

SUPREME AUDIT INSTITUTIONS AND FINANCIAL SUSTAINABILITY IN THE MODERN STATE

I – Introduction: The Brazilian Court of Audit (TCU) in the Context of Financial Sustainability in the Modern State

Over the past 20 years, the Brazilian Court of Audit – TCU, which is the Brazilian supreme audit institution (SAI), has been going through many changes, mainly as a result of the reform of the Brazilian State provided for in the new Federal Constitution of 1988, but also of economic, social and environmental phenomena observed on a national and global scale over the past two decades, such as: globalization; the advance of information technology; an increasing environmental awareness; the establishment of the block of emerging countries; and reforms designed to harmonize the Minimum State principle with that of the Welfare State.

With a view to facing the challenges posed by these changes, TCU has been adopting the most state-of-the-art control techniques applied by the main SAIs in the world, while making an effort to update its system for controlling the legality of governmental acts and contracts, improve the control technologies applied to ensuring the effectiveness of existing public programs and policies, and develop new techniques in tune with the Brazilian reality. For this purpose, the Court set up expert technical units and developed special services and projects designed to:

- control the efficiency, efficacy, and effectiveness of governmental programs;
- follow up on rules applied to fiscal responsibility and governmental macro-evaluation;
- control privatization processes, the concession of public services, and the establishment of public-private partnerships;
- fight fraud and corruption in the public administration on a concomitant and preventive basis;
- monitor and control environmental management processes;
- map out its activities according to the pillars of sustainable development;
- evaluate and provide incentives to the implementation of management processes in the public service;
- control and evaluate large engineering projects;
- manage strategic information in support of governmental control actions;

- control and evaluate the delivery of services and governmental procurement in the area of information technology.

The financial sustainability of the Modern State, which is included in this context of changes, is a challenge extending beyond the borders of traditional public spending control from a mere economic-financial point of view, as it involves more complex issues related to the quality of spending and to the political-institutional configuration of the State, such as: democracy, accountability, effectiveness of governmental programs and policies, and sustainable development, among others. Supreme Audit Institutions - SAIs have a key role to play in ensuring such financial sustainability in this scenario, as they are the only institutions provided with the required technical tools and impartiality for controlling, monitoring, and evaluating governmental activities, as well as for disseminating the results of these activities to society at large with the utmost transparency and impartiality.

This paper constitutes the contribution of TCU to the debate on *Financial Sustainability in the Modern State* to be held during the *5th EUROSAI-OLACEFS Conference* and, mainly, to fostering the institutional strengthening and technical improvement of SAIs, INTOSAI, and its regional groups (OLACEFS, AFROSAI; ARABOSAI; ASOSAI; SPASAI; CAROSAI, and EUROSAI).

I – Sustainability, Modern State, Globalization, Democracy, and Accountability

For one to address the issue of sustainability appropriately, this term must be considered in the light of its etymology. Sustainability is the capacity of a resource appropriation process or means to continue to exist for a long period of time. This leads us to the expression *sustainable development*. In this context, it is also important to draw a distinction between the terms *sustained development* and *sustainable development*, which are often mixed up.

The term *sustained development*, which has fallen into disuse nowadays, refers to development ensured in a recent period that needs to be maintained over time under a foreseeable climate of stable growth based on restrictive measures, which are indispensable for achieving a new growth level and a prerequisite for continued growth. Such measures, which are of a macroeconomic nature, basically consist in controlling the public debt and in ensuring fiscal responsibility and budgetary and financial balance (Brazil, 2002).

The expression *sustainable development*, in turn, entails a more comprehensive perspective. It can be defined as a set of linked structural changes which, under the new model of the information and knowledge society, internalize the sustainability dimension into

various dimensions: social, economic, environmental, political-institutional, and cultural dimensions.

