

V EUROSAI/OLACEFS SEMINAR

FISCAL SUSTAINABILITY, PRESENTATION OF ACCOUNTS AND ACCOUNTABILITY

SUBTHEME 2

THE SAIs CONTRIBUTION, ESPECIALLY ITS RECOMMENDATIONS, FOR THE FISCAL SUSTAINABILITY OF SOCIAL SECTORS

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Introduction

A significant number of States are nowadays living confronted with an increasing pressure regarding public fiscal sustainability.

Such pressure is transversal to all the sectors of the State performance, assuming a worldwide dimension.

For the countries belonging to the Economic and Monetary Union (EMU), like Portugal, such pressure results, in the essential, from the budgetary balance objectives and from the national policies coordination (national convergence programmes, general economic guidelines, multilateral control and excessive deficits procedure), as external ties resulting from the adoption of the Stability and Growth Pact (SGP).

The industrialized countries also face identical pressures, through the expansion of the globalization phenomenon, with OECD recommending an assessment of the current budgetary policies sustainability.

The developing countries also are not out of these parameters as a result of their commitment in relation to the rules established by the International Monetary Fund (IMF) and the World Bank.

In short, it is a globalizing commitment, that involves worldwide level synergies, constituting a bifocal challenge: on one hand, the consolidation of public budgets that depend not only of the adoption of circumstance measures which promote public expenditures containment but also from the implementation of structural reforms at the different public services level; on the other hand, the need to respond to social commitments consecrated in the Constitutions and resulting from the idea of the welfare State, which appeals to a higher quality public services provision.

It is within this context that there has been a growing movement seeking alternative models to the traditional public funding, originating a lot of new semi-public or even private contracting formulas, namely the worldwide phenomenon of public-private partnerships in public sectors, including the social ones.

1 - The fiscal sustainability of social sectors

The fiscal sustainability of social sectors (e.g. health, social security and education) is intrinsically related to the larger problem of public fiscal sustainability, from which it cannot be disassociated.

Among us, the central concern is to assure the continuity of an adequate level of public goods and services provision, either in quantity or in quality, simultaneously guaranteeing the systems funding, without burdening too much future generations and without compromising the demands of financial convergence which is essential to the EMU good performance.

Besides the strictly fiscal reasons that are related to the scarceness of resources and to the need of implementing policies that promote the budgetary consolidation, other factors of structural nature strongly influence the effective performance of the public systems to the extent of putting at risk its medium and long term sustainability. Among them the demographic composition of society stand out – particularly the relative ageing of the population caused by the increase of the average life expectancy and by the decrease of the birth rate; the heavy weight that the state continues to have in the economy, quite obvious in the high level of current expenditures and the persistence of a parallel economy with strong implications at the level of tax revenue collection.

The population ageing and the reduction of the active population are translated into the permanent increase of the social security and health systems expenditures, which impact will be aggravated by the reduction of contributions for the funding of these systems. The schooling system will reflect, in an increasingly intense way, these demographic alterations effects, through the reduction of the demand.

On the other hand, the heavy weight of current expenses, where welfare services are included, have been a strong obstacle to change in terms of budgetary policy.

Already reflecting upon these concerns, the Court of Auditors, in the recent Reports about the General State Account, after evaluating the performance of the macro-economic variables and aggregates (national and international) and present the national economy structural factors with stronger impact in public finances, has highlighted the fact that the more relevant economical policy measures are surely those falling directly on these conditionings. In some cases up the stream, as the reduction of the parallel economy dimension through the fight against tax fraud and evasion, the creation of

more favourable conditions for the entrepreneurial initiative and the schooling system reform in order to adjust the offer and expenses level to the eventual reduction of the demand; in other cases downstream, such as those resulting from the alteration of the rules applicable to the social security systems or promoting equity and sustainability principles and the higher fiscal efficiency in health services rendering.

We should refer that, in what concerns education, reforming policies are being carried out now in order to achieve a more effective use of the investments in the education and training, fighting the ineffective areas (namely through a more rationalized of school buildings, a better management of the teaching schedules, the reformulation of the evaluation system and the change of the management models), creating partnerships and promoting private companies and individuals' investments.

In the health area, there is a tendency for the adoption of entrepreneurial management schemes, in order to emphasize the control of costs, productivity, flexibility, management autonomy and accountability for the results. The organization of hospitals as business corporations, the funding of Health Centres according to the number of persons covered by them, the delegation of health services provision in the market and in civil society, through management contracts, the reinforcement of public-private partnerships and services outsourcing, are examples of the introduced reforms.

In terms of Social Security, the reforms being prepared fall in line with the European Parliament recommendations, that *“the entitlement to pension in the public and private sector should be dealt in an equitable way, instead of a preferential treatment for one of the sectors”* and that measures should be taken to promote the reform in a flexible way and by phases, taking into account the added life expectancy and a better public health. The strategic lines of the social security reform include the introduction of sustainability factors in future pension calculation related to the life expectancy, the transition to new pension calculation formulas (taking in consideration, namely, the totality of the contributive career, the protection of long contributive careers and the limitation of the higher pensions), the progressive revision of the independent workers' (free lancers') social security regime, the reinforcement of the fight against tax evasion and the collection of the debts to social security, the reinforcement of complementary savings, the disaggregating of social security accounts by subsystems and the participation of social partners in social security management.

