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Dear Ms. Davies,

Thank you for the opportunity to contribute to your discussion of best practice budget processes. Our submission is based on the experiences of OECD Member countries and will focus on those areas where we are best able to comment.

This inquiry comes at a critical time as our OECD Working Party of Senior Budget Officials (SBO) is in the process of debating and finalizing a set of 10 (inter-related) high-level *Principles of Budgetary Governance* (see attached) to guide and inform budgetary processes and reforms. These principles are applicable to both central and sub-national governments. While recognizing that budgeting practices can vary widely across countries in light of traditional, institutional, and cultural factors, the principles draw together the lessons of a decade and more of work by the SBO and its associated Networks, as well as insights from other areas of the OECD and of the international budgeting community more generally. In particular, the principles build upon the *OECD Best Practices for Budget Transparency* which are long-established as an international point of reference for good budgeting (see attached).

The principles are:

1. Fiscal policy should be managed within clear, credible and predictable limits.
2. Top-down budgetary management should be applied to align policies with resources.
3. Budgets should be closely aligned with government-wide strategic priorities.
4. Budgets should be forward-looking, giving a clear medium-term outlook.
5. Budget documents and data should be open, transparent and accessible.
6. The budget process should be inclusive, participative and realistic.
7. Budgets should present a true, full and fair picture of the public finances.
8. Performance, evaluation and value for money should be integral to the budget process.
9. Longer-term sustainability and other fiscal risks should be identified, assessed and managed prudently.
10. The integrity and quality of budgetary forecasts, fiscal plans and budgetary implementation should be promoted through rigorous, independent quality assurance.

A discussion of each principle can be found in the attached document. Let us highlight a few points related to your inquiry here.



First, your inquiry asks about **linking budgets to outcomes**. Principle 8 posits the following, while also pointing to the use of evaluation and spending review tools:

“Performance information should be routinely presented alongside the financial allocations in the budget report. It is essential that such information should clarify, and not obscure or impede, accountability and oversight. Accordingly, performance information should be limited to a small number of relevant indicators for each policy programme; should be clear and easily understood; should allow for tracking of results against targets and for comparison with international and other benchmarks; and should make clear the link with government-wide strategic objectives.”

Traditionally, the public sector was held to account for compliance with rules and procedures, including accounting for financial appropriations. Over the past decade however, OECD countries have increasingly sought to develop a focus on the results achieved through performance budgeting. OECD (2007) identifies three broad categories of performance budgeting, with the third being highly unusual: presentational, performance-informed, and direct (or formula) performance budgeting. Arguably, a fourth type might be described as a managerial performance approach which focuses on managerial impacts and changes in organizational behaviour but may de-emphasize a strong budget linkage. Indeed, it may be more useful to think of performance budgeting types along a continuum with simple presentation of information at one end and performance-determined decisions at the other.

Despite widespread adoption of performance budgeting, countries have experienced difficulties actualizing it. While the budget provides a unique crosscutting mechanism to collect performance information, Schick (2013) notes that with few exceptions, performance budgeting has not become the government’s budget process. Rather, for most countries it is an accessory to the budget, adorning spending decisions but not fundamentally changing the way they are made. Many countries, including the United Kingdom, have gone through re-adjustment phases, re-assessing and revising their performance budgeting frameworks. There is a clear trend within OECD Member countries to move from extensive indicator sets to a few but clear objectives; towards a more focused use of performance information for management and accountability purposes rather than for allocation of resources; and towards increasing the importance of performance related-tools like programme evaluation and spending reviews, or what Schick (2013) has termed “performance budgeting extenders”.

Legislatures in particular have struggled to use performance information in the budget process in a meaningful way. Some have found that the reduction in the number of line items and higher level of aggregation in the budget documentation has diminished their control. Despite its long experience with performance budgeting, the United States Congress repeatedly chose not to give up line-item controls. In Germany, the Bundestag resisted attempts at reforms that would have reduced the number of line items arguing in part that this would diminish parliamentary influence and control. Recent reforms to the performance budgeting system in the Netherlands came about in part because budget authorisation on the basis of output targets (instead of financial inputs) was seen to have led to loss of parliamentary control and unreadable budget documentation. Indeed, the Dutch parliament increasingly perceived the almost complete lack of input information as an accountability gap (de Jong et al, 2013).

At the same time, some legislatures have pointed to problems with performance information overload (e.g. extensive indicator sets) and the difficulties parsing out that information which is most relevant and useful. As such, it is important for the legislature to be engaged early on in the process of thinking strategically about what information will be most useful for its budgetary deliberations and decisions. Sweden provides an interesting approach to improving the performance dialogue between the government and the parliament. An informal working group of approximately ten civil servants from the Ministry of Finance and parliament’s Committee on Finance was set up in 2000 and met over a period of several years. The group served as a catalyst, spreading good ideas to governmental and



parliamentary actors by identifying the types of performance information most useful to parliament in its deliberations on the budget, as well as how and when such information should be presented. Another approach of interest is to focus presentation of performance information in the budget on areas where there are changes (e.g. new programmes).

Second, let us touch upon a few lessons around **how other countries achieve devolved financial accountability while retaining central fiscal control**.

