Bundesrechnungshof

2019 Annual Report

on Federal Financial Management

Abridged version

Preface

The present volume contains those audit findings developed by the German SAI that are relevant for the granting of discharge by Federal Parliament (Bundestag) and the Federal Council of Constituent States (Bundesrat) to the Federal Government for FY 2018.

1 The German SAI's annual report volumes I and II – basis for granting discharge to the government

Whereas Parliament is responsible for budget preparation, government is responsible for the execution of the budget. Government has to ensure that the funds provided are duly managed according to the principles of efficiency, effectiveness and economy. After closure of the FY, government is held to account by Parliament and the Federal Council of Constituent States. To this end, the Federal Ministry of Finance submits the annual financial accounts. Following submission, Parliament and the Federal Council of Constituent States decide on granting discharge for the respective FY.

This report provides the basis for informed decision-making by Parliament about granting discharge to government. In our annual report, we especially state

- whether the amounts posted in the annual financial accounts tally with the amounts stated in the underlying accounting records and whether the audited revenues and expenditures have properly been backed up by vouchers;
- major cases where the audited entities have not complied with the applicable regulations and principles;
- the key findings generated by our audits of the management of government shareholdings in enterprises; and
- what steps we recommend for the future.

The President of the German SAI communicates the principal volume (autumn report) to government, Parliament and the Federal Council of Constituent States. Parliament refers our annual report to its Budget Committee. The Budget

Committee communicates the report to its sub-committee, the Public Accounts Committee (PAC) for deliberation.

At the same time, the German SAI presents the annual report to the public. The reports are also available on our website.[1]

The present principal volume contains findings on federal financial management and on trends in federal public finance and cross-cutting and government-wide audit findings and those related to the departmental budgets. In the spring of the following year, we report on further audit findings as appropriate. We use this option to report on current audit findings that have become available only after submission of the principal volume as input for the discharge procedure.

2 Audit findings foster governmental compliance and performance

The annual report contains those of our audit findings and recommendations that the executive branch has not taken up. They are thoroughly discussed by the PAC. The federal ministries are accountable to the PAC. The Committee usually invites the relevant policymakers to attend deliberations. In the vast majority of cases (more than 90 per cent), the PAC endorses our findings and recommendations. In these cases, it adopts resolutions requesting the government to implement our recommendations and to ensure that government operations provide good value for money and comply with applicable regulations.

The Budget Committee prepares the annual discharge decision taking into account the results of PAC deliberations on our annual report. Based on this, Parliament and the Federal Council of Constituent States decide on granting discharge to the government. They call upon the government to pay due regard to the resolution of the Budget Committee on our audit findings when preparing the budget estimates and implementing federal departmental budgets.

We follow up on whether the government has duly implemented the resolutions of the PAC. During this period, too, the respective federal ministries are

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[1] https://www.bundesrechnungshof.de

accountable to the PAC. Furthermore, the findings may serve as input for budget deliberations, thus influencing the appropriation of funds for the following financial year.

In many cases, the audited bodies directly implement our recommendations. If this is the case, audit findings and recommendations are not relevant for granting discharge to the government and are not included in our annual report.

3 The quality of audit findings is ensured by a structured procedure and the involvement of audited bodies

We are independent in the choice of what to audit and how to carry out audit exercises. As a rule, we take up audit requests made by Parliament and its committees.

In our audit work, we apply the criteria of performance, regularity and compliance as set forth in Art 114.2 German Constitution. Furthermore, we check whether the audited bodies have used funds in an efficient way and whether their programmes have actually accomplished the intended objectives. When auditing regularity and compliance, we check whether the audited bodies adhere to applicable standards and principles.

As a matter of principle, we communicate our audit findings to the auditees, e.g. the competent federal ministries, and ask them to comment on our findings, giving them the chance to explain the circumstances or to justify their actions. On this basis, we finally decide on our audit findings. We also decide on whether to include the audit findings in our annual report.

We keep an eye on any remedial action taken or improvements made by the audited bodies in response to our audit findings. We also verify compliance by the audited bodies with the requirements imposed by Parliament.

Our work is carried out in line with clear principles and free from any bias. We continuously adapt our methods where necessary. We do not evaluate policy decisions. However, we may audit and report on whether the assumptions underlying these decisions are accurate and whether a programme based on them has achieved the intended effect.

4 The German SAI advises government and Parliament

On the basis of our audit findings, we may provide advice especially to Parliament, the Federal Council of Constituent States, the government and individual federal ministries. We need to be consulted or informed in many cases such as the promulgation of grant funding guidelines by the federal ministries or changes of government shareholdings in companies incorporated under private law.

4.1 Special purpose reports pursuant to Art. 99 Federal Budget Code

At any time, we may inform Parliament, the Federal Council of Constituent States and the government of matters of particular importance (Art. 99 Federal Budget Code). Once our special purpose reports are forwarded to Parliament, the Federal Council of Constituent States and the government, they are also published on the internet.[2] Recently, we published special reports on various subjects:

- Special purpose report pursuant to Art. 99 Federal Budget Code on the need for a better legal and regulatory framework for the **dissolution of parliamentary groups in the Federal Parliament** of 4 September 2018. The report reveals considerable structural deficits in the procedures for the dissolution of parliamentary groups. There is a lack of clear statutory rules and government control. We have made suggestions how the legislator can improve and accelerate dissolution procedures.
- Special purpose report pursuant to Art. 99 Federal Budget Code on **coordination and steering to implement energy transition** by the Federal Ministry for Economic Affairs and Energy of 28 September 2018. The German SAI found that the Ministry did neither effectively coordinate nor adequately steer the energy transition process. Government will fail to achieve almost all energy transition targets set for 2020. We asked the government to change course. Otherwise energy transition threatens to fail, although costs and

[2] https://www.bundesrechnungshof.de/de/veroeffentlichungen/produkte/sonderberichte

expenditures of government and the consumers imputable to energy transition total at least €34 billion a year (in 2017).

- Special purpose report pursuant to Art. 99 Federal Budget Code on the federal budget **risks associated with the creation of a European Monetary Fund (EMF)** of 30 October 2018. The member states of the euro area are planning to reform the European Stability Mechanism (ESM). The European Commission even proposed to transform the ESM into an EMF. All reform proposals aim at providing stability support to more member states in a more timely and simplified manner and at expanding the tasks of the ESM. ESM funds would more heavily be relied on and weaken reform efforts of the member states. Against this background, the German SAI recommends to Parliament taking an active role in reform discussions at an early stage and to support government in negotiations at EU level. ESM as a remedy of last resort should focus on providing an adequate response in case of financial and currency crises in the euro area. Major decisions on how taxpayers' money is used should not be made without involving national parliaments.
- Special purpose report pursuant to Art. 99 Federal Budget Code on government targets guiding **negotiations with the Deutsche Bahn AG on the service level funding Agreement III for the existing railway infrastructure** of 7 December 2018. The German SAI found major systematic shortcomings in the government funding of the railway infrastructure. Government provides annual budget funds of several billions of euros to the subsidiaries of Deutsche Bahn for replacement investments, without being able to evaluate the value for money of federal funding or the success. Moreover, underlying agreements create incentives susceptible to lead to neglecting maintenance to the disadvantage of the government. Nevertheless, the Federal Ministry of Transport and Digital Infrastructure intended to structure Agreement III largely in line with Agreement II without substantial modifications.
- Special purpose report pursuant to Art. 99 Federal Budget Code on the structural **development of the Deutsche Bahn AG and focus on the government's interests** of 17 January 2019. Government and the Deutsche Bahn failed to achieve the objectives of the railway reform which was initiated 25 years ago. In particular, they did not manage to shift traffic from other modes of transport, especially the road, to the railway. Moreover, they failed to alleviate the strain on the federal budget. Based on the current

calculation method, the Deutsche Bahn currently has debts amounting to some 25 billion euros (June 2019). In addition, the Deutsche Bahn expanded its activities abroad and outside the rail business. In view of the German SAI, the government urgently needs to live up to its constitutional mandate and take due account of the interests and the transportation needs of the public and to act on its responsibility as the owner of Deutsche Bahn.