Although it only refers to the economic-financial dimension of sustainability, as the title of this paper suggests, we believe that this is not a term to be dealt with in isolation. Along this line of thought, TCU, following the trend of Supreme Audit Institutions - SAIs such as those of the United Kingdom (National Audit Office - NAO) and of Canada (Office of the Auditor General - OAG), prepared a project in 2006 which maps out its administrative and external control actions using the following sustainability dimensions as classificatory principles: economic dimension (efficiency, efficacy, and economic use of funds in processes); political-institutional dimension (governance, democracy, institutional capacity, civil-society empowerment, rights assurance and expansion); social dimension (social well-being, quality of life, social inclusion, mutually responsive relationship in labor relations); cultural dimension (respect for cultural, racial, and gender diversity); and environmental dimension (preservation and balanced use of environmental resources). In order to lead by example, SAIs are required to establish sustainable development strategies - SDS for the purpose of encouraging central governments and their agencies and organizations to also implement SDSs with the aim of ensuring the required financial, social, and environmental sustainability for their economies to grow and modernize themselves appropriately. Based on this reasoning, TCU pointed out in its 2006-2010 Strategic Plan that:

"... the following are potential opportunities for strengthening TCU's activities and image before society, among others: **implementing a sustainable development strategy** for minimizing or eliminating environmental impacts caused by activities of the Brazilian Court of Audit and encouraging attitudes and procedures tending to promote the rational use of resources, quality of life in the workplace, health, and social responsibility" (Brazil, 2006, p. 11).

We see the Modern State as a dynamic management model which actually seeks to adapt itself to changes in the environment, to new demands of society, and to technological innovations. A key feature of the Modern State is that of changing a regulation-based organizational culture to one which emphasizes results and the satisfaction of citizens. Therefore, the Modern State is closely associated with a state whose development is based on a sustainable model that incorporates all the above-mentioned sustainability dimensions. It can be concluded, therefore, that the financial sustainability of the state can only be ensured in the context of a Modern State.

The growing phenomenon of globalization created the need for the Modern State to foster its structural reformulation based on the imperative of ensuring sustainable

economic growth and, as a result, enhanced social justice in a context of international economic inclusion. Globalization, in turn, can be basically considered from two perspectives: from the perspective of economic results (trade and financial liberalization) and from that of the results of governmental policies (less custom barriers and capital inflow restrictions). In any case, consolidating such results significantly depends on the level of corruption or suspected corrupt practices, mainly in the public sector. For this purpose, the work carried out by the SAIs in fighting and mitigating corruption in the public sector is highly important.

Democracy, which is a *sine qua non* condition for the Modern State to exist, is a key requirement for solving problems faced by contemporary society in all areas, including economic and financial issues, as they depend not only on technical decisions, but also on the political-institutional design of the state. Democracy is therefore a key factor in developed countries (Modern State), and one of the main pillars of their success.

In a democratic state, accountability is another, equally important factor. This term has different connotations, all of which imply transparency and accountability for governmental acts. Therefore, accountability means political accountability, as consubstantiated through institutional mechanisms which impose a duty on leaders to account for their acts or inaction in managing public affairs. This term also refers to controlling acts of leaders in relation to state-level policies, programs, and activities. Finally, accountability is present in the Modern State as reforms, improvements, and the modernization of state institutions lead to improvements in the performance of governmental programs and to the need for greater transparency and accountability for them on the part of public authorities before society, ultimately ensuring the financial sustainability of the state.

Given these facts, it can be concluded that for emerging economies to rise to the status of developed economies it is useless to steer capitals to investments if institutional reforms are not carried out for reducing inefficiencies in the allocation of resources by governments and ensuring greater control over them by leaders, thereby reducing corruption and patronage problems which affect economic performance and financial stability.

The SAIs play a major role in this process by monitoring, controlling, and evaluating performance aspects of the state, in search of a political-institutional design which can consolidate the kind of reforms that the country needs to develop on a stable basis. For this purpose, in tune with a line of work of a SAI acting in a context of state modernization, TCU seeks to act not only to ensure the probity of public managers by checking their conduct in the light of the law, but also to ensure the efficiency and effectiveness of public policies, using tools designed to evaluate governmental operations. Therefore, we saw that the work

carried out by SAIs can fill a gap prevailing in the analysis of economic policies and public finances from the accountability point of view.

III – Quantitative and Qualitative Control of Public Finances

Two key variables should be highlighted for ensuring the sustainability of public finances in the Modern State. The first one is that of keeping expenses under control, or reducing costs, which can be achieved by adopting a strategy for optimizing the use of scant resources and minimizing any squandering and misuse of funds. In this process, the control mission assigned to SAIs is a key element. The second variable is the spending quality, which depends on the availability of an effective, results-oriented management model, where results are measured by precisely defined performance indicators allowing for the qualitative level of expenditures to be evaluated. The (qualitative) control ensured by SAIs in this connection is equally essential.