As noted in Principle 1 of the draft OECD Principles for Budgetary Governance:

- A sound fiscal policy is one which avoids the build-up of large, unsustainable debts, and which uses favourable economic times to build up resilience and buffers against more difficult times. However, there are a range of political and other factors that can impede governments from effecting such counter-cyclical, or even cyclically neutral, policies.
- At minimum, governments should have a stated commitment to pursue a sound and sustainable fiscal policy. The credibility of this commitment can be enhanced through clear and verifiable fiscal rules or policy guidelines which make it easier for people to understand and to anticipate the government's fiscal policy course throughout the economic cycle, and through other institutional mechanisms (see also Principle 10) to provide an independent perspective in this regard.

The main challenge when designing monitoring mechanisms for sub-national governments (SNGs) is to set up a mechanism which ensures economic stability and sound fiscal management while allowing sufficient flexibility to cope with unforeseen events and financial capacity for delivering public services and financing public investment. Such monitoring mechanisms should also avoid inducing pro-cyclical policies by SNGs. Currently there is a great diversity of practices in monitoring SNG debt across OECD countries, ranging from pure reliance on market mechanisms (arguably the most risky practice as markets tend to expect a bailout), to direct controls (e.g. authorisation from central government to issue debt, again with potential risk regarding bailouts), to sophisticated fiscal rules (with states/regions typically responsible for setting fiscal rules and monitoring local governments' finances). Just as with central governments, rules may include budget balance rules, expenditure and expenditure growth limits, and debt and debt service restrictions. Partly as a result of the crisis, we have seen a tightening of enforcement mechanisms and sanctions for non-compliance with the rules in OECD countries in recent years.

The OECD has identified several key challenges in monitoring SNG debts that should be addressed:

- *Lack of information about SNG budgeting practices.* In some countries, each SNG has its own budget practices and accounting standards. This makes comparison and monitoring very difficult. Ideally, information should be made available on how economic assumptions are set; whether and how SNGs carry out sensitivity analysis of economic assumptions; availability of contingency reserve funds; medium term perspective; and performance and results.
- *Lack of appropriate and timely information about SNG financial and debt situation.* According to principle 5 of the draft OECD Principles for Budgetary Governance, budget documents and data should be open, transparent, and accessible. Both for central government (but also for the legislature) transparency is essential to monitor SNG budgets and policies, track funds, and answer ex post questions about policy implementation. But financial information reported by SNGs often comes with a time lag and may be incomplete. In some cases information is not compiled, and in countries where SNGs use different accounting standards, it may not be comparable even when it exists. This hinders accountability and prevents central governments from taking timely corrective measures.



- *Lack of comparability of SNG data.*
- *Ensuring that SNG budgets present a true, full and fair picture of the public finances. Off-budget funds and local public enterprises or agencies may hide debt and fiscal risks and must be closely monitored (OECD, 2013b).*

Related to this last bullet point Principle 7 of the draft OECD Principles for Budgetary Governance gives the following guidance for providing a true, full and fair picture of the public finances:

- As a contract of trust between citizens and the state, it is expected that the budget document should account truly and faithfully for all expenditures and revenues of the national government, and that no figures should be omitted or hidden (although limited restrictions may apply for certain national security purposes). To underpin trust, this expectation should be made explicit through formal laws, rules or declarations that ensure budget sincerity and constrain the use of “off-budget” fiscal mechanisms.
- Control of the national budget is the responsibility of the central government, and the degree of co-ordination and co-operation with subnational levels of government naturally varies from country to country. The budget documentation should present a full national overview of the public finances – encompassing central and subnational levels of government – as an essential context for a debate on budgetary choices.
- Budget accounting should show the full financial costs and benefits of budget decisions, including the impact upon financial assets and liabilities. Accruals budgeting and reporting, which correspond broadly with private sector accounting norms, routinely show these costs and benefits; where traditional cash budgeting is used, supplementary information is needed. Where accruals methodology is used, a cash statement should also be prepared to show how the national government operations will be funded from year to year.
- Public programmes that are funded through non-traditional means – e.g. PPPs – should be included and explained in the budget reports, even where (for accounting reasons) they may not directly affect the public finances within the time frame of the budget document.

Regarding **how the new budget processes can be made transparent and understandable to all**, discussion of Principle 6 of the draft OECD Principles for Budgetary Governance on achieving an inclusive, participative and realistic budgeting process notes that:

- As well as having access to budget documents and data, parliament and citizens should be able to understand and influence the discussion about budgetary policy options, according to their democratic mandate, competencies and perspectives.
- Detailed and technical information should be presented in a simple manner, and the impact of budget measures – whether to do with tax or expenditure – should be clearly explained. A “citizen’s budget” or budget summary, in a standard and user-friendly format, is one way of achieving this.
- The national parliament has a fundamental role in authorising budget decisions and in holding governments to account. The parliament and its committees should have the opportunity to engage with the budget process at all stages of the budget cycle. The clear setting-out of medium-term budgetary envelopes (see also Principle 4) should help the parliament to participate in the annual process of budget formulation *ex ante* as well as *ex post*.
- Since governments have finite resources at their disposal, budgeting is concerned with identifying priorities, assessing value for money and making decisions. Parliaments, citizens and civil society organisations can contribute usefully to the budget process when they become engaged in the debate about difficult trade-offs, opportunity costs and value for money. Governments should facilitate this



useful engagement by making clear the relative costs and benefits of the wide range of public expenditure programmes and tax expenditures.