4.2 Advisory reports pursuant to Art. 88 para. 2 Federal Budget Code

We may provide advice in summarising our audit findings and recommendations also in advisory reports pursuant to Art. 88 para. 2 Federal Budget Code. The reports addressed to Parliament are thoroughly deliberated at committee level, especially in the Budget Committee and the PAC, its sub-committee. During these deliberations, decisions are also taken about the way in which our recommendations are to be implemented. As soon as a concluding debate has been held on the reports, we publish them in the internet, unless rights relating to personality, business interests or the public interest may be infringed. Advisory reports that have been made public so far are available on our website under “publications”.[3]

5 The Federal Performance Commissioner advises government and Parliament

By tradition, the President of the German SAI holds the ex officio position of Federal Performance Commissioner. One of the Federal Commissioner’s principal functions is to provide advice to government and Parliament on the impact legal provisions may have on government performance. For this purpose, government departments need to involve the Commissioner at an early stage in drafting bills, delegated legislation and administrative regulations.

[3] URL: https://www.bundesrechnungshof.de/de/veroeffentlichungen

General part

1 Findings on the government's annual financial accounts for FY 2018

We audited the annual financial accounts of the federal government for FY 2018. In doing so, we did not find any material differences between the figures stated in the accounts and those in the underlying records. This also applies to the off-budget federal entities. In order to verify the extent to which revenues and expenditures of the federal budget have been properly supported by vouchers and receipts, we used a mathematical-statistical procedure. Results showed that 2.19 per cent of the accounting entries were not properly supported by vouchers and receipts.

The 2018 Budget Act provided for revenues and expenditures of €343.6 billion without any net borrowing. One budget item was a withdrawal from the "asylum seekers and refugees" reserve in the amount of €1.6 billion. Due to the still favourable economic trend, lower unemployment rates and an increase in tax revenues, the planned withdrawal from the reserve was not necessary. Instead, €11.2 billion were transferred to this reserve. This increased the amount of the reserve to more than €35 billion at year-end 2018. In our opinion, a continuous increase of this reserve infringes the principle of annual budgeting.

In FY 2018, government's total expenditure including transfers to reserves was €348.3 billion. Thus, the budget targeted amount of €343.6 billion was exceeded by €4.7 billion. Without transfers to the reserve, expenditure totalled €337.1 billion. Revenues (without net borrowing and revenues from coinage) exceeded the budgeted amount by €4.7 billion. Debt cancellation, rescheduling, *refinancing etc. resulted in federal revenue losses of €3.6 billion. As budgeted, no new borrowing was required.*

The constitutional debt rule was complied with both in drawing up and in executing the budget. Arithmetically, the federal budget closed with a structural surplus of €6.9 billion. A revenue surplus of €10.9 billion was achieved.

Excess and extra-budgetary expenditures amounted to €0,6 billion. This amount was €1.8 billion less than in the previous FY. Unauthorised expenditures totalled €159,000.

At the end of FY 2018, €19.2 billion were available for carry-forward. The amount was similar to the previous FY. While funds eligible both for virements among programmes and for carry-over rose by €0.6 billion, other funds eligible for carry-over fell below the level of the previous FY by €0.4 billion.

Departments and agencies retained unexpended balances of €2.97 billion of a total of €3.19 billion of the expenditure authorisations eligible for virement among programmes and for carry-forward to FY 2018. This means that departments and agencies intended to rely on 93 per cent of the unexpended balances in future financial years.

The 2018 federal budget included commitment authorisations of €87.0 billion. Actual commitments made under these authorisations totalled €40.7 billion. The utilisation ratio was 47 per cent, which was 10 per cent below the level of the previous year. Under the commitments entered into, expenditures of €164.1 billion will have to be made in the coming financial years (as at 31 December 2018). This limits the budget legislator's leeway in the future.

The ceiling for warranties of the government and its off-budget entities totalled €1,128 billion. This included programmes to combat the European public debt crisis and the financial market crisis. Warranties in the amount of €482 billion were actually assumed up to year-end 2018.

The total amount of devolved funds increased by €269 million compared to the previous year's figure. It totalled €2.2 billion at year-end 2018 and comprised eight departmental budgets. As in the previous year, the major portion of this total was accounted for by departmental budget 30 (Federal Ministry of Education and Research) where these funds totalled more than €1.1 billion.

At year-end 2018, the valuated federal assets including those of the off-budget federal entities and trust funds totalled €272 billion. In particular, the capital account does not disclose or does not valuate real estate and infrastructure assets. One of the reasons for this is that the accounting rules do not yet cover non-departmental federal bodies e.g. the Institute for Federal Real Estate. For this reason, the capital account is still not conclusive. Federal debt (including reserves accrued for the payment of pensions and health care benefits) totalled €1,975 billion. Debt from borrowing including liquidity loans totalled €1,112 billion.

Setting up and managing off-budget funds is governed by rigorous criteria. In our view, a number of off-budget funds newly set up in recent years did not meet applicable criteria. For this reason, we were concerned about violations of the budgetary principles of unity and reliability. In some off-budget funds, expenditures were recognised at earlier dates before the payments were actually made or for future commitments. This violates the principle of annual budgeting and the validity principle. This is the case for the Energy and Climate Fund, the Local Investment Promotion Fund and the Digital Infrastructure Fund. As a rule, such expenditures should be part of the government's core budget and not be accounted for in an off-budget federal entity.

General part

2 Findings on trends in federal public finance – Times of budget consolidation at no cost drawing to a close

On 23 September 2019, the Senate, the supreme decision-making body of the German SAI, adopted the findings on trends in federal public finance. The reporting item reflects the status of budget and planning as at mid-September 2019. The findings have been updated to reflect the supplement to the 2020 draft budget estimates adopted by the government on 2 October 2019. The supplementary budget document sets out the financial impact of the federal climate protection programme. We will take a closer look at the different facets of the climate policy decisions in another audit exercise.

