

# *Cour des comptes*

## **Summary**

**May 2011**

### **The State's Budgetary Management and Results 2010**

#### **Notice**

The summary is designed to make it easier to understand, and to comment on, the full report, which is the only document binding on the *Cour des comptes*.

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# Analysis of the State's Budgetary Management and Results: Role of the *Cour des Comptes* and Challenges

## The Mission entrusted to the *Cour des Comptes*

Approval of the financial statements from the last complete fiscal year enables the Central Government, in accordance with the Constitutional By-law on Budget Acts (known as the LOLF in its French initials), to table a draft Budget Review bill and a management report for previous the fiscal year by the 1 June deadline. As part of the constitutional mandate to assist the Government and Parliament, Article 58 of the LOLF provides for “the filing of a report in conjunction with the filing of the Budget Review bill, relating to the previous fiscal year’s outturn and the associated accounts, which, in particular, analyse the utilisation of appropriations by mission and by programme.” The report by the *Cour des Comptes* on the State’s budgetary management and results is thus an integral part of Parliament’s examination of the Budget Review bill. It aims to enable a clear understanding of the year’s budgetary management and results.

### Three approaches to the fiscal year’s financial results:

The *Cour des Comptes* analyses the Central Government’s three types of financial outcome, as set forth in Article 37 of the LOLF:

- the budgetary result for the fiscal year;
- the general accounting result;
- the cash flow result, presented in the cash flow statement.

It is the sum of these three snapshots that enables an accurate and comprehensive overall view of the State’s financial situation.

In a nutshell: The three types of results from the Central Government and Notes to the Financial Statements

- The fiscal year results (budgetary result) are expressed in terms of cash accounting: it is the balance of disbursed expenditure and revenues effectively collected during the fiscal year under the general budget, ancillary budgets and special accounts.
- The general accounting result is expressed in terms of accrual accounting. Items of expenditure and income are entered into the accounts for the fiscal year to which they apply (“service rendered” principle) regardless of the date of actual payment or collection. This result therefore incorporates commitments undertaken during the fiscal year that the Central Government will need to honour at a future date.
- The cash flow result shows the Central Government’s total funding requirements over the fiscal year and the manner in which these were satisfied.
- The Notes to the Financial Statements: The Budget Review bill and the management report are complemented by the Notes to the Financial Statements, which the *Cour des Comptes* also examines: annual performance reports for each of the State’s missions, and the State’s Annual Financial Report (balance sheet and income statement), in which contingent liabilities also appear.

## Analysis of missions and programmes

The analysis of budgetary management by mission and by programme illustrates the sheer scope of the tools, as used by administrators (programme managers), provided for under the LOLF. It also enables an assessment of the performance target approach undertaken by the administration, not only as concerns goal-setting, but also respect for objectives and indicators that each programme entails.

## Issues in the Report on the State’s Budgetary Management

The report on the budgetary management and results of the State describes the conditions of budgetary management for the fiscal year just ended. It enables Parliament, where necessary, to draw conclusions not only for discussing the Budget Review bill (early June), but also for deliberating on the direction that public funding ought to take (end of June) and the draft budget in autumn. This report aims to provide an assessment that is as exhaustive and reliable as possible of the State’s financial situation at the end of the financial year. It also aims to accurately portray changes in expenditure and revenues, to identify achievements as well as the difficulties encountered in the endeavour to improve public management, as envisaged by the LOLF, notably with regard to the administration’s performance.

## Analysis of changes in the State's income and expenses

The analysis of changes in income and expenses, not only as compared with the previous fiscal year, but also with respect to initial budget forecasts, means that determinant factors can be identified and that the effects of measures undertaken in the course of the financial year in question – or in previous years – can be gauged.

## The scope of Parliamentary authorisation

The analysis of the government's budgetary management enables verification that expenditure ceilings were respected, as well as limits on authorisations to undertake liabilities and appropriations, on variation in medium- and long-term debt, and on staffing levels, on all of which Parliament must vote. This is part of the principle of justification “from the very first euro” for appropriations, establishing *ex post facto* the quality of the appropriations budgeting process.

## Budgetary management

The appraisal of the Central Government's budgetary management is based on an analysis of the expenditure cap rule, the parameters of which are defined under the law on multi-year public finance programming, as well as on the consideration of other factors, such as Central Government assistance to local authorities or changes in tax expenditure. Since all expenditure caps stem from agreements, the *Cour des Comptes* checks, in particular, that the one referred to when programming and accounting for budgetary implementation enables a sufficiently comprehensive assessment of the full implications of the expense.