Principle 6 highlights the role of the legislature in the budget process. A well-functioning parliamentary scrutiny process serves to increase budget transparency and accountability, while openness on the part of parliament itself can lead to greater public participation in the law-making and policy-making processes. The new powers devolved to Wales imply a potentially greater scrutiny role for the National Assembly. As such, it may be of interest to look at some of the trends we are seeing around legislative scrutiny in OECD member countries.

It is important to remember that the part played by the legislature is impacted by a variety of factors such as whether parliament has a role in approving ex ante fiscal frameworks, the comprehensiveness of budget documentation, amendment powers, time available for debate, committee organization, and staffing and analytical capacity. Other factors include constitutional division of responsibilities, party systems, and mandatory spending – among others.

One of the most significant changes for just over a third of OECD legislatures is their involvement in reviewing and approving overarching fiscal frameworks and targets – in complement to their traditional roles in enacting detailed appropriations. This parallels the growth of top-down budgetary frameworks in many OECD countries (see Principle 2 of the draft OECD Principles for Budgetary Governance for a discussion of top-down budgetary management) and can help reinforce broad political commitment to fiscal discipline. However, while the legislature gains new influence in setting and approving macro targets, for some there may be a trade-off in terms of freedom to amend appropriations later on.

Legislative influence (and the ability of the legislature to seek out meaningful public input) is also affected by the time available to consider key budget documents. The OECD Best Practices for Budget Transparency recommend that the government's draft budget be submitted to parliament far enough in advance to allow parliament to review it properly – at least three months prior to the start of the fiscal year – and that the budget be approved by parliament prior to the start of the fiscal year.

The most important budget scrutiny happens in committee. There is a trend in OECD countries towards having a dominant Budget/Finance Committee responsible for budget review which coordinates varying levels of input from sectoral committees. Ideally a strong Budget/Finance Committee promotes coordination and consistency in legislative budget action and facilitates fiscal discipline, while involving sectoral committees allows the legislature to draw on their specific expertise. Some Budget/Finance Committees, for example Germany, also use a rapporteur system by which members are assigned responsibility for specific portfolios (departmental budgets) allowing them to develop significant expertise on these departments budgetary allocations and the rationale behind them. Committee deliberation is likely to be more effective if committee members serve on the committee for the full term of parliament, again because it allows them to gain the expertise necessary to challenge executive officials.

By far the most important trend we are seeing in OECD countries is a marked increase in the analytical capacity for legislatures. For many legislatures resources traditionally were limited to committee staff (which often performed more clerical type tasks) and library and research services staffed by generalists covering many areas rather than budget specialists. Today we are seeing more and more budget specialist units established within parliaments such as the UK Scrutiny Unit, Israel Budgetary Control Unit, and the Polish parliament's Department of Social and Economic Research.

There has also been growth in the number of independent parliamentary budget offices (e.g. United States, Mexico, Korea, Australia and Canada). The province of Ontario has also established a Financial



Accountability Office). These have highly specialised staff and typically are given special access to government information necessary to carry out their mandates. Other countries have chosen a fiscal council model. Both models can provide critical independent analysis by undertaking real time surveillance of public finances and fiscal policy, thus promoting quality and integrity in budgeting. The National Assembly for Wales will have the benefit of access to independent forecasts from the UK Office for Budget Responsibility (OBR), as well as other analysis that the OBR produces.

The Committee may be interested to note that the OECD Council recently adopted the *Council Recommendation on Principles for Independent Fiscal Institutions* (February, 2014) which provide guidance on issues to consider when establishing an independent parliamentary budget office or fiscal council (see attached).

Again, the above messages are based on OECD analysis of our Member country experiences. We would be pleased to elaborate on any of these points, as well as other modern budgeting reforms that are covered in the draft Principles of Budgetary Governance, including providing specific country examples.

Again, thank you for the opportunity to provide this submission to the Finance Committee.

Sincerely yours,

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## Draft Principles of Budgetary Governance







**Draft PRINCIPLES OF BUDGETARY GOVERNANCE**  
**First orientations for a set of core standards and principles**

Initial consultation draft  
November 2013



## Introductory note

The objective of these draft Principles is to draw together the lessons of a decade and more of work by the OECD Senior Budget Officials (SBO) Working Party and its associated Networks, along with the contributions and insights from other areas of the OECD and of the international budgeting community more generally. The draft Principles provide a concise overview of good practices across the full spectrum of budget activity, taking account in particular of the lessons of the recent economic crisis, and aim to give practical guidance for designing, implementing and improving budget systems to meet the challenges of the future. The overall intention is to provide a useful reference tool for policy-makers and practitioners around the world, and help ensure that public resources are planned, managed and used effectively to make a positive impact on citizens' lives.