After a continuing robust economic growth since 2010, the pace is projected to slow somewhat down in 2019. While real economic growth in Germany has been at 2.2 per cent of GDP in 2017 and at 1.4 per cent of GDP in 2018, government expects an increase of 0.5 per cent of GDP for 2019. Estimates indicate a rise of 1.5 per cent of GDP for 2020 and the medium-term financial plan up to 2023 is based on an annual growth rate of 1.2 per cent of GDP. The slower upswing has some but no major impact on the federal budget. Tax revenues are projected to rise at a slower pace than in recent years. Given the stable employment situation, labour market expenditures are expected to remain at a low level. The rock-bottom interest rates help achieve the target of balanced budgets also in the course of the new financial plan.

In its 2020 government bill, for the sixth consecutive year, the federal government was able to present a budget in the black without the need for incurring new debt. Also, the financial planning period sees no need for any new borrowing. This planning scenario mainly draws on the migrant reserve to remove across-the-board spending cuts and impose new ones as appropriate to cover global budget shortfalls. There is no sign of any genuine consolidation efforts. Spending is still on the rise.

This means that expenditure on social security and relief grants to the federal states will continue to grow. New benefits such as those for families building a new home and the additional old age pension packages place a sustained burden on the federal budget and the pension funds. The overall analysis of subsidies we have repeatedly urged is still pending.

Over recent years, the government transferred even more expenditure to off-budget funds, a practice that had a major bearing on the budget. This has perpetuated the trend to appropriate and manage off-budget funds outside the regular core budget. As a result of this type of budgeting, allocations to the off-budget funds are recognised as actual expenditure in the current year, although the programmes for which they are designed are usually implemented and accounted for only in succeeding years. This violates the key principles of governmental budgeting such as annuality, completeness and transparency and the current- year principle.

A balanced budget without the need for new borrowing is no end in itself. Doing without new borrowing supports the long-term sustainability of public finances. The funds saved will be needed to cover emerging fiscal challenges. The 2020 draft budget estimates and the new financial plan up to the year 2023, however, are of limited value only for achieving this target.

As to the financial relationship of government levels, the government has by now taken over an overall budgetary responsibility and even fostered this trend of its own accord. As a result, the constitutional boundaries set to separate roles and funding of different government levels have largely been abandoned. The strengthening of the federal states' funding responsibility sought by the initial reform of the government system in 2006 has given way to centralised co-financing. This practice has been enshrined in the constitutional amendments as of 2017 and March 2019. All major components of the states' and local governments' portfolio have meanwhile been stepped up by federal grants – e.g. day-care services for children, nursery schools, schools, universities, public transport, local government investments, social welfare, domestic security, refugee grants or home building for low-income earners. Longstanding *underperformance of the states in the fields such as social and low-income housing or education infrastructure, is now rewarded by additional federal grants. The states have even demanded that the government also plays a role in paying off local governments' old debts.*

This has led to overlapping remits and funding among government levels and created opaque structures. The situation is not in line with the intent of the constitutional provision. Such a mix dilutes responsibilities and impedes the democratic sanctioning of policy decisions. In non-compliance with the Constitution, the tax shares of the two government levels are not calculated and revised periodically. In the year 2017, when the funding relationship of the two government levels was reformed, the federal states chose not to expand their options to generate tax revenue. As a result, this perpetuated an excessively strong financial dependence on the federal government. If the federal states are no longer free to generate revenues of their own, any sustainable and autonomous regional policy-making is put at stake.

The recent constitutional amendments also served to confer new governance and control functions to both the federal government for federal administration and to the German SAI. We wonder if such new functions are adequate. It is doubtful, if these amendments will help ensure a timely, proper and economic use of the grants given to the federal states and local governments. Our lessons learnt for example on implementing the higher education pact or the regionalisation of public transport indicate shortcomings in this area. We found that in a number of cases, the federal states employed the federal grants they had received for the purposes appropriated only with a delay of many years.

Since the year 2015, the federal government has provided major grants to federal states and local governments for the reception and integration of asylum seekers and refugees. To fund this task, the government gives a substantial additional share of turnover tax revenues to the states. Seen from a macroeconomic perspective, Germany has taken a leading role in the EU in receiving refugees, one major reason for this being its economic strength. In line *with the declining number of new refugees, the funds for this purpose have remained rather steady, however, at a high level.*

Given the manifold activities for which the federal government provides grants to fund state and local governments' core tasks, the federal government should not neglect its inherent functions. Key challenges emerging require sound and sustainable funding.

This particularly concerns the demographic change that will affect the federal budget in the medium term. Until the year 2023, expenditures on old age pensioners are projected to rise significantly. The pension package adopted by the former Parliament and other pension benefits adopted by the current Parliament will add to the burden on the budget. This is also true for the mothers' pension II. The introduction of a basic pension even without an eligibility check would also add to the spend. The law on improving benefits and stabilising the statutory pensions insurance stipulates that the contribution rate is to rise no higher than to 20 per cent by 2025. Also during this period, pension payments are to remain at the current level of 48 per cent of average income. Since these two limits have been set, funding risks are projected to emerge from the year 2025 for extra spend on pension insurance, i.e. the grant funded from the federal budget.

It is doubtful whether the current federal grant that has been awarded as a lump sum to statutory health insurance schemes to cover non-insurance benefits, will be high enough in the long term. This also concerns social care insurance to a higher extent than before which is currently not grant-funded from the federal budget. Funding challenges are growing from year to year for the care for the elderly, but government has so far chosen not to come up with support from another tax scheme. Hopefully the Commission set up by the government to deal with the sustainable generations' contract is able to develop sound solutions for this matter.

The 2020 draft budget estimates and the medium-term financial planning again provide for a higher level of funds towards public investments in transportation, digital and educational infrastructure. Long and cumbersome planning and approval procedures have caused a staggered outflow of the funds. The overall investment ratio, the portion of capital expenditure against the budget volume, continues to be much lower than the portion of social security expenditure. The European Court of Justice ruled that the private passenger car infrastructure levy designed to make transportation investments more user-funded violated European Union law and thus put an end to this initiative.

According to government plans, the solidarity surcharge is to be abolished. The government's draft legislation stipulates that sizing down the solidarity charge is to start from the year 2021 only, although the reason for implementing such a surcharge expires in line with the end of the Solidarity Pact II at year-end 2019. The reform of the financial relations between the federal government and the federal states as from 2020 will put an end to the constitutionally unprecedented situation. As a result, the back to normal situation requires other funding instruments for generating tax revenues than a surcharge. Still about half of the current solidarity tax is to be levied beyond the financial planning term. While the majority of taxable persons will no longer have to pay the surcharge, high income earners and companies will continue to be fully subject to corporate tax. The proposed introduction of tax thresholds would considerably impact on the progression levels of revenue tax. This step poses major constitutional risks. Should the regulation proposed not stand the test of the constitutional court, this would result in billions of euros of tax refunds for which no provisions have been made in medium-term financial planning.

Financial planning does not provide for adequate set asides to comply with international ratios targeted within the NATO alliance (NATO ratio) and for development cooperation (ODA ratio). As to the NATO ratio, no provisions have been made at all to achieve at least a rate of 1.5 per cent of GDP by the year 2024. To make better progress towards the 2.0 per cent of GDP initially planned would require earmarking considerably more funds for this purpose. As to the

ODA ratio, the funding earmarked in financial planning is too low to comply with the targeted portion of 0.7 per cent of GDP.

