V CONFERENCE OF EUROSAI/OLACEFS

FISCAL SUSTAINABILITY, PRESENTATION OF ACCOUNTS AND ACCOUNTABILITY

SUBTHEME 1

PRESENTATION OF ACCOUNTS AND ACCOUNTABILITY IN THE CONTEXT OF
THE FISCAL SUSTAINABILITY

Summary:

Introduction

Considering the matters in which the issue of their *sustainability*[1] is somehow comprised, the principle of "accountability" (meaning the "obligation of rendering accounts") proves to be inseparable from the auditing activities that, in one way or another, have to be performed as far as such matters[2] are concerned.

In this text we deal with the sustainability of public finances. Considering the current issue regarding the possibility of Member States continuing to provide their citizens with social benefits (Education, Health, Social Security), which for decades became progressively extended to most populations and the financing of which is currently at stake, this concept naturally achieves a particularly significant relevance.

It is important to note that the issue of accountability has evolved in contexts based on corporate credibility, namely in relation to the notion of Corporate Social Responsibility, becoming one of the general principles of the concept of "good corporate governance".

However, these principles are currently considered inseparable from public service, owing to the fact that the citizens/taxpayers expect that the actions taken by public office holders are governed by the principles of public service delivery, based on transparency, integrity and ethics.

It is therefore logical that INTOSAI, within the scope of its *Auditing Standards*, considers the requirement of "public accountability" as a basic principle[3].

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[1] In this point it is important to mention the area of environment, as it is the context in which this expression arose associated with the issues regarding development (the *Principle of Sustainable Development*), although nowadays it is used in a broader sense in the field of public finances, with regard to their funding. The concept of sustainability involves not jeopardizing in the present the resources of future generations.

[2] In the Portuguese version of this text, the term "responsabilidade" is used with the same meaning that is usually ascribed to the English word "accountability" (in short: "obligation of rendering accounts"). However, the use of any of these expressions may have specific connotations (although similarities may still exist between them). With regard to the translation/equivalence of these expressions, cf. EVERARD, Patrick and WOLTER, Diane, *Glossarium*, Office des publications officielles des Communautés européennes, 1989, p. 56 (Glossary of terms and expressions used in the field of public sector external audit, adopted by the European Court of Auditors).

[3] Cf. INTOSAI, *Code of Ethics and Auditing Standards*, Chapter 1, "Basic Principles in Government Auditing", point 1.0.6 (c), p. 26.

Consequently, when nowadays discussing the current and complex issues of the *sustainability of public finances* and of how the SAI's activities relate to these matters, the principle of accountability turns out to be an unavoidable touchstone for approaching the topic.

However, while acknowledging the relevance of this principle, the truth is that it is currently under debate and reflection and it is actually quite complex, mostly owing to the evolution of the *ways* and *means* used by organizations in the execution of their duties.

1. Accountability as a core principle for the credibility of private and public institutions.

<u>Context of the development of the principle of accountability</u>[4]

The development of this principle is comprised in the set of values that have been defended since the early 1990's, regarding Corporate Governance, and had their basic milestone in *The Cadbury Report* and its *Code of Best Practice*.

This report identifies the three core principles of Corporate Governance: transparency, integrity and accountability.

Then, in the late 1990's, a number of financial scandals, such as those of Enron, WorldCom and Parmalat, gave rise to the concept of *Corporate or Organizational Social Responsibility (CSR or OSR)*[5], which was extended to all European countries through the European Commission's *Green Paper for the Promotion of CSR* (2001).

It is precisely in the abovementioned principles of Corporate Governance that the concept of CSR finds the necessary interaction mechanisms between economic agents.[6]

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[4] On this subject, cf. ERNESTO CUNHA / RUI ÁGUAS / PAULO NOGUEIRA DA COSTA, *Informação Conjunta* (Joint Information) ns. 38/DCP and 7/06-CEMAC, of 04/07/2006. This Information is gathered in a Study that serves as the basis for the preparation of the Portuguese Court of Auditors reply to INTOSAI's document, entitled *"SAI's Transparency and Accountability"*, consisting of seven questions and delivered by Belgium's Court of Auditors, within the scope of the works carried out by the *Professional Standards Committee* (comprised in the context of *Objective nr. 1 of INTOSAI's Strategic Plan for 2005-2010)*.
This study is available on: http://timor/C2/C15/Fontes%20Documentais/Document%20Library/TCP_det.aspx

[5] In English: CSR – Corporate Social Responsibility (quoted in the Study mentioned in the previous footnote, p. 6).