As a draft document, these Principles are a work in progress and will benefit from the constructive input and improvements from interested parties around the world, before they are considered and adopted as a formal instrument of the OECD in the future.

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## Draft PRINCIPLES OF BUDGETARY GOVERNANCE

### First orientations for a set of core standards and principles

#### Introduction: The fundamental national role of the budget and the budgeting process

The budget is a central policy document of government, showing how it will achieve its annual and multi-annual objectives. Apart from financing new and existing programmes, the budget is the primary instrument for implementing fiscal policy. Alongside other instruments of government policy – such as laws, regulation and joint action with other actors in society – the budget aims to turn plans and aspirations into reality. More than this, the budget is a contract between citizens and state, showing how resources are raised and allocated for the delivery of public services. Such a document must be clear, transparent and credible if it is to command trust, and to serve as a basis of accountability.

External stakeholders also look to the quality of the budget document, and of the budgeting process, in assessing the soundness and reliability of a state. The process of shaping the budget is typically led by the Treasury/Ministry of Finance (“central budget authority” or CBA), and draws together the contributions from ministers, parliamentarians, public officials and other trusted advisers, civil society organisations and advocacy groups and, increasingly, from citizens themselves. An *effective* budgetary process is one that takes these contributions, weighs and considers them, and transforms them into a set of proposals for action for the betterment of society. A *sound* budgeting system is one which engenders trust among citizens that the government is listening to their concerns, has a plan for achieving worthwhile objectives, and will use the available resources effectively, efficiently and in a sustainable manner in doing so.

Budgeting is no longer the preserve of central governments: it is a process that encompasses all levels of government, national and subnational. Budget systems and procedures should be coordinated, coherent and consistent across levels of government. These budget principles are therefore relevant, and should be applied as appropriate, to all levels of government.

Moreover, budgeting is not a standalone process, removed from the other channels of government action. Good budgeting is supported by, and in turn supports, the various pillars of modern public governance: integrity, openness, participation, accountability and a strategic approach to planning and achieving national objectives. In this way, budgeting is an essential keystone in the architecture of trust between states and their citizens.

Budgeting practices can vary widely across countries in light of traditional, institutional and cultural factors. However, based on the experience of the Senior Budget Officials (SBO) and the extensive analysis of various aspects of budgeting conducted by the SBO and its networks over recent years and related studies across the OECD (see Bibliography), the common elements of modern budgeting practice can be presented as high-level principles to guide and inform budgetary processes and reforms. Countries that organise their budgetary affairs on the basis of these governance principles are best-placed to meet citizens’ expectations for sound, stable and effective public governance.

These principles deal with the various phases of the budget process, the attributes of the budget document, as well as the wider context within which budgets are formed. The OECD has developed, and is developing, more detailed principles and recommendations for further guidance on specific elements of the overall budgeting framework.

## **1. Fiscal policy should be managed within clear, credible and predictable limits.**

- A sound fiscal policy is one which avoids the build-up of large, unsustainable debts, and which uses favourable economic times to build up resilience and buffers against more difficult times. However, there are a range of political and other factors that can impede governments from effecting such counter-cyclical, or even cyclically neutral, policies.
- At minimum, governments should have a stated commitment to pursue a sound and sustainable fiscal policy. The credibility of this commitment can be enhanced through clear and verifiable fiscal rules or policy guidelines which make it easier for people to understand and to anticipate the government's fiscal policy course throughout the economic cycle, and through other institutional mechanisms (see point 10 below) to provide an independent perspective in this regard.

## **2. Top-down budgetary management should be applied to align policies with resources.**

- The starting point for budgetary management should be the setting of overall budget targets by the CBA which will achieve fiscal policy objectives for each year of a medium-term fiscal horizon. These targets should then be used to ensure that all elements of revenue, expenditure and broader economic policy are consistent and are managed in line with the available resources.
- The accuracy of economic forecasting, and of tax and expenditure baseline projections, is of central importance if top-down budgeting is to be planned and implemented effectively (see also points 4 and 10 below).

## **3. Budgets should be closely aligned with government-wide strategic priorities.**

- To promote alignment with the (multi-year) planning, prioritisation and goal-setting functions of government, the (annual) budgeting process should (a) develop a medium-term perspective, beyond the traditional annual cycle (see point 4 below); and (b) organise and structure the budget allocations in a way that corresponds readily with national objectives.
- The CBA should have a close working relationship with the centre of government (i.e. prime minister's office or cabinet office), given the inter-dependencies between the budget process and the achievement of government-wide policies.
- From time to time, governments may need to revisit or realign their fundamental priorities to take account of developments in the economy or in society. A periodic, comprehensive review of expenditure (see point 9 below) is a useful tool for ensuring that budgetary expectations are managed in line with government-wide developments.

