



An Roinn Airgeadais  
Department of Finance

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Ms. Fiona Cashin,  
Committee Secretariat,  
Committee of Public Accounts,  
Leinster House,  
Dublin 2

1<sup>st</sup> June, 2012

Meeting with Mr. John Moran, Secretary General, Department of Finance  
(7<sup>th</sup> June, 2012)

Dear Fiona,

Your letter dated 18<sup>th</sup> May refers.

As requested, please find attached herewith an up-to-date brief pertaining to issues raised by the Committee or the Comptroller and Auditor General in connection with items on the agenda for the meeting.

I look forward to meeting with the committee on 7<sup>th</sup> June.

Yours sincerely,

  
John Moran  
Secretary General



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## **2010 Appropriation Accounts for the Department of Finance**

The Appropriation Accounts for the Department of Finance in 2010 show a Net Outturn of €61.875m compared to a Budget Estimate for that year of €70.158m. This left a surplus of some €8.283m to be surrendered to the exchequer and represents a 5% reduction in net spend year on year.

The key variances contributing to this surplus included:

- €1.8m saving on the Administrative Budget paybill – arising from delayed recruitment pending the outcome of the external reviews of the Department.
- €1m saving on the Centre for Management and Organisation Development – this arose from cost savings negotiated in the retendering of contracts combined with a delay in the commencement of certain projects.
- €1m saving on the provision for the Banking Inquiry – arising from the timing of the start of the review (later than anticipated)
- €1m saving on the Change Management Fund (now the Reform and Delivery Office)
- €1m timing issue on the funding of Peace/Interreg Programmes

Other smaller cost variances, combined with additional recoupment of costs incurred in the Banking area, make up the remainder of the surplus.

No issues were raised in relation to my Department's Vote, in the report of the C&AG for 2010.

### **Up-to-date information and earlier production of accounts**

We are of common mind with the Committee and the C&AG that we should strive towards earlier publication of accounts. I believe that the C&AG will confirm that my Department is working with his office in this regard.

The 2011 Appropriation Accounts are under audit at the moment. €25.857m was provided for my Department in the 2011 Estimate (reflecting the split of the Department and the transfer of certain functions to the new Department of Public Expenditure & Reform). The provisional outturn for my Department, which is still subject to audit, is €22.582m leaving a projected surplus to be surrendered of some €3.275m.

This surplus arises largely in the banking area (almost €2m of the consultancy provision was not required and some €0.230m of additional receipts were recorded on recoupment of certain banking costs). Provision in relation to the banking area is difficult to estimate accurately – we are seeking to ensure that adequate provision is available to enable the Department to respond to changing pressures in the banking area while balancing this against demands on the Exchequer generally.

The provision for my Department in 2012 is €32.082m of which some €9m had been spent at the end of April.



## **2. Chapter 1: Exchequer Financial Outturn for 2010 and Chapter 3: State Funding Developments**

Chapter 1 of the report of the C&AG shows a Financial Outturn for 2010 of €18.145bn<sup>1</sup> (deficit). This was comprised of two key figures – tax revenue of €31.753bn and net voted expenditure of €46.434bn.

The provisional **Financial Outturn for 2011** shows an Exchequer deficit of €24.917bn. On a headline basis this is a substantial increase on the 2010 Exchequer deficit of €18.744 bn. However, adjusting for banking related expenditure, and for completeness, Exchequer capital receipts from the proceeds of the sale of shares in Bank of Ireland, the underlying deficit actually declined by around €2¾ billion. This is evidence of the progress that is being made in returning sustainability to the public finances.

### **Growth Forecasts and Deficit Targets**

Last year saw a welcome rebound in economic activity, with GDP recording its first full year of growth since 2007. As is typical in small open economies such as Ireland's, the traded sector is leading the recovery. Net exports made a strong contribution to growth last year and are expected to do so again this year, though the more challenging external environment implies some moderation in trade this year. On the domestic demand front, near-term prospects remain muted as households, firms and the government sector are still working through the imbalances built up during the boom.

The Department's latest forecasts - which were published in April's Stability Programme Update (SPU) - project GDP growth of 0.7 per cent this year. The recovery is expected to broaden out and gain ground next year and beyond. GDP is forecast to expand by 2.2 per cent next year, with growth of 3 per cent per annum on average foreseen for the period 2014-15. Given the high degree of uncertainty at the current juncture, the SPU also identified a number of downside and upside risks to this outlook.