2 – SAIs contribution. The importance of the recommendations within a sustainability scope

The question that should be put to the SAIs is to find out to what extent they might contribute to the fiscal sustainability of the State, particularly of the social sectors.

The reply to this question demands a reflection from the SAIs that should be guided in two different directions. On one hand, an internal reflection about its role within the announced reform context; on the other hand, a reflection directed to the exterior, in order to know which are the concerns that should be present in the definition and development of the pertinent reform programmes.

Considering their capacity as Supreme Audit Institutions, the fact that their activities are legitimated by constitutional or statutory law and the central role they perform in public resources management audit, it does not seem that the SAIs can be pushed away from this context. On the contrary, it is expected that they contribute to the fiscal sustainability of the systems, demanding from public institutions, namely:

- The clear identification of the pertinent reforms;
- The increase of efficiency, rigour and transparency in the application of the available resources;
- The compliance of the Law in the resources management and allocation;
- The reinforcement of costs control;
- A larger accountability culture for results.

The SAIs should, simultaneously, question themselves on how they could intervene in order to assure the compliance of these and other aspects, reflecting on its organization and mandate, on the instruments, methodologies, adequate financial and human resources for a correct approach to the set of problems in question.

Considering the SAIs' different acting profiles, it seems to us that recommendations may have an outstanding place in this field and there are several reasons that lead us to affirm it.

The SAIs, activities may be particularly comprehensive and can cover from the lawfulness of the actions, contracts and other instruments generators of individually considered expenditures to the organization, operation and administrative and

fiscal management developed by the entities subject to its audit mandate, in its whole or in particular aspects of them. The recommendations are the corollary of this audit functions.

On the other hand, and because we are in the public policies efficiency and effectiveness field, the SAIs' intervention should be faced more from a preventive, corrective and pedagogical perspective rather than with disciplinary sanctions.

Therefore, the SAIs should also reflect upon the possible ways to optimize the strength and effectiveness of their recommendations, namely, in what concerns its disciplining and corrective effects, on the implementation and development of adequate mechanisms to pursue its application and follow-up by the addressees and, finally, on its relevance in the ascertainment of eventual financial responsibilities.

On other words, it is necessary to assure the useful sense of the recommendations, assuring, namely:

- That the addressees have the duty to take their content in consideration and complying with there;
- That the non-compliance of the recommendations can only occur in exceptional situations duly based and justified (e.g. the occurrence of supervenient situations);
- That SAIs should develop audits following-up their recommendations;
- The addressee's responsibility for the consequences deriving from the non-compliance of the recommendations.

3 – The recommendations relevance: the Portuguese experience

Among us, the legal system in force has the required mechanisms to assure the recommendations effectiveness and to allow its choice as the privileged performing instrument of the Court of Auditors.

Since its original version that the mandate act of the Tribunal de Contas (Court of Auditors) foresees, in several of its statements, the power of the Court to formulate recommendations as a correction instrument of eventual deficiencies or irregularities identified. This possibility is foreseen within the Opinion on the General State Account scope, when exercising its power of previous inspection, in the external verification of accounts and within any audits framework.

The recommendations can strongly contribute for the correction of wasting practices. To assure the achievement of that goal, it is required, naturally, that this way of performance is complemented with a regular follow-up, assuring discipline and the weighting of costs and benefits of the options taken, with the purpose of correcting deficiencies and weaknesses. Within this scope, the Court of Auditors has followed up the execution of multiple public contracts and very high financial investments supported by complex contractual figures, as it is the case of the public-private partnerships, namely in the health sector.

As the implementation of innovative economic policies and depending the performance level achieved by the public managers, are important for the fiscal sustainability of all sectors, the Court has also carried out the assessment of the new managing paradigms, based on economic rationality vectors, management by objectives and performance indicators.

Considering one of the more important and comprehensive areas of intervention – the General State Account – the Court, when issuing its opinion on the fiscal activity of the State, has been developing an assessment of the “Economical Surrounding Areas” that frames the budgetary execution, specially focusing on the behaviour of the major national and international macro-economic variances, on the conditionings of structural nature with stronger impact on public finances, as well as the economic policies and extraordinary measures that have been adopted by the Government.

Namely, in the opinion about the General State Account of 2004, this analysis was also accompanied by a chapter dedicated to “Sustainability Issues”. Supported on audits done on a set of measures put in practice by the Government with the purpose of giving sustainability to public finances, the Court of Auditors assessed their fiscal impact, highlighting the medium and long term budgetary effects.

Outside this scope, the Court of Auditors has also developed audits to follow-up its recommendations, thus seeking to ensure and assess the impact of its action in the improvement of the systems and in the correction of financial irregularities.