## **4. Budgets should be forward-looking, giving a clear medium-term outlook.**

- A medium-term dimension to budgeting is essential both for managing fiscal policy effectively and for resourcing government plans and priorities (see points 1, 2 and 3 above). Moreover, many structural reform measures – whether relating to expenditure or revenue – take several years to yield their expected benefits, and these effects should be planned and budgeted for across the multi-year horizon.
- A medium-term expenditure framework (MTEF) is accordingly of fundamental importance in setting a basis for the annual budget. To be effective, an MTEF should have real force in setting boundaries for the main categories of expenditure, for each year of the medium-term horizon; should be fully aligned with the top-down budgetary constraints agreed by government; should be grounded upon realistic forecasts for baseline expenditure (i.e. using existing policies), including a clear outline of key assumptions used; should show the correspondence with expenditure objectives and deliverables from national strategic plans; and should include

sufficient institutional incentives and flexibility to ensure that expenditure boundaries are respected.

- Capital investment plans, which by their nature have an impact beyond the annual budget, should be grounded in objective appraisal of economic capacity gaps, infrastructural development needs and sectoral/social priorities. The budgeting process should require a prudent assessment of the costs and benefits of such investments; affordability for users over the long term, including in light of recurrent costs; relative priority among various projects; and of overall value for money. Investment decisions should be evaluated independently of the specific financing mechanism i.e. whether through traditional capital procurement or a private financing model such as public-private partnership (PPP).

## **5. Budget documents and data should be open, transparent and accessible.**

- Clear budget reports should be available to inform all stages of policy formulation, consideration and debate, as well as implementation and review. The annual budget document itself, which shows the allocations for each public service area and revenue policy measures under each tax heading, is of central importance. Budgetary information should also be presented in comparable format in advance of the final budget providing enough time for effective discussion and debate on policy choices (e.g. a draft budget or a pre-budget report), during the implementation phase (e.g. a mid-year budget report) and after the end of the budget year (an end-year report) to promote effective decision making, accountability and oversight.
- All budget reports should be published fully, immediately and routinely, and in a way that is accessible to citizens. In the modern context, “accessibility” requires that budget documents be available on-line, and that all budget data be presented in open data formats which can be readily downloaded, analysed, used and re-presented by citizens, civil society organisations and other stakeholders.
- The budgeting process brings together all financial inflows and outflows of government; the use of open, standardised data sets should therefore allow for the budgeting process to facilitate and support other important government objectives such as open government, integrity and programme evaluation.

## **6. The budget process should be inclusive, participative and realistic.**

- As well as having access to budget documents and data, parliament and citizens should be able to understand and influence the discussion about budgetary policy options, according to their democratic mandate, competencies and perspectives.
- Detailed and technical information should be presented in a simple manner, and the impact of budget measures – whether to do with tax or expenditure – should be clearly explained. A “citizen’s budget” or budget summary, in a standard and user-friendly format, is one way of achieving this.
- The national parliament has a fundamental role in authorising budget decisions and in holding governments to account. The parliament and its committees should have the opportunity to engage with the budget process at all stages of the budget cycle. The clear setting-out of medium-term budgetary envelopes (see point 4 above) should help the parliament to participate in the annual process of budget formulation *ex ante* as well as *ex post*.
- Since governments have finite resources at their disposal, budgeting is concerned with identifying priorities, assessing value for money and making decisions. Parliaments, citizens and civil society organisations can contribute usefully to the budget process when they become engaged in the debate about difficult trade-offs, opportunity costs and value for money. Governments should facilitate this useful engagement by making clear the relative costs and benefits of the wide range of public expenditure programmes and tax expenditures.



## 7. Budgets should present a true, full and fair picture of the public finances.

- As a contract of trust between citizens and the state, it is expected that the budget document should account truly and faithfully for all expenditures and revenues of the national government, and that no figures should be omitted or hidden (although limited restrictions may apply for certain national security purposes). To underpin trust, this expectation should be made explicit through formal laws, rules or declarations that ensure budget sincerity and constrain the use of “off-budget” fiscal mechanisms.
- Control of the national budget is the responsibility of the central government, and the degree of co-ordination and co-operation with subnational levels of government naturally varies from country to country. The budget documentation should present a full national overview of the public finances – encompassing central and subnational levels of government – as an essential context for a debate on budgetary choices.
- Budget accounting should show the full financial costs and benefits of budget decisions, including the impact upon financial assets and liabilities. Accruals budgeting and reporting, which correspond broadly with private sector accounting norms, routinely show these costs and benefits; where traditional cash budgeting is used, supplementary information is needed. Where accruals methodology is used, a cash statement should also be prepared to show how the national government operations will be funded from year to year.
- Public programmes that are funded through non-traditional means – e.g. PPPs – should be included and explained in the budget reports, even where (for accounting reasons) they may not directly affect the public finances within the time frame of the budget document.

## 8. Performance, evaluation and value for money should be integral to the budget process

- Parliament and citizens need to understand not just what is being *spent*, but what is being *bought* on behalf of citizens – i.e. what public services are actually being delivered, to what standards of quality and with what levels of efficiency.
- Performance information should be routinely presented alongside the financial allocations in the budget report. It is essential that such information should clarify, and not obscure or impede, accountability and oversight. Accordingly, performance information should be limited to a small number of relevant indicators for each policy programme; should be clear and easily understood; should allow for tracking of results against targets and for comparison with international and other benchmarks; and should make clear the link with government-wide strategic objectives.
- Expenditure programmes (including tax expenditures) should be routinely and regularly subject to objective evaluation and review, to inform resource allocation and re-prioritisation both within line ministries and across government as a whole. High-quality performance and evaluation information should be available to facilitate an evidence-based review.
- In particular, all new policy proposals should be routinely and openly evaluated *ex ante* to assess coherence with national priorities, clarity of objectives, and anticipated costs and benefits.
- Periodically, governments should take stock of overall expenditure and reassess its alignment with fiscal objectives and national priorities, taking account of the results of evaluations. For such a comprehensive review to be effective, it must be aligned with political demand.