The volume of across-the-board spending cuts has significantly grown in the 2020 draft budget estimates and financial planning. Across-the-board spending cuts illustrate that Parliament does not make full use of its control powers over the budget, but lets the executive branch exercise part of Parliament's prerogative powers. We therefore suggest that during the next budgetary deliberations, across-the-board spending cuts be preferably replaced by budget cuts in individual departmental budgets. This recommendation also applies to the update of the financial plan in the next year.

At the European level, the federal government will also have to cope with medium-term and long-term funding challenges. These include the resolution of the mechanism to combat the European sovereign debt crisis, the impact of the Brexit and the new financial planning period for the EU budget from 2021 to 2027. Additional financial burdens may result from the reform of the European Stability Mechanism (ESM). The ESM is to be strengthened and, in particular, provided with additional authorisations for assistance in the banking sector. Proposals also aim at facilitating access to ESM funds. On the whole, the reform is likely to lead to a greater reliance on the financial resources of the ESM, increasing the risks of defaults and of disincentives.

Beyond the financial planning period, which is in any case burdened with current obligations, government will have to shoulder major expenses to abide by its pledges made when adopting the phase-out of lignite-fired power generation. Nuclear waste disposal might also pose a risk to the federal budget if the funds paid into the public law fund for the financing of nuclear waste disposal turn out to be insufficient.

To address these challenges, an active and agile financial strategy is needed. A financial policy that evenly spreads funds across the board is no viable solution. The strategy now needed is one where reasonable and proactive priorities are *set. In addition, in the next years, the government needs to ensure or open up enough room in the budget to shape public budgeting and finance. A promising approach would be to review the added value of numerous tax subsidies granted to various interest groups. Although in its subsidy policy guidelines, government has committed itself to conducting periodic reviews including the progress made towards sustainability, it has limited this review to the schemes covered by the subsidy report. As a result, hardly any subsidy has been removed by now. On the contrary, the law on tax incentives for building rental homes and the tax incentive bill for research and development add to the number of subsidies.*

In the financial planning period up to 2023, structural borrowing governed by the debt rule is projected to remain below the ceiling of 0.35 per cent of GDP. The decline in new borrowing since the debt rule has become effective in 2011 is attributable to the favourable macroeconomic environment and very low interest rates. The real test of the debt rule is yet to come. In the 2020 draft budget, public debt will move closer to the ceiling set since a component of the constitutional debt rule takes into account cyclical trends. This component is currently positive and thus restricts the scope for new borrowing. Also withdrawals from off-budget funds must be taken into account since those operations lead to a negative net financing balance. The merit of the debt rule is that it highlights emerging financial constraints.

The 2020 draft budget does not provide for net borrowing in the ordinary core budget. One reason for this is the use of €9.2 billion of the migrant reserve. In addition, the expenditure from the Special Energy and Climate Fund is to be covered primarily by a withdrawal of €6.0 billion from the Fund's reserve. Against the background of the projected financing balances within the trust funds on Energy and Climate, reconstruction grants, local investment promotion, digital infrastructure and all-day schools, net borrowing governed by the debt rule amounts to €6.2 billion. The migrant reserve drew on surpluses of the budgets 2015 to 2018 and had a volume of €35.2 billion at the end of 2018. The 2019 budget provides for spending of €5.5 billion. The remainder is to cover the borrowing needed to balance the 2021 and 2022 budgets. These will not impact on the ceiling permitted under the debt rule. As a result, the budget will be *balanced in the financial planning period. Loans to cover spending and the negative financing balances in the trust funds must be taken up, but they are not relevant for net borrowing.*

Consolidation requirements are concealed by these operations. As a result, there is no room left for repaying old debts – in excess of the potential central bank profit of more than €2.5 billion: In the cyclical upswing, in the FYs 2015 to 2018, funds were allocated to the reserves so it was not possible to lower debt accumulated under the investment and repayment trust fund that had been set up in the economic and financial crisis (2009) of currently around €19 billion.

It is no sound approach to consider amending the debt rule in order to fund investments from loans. Since the implementation of the debt rule in 2011, the trend in expenditure has illustrated that investment efforts can be strengthened within the scope of applicable constitutional debt regulations. The legislator has the final say on setting budgetary priorities within the limits of the debt rule. There is no need for inserting clauses into the Constitution to privilege specific expenditure items.

Since FY 2012, the federal government has used the top-down procedure to draw up its draft budget and financial plan. In addition to that, substantive spending reviews have been taken into account since the 2016 preparation of the budget. In the course of the 2020/2021 budget preparation, a spending review is to be conducted on "training, return to work and business start-up". As in the years before, the German SAI is ready to monitor the relevant impact analysis and provide professional advice.

Government expects social security expenditure to rise further despite the favourable overall economic trend. In accordance with the 2020 draft budget, social security expenditure amounts to €183.9 billion. This is more than half the budget total. Until the end of the financial planning period in 2023, social security expenditure is expected to reach €198 billion. Then, the social expenditure ratio would rise to 53 per cent. Federal funding for grants to pension insurance and *relief grants to local governments for social welfare also add to social security expenditure. The implemented rise in child benefits and tax relief for parents is not even included in this scenario since the schemes are recorded as tax revenue shortfalls in wage and income tax. The same applies to turnover tax allocations that the federal states receive for social security purposes. In the financial planning period, the investment ratio will remain below 11 per cent.*

Government grants to the statutory pension insurance scheme are the largest item in this expenditure category. These grants are expected to rise from €98.0 billion (2019) to €115.7 billion (2023) which would make up 30.8 per cent of the budget total (2019: 27.5 per cent). This amount does not yet include the annual transfer of €2.0 billion to the pension provisions to meet the pension costs of an ageing population. Pension liabilities taken alone make up three times the total of investments proposed.

Due to the stable situation at the labour market, the burden on the federal budget and the Federal Employment Agency's budget decreased significantly. Therefore, government cut unemployment contributions by 0.5 percentage points to 2.5 per cent as from 1 January 2019. Labour market expenditure will continue to remain at a low level in the 2020 draft budget and the financial planning – despite additional expenditures on employment promotion. As a result, in the 2020 budget estimates, labour market expenditure is expected to rise only slightly until 2023.

With €14.5 billion a year, grants awarded by government via the health care fund to the statutory health insurance schemes remain high. The financial situation of the health care fund and the statutory health insurance schemes is still robust. In some sectors of health care, however, expenditures are on the rise, partly due to the demographic development. This increase has so far been set off by the positive trend in contributions received and federal grants. However, funding needs for major expenditure items – such as ambulant and hospital treatment and medication – are likely to increase further. This will add to the burden on the federal budget. It is doubtful whether the amount of federal block grants awarded to statutory health insurance schemes to cover non-

insurance benefits will then be high enough. As yet, the federal grant has not been determined on the basis of a meaningful calculation of non-insurance benefits by the statutory health insurers.