## Respect for the principles laid down by the LOLF

The *Cour des Comptes* furthermore examines budgetary management with regard to compliance with the regulations and principles stipulated by the LOLF: annuality, speciality, unity, universality and sincerity.

Some definitions:

- The principle of annuality means that for all expenditure that ought to have been settled within the fiscal year, disbursements were indeed made. Under this principle the practice of deferring expenses is not permitted.
- The principle of speciality stipulates the methodologies by which income and expenses may be allocated, notably to the different budgetary programmes.
- Under the principle of unity, it is important to verify that all income and expenses that need to appear in the Central Government budget are indeed entered.
- The principle of universality precludes the offsetting of income and expenses and the allocation of income to listed expenses, notwithstanding the exceptions provided for in the LOLF.
- The principle of sincerity: Article 32 of the LOLF states that the budgets are to “offer a faithful representation of all the State's resources and charges. Their sincerity can be assessed based on the information available and projections that may reasonably result from this information”.

# Analysis by the Cour des Comptes for the Year 2010

## Results from the Financial Year

### Exceptional events

The 2010 fiscal year was witness to major events which greatly affected the balance of the budget, and which need to be taken into consideration when analysing the results.

The conclusion of the economic stimulus plan gave rise to a greater than anticipated budgetary effort; the impact of this on the balance still reached €6.8 billion, after the €28.9 billion noted in 2009.

The dispensatory mechanism chosen for the “future investments” programme led to a total budgetary expenditure of €34.6 billion, whereas the agencies to which these funds were allocated immediately deposited them with the Treasury and will only make the corresponding disbursements over a period of a few years. The effective use of these resources in 2010 amounted only to €675 million in 2010.

The loans to Greece also played a €4.4 billion role in bringing the overall balance down.

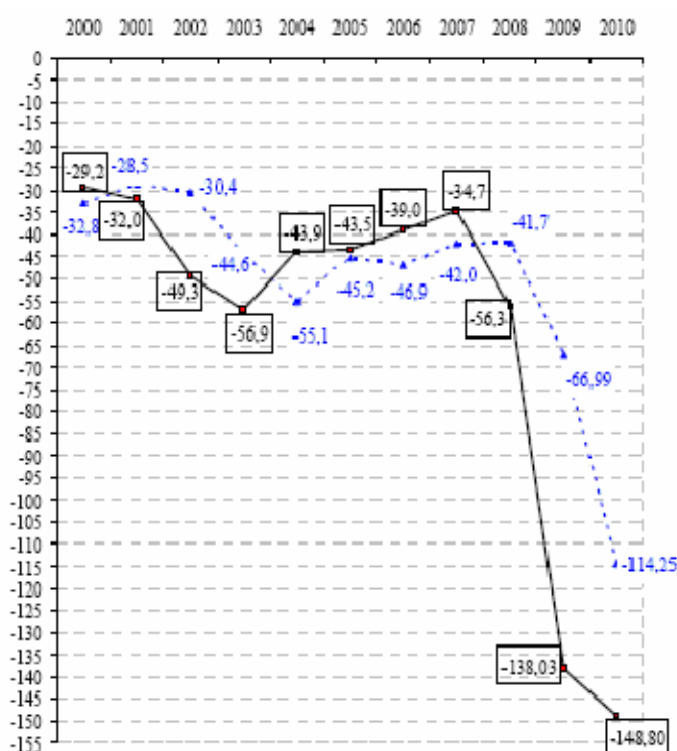
The reform of the locally-levied business tax (the *taxe professionnelle*) was reflected in a series of complex budgetary income and expense re-shuffles, affecting not only the general budget (€17.9 billion), but also the account for advances to local authorities (+ €10.2 billion). Considering the one-off shift in the balance of this account for advances, the net burden on the State budget amounted to €7.7 billion. However, the change in the balance of the account for advances to local authorities stemmed from non-recurring revenues, the exceptional increase of which, not initially foreseen, could not be justified due to shortcomings in the accounting information system. Despite the explanations that the administration has pieced together *ex post facto*, uncertainty remains as to the additional financial burden borne by the budget of the State in 2010.