In tune with these requirements, the Inter-American Development Bank – IDB stressed the importance of implementing control systems in Latin American countries with the aim of improving the management of public accounts, which led to the achievement of two major results: optimized use of scant resources by making up-to-date and reliable information available for financial programming purposes; strict spending control by reducing any squandering or misuse of funds for lack of control (as a result of squandering alone, we estimate current losses at 5% to 10% of all funds earmarked for fixed costs and investments).

Amongst the most significant changes observed in the Brazilian State in the area of public finances since the country's redemocratization process began, in the 1980s, the following ones should be highlighted: the budgetary process was redesigned, with emphasis on planning; the public budget was unified; a central federal accounting agency was set up (the National Treasury Secretariat); a computerized system for managing federal public funds was implemented (the Integrated Financial Management System - SIAFI); the debts of states and municipalities with the Federal Administration were renegotiated and refinanced; inflation was placed under control after the Real Plan was adopted; a results-based management model was implemented; and, more recently, the Fiscal Responsibility Law was passed.

From a technical and institutional point of view, the Brazilian Court of Audit has been following up on the recent political and administrative reforms derived from the modernization of the Brazilian State through various initiatives, among which the following ones stand out: creation of expert technical units charged with controlling the efficiency,

efficacy, and effectiveness of governmental programs; follow-up on the rules established for ensuring fiscal responsibility; control of privatization processes and of procedures for the concession of public services and, recently, for developing public-private partnerships; and investigation of cases of fraud and corruption in the public administration.

The activities carried out by TCU seek to meet the demands of the Nation. For this purpose, the activities of the Court cover the following variables and trends:

“technological evolution; changes in the public administration and in ways of working with society and relating to it; the trend toward downsizing the State through privatizations and concessions of public services, as well as toward establishing partnerships between public institutions and organizations and the private sector; the expansion of the regulatory role and participation of society in controlling and providing public services; a demand for better services; the requirement of greater transparency, ethics, professionalism, and speed in the public administration; lack of resources; the limited capacity of the government to meet social yearnings; the increasing complexity of the relationship between the State and society; an increase in corruption awareness; the need to fight corruption and impunity effectively and relentlessly; the actions and position of other public agencies; challenges as to the legitimacy, effectiveness, and relevance of public institutions”. (cf. *Plano Estratégico do TCU* (TCU Strategic Plan) - PET for 2006-2010; *Brazil, 2006, p. 9*)

In recent years, a new, results-oriented management model generally referred to as “New Public Management” was adopted. Performance accountability is associated with efficiency and effectiveness criteria, sound management practices, good governance, service quality, and targets achieved. Recently, the term accountability has also been associated with the reform of the State, by analyzing how improvements in institutions of the State can lead to improvements in the performance of governmental programs and to greater transparency and accountability of public authorities before society. This trend led to reforms in different countries, among which special mention should be made of New Zealand, Australia, England, and the United States, and also Brazil. Therefore, SAIs began to carry out performance audits directly as a result of the changes observed in the control paradigm, which led them to focus on governmental performance, on making sure accounts are rendered appropriately, and on ensuring the accountability of public managers in relation to results.

In Brazil, the Federal Constitution of 1988 conferred competence upon TCU to carry out performance audit activities, that is, to evaluate how the public administration is performing in governmental programs and in regard to the units and entities under its jurisdiction with respect to their objectives, targets and priorities and in the allocation and use

of available resources, including those made available under foreign financing schemes. In tune with the changes brought about by the reform of the State, by the new public administration, TCU's audit activities began to include evaluations of governmental programs and their performance related to their efficiency, efficacy, economic use of resources, and effectiveness, with a view to ensuring greater transparency in public spending to society and citizens at large.

In this regard, the IDB also places great emphasis on two major objectives of institutional strengthening programs funded by it as part of the efforts being made to modernize the State, namely: developing an integrated vision in public managers involving the management system and the government; and implementing mechanisms for ensuring the sustainability of consolidated advances. In the latter case, an additional issue should be mentioned, namely, the difficulty faced by countries to create mechanisms capable of ensuring the sustainability of programs funded by the Bank, such as investments in infrastructure. With a view to overcoming this problem, the strategy proposed consists in strengthening mechanisms such as: transparency and shared responsibility by disseminating management results to society and publishing budgets, balance sheets, and other official documents; and rendering of accounts and social participation, according to the ideal of a participative budget approach.