For a number of years, government has benefitted from a low level of interest expenditure due to positive refinancing conditions. Overall, the federal budget benefits from interest expenditures which are significantly lower than earlier planning indicated: For the period from 2014 to 2022, the reduction totals almost €130.5 billion. The interest tax rate, i.e. the portion of tax revenue needed to cover interest expenditures, has reached a historic low. At the end of the financial planning period, the interest tax rate will fall below 5 per cent (2023). This is below the 1976 level – however, with a current public debt ratio which is three and a half times higher than in 1976. Due to an annual gross borrowing averaging some €224 billion, the interest rate exposure will remain high in the financial planning period.

According to the estimation of taxes presented in May 2019, tax revenue of all public budgets is expected to further increase even though not as much as in recent years. Between 2020 and 2023, annual tax revenue is to rise by approximately 9 per cent. If the taxes are not cut substantially, the taxation rate could reach 23 per cent of GDP until the end of the financial planning period. If you take into account the partial abolishment in the solidarity surcharge, the rate would be at 22.8 per cent of GDP. Compared to 2017 (22.4 per cent), this would mean another increase of 0.6 per cent or 0.4 per cent, or some €24 billion or €16 billion. The federal government, however, would benefit less from this development since it has to transfer an ever-rising portion of turnover tax revenue to the federal states and local governments. Another reason is the partial abolishment of the solidarity surcharge. The planning reserves provided for this partial abolishment have not been recorded as tax revenues in the financial plan. As a result, tax revenues have been overstated in the financial planning period from 2021 to 2023.

After 2021, due to the Brexit and the new EU financial framework, the portion of tax revenue transferred to the European Union might surge compared to the *estimation of taxes. According to the financial plan, tax revenue transferred to the European Union will rise from €36.3 billion in the 2019 budget to €46 billion in the 2023 budget (including customs). The negotiations on the EU financial framework from 2021 to 2027 will show if this amount is sufficient. The introduction of a tax on financial transactions in the European Union planned for 2012, continues to be delayed. After many years of deliberations at European level, an agreement is not expected any time soon.*

In the wake of the restructuring of the fiscal relations between the federal government and the federal states, federal supplementary grants in the vertical financial equalisation system will rise significantly from €7.7 billion in the 2019 budget to more than €10.3 billion in the 2020 draft budget. Until the end of the financial planning period, supplementary grants to the federal states are projected to grow up to €11,5 billion. On top of that, the federal government has chosen to transfer an annual portion of turnover tax of €4 billion to the federal states as from the year 2020.

Compared to the previous year, federal debt including off-budget funds, is expected to slightly fall again by year-end 2019. Federal debt has thus constantly been decreasing since 2014. The debt incurred by ailing banks that was assumed by the federal government in order to overcome the economic and financial crisis persists even though the level has fallen. The question as to what extent such obligations will keep debt levels high in the long term can only be answered once all support schemes not taken into account in the current financial planning period have been phased out.

Apart from the guarantees set out in the Federal Budget Act, the federal government made guarantee commitments towards the European rescue funds. Such commitments are to support action taken to provide financial assistance to some euro area countries. So far, this has not placed a major burden on the federal budget. Whether this will remain the same in the future particularly depends on whether Greece, the major beneficiary of such operations, will succeed in pursuing its reform path set and repay the loans received to the rescue funds. Most of them are long-term loans with low interest rates.

The frameworks adopted when and after introducing the common European currency aim at supporting sustainable public finances and structural reforms in the member states of the euro area and in the other EU countries. The major spending items are constituted by the Stability and Growth Pact and the Fiscal Compact.

It is imperative to meet these rules in order to sustainably reduce the risk of a new sovereign debt crisis in the European Union. Over recent years, large discretionary scopes were used and no sanctions were imposed in case of non-compliance with the ceiling set by EU rules. The federal government should urge the European Commission to take a more uniform approach in enforcing compliance with the fiscal rules by the member states. The European Public Sector Accounting Standards (EPSAS), on the other hand, which the European Commission plans to introduce to strengthen budgetary control, seem to be inappropriate to strengthen budgetary discipline in Europe. Thus, we warned against compulsory implementation of EPSAS in all EU member states and especially in Germany.

According to the preventive arm of the Stability and Growth Pact, the structural deficit in Germany shall not exceed 0.5 per cent of GDP over the medium term. The ceiling has not been exceeded by German public bodies since 2012. Current projections show that this limit will also not be exceeded in the period of medium-term financial planning. In terms of public finances, Germany is one of the most robust EU member states. With a steadily decreasing public debt ratio since 2012, by year-end 2019, Germany will meet the European debt ceiling of 60 per cent of GDP for the first time ever since 2002. To ensure room for spending in public budgets, this positive trend should be continued and underpinned by a sustainable fiscal policy. The recommendations of the EU Council adopted as part of the European semester can be of help for this approach.

Monitoring domestic adherence to the ceiling of structural macroeconomic funding deficit is a task incumbent on the Stability Council. In this function, the Council is assisted by an independent advisory council. The advisory council of the Stability Council rightly notes, that for reasons of fiscal policy transparency and accountability, data on all federal states should be made public to monitor compliance with the debt rule.

The federal government has significantly contributed to the positive trend of all public budgets by providing a variety of grants to the federal states and local governments. As a result, the federal government finds itself with little room to spend. In the light of the mid-term and long-term challenges emerging, in the future, the government should place focus on maintaining and strengthening financial sustainability of federal finances.

Audit findings on federal government departments and agencies

Federal Ministry of the Interior, Building and Community
(Departmental budget No. 06)

3 IT system for federal building projects delayed for years

The Federal Ministry of the Interior, Building and Community does not have a full overview of federal building projects. For a number of years, the Ministry has delayed developing an IT system designed to manage key project data sets of all federal construction projects. In the absence of such an IT system, the major information basis for reforming federal construction activities is lacking.

We expect the Ministry to avoid further delays, make developing the system a key priority and set a clear timetable.

4 Wasting millions on federal government apps

Several federal authorities spent €4.9 million on offering apps services without having substantiated the need for them or their value for money. Nor did the authorities evaluate the success of marketing such apps. In doing so, they infringed fundamental budgetary rules and regulations. In many cases, they did not comply with procurement law. The apps were designed to provide information about government-related topics. Costs of developing the apps totalled €2.3 million. Advertising and operating expenses amounted to another €2.6 million.

We urged the authorities to substantiate at least retrospectively the current market demand and project efficiency. If the exercise does not produce a positive result, the authorities are to discontinue offering the apps. The authorities may continue to offer an app only if such activity does not cause any further costs.

Being a part of the federal government, the Ministry is entrusted with promoting digital transformation and modernisation government-wide. The Ministry needs *to ensure that the audited bodies provide the justifications required without delay. The Ministry also needs to instruct all federal authorities that seek to offer an app to substantiate efficiency and market demand and to meet the provisions of procurement law.*

5 Concerns about thick allowance jungle

The rules and regulations governing federal civil service allowances are far too complex and inconsistent. 19 different functional allowances and 27 different severity allowances, each with hundreds of subtypes, create a highly complex and baffling system. This undue complexity often results in excessive administrative workload and erroneous payments often at the expense of the staff concerned.

So far, the Ministry has failed to conduct a mapping exercise of the system. The Ministry should review the system without delay to revise and abolish allowances no longer needed.