[6] Cf. Study mentioned in footnote nr. 4, p. 11.

Note that the concept of CSR is still under development. It is through this concept that the assessment of a company/organisation should comprise, besides the economic and financial indicators, its ethical conduct and behaviour in the market.

As a result of this, investment analysts have increasingly started to demand CSR risk analysis before making financing decisions. In addition to this, corporate assessment ratings went on to comprise the fulfilment of CRS criteria, relating to areas such as: environment, ethical conduct practices, disclosure of reports and information, social investment, auditing and the definition and execution of corporate governance policies.[7]

However, the concept of CSR still appears to be insufficiently applied.[8]

Accountability as the principle adopted within the public sector

As mentioned earlier, the concept of accountability was identified in the *Cadbury Report* as one of the core principles of Corporate Governance. Note that these principles were also adopted, namely by the *International Federation of Accountants* – IFAC, as being also applicable to all public-sector entities.[9]

It is in the context of the "Organization structure and procedures", one of the four pillars of governance in public-sector entities, that we find, among other concepts, the following approaches to accountability:

- Statutory Responsibility – establishing standards and requirements to ensure compliance with by-laws, regulations and other good practices;
- Financial Liability – establishing suitable standards and requirements to ensure the proper use of public resources, through economy, efficiency, effectiveness and zeal;
- Communication – providing transparent communication channels to all the groups of interested parties in terms of mission, rules, objectives and performance; defining procedures for the proper functioning of that communication;
- Rules and responsibilities:

[7] Idem, p. 7.
[8] Idem, p. 9.
[9] Cf. *International Federation of Accountants* – IFAC, 2001-Study 13 Corporate Governance in the Public Sector. A Governing Body Perspective-pp. 15-19 (quoted in the Study mentioned in footnote nr. 4, p. 17).

- Of who presides over the public entity;
- Of the duties and competences of the entity's board;
- Of strategic leadership;
- Of the non-executive board members;
- Of the executive directors;
- Of the salaries and benefits policy.[10]

Still referring to public sector auditing, the Glossary of terms and expressions used in the field of public sector external audit, adopted by the European Court of Auditors[11], defines the expression "accountability" in the following manner: *"Duty imposed on an audited person or entity to show that he/it has administered or controlled the funds entrusted to him/it in accordance with the terms on which the funds were provided.."*[12]

This definition is supported by the International Organization of Supreme Audit Institutions (INTOSAI) which, in its Glossary, adopted an expression (naturally referring to the public sector) that bears obvious similarities to the one just mentioned above: *"Public Accountability – The obligations of persons or entities, including public enterprises and corporations, entrusted with public resources to be answerable for the fiscal, managerial and program responsibilities that have been conferred on them, and to report to those that have conferred these responsibilities on them."*[13]

With reference to more specific basic principles (those of good budgetary practices), mention must be made of the Code prepared by the International Monetary Fund[14], which presents four key points: a clear definition of duties and responsibilities; public access to information; transparency in budget preparation, execution and rendering of accounts; and guarantees of integrity.

Finally, from a more global point of view (with regard to the area of international development), it is important to highlight the fact that the World Bank

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[10] Cf. Study mentioned in footnote nr. 4, p. 17-18.
[11] Cf. Footnote nr. 2.
[12] Cf. Study mentioned in footnote nr. 4, p. 85.
[13] Cf. INTOSAI, *Code of Ethics and Auditing Standards*, enclosed Glossary, .p. 73.
[14] "*Code of Good Practices in Fiscal Transparency*", approved by the Executive Board of the International Monetary Fund in 2001, available on www.inf.org/external/np/fad/trans/code.htm (quoted in the Study mentioned in footnote nr. 4, p. 22).

establishes good governance strategies, in order to improve government performance through reforms[15] implemented with regard to their Public Administrations.