With respect to the public finances, we remain on track to adhere to the 8.6 per cent of GDP General Government deficit limit this year.

The public finances are moving in the right direction. An underlying General Government deficit of approximately 9.4 per cent of GDP was recorded in 2011 as reported in the April Maastricht Returns. This is well within the 10.6 per cent of GDP target previously set by the ECOFIN Council. The return of the underlying deficit to single figures is a positive development and reflects the strong progress that has been made in restoring order to our public finances. This progress has in large part been due to the very significant adjustments to revenues and spending implemented since mid-2008.

We have also made a solid start to 2012. End-April 2012 Exchequer Returns data were generally positive showing tax revenues up significantly year-on-year and some €370 million or 3.5 per cent ahead of profile. Three of the four main tax-heads – corporation tax, income tax and VAT – recorded surpluses over target in the first four months of the year. However, there are some signs of spending pressures, in the Social Protection and Health areas in particular, which will need to be carefully managed.

All six of the end-quarter Exchequer primary balance targets set so far as part of the EU/IMF Programme have been met as have the corresponding Central Government net debt targets, including most recently for end-March 2012.

### State Funding Developments and Cost of Debt

Chapter 3 sets out the detail of the State Funding Developments including the EU/IMF Programme of Financial Support, which comprises €67.5bn in external funding from the EFSF, the EFSM, the IMF as well as bilateral loans from the UK, Denmark and Sweden. The value of the total Programme, including the use of our own resources, is €85bn.

### Profile of National Debt

Net borrowings<sup>2</sup> by the NTMA in 2011 amounted to €27.1bn (€12.5bn in 2010). Borrowings in 2011 were raised mainly from funds available under the EU/IMF Programme of Financial Support. The cumulative borrowing is composed of a variety of elements with differing maturity profiles. Figure 3 sets out the breakdown of the debt by its major component types.

**Figure 3 Gross National Debt**

	2008	2009	2010	2011
	€m	€m	€m	€m
Government Bonds – original maturity more than one year	41,863	70,858	90,102	85,310
EU-IMF Funding Programme	-	-	-	34,646
Other Medium/Long-Term Debt – original maturity more than one year	483	670	673	673
Short-Term Debt – maturity less than one year	21,783	16,261	6,972	2,903
Borrowings from other State Funds*	2,605	1,783	1,524	1,696
Government Savings Schemes – maturity of up to 5½ years	5,723	7,396	10,338	11,546
<b>Gross National Debt</b>	<b>72,457</b>	<b>96,968</b>	<b>109,609</b>	<b>136,774</b>
Related Assets	(22,059)	(21,816)	(16,164)	(17,692)
<b>Net National Debt</b>	<b>50,398</b>	<b>75,152</b>	<b>93,445</b>	<b>119,082</b>

2011 figures are unaudited. The figures include the effect of currency hedging transactions.

\*The main element of this borrowing relates to short-term advances from the Post Office Savings Bank Fund.



Most of the Medium and Long-Term Debt is borrowed in the form of Government bonds which have differing maturities, the longest of which at end-2011 was 13 years. Short-term debt which is debt with a maturity of less than one year, is comprised mainly of borrowings using the NTMA's Euro Commercial Paper Programme and Exchequer Notes programme.

The focus of Government presently is on stabilising the General Government debt-to-GDP ratio and beginning the process of reducing it to a lower, safer level over time. This will be done through the implementation of further budgetary consolidation as well as policies which foster both employment and economic growth.

General Government Debt is the measure of the total debt of the State and is used for comparative purposes across the European Union. It is therefore the main focus of attention when assessing debt developments. National Debt is the principal component of General Government Debt. General Government Debt also includes the debt of central and local government bodies as well as Promissory Notes issued to a number of financial institutions as a means of providing State support to these institutions. Unlike the National Debt, General Government Debt is reported on a gross basis and does not allow for the netting off of outstanding cash balances and other related assets.

The majority of the €50bn difference between the levels of General Government debt (€169.3bn) and net National debt (€119.1bn) at end-2011 can be explained by the Promissory Notes (€28.3bn outstanding at end-2011) as well as related assets (€17.7bn).

