.4. The challenge of social investment as a largescale change management process

A persistent theme from both the interviews and the published literature was the fact that moving to a social investment approach is a large scale change management process. As such, it is faced with the general organisational change problems that can block or derail any new programme, such as patch protection, resistance to changing standard operating procedures and risk aversion (Gill, 2017[15]).

Another barrier to stakeholder buy-in for the idea of social investment was the language of 'liability'. This was felt to sit uneasily with people who are values driven. There was also discussion about whether the liability calculations could be too narrow, and whilst some felt there was room to take a more holistic view of some areas, there was a general consensus that developing this approach to performance was a significant improvement on the legacy system. This came to a head with the commissioning of an extended modelling approach which will seek to encompass a wider range of fiscal and non-fiscal outcomes so that a more holistic wellbeing perspective can be adopted.

4.5. The challenges of defining cross government outcomes

Interviewees recognised that, although not without their challenges, determining the outcomes with which to measure success for the *Employment Outcomes Strategy* and *Social Housing Strategy* was comparatively straightforward. In other areas such as child development or adult mental health, it was recognised that there is 'no common understanding of what contributes to effective outcomes for people receiving services and how this informs a social investment approach' (Wakeman and Garret, 2017[21]). Nevertheless, interviewees were clear that there was a need to build cross-government consensus on defining and measuring outcomes that were relevant to the multiple agencies – as having multiple definitions and measurement approaches would be confusing for stakeholders and inefficient in practice.

Interviewees acknowledged that, over time, it was necessary to embed further complexity and an understanding of ecological systems theories. This would enable a broader understanding of the risk and resilience factors that explain why some individuals and families more than others are more affected by adverse circumstances, such as poverty. Although some modelling and evaluation work had already started to build such an understanding, interviewees recognised that the outcome matrix in contracts meant that service providers were not currently incentivised to focus on risk and resilience factors, which could potentially undermine long term transformative change.

5. How could social investment in New Zealand be improved?

5.1. Further improvements to the IDI will yield benefits in more robust evaluation

The IDI was said to provide an extremely valuable but incomplete contribution to the type of research and analysis demanded by a social investment approach (Wakeman and Garret, 2017[21]) and there were a number of suggestions from interviewees for how it could be improved.

Although the use of the IDI for research and evaluation purposes was increasing, interviewees noted that there were still relatively high transaction costs to accessing and using IDI. Anyone wishing to use the IDI must apply for access, pass relevant referee checks and justify use on a case-by-case basis. Access is restricted to use within a secure lab environment at a Statistics New Zealand office or the premises of a regular user (Wakeman and Garret, 2017[21]). Within the limits of privacy and ethical constraints, Statistics New Zealand could attempt to make access easier for third party researchers. In seeking to make improvements to the quality and use of administrative data such as the IDI, important lessons come from countries such as Denmark, with a long history of the use of administrative data (Box 2).

Interviewees also made suggestions about improving the usability and richness of the data. Interviewees noted that structuring the data so that it is useful for both administration and evaluation purposes is a particular skill. Interviewees felt this process of data archiving and curation was an area for improvement, moving towards a situation where the data is viewed as a key strategic asset and a critical aspect of good governance. For example, the fact that service providers report different data to different organisations and in different formats, means that the IDI is not all in a uniformly 'clean' and usable format (Wakeman and Garret, 2017[21]). Thus interviewees thought there was the potential to standardise some key data elements across service providers, which would facilitate the transfer of data through the system and enable research and evaluation. Interviewees also noted that the ability to incorporate more qualitative and contextual information into the IDI would be beneficial. This would enable service providers to document experience, knowledge and connections within their communities, which provides an important source of information about what works, for whom and how to implement long term sustainable change (Wakeman and Garret, 2017[21]).

Box 2. The use of data for policy research – the Danish system for access to micro data

- To facilitate register-based research, Statistics Denmark gives researchers access to anonymised data on researchers' own computers by providing secure remote access to servers at Statistics Denmark via the Internet. This gives researchers a unique possibility to use micro data in their research.
- Denmark introduced the Personal Identification Number (CPR) in 1968. It was used in a census for the first time at the Population and Housing Census in 1970 which became the first Danish register using the Personal Identification Number as an identification key. Like in the other Nordic countries, the person and business registers in Denmark now cover a very substantial part of the production of statistics. Altogether data from 250 subject areas are available for research purposes through Statistics Denmark which fall under the following headlines:
  - Population and demography
  - Labour market
  - Earnings
  - Income, consumption and prices
  - General economic statistics
  - Agriculture
  - Manufacturing industries
  - Construction and housing
  - Service sector
  - Transport
  - Environment and energy
  - External trade
  - National accounts and balance of payments
- Access to micro data can be granted to researchers and analysts from research environments pre-approved by Statistics Denmark. Authorisations can be granted to public research and analysis environments (e.g. in universities, sector research

institutes, ministries, etc.), to research organizations as a part of a non-profit foundation and to some organisations in the private sector.