According to the OECD, the majority of its member countries have approved codes of ethical conduct in view of providing high standards of behaviour by those who intervene in public service.

Therefore, in the public sector field, there is parallelism with the objective of strengthening, within the private sector, the trust of shareholders and other agents in the management boards of companies, which is linked to several (other) topics related to leadership and control and which has the purpose of "ingraining" a culture of responsible and transparent management at the service of the community.

However, a number of studies reveal that, when the measures intended to implement the principles of good governance in the public sector are compared to those adopted in the private sector, there is still much work to be done[16].

2 – Approach adopted by the Supreme Audit Institutions (SAIs)

<u>Accountability as a basic principle for SAIs</u>

Within the scope of its *Auditing Standards*, INTOSAI considers the requirement of "public accountability", as far as people and entities who manage public resources are concerned, as one of the basic auditing principles to be implemented by the Supreme Audit Institutions (SAI)[17].

The Supreme Audit Institutions adopt and adapt to their realities the principles and standards established by INTOSAI and by other auditing organizations, and it is widely acknowledged that accountability in the public sector "refers to the existence of an efficient management of public resources, transparency and good governance, in accordance with standards of ethics and performance that are enforced in order to contain public expenditure, while preserving the quality of public service delivery,

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[15] *The World Bank Public Sector Group, Reforming Public Institutes and Strengthening Governance,* 2000 (quoted in the Study mentioned in footnote nr. 4, p. 22).

[16] Among other documents, see "Corporate Governance in the Public Sector: An Evaluation of its Tensions, Gaps and Potential" and "Corporate Governance and Performance" on <u>www.canberra.edu.au/</u> (quoted in the Study mentioned in footnote nr. 4, p. 20)

[17] Cf. INTOSAI, *Code of Ethics and Auditing Standards,* Chapter 1, "Basic Principles in Government Auditing", point 1.0.6 (c), p. 26.

prevent escalation in the tax burden and avoid jeopardising future generations with liabilities that are taken today and cannot endure into the future[18]".

This is, indeed, a major issue of *public finances/policies sustainability*, which is in fact assessed through the adoption of criteria for effecting responsibility of agents who, in some way or another, are involved in the preparation and implementation of policies.

On the other hand, the Supreme Audit Institutions themselves should necessarily "be equally obliged to submit their accounts and management for examination and review by duly qualified and licensed professionals, given that citizens have the right to be informed of the accounts submission by people holding a public office and who generate and manage public money and assets[19], and, in this case, SAIs have increased responsibilities.

Another essential aspect of this matter is the need to adapt the auditing activity and practical implementation of the principle of accountability by the Supreme Audit Institutions to the new realities of public management.

As highlighted by the OECD[20], in the past decades, new forms of public management, privatisation policies and new technologies have changed the way the public sector performs its role and, at the same time, have created a need for new forms of effecting responsibility of both organizations and governments, for what they do.

With an increasingly more developed public sector, it has become ever more difficult to ensure consistency between the activities carried out and the objectives of policies, auditing and expenditure; besides, the monitoring of the performance of the current organizations has become gradually more complex.

<u>Reflection within INTOSAI</u>

The INTOSAI's document entitled *Implementation Guidelines for Performance Audit* refers to some complexity in the term "accountability". First of all, one must recognize that it finds differing "shades" of meaning in its connotations in the different languages and countries.

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[18] Cf. Study mentioned in footnote n.º 4, p. 24
[19] Idem, Ibidem.
[20] Cf. *Public Sector Modernisation; Modernisation Accountability and Control*, Policy Brief, OECD Observer, April 2005.

Therefore, in some countries, the concept of "accountability" is restricted to the field of accounting, or is envisaged as a liability to be called on to render accounts. Other cultures use the expression with broader meanings, related to the obligation of those who are entrusted with public resources to be answerable for their actions.