The forecasts contained in the April Stability Programme Update (SPU) show that by the end of current forecast horizon in 2015, the debt to GDP ratio is expected to be 117.4 per cent, down from an estimated peak of 120.3 per cent next year.

**Table 1: General Government Debt Projections 2011-2015**

€bn	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
General Government Debt	169.3	186.7	197.6	204.6	210.0
GDP	156.4	158.9	164.2	171.2	178.9
<b>Debt-to-GDP Ratio</b>	<b>108.2</b>	<b>117.5</b>	<b>120.3</b>	<b>119.5</b>	<b>117.4</b>

It is important to note that these forecasts made no allowance for any asset disposals. Any such disposals could therefore play a role in reducing the debt levels. Ireland's debt dynamics and sustainability were also improved by the interest rate reduction on EU/IMF Programme funding secured last July as well as the lengthening of maturities on Programme loans. This will be of particular assistance as it means there is less pressure on the State to borrow to refinance maturing debt in the short-to-medium term, giving the State valuable breathing space to continue with the process of returning the economy to health and the public finances to a sustainable position.

Moving towards a balanced budgetary position is a necessary pre-condition for restoring the economy to sustainable growth and job creation and to securing our objective of re-entering the international bond markets.

As I have indicated, we are on track to adhere to the 8.6 per cent of GDP deficit limit we have been set for this year. That said we must bear in mind that a deficit limit of 8.6 per cent of GDP equates to a gap of around €13½ billion between General Government revenues and expenditure. So, notwithstanding the progress made, there remains a very sizeable deficit in our public finances, one that we must continue to close over the coming years. Every Department can play its part in that regard and it will be very important that spending targets are adhered to this year, as was done in 2011.

Our budgetary policy at present is framed against the backdrop of this still large deficit. We cannot continue to consistently spend more than we collect in revenue each year. It is not sustainable. We need to ensure that more of our now more scarce resources are available for the provision of important public services rather than going towards servicing an ever increasing burden.

Clearly the budgetary adjustment process presents challenges for all of us, but we must remain steadfast in our commitment to continue meeting our budgetary targets. It is very important that we remain on a credible path of budgetary adjustment. We have gained much credibility internationally in recent times for the progress we have made. As we strive to return to international financial markets to source our own financing, it is vital we do not jeopardize these hard won gains.

#### **Debt service costs**

The provisional total debt service cost for 2011 was €5.4 billion (inclusive of €0.6 billion used from the Capital Services Redemption Account (CSRA)) and an increase of just over €1.1 billion on the 2010 figure, principally due to the increase in the amount of debt outstanding. Because of timing issues and the fact that a lot of debt issued in 2010 did not have coupon payments until 2011, a balance was carried on the CSRA at end-2010. This balance was unwound in 2011 to pay those coupons.

The spread on 9-year Irish bonds compared to the German 10-year benchmark equivalent stood at approximately 590 basis points at end-May. The estimated all-in fixed euro equivalent cost of funding under the EU-IMF programme in 2011 was 3.7% (The weighted average cost of funding raised from bond issuance in 2010 was 4.7%).



### **3. Chapter 4: Banking Stabilisation Measures**

Returning the banking sector to health is an area that has been a particular priority for the Government over the last year – we must have a financial system that supports a return to sustainable growth in the economy.

2011 was a year of significant progress in the banking sector and work in this area is continuing in 2012.

The key steps taken in the stabilization process during 2011 are set out in the attached presentations.

### **4. 2010 Finance Accounts**

The Finance Accounts were cleared by the C&AG on 9<sup>th</sup> September, 2011. No matters were raised under the “Report by Exception” category.

The Financial Outturn and matters relating to the General Government Debt are covered under Chapter 1 above.

The accounts for the 2011 calendar year are currently under audit.

### **5. €3.6bn error in debt statement**

#### **Background**

Towards the end of October of 2011, it was established in the Department of Finance that the General Government Debt figures reported to EUROSTAT in respect of the period to the end of 2010 overstated the debt figure because of double counting. The double count arose because money borrowed from the NTMA by the Housing Finance Agency (HFA) in 2010, which was already included in the National Debt, was incorrectly counted as further addition to Gross Government Debt (GGDebt). The reported figure for the end of 2010 was €148 billion, which overstated the correct amount by €3.6 billion.