Federal Ministry of the Interior, Building and Community

(Departmental budget No. 06)

Federal Foreign Office

(Departmental budget No. 05)

6 Ensure consistent application of Schengen security rules

In recent years, the Schengen states have failed to carefully and properly check visa applications and individuals entering the area.

The Schengen area encompasses 26 European countries, including Germany. Within the Schengen area, all travellers from non-EU countries may move freely without border control. To make up for this, the Schengen states have agreed to set up a security regime to harmonise the rules governing the entry to the Schengen area and Schengen border controls. This particularly includes uniform legislation governing visa issuing and minimum border controls. The two tasks lie within the remit of the national authorities of the Schengen states.

The shortcomings of current checks of visa applications and individuals from non-EU countries entering the Schengen area need to be addressed not only with the aim to ensure compliance. Such shortcomings may jeopardise public safety and order and undermine public trust in the Schengen system. They ultimately jeopardise the principle of free movement of persons in the Schengen area.

We therefore urged the Federal Ministry of the Interior, Building and Community and the Federal Foreign Office to engage with authorities at EU level to ensure proper and consistent implementation of the Schengen security system. At the same time, government departments need to ensure that German authorities comply with the harmonised set of rules.

7 Federal Office of Administration: Deficiencies in terms of office location strategy and organisational structures

The Federal Office of Administration should enhance organisational and operational structures and resume work on its office location strategy immediately. In doing so, the Ministry should comply with the resolution of the parliamentary Budget Committee.

The Office has branch offices at 20 differing locations. These are spread on 26 premises all over the country. As early as in 2011, the Budget Committee took up our audit recommendations and demanded the Federal Ministry of the Interior (now: Federal Ministry of the Interior, Building and Community) and the Office to develop an overall office location strategy providing value for money for its branch offices. The Office was demanded to take steps to enhance organisational and operational structures. At that time, the Office had two premises at its headquarters in Cologne and seven branch offices spread across Germany. Since that time, the Office significantly ramped up the number of branch offices, functions and staff. Several years ago, the Office reached agreement with the Ministry to suspend the required office location strategy initiated in 2012. The Office also failed to enhance its organisational and operational structures. The Office ignores the requirements set by the Budget Committee. The Office is unable to submit evidence that the branch offices are an efficient option.

Federal Ministry of Finance

(Departmental budget No. 08)

8 Need for enhancing programme evaluations of KONSENS project

The Federal Ministry of Finance needs to enhance the basis for evaluating the results of the KONSENS project (German abbreviation for coordinated new software development of tax authorities). Otherwise, the Ministry will not be able to timeously detect and advert undesirable trends in developing the tax software project.

The KONSENS project is a joint effort of the federal and state governments to develop and implement a high-performing tax system. The uniform system is to enhance the quality of tax enforcement. In the future, tax revenues of more than €600 billion are to be assessed and collected in an efficient manner. The Ministry seeks to accelerate the project. To steer a key project of that scale, the Ministry should also carry out concurrent programme evaluations. However, the Ministry lacks the basis for such evaluations. The Ministry needs to set measurable targets for all KONSENS processes critical to project success, such as nationwide roll-out of the software.

Federal Ministry of Finance

(Departmental budget 08)

9 Fuel subsidies for public transport operators: No incentive to use low-emission vehicles

Fuel subsidies to public transport operators are paid from the federal budget. This practice is in conflict with the government's environmental and climate targets.

The aggregate tax relief hits €1.2 billion for the period starting in 2000. As this subsidy is in line with actual fuel consumption, tax relief granted to transport operators using low-emission and low-fuel vehicles is lower than to those using more fuel-consuming vehicles. The subsidy thus does not encourage operators to *use low-emission vehicles. Still, the Ministry has not provided any evidence proving that the subsidy strengthened local transport services and encouraged private vehicle owners to switch to public transport.*

We recommend abolishing this tax relief. The subsidy could be replaced by incentives that take into account the pollutant category and energy efficiency of the vehicles used. On this front, financial assistance should be preferred over tax subsidies.

The Ministry should also ensure that the applications for tax relief are processed more thoroughly and that field inspections are regularly performed at recipient transport operators.

Federal Ministry of Labour and Social Affairs
(Departmental budget No. 10)

10 Flawed processing of old-age pensioners′ health insurance schemes

Overstated payments running into tens of millions annually made by the pensioners' health insurers could be avoided if the health and pension insurers better aligned their actions.

Statutory health insurers regularly send retrospective alerts to the pension insurers if a pensioner's membership has changed from voluntary to mandatory status. In such a case, the pension insurer needs to claim back compulsory health insurance contributions not withheld and wrongly paid contribution subsidies. This creates red tape and reimbursement efforts are often futile.

We had recommended modifying the procedure. We suggested that the pension insurance scheme should pay health insurance contributions directly to the health insurer also in the case of pensioners having a voluntary membership. The pension insurer could then set off outstanding receivables from the relationship with the health insurer.

So far, the Federal Ministry of Health and the Federal Ministry of Labour and Social Affairs have not reached agreement on a new procedure. The Health Ministry fears that an amended procedure could lead to losses in health insurance revenues, and the Labour Ministry believes that the pension scheme's administrative burden could increase.

We recommend that the two ministries agree on a solution satisfactory to both sides.

11 Inadequate audit of annual financial statements of the statutory pension insurance

The Ministry should instruct the pension insurance to ensure that its annual accounts are audited by an independent audit company in compliance with recognised auditing standards.

At present, the annual accounts are examined by the internal audit function. Internal auditors are indirectly subordinated to the governing board which is responsible for preparing the annual accounts. Hence, the internal auditors are not independent. Their work is not subject to recognised auditing standards. Not all of the internal audit units possess the expertise required for this job (e.g. in business economics, asset management and IT).

The Ministry should adopt an ordinance making it mandatory to rely on an independent audit body and to comply with recognised standards.

12 Excess management staff at the Federal Employment Agency

At almost one third of the Agency's field offices, the head of unit directly reports to the head of office. This one-tier reporting system has been in place since the Federal Employment Agency significantly reduced the field offices' functions. The Agency failed to adapt its organisational set-up accordingly. There are no compelling reasons for the use of a one-tier reporting system.

Federal Ministry of Transport and Digital Infrastructure

(Departmental budget No. 12)

13 Deutsche Bahn refuses to provide information on the sale of electricity to private customers – federal government tolerates this illegal practice

Government tolerates the fact that Deutsche Bahn stock corporation of which it is the sole shareholder refuses to disclose to us information on their business activities. Deutsche Bahn has the statutory duty to make available such information. This duty is also set forth in their articles of association. Without such information, we cannot audit governmental shareholding management activities at Deutsche Bahn.

We examine federal government mission performance, as the owner of Deutsche Bahn in the sale of electricity to private customers. Government officials were unable to answer all our questions. We therefore turned to Deutsche Bahn that refused to provide any response. For this reason, we had to suspend our audit work.

Government is aware of the fact that Deutsche Bahn refuses to provide the required information. Government did not support us in enforcing our audit access. We hence urged government to ensure that Deutsche Bahn complies with its duty to provide the required information promptly and to enable us to fulfil our constitutional audit and advisory mandate.