### The 2010 results

Excluding tax refunds and shelters – which amounted to €89.89 billion in 2010 – the general budget’s net revenues were established as totalling €171.95 billion, as opposed to net expenditure of €322.75 billion. The balance of the special accounts was in the positive by €2 billion.

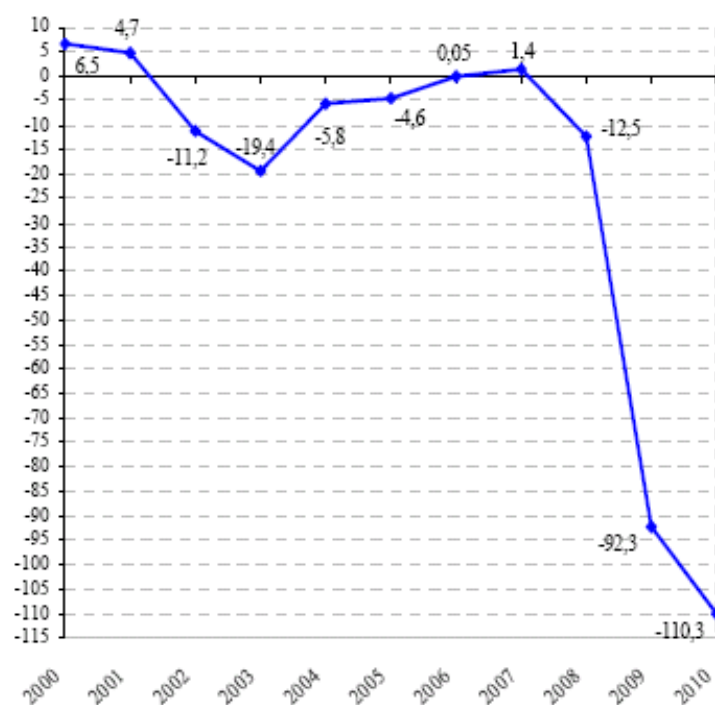
According to the Budget Review bill, the 2010 fiscal year drew to a close with a budget deficit of €148.8 billion, a deterioration of €10.8 billion as compared with that of 2009, and €31.4 billion higher than that provided for in the initial budget (€117.4 billion). This result marks a new historic low after that of 2009. Between 2007, the last year in which there was a deficit reduction, and 2010, the budget deficit has deepened by €114.1 billion. It represents 86.5% of the year’s net revenues and 46.1% of net expenditure.

### Changes in budgetary results 2000-2010 with regard to initial budget forecasts



Initial Budget - Budget Review Act (implementation)

Despite a period of recovery between 2003 and 2007, the primary balance – which is to say, excluding interest payments on government liabilities (€40.5 billion in 2010) – has also deteriorated anew, reaching €110.3 billion. Not counting the future investments programme, the primary balance stood at €76.3 billion, indicating that 18.5 % of the Central Government’s current expenditure is financed through borrowing.



## Tax revenues

Following the sharp drop in tax revenues recorded in 2009, the recovery noted in 2010 was somewhat lukewarm. The 18 % increase in net tax revenues (+€39.3 billion) in fact stemmed from factors that artificially inflated the amounts collected: the transitional impact of the reform of the *taxe professionnelle* (+€14.5 billion); the non-renewal of certain taxation initiatives that were part of the stimulus plan (also +€14.5 billion); and measures that reclassify some non-tax revenues as tax revenues (+€3.3 billion). If the calculation ignores the extra costs incurred in 2010 due to the July 2009 drop in VAT for restaurants (-€1.9 billion) and the additional impact of the 2007 fiscal package (-€0.6 billion) and takes into consideration the positive effect of the anti-tax fraud unit on revenues (+€0.9 billion), this growth appears as low as €7 billion.

## Expenditure

The Central Government's net expenditure, excluding the balance of the special accounts, grew by 11 % compared with 2009. This increase stems chiefly from four one-off events that occurred during the fiscal year and, more particularly, from the future investments programme.

The future investments programme increased the amount of nominal budget expenditure by €34.64 billion although it gave rise to only low levels of effective expenditure and did not exacerbate the State's funding requirements. Not counting the stimulus plan, nor the future investments programme, net expenditure from the general budget and ancillary budgets decreased by 2.8 % in terms of funding authorisations and increased by 2 % in terms of payment appropriations.