- Access to micro data for research is given through a powerful research server placed at Statistics Denmark. When research data for a project have been prepared by the Division of Research Services, the data are transferred to the research server where remote access is given via the Internet. All aggregated results from the researchers´ computer can be stored in a special file and such printouts are sent to the researchers by e-mail. This is a continuous process (every five minutes) which has shown to be quite effective. The advantage for Statistics Denmark is that all e-mails are logged at Statistics Denmark and checked by the Research Service Unit. Several computer packages are available on the research server, such as SAS, SPSS, STATA, GAUSS and R. The programs are frequently updated with new versions.

Source: (Statistics Denmark, 2014[28])

5.2. The need to embed evidence into all stages of the policy cycle, starting with policy design

MSD had already made significant progress in embedding evidence throughout the policy cycle. Nevertheless, there were areas where this could be improved. Although a robust system of programme evaluation had been implemented, interviewees noted that evidence was still underutilised in the process of problem identification and design of policies and interventions. A number of what works reviews had been carried out in different areas, and while the existing stock of knowledge was well used in the employment work, elsewhere it was unclear if this knowledge had been used to improve policies and interventions (Kelly and Collins, 2017[18]). Ensuring that international clearing houses of systematic review evidence, such as Cochrane and Campbell would be an economical way to take advantage of the global evidence base. Even within the employment work, evaluation work sometimes had to 'retrofit' programme logic and interviewees suggested that research and evaluation staff could be more involved in programme design, by working with policy staff to develop programme theories of change and logic models. Interviewees also noted that there was a capacity gap in the frontline service delivery organisations in term of using data and evidence for intervention development; thus finding ways in which these organisation can benefit from the expertise of the ministries, such as theory of change workshops, is critical.

5.3. Improving the knowledge broker function as a driver for EIPM

Despite the huge advances in data quality and coverage and the analytical techniques to turn the data into evidence about intervention effectiveness, interviewees acknowledged that increasing the visibility and usability of this evidence for decision making still had room for improvement in New Zealand. This challenge is recognised in many jurisdictions and across many policy areas (OECD, 2015[29]; OECD, 2015[30]; Oliver et al., 2014[31]).

There has been debate about whether New Zealand would benefit from consistent standards of evidence of effectiveness. The former Social Policy Evaluation and Research Unit (SUPERU), disestablished in July 2018, completed a series of reports which reviewed hierarchies or standards of evidence developed and used internationally, and used these to derive a rating scale for New Zealand (SUPERU, 2017[32]; SUPERU, 2017[33]; SUPERU, 2016[34]). This approach is described in further detail in Box 3.

Box 3. SUPERU's Standards of Evidence Rating Scale for New Zealand

SUPERU examined the role of standards of evidence for understanding what works, drawing on the international experience and looking at the prospects for Aotearoa New Zealand. This resulted in a five point scale which corresponds to ascending rankings for strength of evidence and the expectations about the type of evidence that can and should be generated about an intervention as it matures and grows.

- **Level 0**: Intervention is a pilot of a new initiative.
- **Level 1**: Intervention is in its early stages of implementation, or planned but not yet implemented. This intervention's evidence base will be built over time.
- **Level 2**: Typically, this intervention has been in operation for around one to three years. It has met all Level 1 criteria and has been evaluated at least once. The evaluation indicates some effect, but it may not yet be possible to directly attribute outcomes to it. This intervention's evidence base will continue to be built over time
- **Level 3**: Typically, this intervention has been in operation for around three to ten years. It has an established design which is consistently implemented, and quality assurance procedures are in place. It has met all the Level 2 criteria, plus it has at least one evaluation that provides evidence about impact. It also has some information available that will help with implementation in new contexts.
- **Level 4**: Typically, this intervention has been in operation for around eight years or longer and is large scale or high risk, justifying extra evaluation effort. It has met all the Level 3 criteria, plus it has been replicated at least once. It has been evaluated at least twice and the evaluations provide strong evidence about effectiveness and impact, insights into how the intervention causes change, what works well or less well for different participants, and cost-benefit. There is support for implementation in new contexts.