14 The Ministry impedes our audit work at Deutsche Bahn

For a number of years, the Federal Ministry of Transport and Digital Infrastructure has failed to fully account to us in a timely manner on its railway shareholding activities. The Ministry has the statutory duty to send us documents of the supervisory board and own reports within three months after certification of financial statements. The Ministry does not meet this obligation at all or only with significant delay. These shortcomings concern the parent enterprise, large subsidiaries such as the DB Fernverkehr AG and the DB Netz AG and federal shareholdings abroad.

The Ministry thus impedes our audit work on federal shareholdings at Deutsche Bahn and its 680 subsidiaries located in more than 140 countries. As a result, we *are not in the position to properly provide advice to Parliament and government. We urge the Ministry to meet its reporting and accounting obligations with regard to Deutsche Bahn and its subsidiaries in due course.*

15 No evidence of efficiency: Planned public toilets at motorways cost over €80 000 per cabin

The Ministry sticks to its plans to build oversized high-tech toilet facilities in unmanaged rest areas near federal motorways in the federal state of Lower Saxony. In addition to that, the Ministry plans to contract out another eight toilet facilities with six cabins each totalling some €4 million. Total costs per cabin thus amount to more than €80 000. The Ministry neither analysed efficiency of the project nor explored other options. We found that the facilities were susceptible to malfunctioning and required extensive maintenance. We urged the Ministry to acquire more toilet facilities only on the basis of the project's proven efficiency compared to other options.

16 Unduly burdening of the federal budget: flawed accounting on road operation by the federal states due to the Ministry's framework

Drafting a new booklet of specifications for the operation of trunk roads will not prevent the federal states from making errors in accounting for their inspection work and unduly charging expenditures to the federal government.

The federal government conferred the operation of trunk roads to the federal states. The current booklet of specifications provides a detailed description of the federal states' tasks and functions. The specifications are used as a starting point for recording all activities performed by motorway maintenance agencies and road maintenance depots. It is the basis for balancing accounts between the federal government and the federal states' public roads administration.

In the current booklet of specifications, the Ministry draws a clear distinction between maintenance and inspection activities (e.g. inspection of routes and bridges). The Ministry does not apply any other categorisation or grouping of *tasks. The federal government and the federal states are currently updating the booklet of specifications. We repeatedly urged the Ministry to stipulate in the new draft that the federal states remain responsible for inspecting trunk roads and that they need to record their work as administrative services. The Ministry rejected our recommendation. After responsibility for federal motorways is conferred to the federal government, the current practice will still put inadmissible burdens on the federal budget of €7 million per year.*

Federal Ministry of Defence

(Departmental budget No. 14)

17 Ensure staff integrity and efficient accommodation of the quality assurance unit

The fact that quality assurance staff of the German Armed Forces have their offices in the inspected enterprises is likely to lead to conflicts of interest and is highly expensive in a number of cases.

The quality assurance unit is responsible for assuring the quality of defence materiel. Many quality assurance teams have their offices in the buildings owned by the enterprises whose products and services are to inspect. Rental costs are not transparent in many cases as there are no separate rental contracts. In most of the remaining cases, the amount of the rent paid is excessive. There is a potential for considerable savings.

In order to ensure staff integrity, inspection staff should, possibly, not be accommodated in the buidlings owned by the inspected enterprises. As long as this practice continues, the Ministry should ensure that separate accommodation contracts are concluded. Office space should preferably be located in federal real estate. Where offices need to be rented from the private-sector housing market the rent paid must not exceed local market levels.

18 PUMA armoured infantry fighting vehicle still without combat simulator

The Armed Forces incurred avoidable costs of €46 million and time overruns in developing the PUMA combat simulator. Without a simulator, training is only possible in the PUMA vehicle itself. This causes additional wear and tear and maintenance expenses.

As to the former MARDER infantry vehicle, the Armed Forces use simulators that are permanently mounted into containers. Simulators serve to enhance training quality. In addition to that, it is less costly to use simulators instead of large defence vehicles for training. The simulator for the new PUMA vehicle was to be installed in the vehicle itself and not in a container. Costs incurred for developing and procuring the new simulator technology have hit €105.7 million so far.

Since 2006, the army has been profoundly concerned that using the PUMA vehicle as a simulator station is no good and feasible solution. We highlighted already in 2010 that the Armed Forces had not explored the container-based option. Despite such concerns, the Armed Forces stuck to its plan. We again stated our concerns in 2018. Following extensive testing, the army declined to install the simulator in the PUMA vehicle in 2019. The Armed Forces can only partly reuse existing simulator assets. Simulator assets worth €46 million remain unused. Although the Armed Forces have operated the PUMA vehicle since 2015, a training simulator is still not in place. The Armed Forces will now develop and procure a simulator at extra cost and time.

19 Armed Forces still make mistakes in calculating pay of fresh recruits

The Federal Ministry of Defence did not adhere to its promise to bring erroneous military pay to a stop. It is time for the Ministry to put effective control mechanisms into place to ensure an accurate military pay of all soldiers.

As early as in 2013, we stated in an annual reporting item that in a number of cases the Armed Forces had committed errors in determining pay bands and *grades. As a result, the Public Accounts Committee demanded the Ministry to ensure accurate pay to soldiers and to implement effective control mechanisms.*

Federal Ministry for the Environment, Nature Conservation and Nuclear Safety

(Departmental budget 16)

20 The Ministry for the Environment, Nature Conservation and Nuclear Safety needs to support adaptation to the impacts of climate change in an effective way

Since the year 2011, the Ministry has grant funded programmes designed to adapt to the impacts of climate change without analysing programme effectiveness.

The grant programmes met with little demand only. By 2016, a mere €12.6 million had been called up which is 30 per cent only of the €41.2 million earmarked for this purpose. Since no measurable targets were in place, the Ministry was unable to review programme achievements. Most of the grants were spent mainly on strategies and educational courses. The Ministry even failed to review whether the programmes had been implemented.

At the earliest in 2020, the Ministry plans to refine grant funding and to explore ways to set more specific targets and to measure target achievement. The Ministry should promptly realign its grant programme, exploring ways to effectively support steps to adapt to the impacts of climate change. In doing so, it should bear in mind that responsibility for such adaptation programmes lies in the first place with the federal states and local governments. If the Ministry intends to pursue this grant programme it should duly take into account their programmes and activities designed to adapt to the impacts of climate change.

Federal Ministry for the Environment, Nature Conservation and Nuclear Safety

(Departmental budget No. 16)

21 Federal Office for Radiation Protection neglected IT security for many years

The Federal Office for Radiation Protection has not yet addressed security shortcomings detected in 2008. The Office needs to enhance and ensure sustainability of IT security and contingency planning.

In case of a radiological emergency – e.g. after a reactor accident – the Office assesses and projects the impact on the population and the environment and issues safety recommendations. The Office also keeps the records on highly radioactive sources and the level of radiation to which some 400 000 citizens are exposed at their workplaces. The Office therefore needs to ensure a secure and highly available IT system, particularly with regard to a potential contingency.