IV – Control Mechanisms to Ensure the Financial Sustainability of the State

The passage of the Fiscal Responsibility Law - LRF ensured a major advance in the control of public finances. Its rules apply to the management of public funds and to public indebtedness and assets for the purpose of preventing risks and correcting any misuse of funds that can affect the balance of public accounts, with emphasis on planning, control, transparency, and accountability. For this purpose, the LRF sets out targets for revenue-spending results and caps and conditions to be complied with in terms of revenue waiving, generating expenses with staff, social security and other items, including consolidated and securities debt, credit operations, even through revenue anticipation, granting of guarantees, and accounting of outstanding liabilities.

The LRF was designed to cope with changes in the international political and economic scenario, as were the Fiscal Responsibility Act of 1994 of New Zealand, the Maastricht Treaty of the European Community, and the Budget Enforcement Act of the United States of America. The law was also designed to be used as a tool for consolidating the

Fiscal Stabilization Program in Brazil, as required by international organizations, particularly the International Monetary Fund (IMF).

More than just a mere fiscal control tool applied to public spending, the LRF constitutes a mechanism for strengthening the oversight actions of the Legislative Branch using an integrated system involving oversight activities to be carried out with the assistance of audit courts and the internal control system of each Branch. This approach makes it possible to correct failures during the budget and financial execution process, with emphasis on ensuring the fiscal targets set out in the Budget Guidelines Law - LDO.

The adoption of control mechanisms as a key principle for ensuring fiscal responsibility enhances their role as decision-making tools for the benefit of society as a whole. It is imperative to acknowledge that control actions are inherent in management process where taxpayers are the owners of the resources involved. Therefore, when it comes to public funds, debts, spending with staff, and actions which can harm the public treasury, the population as a whole can suffer damages. For this reason, the controls applied to fiscal responsibility involve controls and agents of all kinds. The LRF is based on these assumptions, and therefore it constitutes a democratic accountability mechanism based on the creation of State-level inter-temporal political accountability rules applied to public finances.

Another issue to be addressed in relation to the financial sustainability of the Modern State is the need to ensure the feasibility of investments in a scenario of fiscal restrictions, without which economic growth is impossible, in a transparent and responsible way. Many countries have resorted to public-private partnerships as an efficient mechanism for public service delivery, taking into account the required financial sustainability and socioeconomic feasibility of projects. In Brazil, a Public-Private Partnership Law (PPP) has been passed.

One should bear in mind that policies jointly carried out by the public and the private sector should excel in public transparency and rely on effective external follow-up and measuring mechanisms. Therefore, controlling this new kind of contract of the public administration is a must, given its high complexity, the significant amount of public funds involved in it, and the strong social interest it entails, which are features requiring structured and timely follow-up actions from the SAIs of emerging countries to prevent any damages to the public treasury and ensure its highly relevant role in leveraging development and reducing regional and social inequalities in the country.

With regard to fighting corruption and fraud, the Brazilian SAI prepared a project designed to enhance the institutional capacity of TCU to prevent, dissuade, detect, investigate, and punish fraud and corruption in the public administration and recover any

embezzled funds. The positive effects of this project will have a direct bearing on the efficiency of the public sector and on the economy at large, thereby contributing toward ensuring the country's financial sustainability.

Moreover, TCU, in the process of defining the paths to be taken in its task of carrying out accounting, financial, budget, performance, and property oversight in the Federal Administration and entities of the direct and indirect administration for their legality, legitimacy, economic use of resources, use of subventions and revenue waiving, considered in its current Strategic Plan (2006-2010) that:

“Society yearns for morality, professionalism and excellence in the public administration, as well as for a better quality of life and less social inequities. Citizens have been gradually leaving behind their past as passive subjects in their relationship with the State and have been progressively demanding better services, respect for their citizenship rights and more transparency, honesty, economic use of resources, and effectiveness in the use of public funds. In this regard, the Court plays a key role in preventing, detecting, correcting, and punishing fraud, embezzlement, corruption, and squandering of public funds and contributes toward ensuring transparency and improving the performance of the public administration and the allocation of federal resources” (Brazil, 2006, p. 7).

In this context, the challenge facing SAIs is one of adding the requirements imposed by the modernization of the States to their traditional oversight work, with a focus on analyzing legality and conformity aspects, namely: consolidating a results-oriented management model, enhancing the transparency of public accounts, ensuring fiscal responsibility and the qualification of public investments, and fighting corruption and fraud. This process allows for control to be applied as a political accountability tool in connection with public finances in a context of redesigning the State, with a view to meeting sustainable economic growth demands at different levels, in tune with the new model of the information and knowledge society.