Following the discovery of this statistical error, the Department arranged for both internal and external investigations into the issue.

The internal investigation, which was conducted by the Budget & Economic Division with the assistance of the Internal Audit unit, focussed on the examination of the specific events surrounding the statistical discrepancy.

The external review, which was conducted by Deloitte, focussed inter alia on the systems and risk controls relating to the all aspects of the compilation and presentation of the National Accounts and the EUROSTAT presentation of those accounts.

## **Findings of the reviews**

### *Internal Review*

The Internal Review produced findings under seven headings. Key findings are that:

- The possibility of a double count only arose when the HFA became part of the General Government Sector in March 2007.
- The discrepancy occurred for the first time in the European System of Accounts (ESA) returns made in Quarter 1 of 2007 by the CSO when there were double counts for December of 2004, 2005 and 2006.
- NTMA references during 2010 to cash placed with the HFA from the Exchequer should have prompted a response from the Statistics Unit in the Department of Finance that might have prevented the error. Correspondence within the Department in March 2011 should have prompted a reconsideration of the GGD calculation for end-2010.
- The calculation of GGD is carried out by both the Department of Finance and the CSO independently of each other with inputs from the NTMA and other agencies resulting in considerable duplication of effort between the two Offices.
- There was a shortfall in documentation setting out the specific roles of each of the Bodies involved in this calculation.
- The current systems carry a significant risk of errors or omissions occurring and this risk has increased considerably in recent years because of increased work pressures and a greater complexity of the GGD calculation process.
- There were questions about whether the NTMA correspondence was sufficient to alert the Dept of Finance Statistics Unit to the nature and scale of the change in the status of the HFA borrowing.

### *External Review*

The key observations of the External Review were:

- Calculation of GGDebt is a complex activity governed by a set of policies and statistical standards, EU regulations and ESA methods.
- Regular clarification is required as to the public bodies and items that should be included in the various elements of GGDebt reporting.
- By its nature there are multiple parties involved in the calculation and/or provision of input data.
- As this involves statistical reporting there are estimations involved, and hence regular revisions to adjust for updated information specifically bi-annual/quarterly revisions to numbers, retrospectively for four years. This is common across all countries.



- Given the significance of General Government Debt (and deficit) calculations and reporting, greater awareness amongst all Government departments, agencies and local authorities is required and this should form part of future budgetary/expenditure reform processes.

The External Review made 12 observations and 20 recommendations grouped under the following 5 principles:

- i) Effective organisational arrangements
- ii) Efficient process and systems
- iii) Clarity of communications
- iv) Appropriate resourcing
- v) Data integrity

### **Current position**

While the reports make a number of specific recommendations which are currently being acted upon, there are changes underway in the Department of Finance at a broader level that will help improve risk management.

The Department's current Secretary General has produced a new Statement of Strategy which was published on 10 May. A key part of this new Statement is an improved organisational structure to allow for a more efficient and effective Department, which is being rolled out over the next months. The new structure establishes four policy streams, focusing on: economics; budget and fiscal; EU and international; and financial services. These four policy streams will be supported by two units – one dealing with corporate affairs and one concerned with finance issues. An important part of the role of this new Finance Office will be risk management. The Department is working on improving enterprise risk management – developing processes to identify and address current, emerging and potential risks. The initial emphasis is on detailing risk assessment and risk management at all levels from Principal Officer upwards. In time, this will be rolled-out through the entire organisation.

The Head of the Finance Office will chair an inter-organisational group charged with the implementation of the recommendations of the reports and any other improvements required to ensure a fully robust process around the preparation of accounts in the future.

