



Changes in Budget Cycle Procedures

Executive Summary

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The Independent Authority for Fiscal Responsibility (AIReF) was founded with the mission of overseeing strict compliance of the budget stability and financial sustainability principles provided for in article 135 of the Spanish Constitution.

AIReF Contact:

C/ José Abascal, 2, 2ª planta, 28003 Madrid. Tel. +34 917 017 990
Email: info@airef.es
Website: www.airef.es

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Spanish Organic Law 6/2013, of 14 November, assigns the mission of overseeing strict compliance with the principles of budget stability and financial sustainability to the Independent Authority for Fiscal Responsibility (AIReF) through a **continuous evaluation of the budget cycle** and of public indebtedness, and the analysis of economic forecasts.

This continuous evaluation of the budget cycle gives the term “**strict compliance**” full meaning upon defining the scope of the mission beyond what would derive from merely tracking and verifying that the activities of the public administrations stay in line with the objectives of budget stability and financial sustainability. These objectives are established and defined in accordance with the methodology of national accounts, although the starting point is budget data which, as indicated in Directive 2011/85/EU, of 8 November 2011¹, allows for surveillance sufficiently in advance so as to prevent the late detection of significant errors.

The budget cycle involves four phases (drafting, approval, execution and control), which follow up on three preliminary references: determining the multi-year budget scenario, the budget stability objectives and the non-financial expenditure limit. Bound to these budget cycle milestones, the AIReF organic statute mandates the reports that must be issued. They require an individual analysis of each public administration in addition to an overall assessment.

Without prejudice to the diagnostics and proposed actions for each administration that will be specified in these reports, it has been considered appropriate to conduct a preliminary general analysis for them as a whole. This analysis aims at identifying a series of best practices, some of which are already being applied, at least partly. Nevertheless, even in these cases, they require further development.

This analysis identified a number of areas where some changes are necessary. Although the changes proposed in these areas are not exhaustive, they are deemed a priority, as they limit the possibilities of analysing the budget cycle, as well as the usefulness of the budget document itself as a control instrument aimed at budget stability and financial sustainability. This opinion on changes in the budget cycle mainly refers to formal and transparency requirements. These requirements are relevant because the information available, the application of accounting standards and the functioning of the procedures provided for in the budget stability regulations will significantly affect the scope of the reports that must be issued. AIReF will monitor in its regular reports the progress made on the recommendations formulated in this opinion.

This opinion is issued under the scope of the provisions of articles 5 and 23 of Spanish Organic Law 6/2013 on the creation of the AIReF, which empowers the institution to issue opinions relating to compliance with the objectives of budget stability and financial sustainability.ⁱ

¹[L00041-00047.pdf](#)

1. All public administrations must publish their budget scenarios, specifying the multi-year frameworks they must prepare pursuant to the provisions of the Law.

Ensuring the financial sustainability of public accounts is a medium and long-term task and, as a result, the budget process must be framed within this time dimension.

A budget is a document that delimits the actions of the public administrations to the extent that it gathers the mandate of the legislative powers as to how much, when and on what money should be spent, in addition to the resources available for financing these expenditures. In accordance with Spanish Organic Law 2/2012, of 27 April, on Budget Stability and Financial Sustainability (LOEPySF, as it is known in Spanish), this annual roadmap must fit within a multi-year framework indicating the estimated evolution of revenue and expenditure in the medium term, as well as identify economic trends, expected developments and those deriving from changes in the laws regulating them.

As part of these frameworks, the budget scenarios for each one of the public administrations should contain the revenue and expenditures in budget and national accounting terms for the years covered, as well as the correspondence between both, given the close relationship with the stability programme drafted for all public administrations together with the methodology of national accounts². Moreover, they must be adapted to the provisions of Directive 2011/85/EU of the Council, of 8 November 2011, on the requirements applicable to the budgetary frameworks of Member States.

To this end, current budgeting laws already provide for the generalised preparation of multi-year budget scenarios. Specifically, article 28 of the Spanish General Budget Act³ regulates the contents of scenarios for the General Budget of the State and its link to the stability objective through adjustments that are necessary to move from budget data to national accounting data.

As regards this point, it would be very positive for institutions with competence in the area of national accounting⁴ to draft a Guide on the methodology to be used by public administrations in establishing the link between budget accounting and national accounting. This guide should develop, at the disaggregate level of expenditure and revenue items, the Manuals for calculating the deficit already published by the General Intervention Board of the State Administration.