Some expenses displayed a great deal of dynamism in the 2010 fiscal year. While nonetheless below the initial forecast, the debt burden rose by 7.7 % in comparison with 2009. Payments from the general budget to the special purposes account for pensions increased by 1.8 %

under current conditions, but by 5.2 % on a like-for-like basis. Some intervention expenditure items rose sharply over the course of the year. Insufficient cover for multi-year liabilities appeared in relation to several missions. In particular, an examination of budget implementation for four sizeable missions (Defence, Labour and Employment, Research-Higher Education and Ecology, Sustainable Development and Land Planning) revealed risks regarding the cover for their multi-year obligations.

The wage bill for the Central Government excluding pensions rose by 0.7 % on a like-for-like basis. Considerable tension arose in management regarding overestimation of the number of employees going into retirement and the tardy rectification of this misjudgement which came about in the dubious form of an appropriations decree at the very end of the year. The rule by which only one retiring civil servant in every two is to be replaced was practically observed in full. This led to savings of €808 million. 47 % of these savings (€380 million) were passed on to officials. The policy and staff-related measures entailed in this form of staff management need to be compatible with the Government's stated goal of stabilising the wage bill.

In 2010, the State pursued its efforts to discharge its debt vis-à-vis the social insurance system. It did nevertheless have partial recourse to direct allocation of taxes and levies to the social insurance system earmarked for funding the mechanism of reduced deductions for low-income earners, totalling €1.4 billion. With this solution, no expenses were incurred from the operation, in commitment accounting terms, and further negative effects on the balance were avoided.

The special accounts made a €2 billion contribution to the budget balance. This overall figure was reached thanks to the balance of the account for advances to local authorities (+€10.2 billion).

## Limits as to the implications of the balance

The exceptional events that occurred during the fiscal year had a profound impact on management in 2010. Over and above the abolition of the *taxe professionnelle*, the ensuing implementation of the stimulus plan, Plan Campus (for enhancing French universities' profile) and the future investments programme resulted in a weaker correlation between the budget and the budget balance. Indeed, there are countless extra-budgetary expenses which are not taken into consideration under the expenditure caps set by the Government.

## The general accounting result

The State's net deficit in 2010 stood at -€112 billion, which is €12.1 billion greater than that of 2009.

The State balance sheet shows net equity of -€756.6 billion in 2010, which is a deterioration of €92 billion, stemming, on the one hand, from a €4 billion increase in assets (revaluation of concessions and implementation of the future investments programme) and, on the other hand, from an increase in liabilities of €136.8 billion, including €79.4 billion in financial debt alone, and €43.3 billion in cash and liquid liabilities. The cash and liquid liabilities are increasing because the fund management bodies for the future investments programme are under obligation to deposit their allotted funds with the Treasury.

## The cash flow statement

After the record levels reached in 2009 (€246.2 billion), funding requirements decreased slightly in 2010 to settle at €236.9 billion.

The State reimbursed €87.1 billion in debts and offset the impact on cash flow from the balance. In 2010 the latter represented 63 % of total funding requirements. These were nevertheless inevitably increased by the transactions relating to the future investments programme (€35 billion). Given that the fund management agents for the programme are to deposit their assigned funds with the Treasury, net funding requirements regarding national borrowing amounted only to the disbursements for the year (€675 million after budget implementation).

The year 2010 was witness to a record medium- and long-term issuance programme (€210.7 billion).

Short-term indebtedness dropped, representing 15.2 % of total tradable public debt as at the end of 2010, as compared with a proportion of 18.6 % one year earlier.

# Budgetary Management

## Expenditure Cap Rules

The rules governing expenditure level increments apply to a series of expenses comprising general budget expenses (net of refunds and exemptions), to deductions on income channelled to local authorities and the European Union, and to certain earmarked revenues.

Given the inflation assumption of 1.2 %, the 2010 expenditure cap displayed an increase of €4.4 billion with regard to the initial 2009 budget. On this basis, expenditure rose – stimulus plan notwithstanding – from €347.9 billion in 2009 to €352.5 billion in 2010, which is an increase of 1.3 %. Meanwhile, prices rose by 1.5 %. The “zero growth” rule for public spending, if applied to the expenditure situation between the 2009 implementation and that of 2010, would have thus been respected.