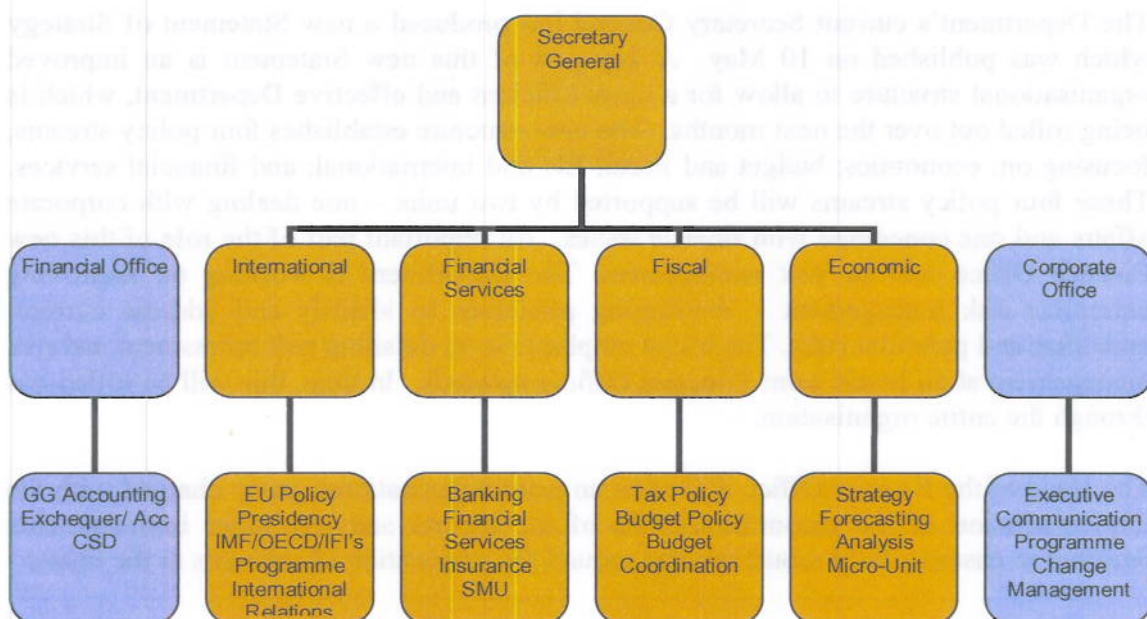
## 5. Other Issues

In addition to the above agenda items I would like to comment briefly on the following items which I feel might be of interest to the Committee or might have been referred to during my predecessor's meeting with the committee in July of last year.

### Capacity of the Department

Much comment has been made, both in at Committee fora and in the media regarding, the capacity of the Department. External reviews of the Department have made a substantial number of recommendations and these have, to a large degree, been accepted by the Department and progressed (establishment of a Fiscal Advisory Council, resourcing of the Department, restructuring of the Department, etc). However, I am also on record as saying that staff cuts and reduced resources have hamstrung the ability of this Department to achieve the goals set out by the Government.

With this in mind I sought an increased allocation for staffing for the period 2012-2015 which has been supported by the new Government. I have also just published an updated Statement of Strategy for my Department for the 2011-2014 period (copy attached with this letter). As part of this Statement of Strategy I am proposing some significant changes to the structure of the Department:

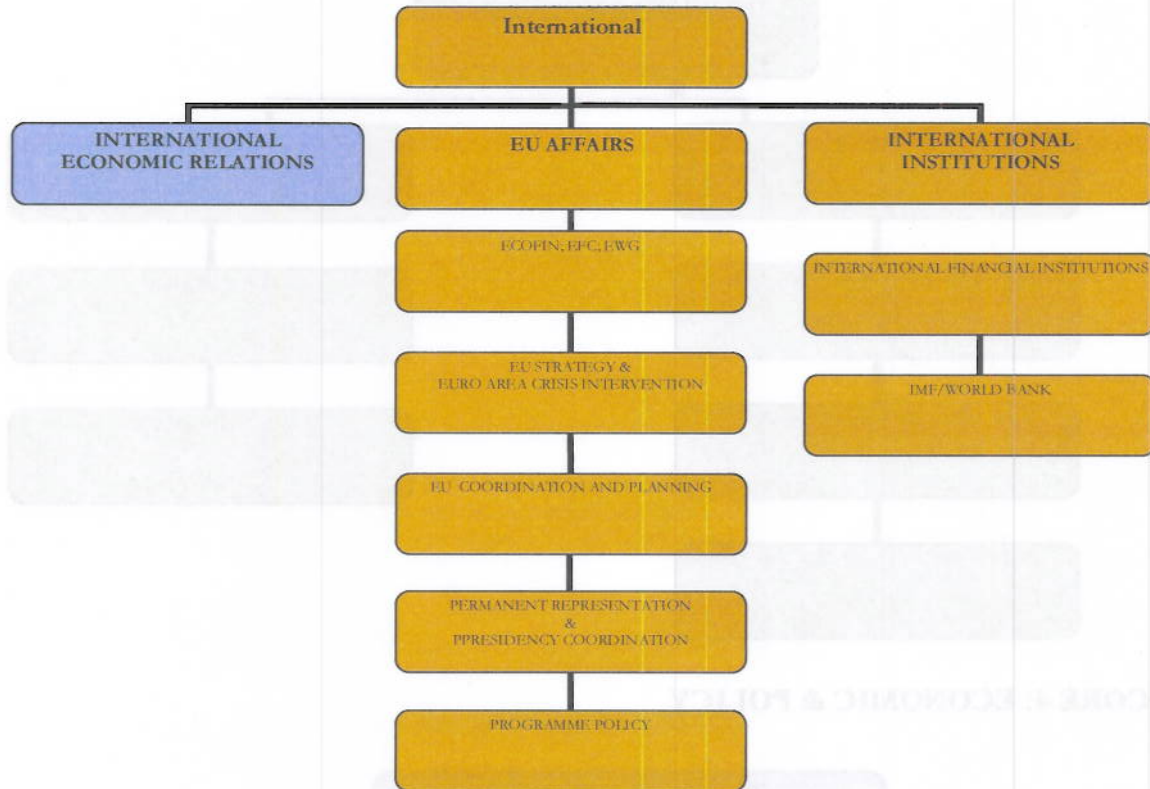


The Department will have a Corporate Office and a Financial Office, as well as Divisions based on core policy areas. The corporate and finance offices will provide services across the Department including finance, greater risk assessment, compliance, Government accounting and HR in the Financial Office, and communication, business planning and strategy, change management and programme monitoring in the Corporate Office.

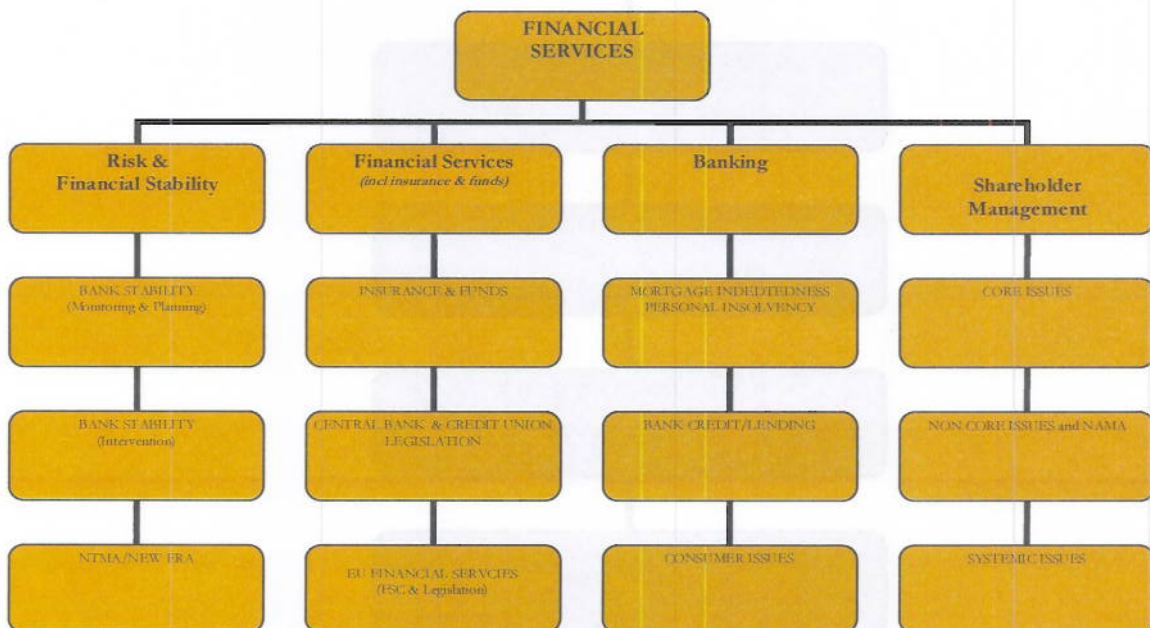


The Core policy areas will be structured as follows:

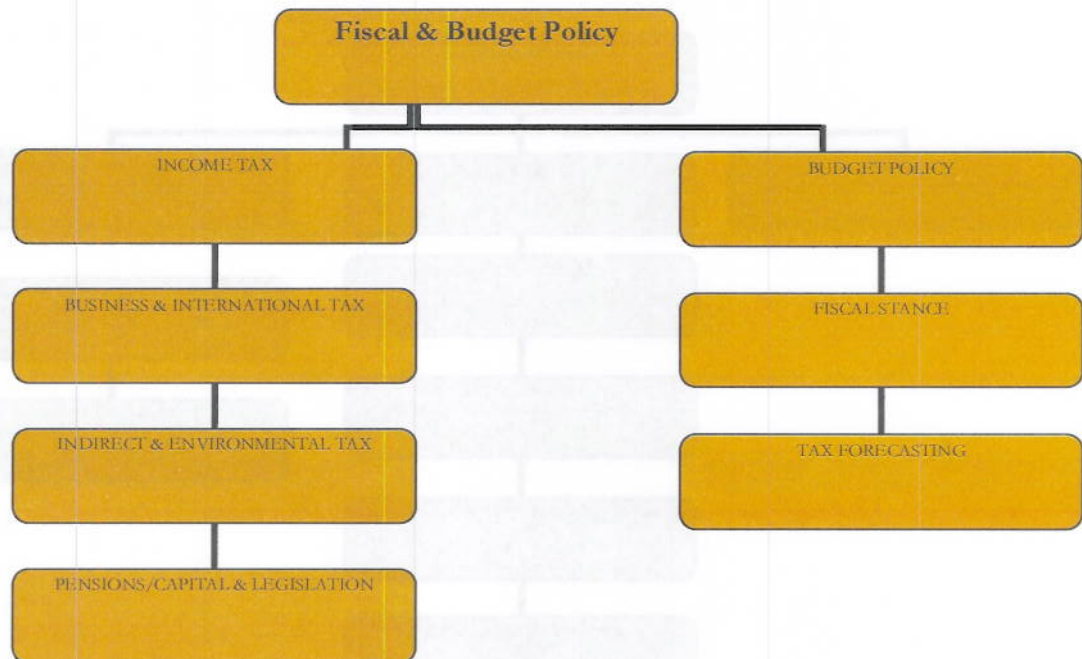
## CORE 1: INTERNATIONAL



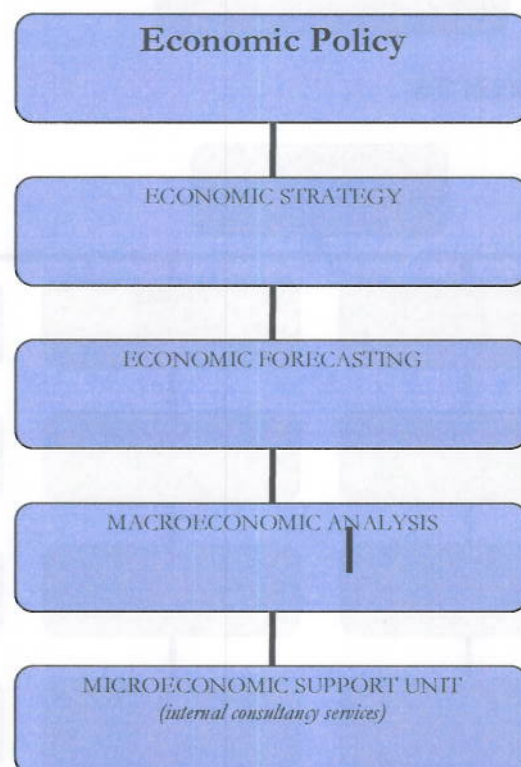
## CORE 2: FINANCIAL SERVICES



### CORE 3: FISCAL & BUDGET POLICY



### CORE 4: ECONOMIC & POLICY





At this juncture, we must re-optimize our resources by identifying our most significant initiatives and realign our resources in line with our revised and more forward looking strategic plan. Everyone throughout the organisation will be working to common goals and to finding the solutions which forward the attainment of our objectives. Given the limited financial resources available to us; this may involve giving greater priority to certain tasks and lesser priority to others but with a particular focus on initiatives which contribute to economic growth and recovery and which address the more ambitious targets included in our revised Statement of Strategy.