²Data is supplied in the Stability Programme (SP) under the terms of the Excessive Deficit Procedure (EDP). The SP is considered a medium-term national fiscal plan pursuant to article 4 of the Regulation (EU) 473/2013.

³The Spanish General Budget Act applies to the national public sector. Notwithstanding, it may be additionally applied to all other public sectors without prejudice to the regulations contained in the Modified Text of the Law Regulating Local Tax Administrations and the Taxation Laws of each autonomous region.

⁴Spanish National Statistics Institute, General State Administration Intervention and Bank of Spain.

This methodology, which should also apply to annual budgets and their execution, would help monitor each one of the public administrations' budget cycles and how they fit aggregately with the Stability Programme and the Annual Budget Plan.

The extension of the budget scenarios to all transactions and units of the public administrations that are not a part of the ordinary budgets, and the application of the obligations and procedures of national budget frameworks to all sub-sectors of the public administrations, implies establishing collaborative channels for the fluid exchange of information within each administration and between the different levels of government. This is especially important for variables that significantly affect the preparation of scenarios for budget stability objectives by some of them, such as the resources from the financing system of autonomous regional and local governments and the regional GDP forecasts for the time period contemplated in their scenarios.

These scenarios should be subject to regular monitoring and ex-post evaluation, and the conclusions and findings should be made public.

The AIREF believes that drafting and publishing multi-year budget scenarios for all public administrations should be contemplated as a fundamental milestone in the budget process and, therefore, recommends that this practice be introduced in the budget preparation process as of 2016.

These scenarios should be detailed and complete, and make it possible to connect the budget data to the budget stability objective by identifying any national accounting adjustments that affect each one of the revenue and expenditure categories.

2. Respecting the self-organisation prerogative of public administrations is compatible with the existence of common budget structures. This harmonization is essential to facilitating the monitoring of the budget cycle and ensuring the widespread adoption of best budget practices.

The exercise of the self-organisation authority of the different levels of government must be compatible with the need to analyse all public accounts in an effort to adequately supervise compliance with budget stability and financial sustainability principles regulated in national and EU laws.

Among other issues, it would be appropriate to establish the basic information and documentation that must be included in the budgets and general accounts, as well as the level of detail for which the specific and differential characteristics of each administration do not justify the existence of different budget classifications. From that level, the standardisation of budget structures should affect the economic classification of revenue and

expenditures and the classification by expenditure programmes, so that it should be possible to produce comparable aggregate figures and consolidate budget data for all public administrations.

In order to do so, the necessary regulatory measures should be adopted through inter-administrative coordination bodies with competence in this area, following the production by the Spanish Ministry of Tax Administration and Public Administrations (MINHAP) of a base document created in collaboration with other public administrations.

The process could be structured into two phases, so that a set of budget data tables and the common documentation for all public administrations would first be determined to later make the necessary changes to completely standardise the budget structures.

The AIReF recommends taking the necessary steps so that the budgets drafted for the year 2016 already include a harmonised budget basis for all public administrations.

3. **Instructions should be issued in order to ensure the proper use of the “Payables for transactions pending application to the budget” account, detailing the situations where its use is appropriate, the maximum validity period for each case and the circumstances in which an operation may remain pending budget allocation as of 31st December.**

Moreover, the information on this account should be expanded and there should be special follow-up on the final balance, as it may reflect under-budgeting of expenditure in certain areas which must be taken into consideration when evaluating the budgets presented.

The annual budget must fit with the expected multi-year scenario, considering the stability objective established and the limit approved for expenditure, and the execution thereof must strictly comply with the mandate received.

The expenditure budget is generally limiting, which means that no more than the authorised amount can be spent, without prejudice to the legal exceptions provided for as concerns possible budget modifications or the possibility of extending certain appropriations. For this reason, there is a procedure that guarantees compliance with the legal requirements established for the management, record keeping and control of public expenditure.