Several factors facilitated this apparent observance of the rule. The debt burden was lower than forecast (€42.5 billion in the initially voted budget; €40.5 billion post-implementation owing to weak interest rates), and the same is true for deductions on income channelled to local authorities and the European Union (€71.2 billion in the initial budget; €70.4 billion post-implementation). This lower-than-anticipated expenditure meant that the appropriations necessary for budgetary missions facing sharply increasing expenses (Solidarity, Integration and Equal Opportunity, Agriculture, Defence, Education, Inter-Ministerial Mission for Research and Higher Education), could be financed under the December 2010 amended budget while nonetheless observing the same spending ceiling.

Some measures were excluded, rather questionably, from the calculation of the expenditure cap: allocation of resources earmarked for discharging debts regarding the social insurance system; recourse to special accounts for transactions that could otherwise have come from the State’s general budget; increase in spending on RSA income support; disbursements effectively made under the future investments programme.

When these factors (the overall impact of which amounts to €3.3 billion) are taken into consideration, expenditure falling within the scope of the rule amounted to €355.8 billion. The objective of €352.6 billion which was set by the Government and which complies with the “zero growth” rule for public spending was exceeded by €3.2 billion, which represents 0.9 %

of the expenditure subject to the rule. When measured against implementation in 2009, the recalculated expenditure for the year 2010 rose by 2.2 % in terms of value, or 0.7 % in terms of volume, given the observed inflation rate of 1.5 %.

In all, there is no justification for exempting expenditure relating to the future investments programme from the rule, unless the latter is considered as focussing, as a matter of priority, on operating and staffing expenses, while the investments are given dispensatory, unrequited treatment, in the name of additional savings efforts. The efforts deployed to boost the French economy's potential for growth through the future investments programme need to be framed in a reaffirmed budgetary perspective of keeping expenditure under control. In order to prevent year-in-year-out bypassing of the expenditure cap rule, the *Cour des Comptes* suggests adding the utilised portion of useable allocations to expenditure falling under the scope of the rule each year, starting from 2011.

The *Cour des Comptes* has been recommending, for some years now, that adjustments be made regarding the current rule, with the aim of making the spending level guidance more meaningful. Expenditure from the special purpose accounts Traffic Offence Automated Control and Penalties, Rural and Agricultural Development, and Management of the State's Real Estate Assets, which do not distinguish between expenses from the general budget and allocation of specific revenues, needs to be taken into account when calculating the extended rule. The same is true for expenditure from the "clean vehicle" acquisition subsidy facility.

The refunds and exemptions that chart expenditure linked to public policies or which relate to locally-levied taxes also need to be taken into consideration so as to better monitor developments that affect public spending control.

## Tax expenditure

Based on the 2009 context, the "Ways and Means" appendix to the 2011 draft budget (Volume II), shows a drop in tax expenditure from €74.46 billion in 2009 to €73.37 billion in 2010. However, if the effects of the stimulus plan and the reform of the *taxe professionnelle* are not included in the calculation, tax expenditure actually increased by €2.5 billion (+4.3 %) between 2009 and 2010.

## Regularity

### Irregularities and Misstatements regarding the General Budget

Overall discharge of the State's debt vis-à-vis the social insurance system (€2.5 billion) as well as that of Crédit Foncier de France regarding funding for home-ownership savings scheme expenditure (€192 million), showed genuine progress. As concerns the social insurance system, however, expenses that the general budget ought to have covered in 2011, totalling more than €473 million, were brought forward, which runs counter to the principle of budgetary annuality. Resorting to the use of resources not recorded in the budget commitment accounting system meant that a portion of the debt could be settled without having to apply for funding authorisations, which would have been required in order to ascertain the corresponding funding requirements.

The budget commitment accounting procedures provided for in Article 8 of the LOLF are insufficient. A statement of budget commitments regarding transactions for which the service

rendered did not take place fails to enable identification of the missions that have indeed given rise to accounting entries for accrued liabilities while no applications for funding authorisations were made. Moreover, the total for these accrued liabilities is incomplete; nearly €4.7 billion fails to appear on the statement.

The legal obligations of the agency for financing France's transport infrastructure (AFITF) are binding upon the Central Government. The initially voted budget should envisage minimum cover for funding authorisations equalling the expenditure not covered by the agency's own resources. The total of the remainder payable should reach €24 billion by 2014, and currently stands with no guarantee of the corresponding funds.