Standards of evidence thinking already pervades the work of MSD, as is evident from the rating scale described in Table 1. However, interviewees acknowledged that this work could be taken further. In order to explicitly rate interventions against SUPERU's scale, it would be necessary to further develop detailed criteria that could be used to assess features of the measurement, sample, analysis and scale of impact. This would enable an assessment of threats to internal and external validity. Fortunately, many of the international clearing houses reviewed by SUPERU already have such detailed criteria which would serve as a useful starting point.

Interviewees felt that, on the whole, the policy profession had not yet developed the ability to weigh evidence from evaluations with different findings and evaluation designs. International experience suggests that standard of evidence rating scales can be useful to communicate to scholars, policymakers and practitioners that not all research is of the same quality and that more weight should be given to higher quality evaluation studies (Sherman, 2006[35]).

Interviewees had mixed views about whether elements of the knowledge broker function, such as rating the effectiveness of interventions, was more appropriately held inside government or in an independent institution, with interviewees acknowledging that there were trade-offs with both models. An independent institution gains in impartiality and the

ability to operate somewhat outside of political timelines and pressures, but may lack the detailed operational knowledge of government and the policy making process. In contrast, locating these functions within government has the gains in increased operational understanding but may lack perceived independence. For this reason, interviewees recommended that the tasks of carrying out impact evaluations and then assessing the standard of evidence produced should be kept operationally separate. Interviewees identified the Social Investment Agency as a promising site for some of the knowledge broker functions.

5.4. Moving to a cross-government approach to impact evaluation and CBA

As New Zealand moves from social investment being located in a few agencies to part of the fabric of government, interviewees recognised that there could be benefits from moving to a more cross government approach to evaluation. Interviewees noted that in some cases there has been a replication of analytic and evaluation functions across government agencies, with opportunities for pulling this together in a coherent way (Wakeman and Garret, 2017[21]). Interviewees thought that Treasury was already playing an important role in addressing these issues. For example, there is already comprehensive guidance on 'Social Cost Benefit Analysis'. MSD and Treasury could also consider similar guidance on the components of social investment. MSD is now a centre of a wealth of knowledge and experience on the process and carrying out actuarial modelling, evaluation design and implementation, and using evidence of effectiveness to guide decision making. Ensuring that this is available for other agencies to benefit from is an important role that Treasury can play.

An area interviewees highlighted as being critical for further development was ensuring high standards for economic evaluation. Interviewees noted that, just because an intervention is judged to be effective, this does not necessarily mean the intervention has a positive return on investment (de Boer and Ku, 2017[23]). This is why in future reports; MSD intends to include two measures of cost effectiveness:

- Welfare Return on Investment (WRoI): a comparison the MSD cost of delivering EA interventions to the savings achieved through a reduction in welfare liability.
- Social Return on Investment (SRoI): takes a wider view of the social costs and benefits of interventions. For example, including the value to society of the employment, income, justice and education impacts interventions. The development of the SRoI will occur in collaboration with central agencies to ensure consistency across the social sector in measuring and valuing social impacts.

In carrying out such analyses, a useful source of information is the recent Standards of Evidence for Conducting and Reporting Evaluations in Prevention Science (Crowley et al., 2018[36]; Yates, 2018[37]). These standards share much of the prevention and well-being focus of New Zealand's recent policy focus. A focus on prevention creates methodological and ethical issues in carrying out economic evaluation. For example, the returns may accrue to systems in both the public and private sectors, across protracted periods of time.

Given these considerations and a lack of clear guidelines, economic evaluations of such prevention programs can yield varying and inconsistent results. This makes findings from different studies difficult to compare, making them of limited value to decision makers. Therefore, taking steps to ensure the uptake for standards for economic evaluation will be important going forward.

In addition to the issue of ensuring that the appropriate tools are in place to carry out economic analysis in a robust and replicable fashion, a further issue is ensuring that economic analysis is used in policy making. The direct impact of the social investment approach has been confined to the micro and meso levels of budgeting within a handful of agencies such as the MSD. To date the rollout of the approach has had no material impact on the overall sector or allocations of overall Budget resources at the macro level. The focus has been on new initiatives – the marginal new resources apportioned during the Budget rounds. There has been no impact on baselines, on the mix of spending between department and departmental output expenses, or on changes in the performance reporting requirements.

Building on the success of social investment at the micro and meso levels of the budget processes, it was felt that future improvements would see impacts on overall sector allocations and overall resources at the macro level. For example, interviewees noted that to date, the focus had been largely on funding and evaluating new initiatives and that more focus needed to be directed towards evaluating baseline expenditure. Interviewees also suggested that more focus is required on the mix of spending between departments and any necessary changes in reporting requirements (Gill, 2017[15]). Interviewees recognised that it will be important to continue experimenting with further ways of integrating the social investment approach with the budget process and sharing learning across government.