As early as in 2008, we identified IT security weaknesses at the Office. For example, the IT security strategy was patchy and workplace computer interfaces were not safe. In 2009, the Office pledged to address the weaknesses we had detected. However, the Office has not taken action for more than ten years. In 2018, we found additional IT security weaknesses. For example, the Office did not have a contingency response plan in place.

The Office needs to promptly eliminate security vulnerabilities and live up to its 2009 pledges. The Office has to set up, implement and regularly update its strategies, including the contingency response in case of disasters.

Federal Ministry of Education and Research

(Departmental budget No. 30)

22 Federal government made excess payments of about €20 million for construction projects run by the Fraunhofer Society

The federal government overstated the federal budget share in grants towards construction projects run by the Fraunhofer Society (a German research organization) by €20 million or more. The overstated amount should have been borne by the federal states.

The Ministry and the federal states jointly fund the Fraunhofer Society. 90 per cent of the expenditures on construction works valued at less than €1 million are funded from the federal budget. The federal funding share for large-scale construction works exceeding €1 million is 50 per cent. The Fraunhofer Society has sole responsibility for running small-scale projects, but major projects are subject to approval by the Ministry and the federal states.

The Fraunhofer Society carried out large-scale projects applying the rules of small-scale projects. Government hence bore a portion larger than permitted of the costs. The Fraunhofer Society's documents on our audit sample show that between 2013 and 2017 the excess amount borne by the federal budget totals €20 million or more. The Fraunhofer Society formally ran major projects as small-scale projects and did not submit them to the approval of the Ministry. As a result, the Ministry was not in the position to play an active role in project implementation.

We urged the Ministry to ensure that it only bears the costs properly chargeable to the Ministry and that the Fraunhofer Society complies with applicable funding rules.

23 Flawed recovery and IT weaknesses in the students' loans programme

The Ministry has lost track of €139 million of outstanding receivables under the Federal Training Assistance Act. The reason for this is that the implementing federal states do not use the federal financial and accounting system. The Ministries of Education and of Finance have failed to set the fiscal prerequisites for this purpose although benefits under the Act are fully federally-funded since 2015.

The federal states have the duty to recover, for example, overstated payments and to transfer the amounts in full to the federal government. Since the federal states neither use the federal financial and accounting system nor the central control procedure, the federal states are not in the position to furnish reliable data on the status and structure of claims to the Ministry. The level of defaults of receivables is also not recorded. Also, the federal states' IT systems are not subject to the federal requirements providing for proper and secure financial management. Measured against the federal yardstick, some federal states' IT systems have considerable shortcomings, particularly regarding the cross-checking principle.

In similar programmes such as parental benefit, the federal states are part of the federal financial and accounting system and using the central control procedure is compulsory. We demand to adopt the same procedure for the students' loan programme to strengthen federal governance functions.

General Fiscal Administration

(Departmental budget 60)

24 Lax government control over financial grants

The Federal Ministry of Finance does not fully exercise control powers set forth in the German Constitution to monitor the use of federal grants towards capital *expenditure projects of local governments. As a result, the Ministry runs the risk that cases of non-compliant use of federally funded investments of €7 billion remain undetected.*

If federal grants are not used by the federal states for the purposes for which they have been appropriated they fall short of the targets set by Parliament. Nevertheless, the Ministry has so far only carried out a rather simplified review to check if the use of funds has been in line with the specified purposes. Neglecting its duties, the Ministry does not take into account diverging review practices in the federal states. Therefore, the likelihood of detecting cases of non-compliance varies across the states. The Ministry has not fully used constitutional powers to conduct sample checks and require relevant documents for this purpose from the recipient states. Nor has the Ministry instructed the federal states to carry out in-depth reviews themselves. As a result, the Ministry does not obtain any substantive data permitting a reliable statement on the proper use of funds.

We recommended to the Ministry making full use of the governance and control mechanisms laid down in the Constitution. The Ministry should ensure that the likelihood of detecting non-compliance cases is at uniform high levels nation-wide.

25 Finally abolish outdated turnover tax privileges

For a number of years, the Ministry of Finance has failed to abolish an outdated flat-rate regulation on input tax deduction.

Businesses from 58 different professions and trades are authorised to rely on lump-sum (average) rates to calculate the input tax deductible from VAT. Such special tax treatment of eligible professions and trades and the level of the average rates is outdated. In daily practice, this regulation is of little significance but fiscal processing is lengthy and cumbersome for the tax offices. We hold that this special exemption from standard rules is no longer justified. We recommended abolishing it. The Ministry concurred with our view. The Ministry *should take prompt action and initiate the statutory amendment it announced as early as in the year 2016.*

26 Avoid tax shortfalls at German airports

Sales at German airports are exempt from turnover tax even if the required export confirmation of the customs authorities is lacking.

The sales of goods to travellers residing outside the European Union are not subject to turnover taxation if the goods are exported outside the EU. The trader is to provide evidence of entitlement to tax exemption. To this end, the seller needs to obtain a customs confirmation indicating that the purchaser lives outside the EU and that the goods have been exported to a country outside the EU. In the absence of such a confirmation, related sales are subject to turnover tax. Some tax offices of the federal states chose not to demand all and any supporting documents by traders running shops within the security area of an airport. Such traders did not have to submit the required customs confirmations and the authorities exempted annual export-related sales worth millions from turnover taxation. As a result, there was a risk of considerable turnover tax shortfalls. The Ministry should perform its oversight function of the federal states rigorously and help ensure that the undue deviation from substantiation requirements is revoked without delay.

27 Allowance for income from farming and forestry falls short of target set

The tax allowance for income from farming and forestry falls short of the target set of supporting small-scale and micro-farming.

As a fact, often larger farms only benefit from the allowance or farms that are not actively operated. In addition, the allowance is also granted to lessers of farms. The allowance does not only apply to current farm profits but also to sale profits. In case of multiple farm owners, each of them is eligible to a tax allowance. These rules may result in a rather high amount of tax relief for farm *profits. Spouses and civil partners also benefit from the tax allowance, even if they have no revenues from farming.*

The allowance is limited to incomes from farming and forestry. Traders and self-employed people are not eligible to similar tax relief. From the legal point of view, this unequal tax treatment is questionable.

We recommended abolishing the tax allowance. If there is a justified need to support small-scale and micro-farming, the tax allowance should better be replaced by a direct subsidy.

28 Effective inspection needed of relief from German withholding tax for artistic and sporting performances

No effective control is in place of the tax relief granted to foreign artists and athletes for income from artistic and sporting performances in Germany. Foreign taxpayers receive relief from German withholding tax either through a refund of tax amounts that have already been paid or by being issued a certificate of exemption before remuneration is paid.

Such revenues are subject to a flat-rate tax deduction at the level of the organisers. In 2014, the Federal Central Tax Office adopted the procedure used by the federal states. Since then, the Office has focused on implementing the technical aspects of the procedure. In the past, controls were performed by the tax offices' internal units. This practice is no longer applied. The federal states which remain responsible for tax inspections fail to fulfil their statutory mandate to check as to whether taxes have properly been retained and paid.

The Ministry and the federal states need to agree on how controls could be performed in the future. The Ministry is to direct the federal states to ensure that field inspections also cover tax deductions.