## 9. Longer-term sustainability and other fiscal risks should be identified, assessed and managed prudently

- To promote a stable development of public finances, mechanisms should be applied to promote the resilience of budgetary plans and to mitigate the potential impact of fiscal risks.

- Fiscal risks, including contingent liabilities, should be clearly identified, explained and classified by type: e.g. forecasting assumptions; national and international economic risks and scenarios, including uncertainties relating to the economic cycle and internal and external economic imbalances; liabilities and guarantees in the public sector, including public enterprises; potential liabilities in the broader economy, including any implicit support for strategic industries or private-sector pension schemes; risk-sharing and joint financing arrangements with the private sector, including PPPs; implicit guarantees for sub-national debt; risks from natural disasters and other unpredictable events; and longer-term sustainability risks, including those related to publicly-funded pensions and any implicit support for private-sector pensions.
- Fiscal risks should also be quantified as far as possible, and the mechanisms for managing these risks should be made explicit and reported alongside the annual budget. Such mechanisms should include, as appropriate: adoption of a prudent fiscal stance; adequate fiscal buffers against cyclical volatility; charging market-based fees for the implicit costs associated with liabilities and guarantees; credible repudiation by the government of any perceived responsibility for risks that belong in the private sector; and protected reserve funds for unforeseen events and for longer-term budgetary challenges.
- Longer-term demographic changes and other factors can also give rise to major pressures and challenges for budgetary policy: issues such as social security, health care, care for older people, education, energy policy and the structure of the tax base should be considered under this heading. A report on long-term sustainability of the public finances should be published regularly (at least once every 3 years), and its policy messages – both near-term and longer-term – should be presented and considered in the budgetary context.

## **10. The integrity and quality of budgetary forecasts, fiscal plans and budgetary implementation should be promoted through rigorous, independent quality assurance.**

- The CBA needs to command the confidence of a broad range of stakeholders – across government, within parliament and the public, and internationally – in the quality and integrity of its budgetary forecasts and fiscal plans and in its ability to manage budgetary implementation and delivery.
- In the first instance, governments should invest continually in the skills and capacity of staff to perform their roles effectively – whether in the CBA, line ministries or other institutions – including by reference to current international standards and norms.
- The credibility of national budgeting – including economic forecasting, adherence to fiscal rules, longer-term sustainability and handling of fiscal risks – can also be enhanced through independent fiscal institutions or other structured, institutional processes for allowing objective scrutiny of, and input to, government budgeting. An open, transparent and participative approach to budgeting (see points 4 and 5 above) also promotes the credibility and quality of the budgetary process.
- Independent internal audit is an essential safeguard for the quality of integrity of budget processes and financial management, both within the CBA and within line ministries.
- The supreme audit institution (SAI) has a fundamental role, as a guardian of the public trust, in ensuring that budgeted resources are used properly. A well-functioning SAI should deal authoritatively with all aspects of financial accountability. As regards efficiency and value for money, both the internal and external control systems should have a role in auditing the cost-effectiveness of individual programmes and in assessing the quality of performance accountability and governance frameworks more generally.

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# OECD Best Practices for Budget Transparency



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# OECD Best Practices for Budget Transparency

## Note from the Editors

The relationship between good governance and better economic and social outcomes is increasingly acknowledged. Transparency – openness about policy intentions, formulation and implementation – is a key element of good governance. The budget is the single most important policy document of governments, where policy objectives are reconciled and implemented in concrete terms. Budget transparency is defined as the full disclosure of all relevant fiscal information in a timely and systematic manner.

OECD Member countries are at the forefront of budget transparency practices. At its 1999 annual meeting, the OECD Working Party of Senior Budget Officials asked the Secretariat to draw together a set of Best Practices in this area based on Member countries' experiences.

The Best Practices are in three parts. Part 1 lists the principal budget reports that governments should produce and their general content. Part 2 describes specific disclosures to be contained in the reports. This includes both financial and non-financial performance information. Part 3 highlights practices for ensuring the quality and integrity of the reports.

The Best Practices are designed as a reference tool for Member and non-member countries to use in order to increase the degree of budget transparency in their respective countries. The Best Practices are organised around specific reports for presentational reasons only. It is recognised that different countries will have different reporting regimes and may have different areas of emphasis for transparency. The Best Practices are based on different Member countries' experiences in each area. It should be stressed that the Best Practices are not meant to constitute a formal "standard" for budget transparency.