Another topic for reflection is the definition included in the abovementioned document, according to which: *"Auditing is normally associated with accountability, but in performance auditing this is not always the case."* [21]

In auditing, "accountability" may be described as the assessment of how the people in charge, at different levels of the scale, achieved significant objectives and obtained other qualifications for which they are fully responsible, leading to the assumption that the factors that do not fall within the control of the audited subjects, will not affect the results.

Still referring to the abovementioned document, an alternative approach consists of focusing on the understanding and explanation of the observations made during the audit. By this way, instead of attempting to find out who is to blame, it is possible to analyse the factors that led to the problems observed and to discuss what can be done to solve those problems. This approach reflects the idea that the general purpose of performance auditing is to encourage economy, efficiency and effectiveness.[22]

This leads us to the following remark: *"The two approaches represent different ideas to performance auditing: one in which accountability (as in compliance and financial auditing) is at the centre of attention of the audit, while the other – which puts emphasis on economy, efficiency and effectiveness – primarily concerns itself with the subject matter of the audit causes of problems observed."*[23]

Still referring to the audit results, the INTOSAI's document above referred to mentions the risks involved in an approach focused on "accountability", given that the outlook and scope must be limited, which, in turn, unfairly limits the possibility of performing an independent analysis. The approach focusing on the possible causes of the problems observed simplifies audits, covering areas which fall under the responsibility of different parties. However, with regard to this, the document presents

[21] Cf. INTOSAI, *Implementation Guidelines for Performance Audit*, p. 28.
[22] Idem, ibidem.
[23] Idem, ibidem.

the following remark: "*… this approach makes greater demands in terms of the skills of auditors.*"[24]

Moreover, it must be acknowledged that, in the context of INTOSAI, this topic is currently under analysis and development in the context of the activities that are being carried out by the Professional Standards Committee (Objective nr. 1 of INTOSAI's Strategic Plan).

To this effect, it is understood that SAIs must also set good examples of accountability and transparency, which should be elucidated through the description of cases of good practices, implying a widespread acceptance of the concept at issue.

3. Conclusions

1. The principle of "accountability" (meaning the "obligation of rendering accounts") is inseparable from the assessment of the credibility of private and public institutions and is comprised among the basic principles adopted by organizations that associate audit entities, such as IFAC and INTOSAI.
2. Considering the issues of public finances/policies sustainability, namely with regard to the social sectors, the policy-executing organisations are facing increasing demands for efficient resource management, transparency and good governance, in accordance with standards of ethics and performance that are enforced in order to contain public expenditure, while preserving the quality of public service delivery.
3. Acknowledging that the organization and performance of the SAI's activities will also have to start reflecting, in some way or another, the need for deep reforms of Public Administration, which is currently falling upon States (inseparable from the issues of financial sustainability), we are led to the conclusion that these institutions shall always have to adopt, somehow, accountability criteria applicable to the agents who intervene in the execution of policies.
4. However, despite its widespread acceptance and adoption by the auditing bodies, mention must be made of a number of complex aspects that also characterise this matter, such as the following examples (in brief):

[24] Idem, ibidem.

- The meaning of the expression “accountability”, which, up to a certain point, differs according to the cultures in which it is used;
- The changes in the public sector management (which includes institutional and financial aspects);
- Methodological issues (*maxime*, those pertaining specifically to performance auditing, namely when the identification of the causes of problems observed is at issue);
- As a result of the previous remarks: there is a true need for further development of the matter (the debate that is currently taking place within INTOSAI must be considered).

This is, no doubt, a matter that poses *future challenges*.

4. Recommendations

1. The Supreme Audit Institutions must equip themselves, in terms of human, legislative and financial resources, with the necessary instruments for their intervention in the assessment of the financial sustainability of Member States. This is an unavoidable issue and, as it is already a challenge now, it will, predictably, become increasingly more complex.

2. The principle of “accountability”, meaning the “obligation of rendering accounts”, widely adopted by SAIs, must evolve not only in the sense of increasing its scope (namely, comprising the different types of entities that have become involved in the management of public money and assets, which may, in certain cases, imply legislative changes), but also from the point of view of conceptual revision, in order to become applicable to the different realities already existing in the areas related to the delivery of goods and services that are funded by public resources.