5.5. A greater focus on programme implementation and scale up

Interviewees recognised that moving from evidence of the effectiveness of an intervention to scale up in order to achieve impact at the population level is a challenge for the social sector in New Zealand, and has a number of areas for improvement. Interviewees recognised that, in focusing services towards those in greatest need, this had put increased pressure on delivery organisations and service delivery staff. Interviewees suggested that, as social investment becomes mainstreamed throughout the system, it will be necessary to offer more support for delivery staff, in order to ensure they succeed in managing more demanding caseloads.

Interviewees also recognised that to date, the system had been more successful in stopping or modifying activity that had been found to be ineffective in the impact evaluation work and less effective in taking effective interventions to scale. Interviewees felt that Intensive Client Support is the best example of a service that had been received positive evaluation results and had then been incrementally delivered in successive areas in New Zealand. However, interviewees also mentioned a number of cases where an intervention had shown promise in an efficacy trial, but then 'broke' when it is taken scale. For example, two issues that were mentioned were training happening too early before the onset of service delivery (such that practitioners needed a refresh) and insufficient referrals being received.

The challenge of moving from evidence of effectiveness to effective scale up is recognised across the OECD and across policy areas (Kirk et al., 2015[38]; VanLandingham and Silloway, 2016[39]). New Zealand was already taking steps to improve implementation of a number of services, such as by codifying interventions to make them easier to replicate in a number of different areas. Using one or more tools from the implementation science literature may also be useful, such as the Consolidated Framework for Implementation Research (Damschroder et al., 2009[40]) or the Getting to Outcomes Framework (Wandersman et al., 2008[41]; Wandersman et al., 2000[42]). These involve detailed approaches, strategic planning, implementation, evaluation, continuous quality improvement and sustainability. Getting to Outcomes for example is a detailed roadmap

for the implementation of interventions in community settings and has been shown to be effective using a variety of different evaluation methods.

Note

1. Evidence can be defined as 'a systematic investigative process employed to increase or revise current knowledge' (Langer, Tripney and Gough, 2016[46]).

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Annex A. Methodology for the country case studies.

Methodology

Case studies

A qualitative case study methodology was chosen for this project. A case study design is appropriate for this study because:

- The focus on the study is to answer 'how' and 'why' questions.
- The behaviour of those involved cannot/should not be manipulated
- It is important to examine the contextual conditions of the reforms (Yin, 2014).

Sampling and recruitment

Case study sampling does not require a large sample size and depending on the topic or issues being researched the sample can vary form a single extreme or anomalous case to 4-8 case studies to explore and compare issues across and within cases. New Zealand is the first case study in a planned series looking at a variety of different country approaches to evidence informed policy making.

Methodology

A two stage process - scoping and primary data collection - to develop case studies. Primary data collection in the form of in-depth interviews were conducted in two phases.

1. Scoping of case study countries

This built on the information gleaned from the desk-based scoping review. Informal discussions with internal and external stakeholders also informed the selection on country case studies.

2. Country case studies

a) Senior central government interviews

To explore the national picture of reforms to social investment a number of telephone interviews with senior government officials were conducted.

The aim of these interviews was to understand the provision landscape from a national strategic perspective exploring topics such as national policy context, the reform agenda.

Interviews lasted up to 60 minutes and were conducted by telephone using thematic topic guides, which were agreed upon with relevant stakeholders before the fieldwork started. Thematic topics guides were designed to ensure flow in interview discussions and included probes and prompts to support a deeper exploration of themes and issues.

The information obtained from these interviews also informed the structure and content of the line ministry interviews.

b) Line ministry operational civil servant interviews

The majority of the fieldwork consisted of interviews with officials from MSD.

Interviews were conducted using thematic topic guides.

c) Document analysis

During the interview process we requested relevant documents relating to

- Strategic documents pertaining to the reforms
- Policy and guidance documents pertaining to reforms
- Details of any training received by programme managers on policy evaluation.
- Other documents felt to be relevant by participants.

The ability to use multiple data sources is one of the hallmarks of case study research (Patton, 2015). Being able to look at official documentation, alongside the interviews strengthened the findings and enabled a richer understanding of the reforms.

Analysis and framework for reporting

The final framework for reporting of the results was informed by the data, and covered the following topics:

- The **policy landscape** that lead to reforms.
- The **institutional** context of the reforms.
- The **processes** and **tools** and **staff** involved in the reforms.
- The **barriers** and **facilitators** of the implementation of the reforms.

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Volume 2019/1

OECD*publishing*
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ISSN 1608-7143
VOLUME 19
(3 ISSUES)