In order to assure the recommendation effectiveness, we have to underline the last change introduced in the law that governs the Court of Auditors, which granted it a clear juridical relevance:

- By typifying as financial infraction the reiterated and unjustified non-observance of the recommendations formulated by the Court. Thus, should the Court of Auditors verify that its recommendations are not being duly acknowledged, by verifying the persistence of the infracting behaviour without any reason to justify it, the infractor may be condemned to the payment of a fine.
- By underlining the relevance that the non-compliance of the recommendations assumes when assessing the agent's blame degree, taking into account, namely, the Court's recommendations observance level.
- By allowing that the recommendations observance gives origin to the financial responsibility discharge. Among the legally demanded requirements so that the Court of Auditors might discharge the agent's responsibility is the prior inexistence *“of recommendation from the Court of Auditors or any other internal control body to the audited service for the correction of the adopted procedure irregularity”*.

4 – Recommendations within the fiscal sustainability of the social sectors

The Court of Auditors has sought to reinforce the corrective and pedagogical nature of its action, within the scope of the many areas of its intervention. Some scopes of this action have fallen specifically in the social sectors framework, in matters that highlight its fiscal sustainability. Let us see some examples:

An audit carried out by the Court to the public servants' social protection scheme, guided into the regime analysis and diagnosis, in the perspectives of its comparison with the general social security scheme and the evaluation of its fiscal sustainability has concluded that the system funding requirements will double within the next 20 years. By elaborating scenarios to assure respective fiscal sustainability, through, namely, the capitalization of surplus of one of the sub-systems in a certain period, the Court recommended the Government to rethink the scheme and its management model.

Within an audit framework carried out in 2005 to the transfer of funds and liabilities with pensions of the personnel of several public capital companies to the public retirement fund,, the Court of Auditors concluded that:

- The liabilities were sub-evaluated and the transferred funds were insufficient to cover them;
- The direct impact on public finances resulting from the referred transferences had a positive effect on the State revenues in the transference year but will have the reverse effect in the following years, due to less revenue compared to the expenditures. The studies done by the Court indicated that the negative effect accounted should be increasing until 2014, that contributions and sharings should end in 2033 and liabilities with pensions should be extended till 2071.

The Court recommended then to the Government that, should new pension funds transferences of public or private entities occur to the Social Security public scheme, before any transference is done, independent actuarial studies are carried out and published, to adequately calculate the value of the liabilities transferred. The Court indicated precisely all the aspects to take in consideration in those studies.

When auditing the management, funding, economical and financial situation and the performance of several hospital-turned-enterprises models, including the evaluation on the eventual gains in terms of service efficiency and quality, the Court assessed the accumulated fiscal deficit of those hospitals and the indebtedness generated by them, the identified situations where no good use was made of the productive capacity and the constraint reasons in the access to health care. The Court concluded that there were efficiency increases without any loss of equity in the access, but formulated recommendations in order to, namely:

- Conceive forecast mechanisms based on demand,, considering the installed capacities in the hospitals, the planning of the hospital activity and the definition of the health requirements, aiming at improving the contracting model;
- Modernize information and analytical accounting systems to allow the monitoring, audit and assessment of the hospital-turned-enterprises performance, the identification of strategic areas and risks integrating the economical and financial perspectives, those of quality and equity, the reinforcement of internal control and the evaluation of the production, costing and quality indicators;

- Approve accounts consolidation standards in the health sector, allowing to assess in an adequate way the economical, financial and assets situation of the National Health Service services and organizations and of its sub-sectors.
- Adopt measures to obtain higher efficiency in the utilization of the surgery rooms, which was verified to being not used to its full extent.

Within audits to the State expenditures with Public-Private Partnerships, the Court of Auditors observed that there was an excessive dependence of the State in relation to the outsourced consultants, recommending the reinforcement of public competences for contracts monitoring and management. It also verified that the additional charges with expropriations and financial re-balances had not been adequately forecasted, harming the estimates credibility of the actual cost of contracts and respective budgeting. The Court also indicated alternative mechanisms to be used in order to reduce the costs borne by the State with future partnerships.

5 – Conclusions

1. The problem of the fiscal sustainability of the social sectors (e.g. health, education and social security) is intrinsically connected to the wider problem of the fiscal sustainability, taking an essential dimension, among us, by assuring an adequate level of public goods and services provision and by guaranteeing its funding, however without putting at risk the intergenerational equity and the objective of public accounts consolidation, at medium term.
2. Considering the SAIs central role in the public resources management audit, it is expectable that they contribute for the systems sustainability, demanding, from the public institutions, namely, a clear identification of pertinent reforms, the increase of the efficiency and discipline in the available resources application and allocation, the costs control reinforcement and higher accountability for results;
3. Independently of the audit strategies and methodologies to be adopted by the SAIs, the recommendations constitute an essential instrument in the assertion of a more responsible and effective managing culture.

6 – Recommendations:

SAIs should reflect upon the possible ways of optimizing its recommendations strength and effectiveness, by assuring:

- That the addressees have the duty to consider their content and of accepting and observe them;
- That the non-observance of the recommendations may occur in duly grounded and justified exceptional situations (e.g. the occurrence of supervenient situations);
- That the SAIs develop audits to follow-up their recommendations;
- The addressee's responsibility for the consequences deriving from the non-observance of the recommendations.