From an accounting perspective, the justification for the existence of the off-budget account 413/409 “Payables for transactions pending application

*to the budget*⁵ is complying with the accrual principle, as it temporarily includes expenditures and acquisitions of assets until all of the requirements for their allocation to the budget are fulfilled. Now then, the efficacy of this system lies on the proper use of this account which, by the end of the fiscal year and subject to some restricted limitations, must only record transactions for which the budget processing could not be completed because they occurred at the end of the year. Therefore, the existence of a high balance in this account as of 31st December could indicate that the quantitative, qualitative or time limits of the budget were not respected and it could even indicate the existence of under-budgeting if this situation is recurrent. Furthermore and as concerns expenditure control, the inadequate use of this account reduces the efficacy of instructions for the closure of the accounts, the effects of which are at times limited to a mere accounting issue with respect to the annotation in the budget or off-budget of an expense that continues to be made.

Without prejudice to the fact that national accounts already record any expenditure when it is made, irrespective of the point in time at which it is entered into the books and of the budget or off-budget nature of the account used, the issue here is one of budget discipline: it should be guaranteed that no expenditure is incurred above the approved budget appropriation and/or without strict observance of the established management procedure. Otherwise, and additionally, extensions of supplier payment periods may be generated, which would counter the efficacy of the measures that have been adopted to control arrears by public administrations.

As concerns this last aspect, the existing regulations on entering invoices into the books, which also include those corresponding to expenditures recorded in off-budget 413/409 accounts, is considered fundamental to controlling arrears. This means that expenditure recorded in off-budget accounts must be taken into account for the calculation of average payment periods that public administrations must establish and publish, in accordance with current law.

⁵The account code in the General Public Chart of Accounts for "Payables for transactions pending application to the budget" is 413. Notwithstanding, some autonomous regions use the number 409 for this account.

These measures are part of a more general regulatory strategy, already developed over the last two years in the area of managing public expenditure, which is aimed at promoting the strict application of the accrual principle and ensuring that all transactions are recorded properly, by limiting as much as possible any discretionary actions by public administrations in their accounting and payments practices. It is worth highlighting that Spanish Law 19/2013, of 9 December, on transparency, access to public information and good governance establishes as a very serious offence committing expenditures, recognising obligations and ordering payments without sufficient credit to do so or in violation of the provisions of applicable budget laws.

Along these lines of action, the AIReF believes it is appropriate to continue progressing on issues related to budgeting tools and, therefore, recommends that rules be enacted specifying the regulation of the account 413/409 “Payables for transactions pending application to the budget” contained in the general scheme of accounts.

Moreover, it recommends that those who hold accounting duties within the public administrations expand the information supplied on account 413/409 so that internal and external control bodies may examine the information relating to this account in detail. This information could include aspects such as the following, among others:

- ✓ ***The date when the service was provided.***
- ✓ ***The date on which justification for the payment obligation (invoice or equivalent document) was received by the entity.***
- ✓ ***The reason why the obligation remains in the account.***
- ✓ ***An indication of whether it was subject to auditing or not and, if it was, a summary of the report issued.***

Furthermore, the following is recommended so that the AIReF may have synthesizing information in order to monitor the evolution of account 413/409:

1. ***As part of the monitoring of budget execution and the average payment periods of public administrations and their sub-sectors, all transactions recorded as well as the time they remain in the “Payables for transactions pending application to the budget” account should be tracked quarterly.***

2. ***The data relating to the closure of accounts for the year (advance and provisional) should include a report detailing the transactions which are pending allocation to the budget at the end of the year, as well as the circumstances justifying them, an indication of the date on which the service was provided and the date on which justification of the payment obligation was received by the entity.***
3. ***The foregoing information should be included with the data sent in application of Order HAP/2105/2012, of 1 October, which outlines the information supply obligations provided for in Spanish Organic Law 2/2012, of 27 April, on Budget Stability and Financial Sustainability.***
4. **The budgets prepared by public administrations should include a comparison with the forecasted liquidation of the budget for the current year.**

In general, the different public administrations present each year's budgets with a comparison with the approved budget for the current year. The revenue budget includes not only the initial forecasts, but also a detailed expected liquidation of taxes, which allows for a more accurate assessment as it adds information on deviations expected by the end of the year. However, the expenditure budget does not often include a forecasted liquidation or, if there is one, it is only partial with an insufficient degree of detail (at a budget chapter level).

This circumstance, which limits the possibilities of comparison to the initial appropriations from one year to another, makes it impossible to determine whether a specific expenditure increases or decreases with respect to the level which, in accordance with the execution up to that time, is expected by the end of the year.