The regulations that limit the volume of appropriations that can be carried forward to the following financial year have been circumvented by the Ministry of Agriculture, Food, Fisheries and Rural Affairs. There was double offsetting of income and expenses on the special purpose account for pensions, which contravenes the principle of budgetary universality. Appropriations were authorised before passing before the authorising officers through a decree allocating the funds, for a total sum of €500 million.

## Irregularities concerning the Ancillary Budgets and Special Accounts

Irregularities were detected regarding use of the ancillary budgets and special accounts for expenses that ought to have been financed from the general budget.

State services are being financed from the Aviation Operations and Control ancillary budget, which is in breach of current regulations. As in previous years, the *Cour des Comptes* has detected non-compliance with provisions of the LOLF as concerns two special purpose accounts, to which non-eligible expenses were charged: the Central Government Financial Participations account and the Management of the State's Real Estate Assets account.

Two financial assistance accounts fail to meet the definition set forth by the LOLF: the Advances to Local Authorities account and the Advances to the "Clean Vehicle" Acquisition Subsidy Facility account. Four accounts fail to respect certain provisions of the Constitutional By-law: the Loans to Foreign States account fails to comply with all of the provisions designed to guarantee transparency regarding liabilities; the Advances to Various State Services or Bodies managing Public Services account issues loans of up to 12 years and not advances to the Aviation Operations and Control ancillary budget; the International Monetary Agreements account has not been allocated appropriations, which is in contradiction with the provisions of the LOLF.

## The Future Investments Programme

The future investments programme, designed to finance investments in certain strategic priority sectors, contravenes the budgetary principles of annuality, unity and universality. The appropriations authorised for specific budgetary programmes were transferred to managing bodies within the framework of agreements signed with the Central Government. Utilisation and disbursement of these appropriations will be spread over the next ten years.

This unique framework also has its own specific governance structure. The *Commissariat général à l'investissement*, a department under the authority of the Prime Minister which is specialised in investments, is overseeing implementation of the initiative. A monitoring committee made up of eight Parliamentarians is to conduct an annual assessment of the programme. There is, in addition, a rigorous performance review mechanism comprising

indicators for monitoring the progress and outcomes of the projects.

Risks that programmes from the general budget and those of the future investments programme could become substituted for one another have been identified. While the appropriations authorised for the latter constitute new resources, they are not all being used to finance new projects: some are funding pre-existing projects, or even projects already under way.

Particular vigilance is required in relation to certain important points. Some managing bodies have been entrusted with projects that were not entirely within their field of competence. The national research agency will need to manage a far greater mass of appropriations than it was previously able to handle. The structural complexity of some of the agreements could affect the clarity of certain initiatives. There needs to be consistency between the programme officials in charge of initiatives financed by the general budget and those in charge of programmes under the future investments programme.

## **Budgetary Management and the Performance-based Approach**

The 2010 fiscal year demonstrated that while efforts are continuing to hone the technical tools required to gauge performance, the budgetary reality is still not sufficiently connected to the performance-based approach.

The reliability of the indicators associated with the administration's stated objectives was still erratic in 2010. In some cases, information was unavailable for these indicators or the indicators appeared to be of little relevance. While the overall number of indicators has dropped since 2006, there are still too many in use for some missions. The numbers need to be stabilised so that programme officials can focus more attention on the requirement for reliability. It is still as vital as ever that cost accounting be implemented, as it will play a positive role for steering mechanisms and decision-making. The annual performance reports issued by the administration often fail to portray management accurately.

Connections between the performance-based approach and programming and budgetary management are all too seldom made. In a context of budgetary tension, performance tools ought to be a useful solution for helping to guide public spending. The role of the programme manager, who sometimes has mere rubber-stamping authority over the appropriations assigned to the programme, remains problematic. The nexus between the programme manager's responsibility and that of the Secretary General of the ministry has not been clarified.

Analysis of management in 2010 revealed that the identification of support functions and implementation of a support programme, within a given mission, combining resources from several programmes is not easily reconcilable with the logic of budgetary programmes which group together the resources required for a single State initiative and which permit assessment of the outcomes of their deployment. In the absence of a precise definition, the clustering of support functions suffers from an illogical and poorly structured architecture. The desired budgetary impact of this approach, in terms of enhanced efficiency, has yet to be demonstrated.