Studies point out a directly proportional relation between the economic growth of a country and its economic policy and institutional capacity. This shows that when the institutional framework of the State is efficient, the targets and objectives outlined in public policies are more likely to be achieved. Specifically in relation to economic aspects, the guidelines set by the government should be supported by solid and reliable institutions.

As examples of this new paradigm, mention should be made of the management reforms of the so-called New Public Administration – which were mainly disseminated in England, New Zealand, Australia, and Sweden – that made it possible for

countries to achieve positive results in terms of resuming their economic growth based on fiscal discipline, as a result of the availability of consistent public policies combined with an institutionalized culture of compliance with rules and standards.

For these reasons, building fiscal sustainability indicators, for example, as part of efforts to promote the financial sustainability of the state through control/follow-up mechanisms, is a necessary, albeit not sufficient, condition for ensuring such sustainability. Other factors, such as democracy, accountability, corruption, globalization, the distributive effects of the fiscal policy, and the institutional organization of the state should be taken into account for the financial sustainability of the state to be supported by the required and sufficient conditions for ensuring the desired achievements in practice.

V – Conclusions: The Role of SAIs in Ensuring the Financial Sustainability of the Modern State

The great challenge for emerging economies seeking the status of a Modern State is combining the imperative of controlling, restraining, and reducing expenses with the need to expand the coverage and enhance the quality of service delivery. Following this line of thought, the financial sustainability of the state also depends, basically, on having spending control mechanisms in place for improving the management of public accounts, so that expenses can be restrained and reduced on a sustainable basis. However, it will also depend on putting a new results-oriented management model in place, so as to ensure universal access to public services and improve their delivery.

The SAIs play a key role in facing this challenge, as they have the noble task of controlling, monitoring, and evaluating governmental activities, as well as of disseminating these activities to society as a whole with the utmost technical and political transparency and impartiality. This is the fundamental pillar for ensuring the financial sustainability of the state. Carrying out control, follow-up, and evaluation activities on an integrated and impartial basis is a task that can only be performed by external control mechanisms under the responsibility of a SAI in its work of checking accounts or carrying out inspections/audits.

A scenario of financial stability or sustainability also requires a state institutional design capable of ensuring an equally stable environment for the efficient performance of economic activities as a whole and, mainly, one in which the government can ensure an optimum allocation of scarce public funds. These parameters of economic efficiency and optimum distributive effects make it possible to provide a feedback of mechanisms and resources which can ensure the country's sustainable economic growth,

avoiding, among other things, bottlenecks in the sources funding governmental activities, thereby ensuring the financial sustainability of the state. In their control, follow-up, and evaluation of governmental activities, the SAIs should be aware of these facts, so that they can carry out their work based on a systemic vision, seeking to integrate all analysis levels into a whole based on which parliament and citizens can understand and monitor the performance of the central government.

TCU is intent on carrying out its activities in tune with this line of thought by integrating all the activities performed by its technical units. The tools used by the Brazilian Court of Audit in playing its external control role include checking accounts (taking and rendering of accounts) and carrying out inspection activities, which comprise data collection, audits, and other actions. Since the Governmental Macro-Evaluation Secretariat was set up, other integrated actions are also being carried out, such as systemic and economic analyses of governmental programs, preparation of preliminary reports on accounts rendered by the presidents of the Executive, Legislative, and Judiciary branches, and periodic follow-up on targets and caps provided for in the Fiscal Accountability Law. Recently, the Brazilian Federal Administration launched a plan to speed up the growth of the domestic economy, the Growth Acceleration Plan - PAC. In this case, the control task assigned to the Brazilian Court of Audit is one of a preventive nature and it will be carried out in coordination with ministries, agencies and other governmental entities with the aim of ensuring a systemic and integrated vision on the PAC, so that TCU can contribute toward the actions contemplated therein, toward avoiding any overlapping of efforts, and toward promoting efficiency and a regular and economic use of resources, ultimately ensuring the financial sustainability of the Brazilian State.

Finally, we should stress that the SAIs play a key role in the efforts to ensure financial sustainability in a Modern State through their analysis of accounts and audit/inspection actions, which should be carried out based on an integrated/systemic state control vision (macro-evaluation), with the aim of providing inputs to parliament and society at large, so that all efforts made to ensure economic growth may rely, as much as possible, on the financial sustainability of public accounts and may avoid jeopardizing the well-being of future generations and our socioeconomic and environmental balance.

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