The AIReF recommends including in the 2015 budgets a forecasted liquidation of all major revenue and expenditure concepts, which in addition should be included in the economic-financial reports attached to the budgets, so as to facilitate their interpretation and reading.

5. The efficacy of the economic-financial plans (PEF, as they are known in Spanish) and their contribution to compliance with the budget stability and financial sustainability principles demands that certain minimum requirements of transparency and non-discretion be met.

The need for budget control, supervision and self-discipline are completely unavoidable in the case of public administrations that do not comply with the established objectives of budget stability, financial sustainability and/or the expenditure rule. In these cases, budgets are reinforced with the presentation of an economic-financial plan within a period of one month from the observance of non-compliance, which must be approved, following a report by the AIReF, by the competent bodies within two months following presentation of the plan. The efficacy of the PEF requires the objective and automatic application of the measures provided for in the LOEPySF without any margin for discretion in their application. In particular:

- ✓ **Any public administration that does not comply with the budget stability, public debt or expenditure rule objectives must present an economic-financial plan with the content and through the process provided for in the LOEPySF.** This is established by article 21 of this law and, therefore, the decision of whether or not to present it to the bodies with competence for approving it, if appropriate, cannot be left to discretion. As indicated in article 23 of this law, these bodies are:
 - a. The Spanish Parliament, in cases involving the central government;
 - b. The Fiscal and Financial Policy Board, in cases involving the Autonomous Communities;
 - c. In municipalities, the plenary session of the corporation, with final approval by the body that exercises financial oversight (MINHAP or the Autonomous Community), in the case of corporations referred to in articles 111 and 135 of the Modified Text of the Law Regulating Finances of Local Administrations.-

- ✓ **The moment when the violation of the established objectives is considered proven must be clearly defined.** This is important because this date is the reference for the calculation of the deadline for submitting the PEF, which must be reported on by the AIReF, in accordance with the terms of article 23 of the LOEPySF. This proof must be generally the date when the Spanish Ministry of Finance and Public Administrations notifies the Government of the reports on the level of compliance with the previous year's objectives, which is the point when it must be made public. Nevertheless, said report in the case of local entities refers to the entire sub-sector. In this case, the deadline for submitting the PEF must begin when the plenary session of the corporation discusses the budget liquidation and the local auditor's report on the non-compliance with the objectives established.
- ✓ **It must be disseminated the name of those public administrations that are in a situation of non-compliance with the budget stability, public debt or expenditure rule objective and that, therefore, must formulate a PEF in accordance with article 21 of the LOEPySF.** The publication of non-compliance in the local arena is connected to the communication to the National Local Administration Commission of the summary of the plans presented which have been approved or rejected by the bodies exercising financial oversight, as well as those that do not require approval by these bodies. In other words, only the local entities that have presented a plan after failing to comply with the established objectives are subject to publication. From a reputational perspective, this practice offers an incentive for not submitting a plan. It is essential to publish the list of all local entities that violate the established objectives without prejudice to whether or not it must be later revealed if they have presented a plan or not.

- ✓ **In situations where a public administration fails to comply with the PEF for a certain year and, therefore, is required to present another one, that administration should justify in the latter the reasons for the failure to comply with the provisions contained in the previous one.** This justification should outline each one of the measures planned and each one of the revenue and expenditure items in the budget scenario. In particular, all deviations from the baseline economic forecasts must be identified and justified, as well as any errors calculating the expected impact of the measures adopted, and the reasons for a failure to fully or partially implement them. This analysis will make it possible to more accurately assess the adequacy of the budget scenario, and the expected level of certainty about the implementation of the measures provided for in the PEF at the time of presentation.

The AIReF suggests that the above recommendations be applied to PEF that must be submitted by public administrations that have failed to comply with the budget stability and financial sustainability objectives pursuant to the Report sent by the Spanish Ministry of the Tax Administration and Public Administrations to the Government on 11th April.

ⁱThe draft opinion was issued in application of the provisions of article 22 of the Organic Statute of the Independent Authority for Fiscal Responsibility to the intended recipient Administrations; therefore, to the State, the Autonomous Regions and the Spanish Federation of Municipalities and Provinces in representation of the Local Entities pursuant to the provisions of additional provision five of the Spanish Law Regulating the Local System. Finally, it is important to indicate that remarks have been received relating to the draft from experts from the Bank of Spain, the European Commission, the European Central Bank and the International Monetary Fund.