## 1. Budget reports

### 1.1. *The budget*

- The budget is the government's\* key policy document. It should be comprehensive, encompassing all government revenue and expenditure, so that the necessary trade-offs between different policy options can be assessed.
- The government's draft budget should be submitted to Parliament far enough in advance to allow Parliament to review it properly. In no case should this be less than three months prior to the start of the fiscal year. The budget should be approved by Parliament prior to the start of the fiscal year.
- The budget, or related documents, should include a detailed commentary on each revenue and expenditure programme.
- Non-financial performance data, including performance targets, should be presented for expenditure programmes where practicable.
- The budget should include a medium-term perspective illustrating how revenue and expenditure will develop during, at least, the two years beyond the next fiscal year. Similarly, the current budget proposal should be reconciled with forecasts contained in earlier fiscal reports for the same period; all significant deviations should be explained.
- Comparative information on actual revenue and expenditure during the past year and an updated forecast for the current year should be provided for each programme. Similar comparative information should be shown for any non-financial performance data.
- If revenue and expenditures are authorised in permanent legislation, the amounts of such revenue and expenditures should nonetheless be shown in the budget for information purposes along with other revenue and expenditure.
- Expenditures should be presented in gross terms. Ear-marked revenue and user charges should be clearly accounted for separately. This should be done regardless of whether particular incentive and control systems provide for the retention of some or all of the receipts by the collecting agency.

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\* The Best Practices define "government" in line with the System of National Accounts (SNA). This definition encompasses the non-commercial activities of government. Specifically, the activities of state-owned enterprises are excluded from this definition. Although the SNA definition focuses on general government, *i.e.* consolidating all levels of government, these Best Practices should be seen to apply to the national government.

- Expenditures should be classified by administrative unit (*e.g.* ministry, agency). Supplementary information classifying expenditure by economic and functional categories should also be presented.
- The economic assumptions underlying the report should be made in accordance with Best Practice 2.1 (below).
- The budget should include a discussion of tax expenditures in accordance with Best Practice 2.2 (below).
- The budget should contain a comprehensive discussion of the government's financial assets and liabilities, non-financial assets, employee pension obligations and contingent liabilities in accordance with Best Practices 2.3-2.6 (below).

### 1.2. *Pre-budget report*

- A pre-budget report serves to encourage debate on the budget aggregates and how they interact with the economy. As such, it also serves to create appropriate expectations for the budget itself. It should be released no later than one month prior to the introduction of the budget proposal.
- The report should state explicitly the government's long-term economic and fiscal policy objectives and the government's economic and fiscal policy intentions for the forthcoming budget and, at least, the following two fiscal years. It should highlight the total level of revenue, expenditure, deficit or surplus, and debt.
- The economic assumptions underlying the report should be made in accordance with Best Practice 2.1 (see below).

### 1.3. *Monthly reports*

- Monthly reports show progress in implementing the budget. They should be released within four weeks of the end of each month.
- They should contain the amount of revenue and expenditure in each month and year-to-date. A comparison should be made with the forecast amounts of monthly revenue and expenditure for the same period. Any in-year adjustments to the original forecast should be shown separately.
- A brief commentary should accompany the numerical data. If a significant divergence between actual and forecast amounts occurs, an explanation should be made.
- Expenditures should be classified by major administrative units (*e.g.*, ministry, agency). Supplementary information classifying expenditure by economic and functional categories should also be presented.

- The reports, or related documents, should also contain information on the government's borrowing activity (see Best Practice 2.3 below).

#### **1.4. Mid-year report**

- The mid-year report provides a comprehensive update on the implementation of the budget, including an updated forecast of the budget outcome for the current fiscal year and, at least, the following two fiscal years. The report should be released within six weeks of the end of the mid-year period.
- The economic assumptions underlying the budget should be reviewed and the impact of any changes on the budget disclosed (see Best Practice 2.1 below).
- The mid-year should contain a comprehensive discussion of the government's financial assets and liabilities, non-financial assets, employee pension obligations and contingent liabilities in accordance with Best Practices 2.3-2.6 (below).
- The impact of any other government decisions, or other circumstances, that may have a material effect on the budget should be disclosed.

#### **1.5. Year-end report**

- The year-end report is the government's key accountability document. It should be audited by the Supreme Audit Institution, in accordance with Best Practice 3.3 (below) and be released within six months of the end of the fiscal year.
- The year-end report shows compliance with the level of revenue and expenditures authorised by Parliament in the budget. Any in-year adjustments to the original budget should be shown separately. The presentation format of the year-end report should mirror the presentation format of the budget.
- The year-end report, or related documents, should include non-financial performance information, including a comparison of performance targets and actual results achieved where practicable.
- Comparative information on the level of revenue and expenditure during the preceding year should also be provided. Similar comparative information should be shown for any non-financial performance data.
- Expenditure should be presented in gross terms. Ear-marked revenue and user charges should be clearly accounted for separately.

- Expenditure should be classified by administrative unit (*e.g.* ministry, agency). Supplementary information classifying expenditure by economic and functional categories should also be presented.
- The year-end report should contain a comprehensive discussion of the government's financial assets and financial liabilities, non-financial assets, employee pension obligations and contingent liabilities in accordance with Best Practices 2.3-2.6 (below).

### **1.6. Pre-election report**

- A pre-election report serves to illuminate the general state of government finances immediately before an election. This fosters a more informed electorate and serves to stimulate public debate.
- The feasibility of producing this report may depend on constitutional provisions and electoral practices. Optimally, it should be released no later than two weeks prior to elections.
- The report should contain the same information as the mid-year report.
- Special care needs to be taken to assure the integrity of such reports, in accordance with Best Practice 3.2 (below).

### **1.7. Long-term report**

- The long-term report assesses the long-term sustainability of current government policies. It should be released at least every five years, or when major changes are made in substantive revenue or expenditure programmes.
- The report should assess the budgetary implications of demographic change, such as population ageing and other potential developments over the long-term (10-40 years).
- All key assumptions underlying the projections contained in the report should be made explicit and a range of plausible scenarios presented.

## **2. Specific disclosures**

### **2.1. Economic assumptions**

- Deviations from the forecast of the key economic assumptions underlying the budget are the government's key fiscal risk.
- All key economic assumptions should be disclosed explicitly. This includes the forecast for GDP growth, the composition of GDP growth, the rate of employment and unemployment, the current account, inflation and interest rates (monetary policy).

- A sensitivity analysis should be made of what impact changes in the key economic assumptions would have on the budget.

## **2.2. Tax expenditures**

- Tax expenditures are the estimated costs to the tax revenue of preferential treatment for specific activities.
- The estimated cost of key tax expenditures should be disclosed as supplementary information in the budget. To the extent practicable, a discussion of tax expenditures for specific functional areas should be incorporated into the discussion of general expenditures for those areas in order to inform budgetary choices.

## **2.3. Financial liabilities and financial assets**

- All financial liabilities and financial assets should be disclosed in the budget, the mid-year report, and the year-end report. Monthly borrowing activity should be disclosed in the monthly reports, or related documents.
- Borrowings should be classified by the currency denomination of the debt, the maturity profile of the debt, whether the debt carries a fixed or variable rate of interest, and whether it is callable.
- Financial assets should be classified by major type, including cash, marketable securities, investments in enterprises and loans advanced to other entities. Investments in enterprises should be listed individually. Loans advanced to other entities should be listed by major category reflecting their nature; historical information on defaults for each category should be disclosed where available. Financial assets should be valued at market value.
- Debt management instruments, such as forward contracts and swaps, should be disclosed.
- In the budget, a sensitivity analysis should be made showing what impact changes in interest rates and foreign exchange rates would have on financing costs.

## **2.4. Non-financial assets**

- Non-financial assets, including real property and equipment, should be disclosed.
- Non-financial assets will be recognised under full accrual-based accounting and budgeting. This will require the valuation of such assets and the selec-

tion of appropriate depreciation schedules. The valuation and depreciation methods should be fully disclosed.

- Where full accrual basis is not adopted, a register of assets should be maintained and summary information from this register provided in the budget, the mid-year report and the year-end report.

### **2.5. Employee pension obligations**

- Employee pension obligations should be disclosed in the budget, the mid-year report and the year-end report. Employee pension obligations are the difference between accrued benefits arising from past service and the contributions that the government has made towards those benefits.
- Key actuarial assumptions underlying the calculation of employee pension obligations should be disclosed. Any assets belonging to employee pension plans should be valued at market value.

### **2.6. Contingent liabilities**

- Contingent liabilities are liabilities whose budgetary impact is dependent on future events which may or may not occur. Common examples include government loan guarantees, government insurance programmes, and legal claims against the government.
- All significant contingent liabilities should be disclosed in the budget, the mid-year report and the annual financial statements.
- Where feasible, the total amount of contingent liabilities should be disclosed and classified by major category reflecting their nature; historical information on defaults for each category should be disclosed where available. In cases where contingent liabilities cannot be quantified, they should be listed and described.

## **3. Integrity, control and accountability**

### **3.1. Accounting policies**

- A summary of relevant accounting policies should accompany all reports. These should describe the basis of accounting applied (*e.g.* cash, accrual) in preparing the reports and disclose any deviations from generally accepted accounting practices.
- The same accounting policies should be used for all fiscal reports.
- If a change in accounting policies is required, then the nature of the change and the reasons for the change should be fully disclosed. Information for

previous reporting periods should be adjusted, as practicable, to allow comparisons to be made between reporting periods.

### **3.2. Systems and responsibility**

- A dynamic system of internal financial controls, including internal audit, should be in place to assure the integrity of information provided in the reports.
- Each report should contain a statement of responsibility by the finance minister and the senior official responsible for producing the report. The minister certifies that all government decisions with a fiscal impact have been included in the report. The senior official certifies that the Finance Ministry has used its best professional judgement in producing the report.

### **3.3. Audit**

- The year-end report should be audited by the Supreme Audit Institution in accordance with generally accepted auditing practices.
- Audit reports prepared by the Supreme Audit Institution should be scrutinised by Parliament.

### **3.4. Public and parliamentary scrutiny**

- Parliament should have the opportunity and the resources to effectively examine any fiscal report that it deems necessary.
- All fiscal reports referred to in these Best Practices should be made publicly available. This includes the availability of all reports free of charge on the Internet.
- The Finance Ministry should actively promote an understanding of the budget process by individual citizens and non-governmental organisations.